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You lend \$100,000 at 9% Nominal interest in 2020 to be repaid in 2021

CPI = 210
2020



You guess
Inflation will
be 5%

CPI = ?
2021

You want to earn a 4% Real interest rate

You earn

$$\text{Interest Income} = 100,000 \times 0.09 = \$9,000$$

Tax on interest income is 25%

Tax you owe

$$\$9,000 \times 0.25 = 2,250$$

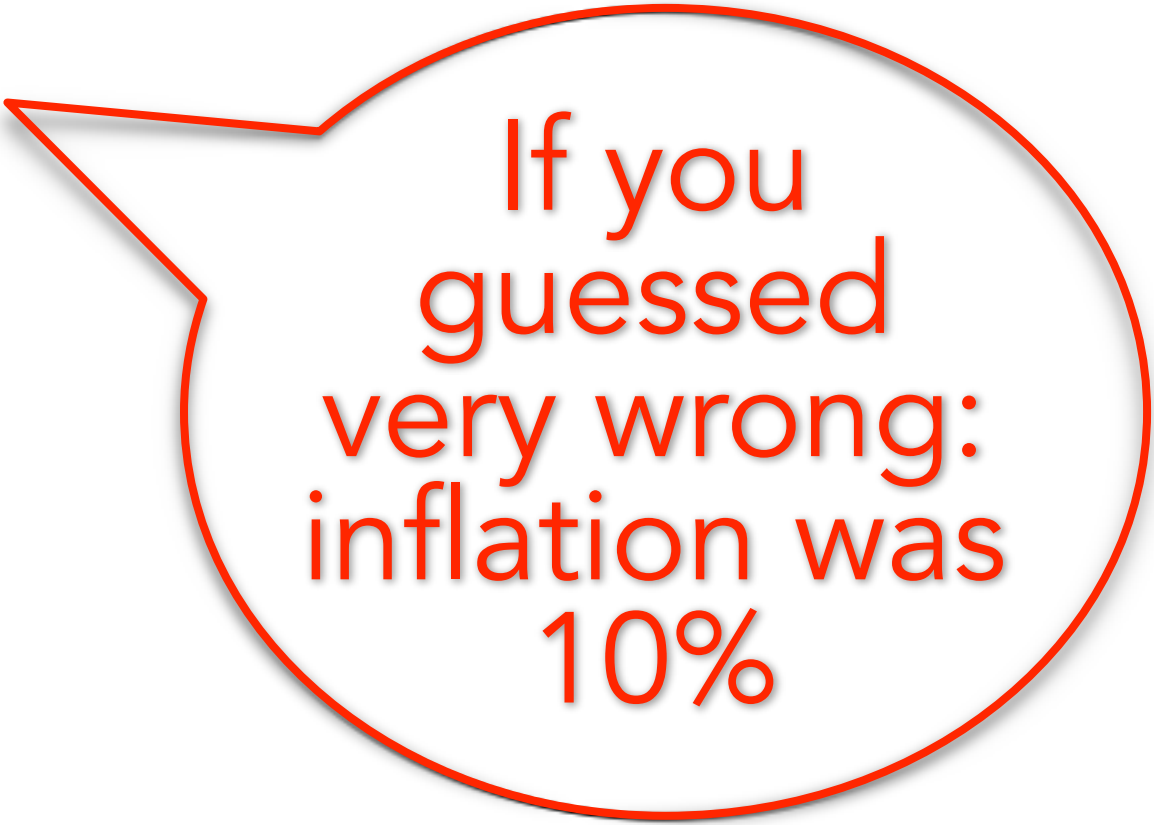


You earn

$$\text{Real Interest rate} = 9\% - 10\% = -1\%$$

$$\text{Real Interest Income} = 100,000 \times (-0.01) = -1,000$$

Even though in **Real** terms you incurred a **\$1,000**
loss the government still makes you pay **\$2,250!**



If you
guessed
very wrong:
inflation was
10%

Inflation imposes an **unfair** tax on Interest Income

CPI = 210
2020



CPI = ?
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Real Interest Income = $100,000 \times (-0.01) = -1,000$

Even though in **Real** terms you incurred a **\$1,000 loss** the government still makes you pay **\$2,250!**

Capital Gains