28

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

CPI = 210

2020

CPI = ?

2021

You want to earn a 4% Real interest rate

Interest Income = 100,000 x 0.09 = $9,000

If the tax on interest income is 25%

$9,000 x 0.25 = 2,250

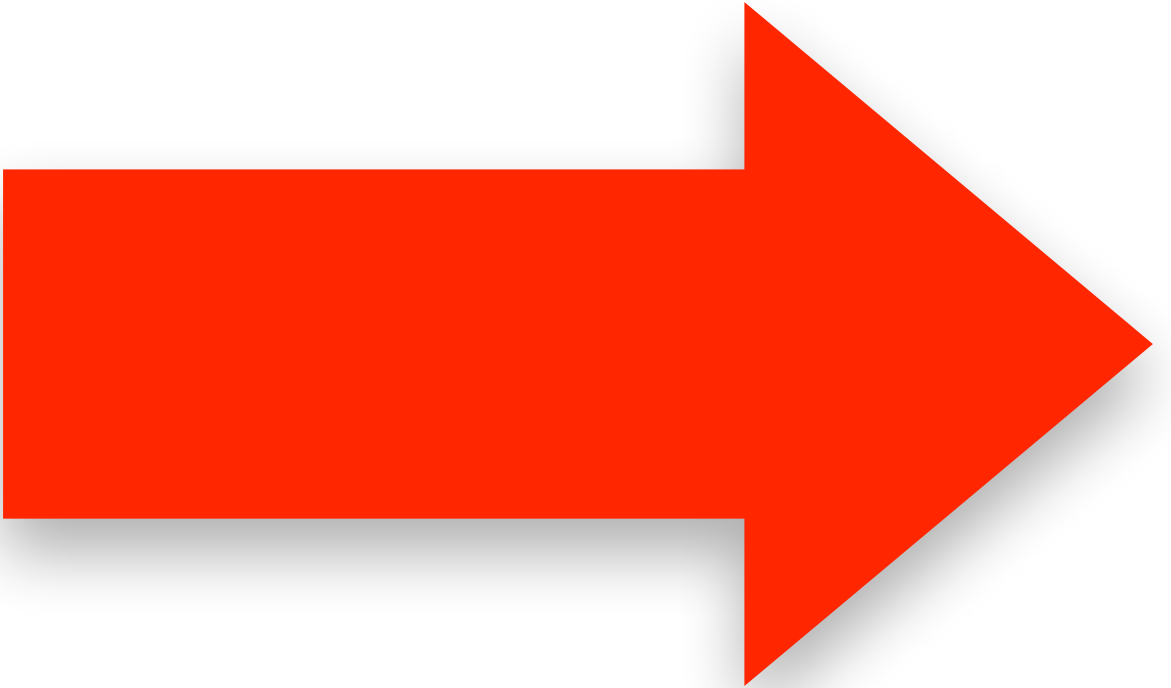
You earn

Real Interest rate = 9% - 7%= 2%

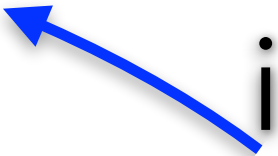
Real Interest Income = 100,000 x 0.02 = 2,000

Even though your Real Income was only $2,000

the government still makes you pay $2,250



You pay 112%
instead of the 25%
you are supposed
to pay by law



If you guessed wrong: inflation was 7%

Inflation imposes an unfair tax on Interest Income

$$\frac{2{,}250}{2{,}000} \times 100 = 112\%$$ effective tax!

CPI = 210

2020

CPI = ?

2021

If you guessed wrong: inflation was 7%

Inflation imposes an unfair tax on Interest Income

You earn

Interest Income = 100,000 x 0.09 = $9,000

If the tax on interest income is 25%

Tax you owe

$9,000 x 0.25 = 2,250

You pay 112% instead of the 25% you are supposed to pay by law

You earn

Real Interest rate = 9% - 7%= 2%

Real Interest Income = 100,000 x 0.02 = 2,000

Even though your Real Income was only $2,000 the government still makes you pay $2,250

$$\frac{2{,}250}{2{,}000} \times 100 = 112\%$$ effective tax!

CPI = 210

2020

CPI = ?

2021