



CPI = 200

CPI = 210

2009



2019

$$\text{Inflation} = \frac{210 - 200}{200} \times 100 = 5\%$$

Suppose you lend \$100,000 (one full basket) at **zero interest** in 2009 to be repaid in 2019

Loan = 1000,000

The borrower returns = 1000,000



\$100,000

Full Basket



Full Basket

5% inflation means that the basket in 2019 costs 5% more:

$$\$100,000(1.05) = \$105,000$$

\$105,000

\$100,000 does not buy a full basket. It only buys:
 $(100,000/105,000) \times 100 \sim$
95% of the basket ...

The borrower
returns less than
what he
borrowed



Lenders must protect from inflation by charging
interest

95% of the basket

CPI = 200

2009

CPI = 210

2019

$$\text{Inflation} = \frac{210 - 200}{200} \times 100 = 5\%$$

Lenders must protect from inflation by charging interest



The borrower
returns less than
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\$100,000

Full Basket