

1

4

CPI = 210

2020



CPI = ?

2021

You lend \$100,000 (one full basket) at 9% interest in 2020 to
be repaid in 2021

Loan = 1000,000

The borrower returns $= 100,000(1.09) = 109,000$



\$100,000

Full Basket




Full Basket

13% inflation means that the basket in 2021 costs 13% more:

$$\$100,000(1.13) = \$113,000$$

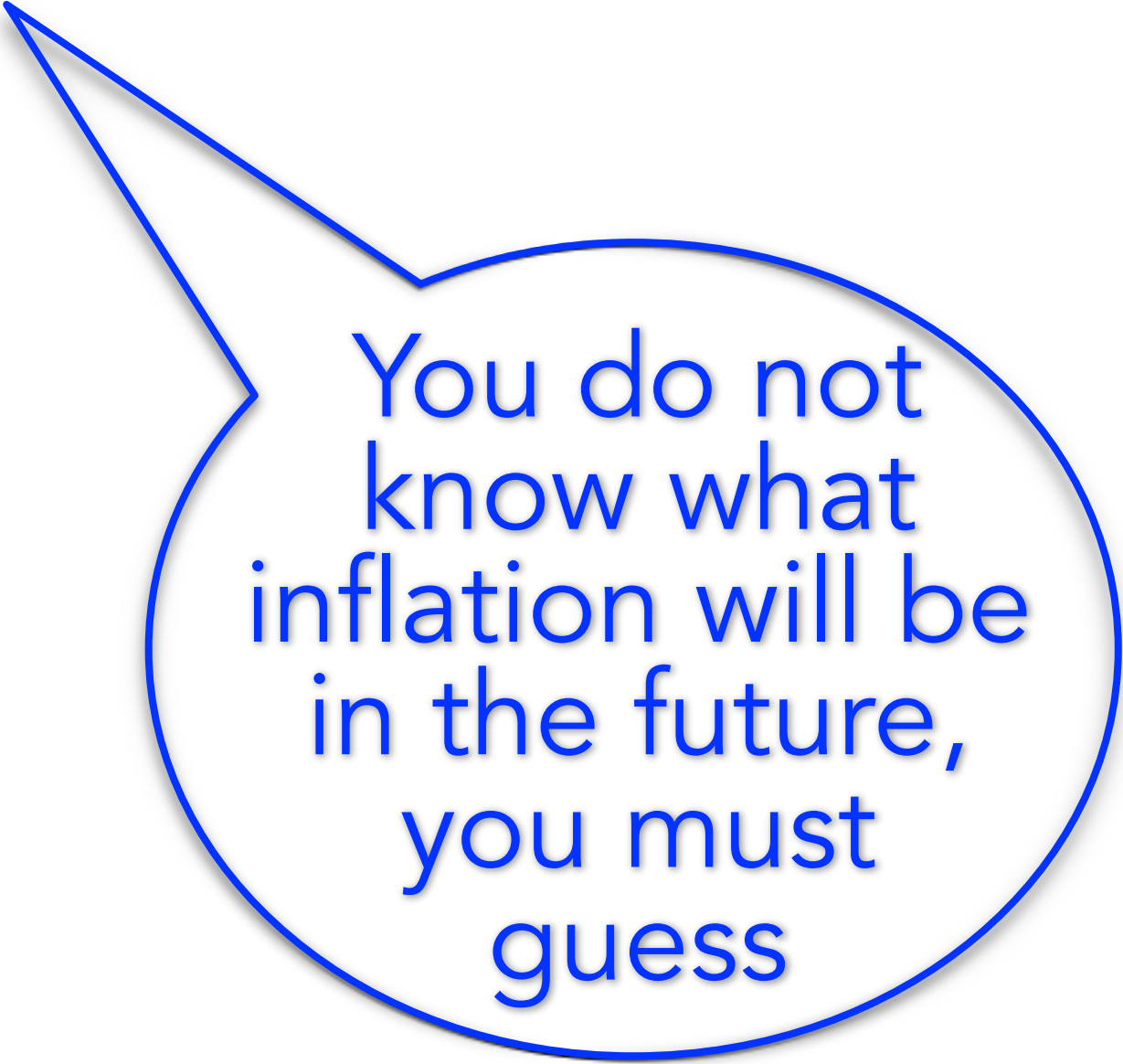
\$113,000

\$109,000 does not buy a
full basket: you are \$4,000
short



The borrower returns
\$4,000 less than what s/
he borrowed and **you**
earn zero interest

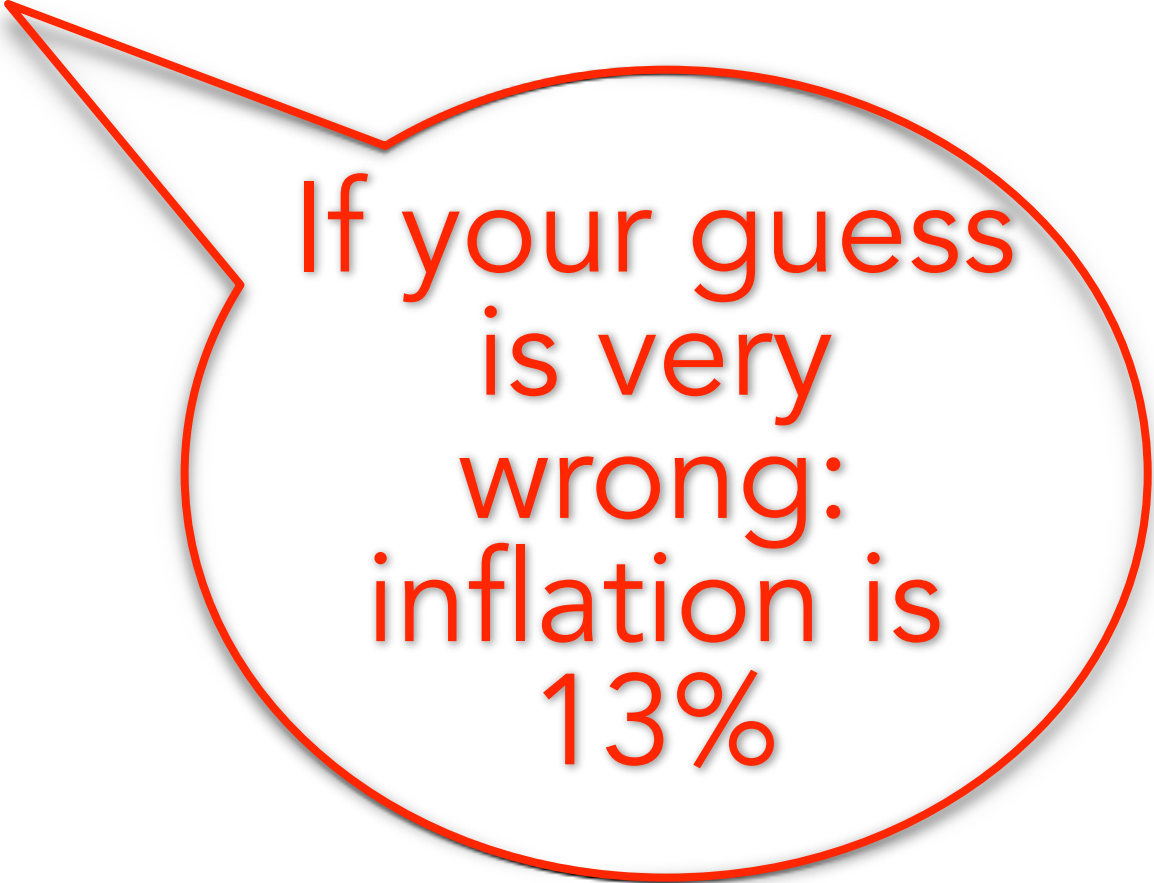
If lenders guess inflation **very** wrong they end up
giving money away!



You do not
know what
inflation will be
in the future,
you must
guess



You guess
Inflation will
be 5%



If your guess
is very
wrong:
inflation is
13%

CPI = 210

2020



CPI = ?

2021

If lenders guess inflation **very** wrong they end up giving money away!



The borrower returns
\$4,000 less than what s/
he borrowed and **you**
earn zero interest

\$113,000



