



# Islamic solution for household debt

Jonathan Shapiro

Few economists would look to religion for the solution to a growing household debt problem, but Willem Buiter says Islamic finance is an unlikely future source of much needed innovation.

A traditional mortgage - which is the core offering of a traditional bank - is "poor financial design", Citigroup's chief economist tells *The Australian Financial Review*.

"Households are the last entities that should take on debt. They should take on equity-type stakes, he says from his office overlooking New York's Hudson River.

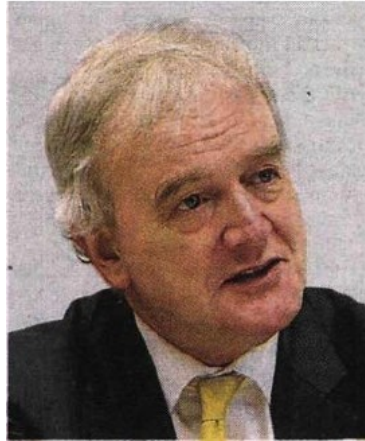
Households, he explains, have the least amount of collateralisable wealth, which they can pledge against a loan - making them ill-suited to take on large amounts of debt. "They have two big assets: human capital, which is not 'collateralisable'. And the property, itself, which is illiquid and hard to realise," he says.

The solution, he says, is an Islamic-style mortgage. The faith outlaws the charging of interest, so to skirt this restriction "financiers instead charge rent and allow the borrower or tenant to gradually purchase equity in the property. The motivation may be to adhere to religious codes but the result is a less risky financial arrangement for the household than a standard home loan.

A classic Islamic mortgage is a dual equity mortgage where the bank owns the house to begin. I buy the house from the bank with two payment streams. One is a rental stream related to the [rental] market. As long as I keep up that payment I won't be evicted," he says.

"But the second is a discretionary payment. For example you buy 5 per cent from the bank each year."

The benefit of the arrangement is



Citigroup chief economist Willem Buiter is thinking outside the debt square.

there is less financial risk assumed by the tenant than would otherwise be incurred by a large loan.

"If you have a disruption in your employment you can stop buying equity in the house or even sell back what you have already bought - the chances of eviction and dispossession are much lower."

As Buiter explains, such arrangements extend beyond Islam and have proved practically useful in places where housing is unaffordable.

"Stanford University does this. It is too expensive for an assistant professor to buy a house (in Palo Alto, California) so they go 50-50 with the university. If you make tenure you buy out Stanford and if you don't they buy you out. So it turns into joint equity."

The Islamic mortgage is a rare example, Buiter says, of "good financial engineering" rather than attempting to avoid paying tax or skirting regulation. Buiter is known, among other things,

as one of the co-creators of the term "Grexit" to describe the potential exit of Greece from the European Union. The latest iteration is "Brexit", as a looming referendum has made Britain's exit from the EU a real possibility. Emotions are running high while markets are growing increasingly anxious. Buiter, a former Bank of England official, was restricted on commenting on Europe or "Brexit".

But he did describe it, along with the rise of Donald Trump in the US, as one of the "high frequency wobbles" that has his attention.

"Should we get Trump [as US President] the risks of a serious global trade war are higher, which would be a global negative - especially for a country as open as Australia," he says.

In the longer term it is China that is the source of his anxiety and the reluctance of policymakers to deal with "excess debt and excess capacity", which he describes as building blocks of a classic recession.

The massive debt overhang is "unprecedented by the standards of emerging markets", he says.

"Even if nothing unexpected happens, China is headed for a further slowdown. The question is whether or not it's controlled," he says.

Buiter says Chinese policymakers possess "the tools to restructure and then rebalance the economy in an orderly way" but he has his doubts as to whether they can achieve this.

"Like every Communist system - they are consensus decision makers, which means they are often behind the curve. But in addition there is a huge political snuggle going on. We are in the fourth year of the anti-corruption campaign and if anything it's intensifying. There is clearly a sense in the leadership that they don't have sufficient control yet"