

1

3

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

9% inflation means that the basket in 2021 costs 9% more:

$$\$100,000(1.09) = \$109,000$$

\$109,000

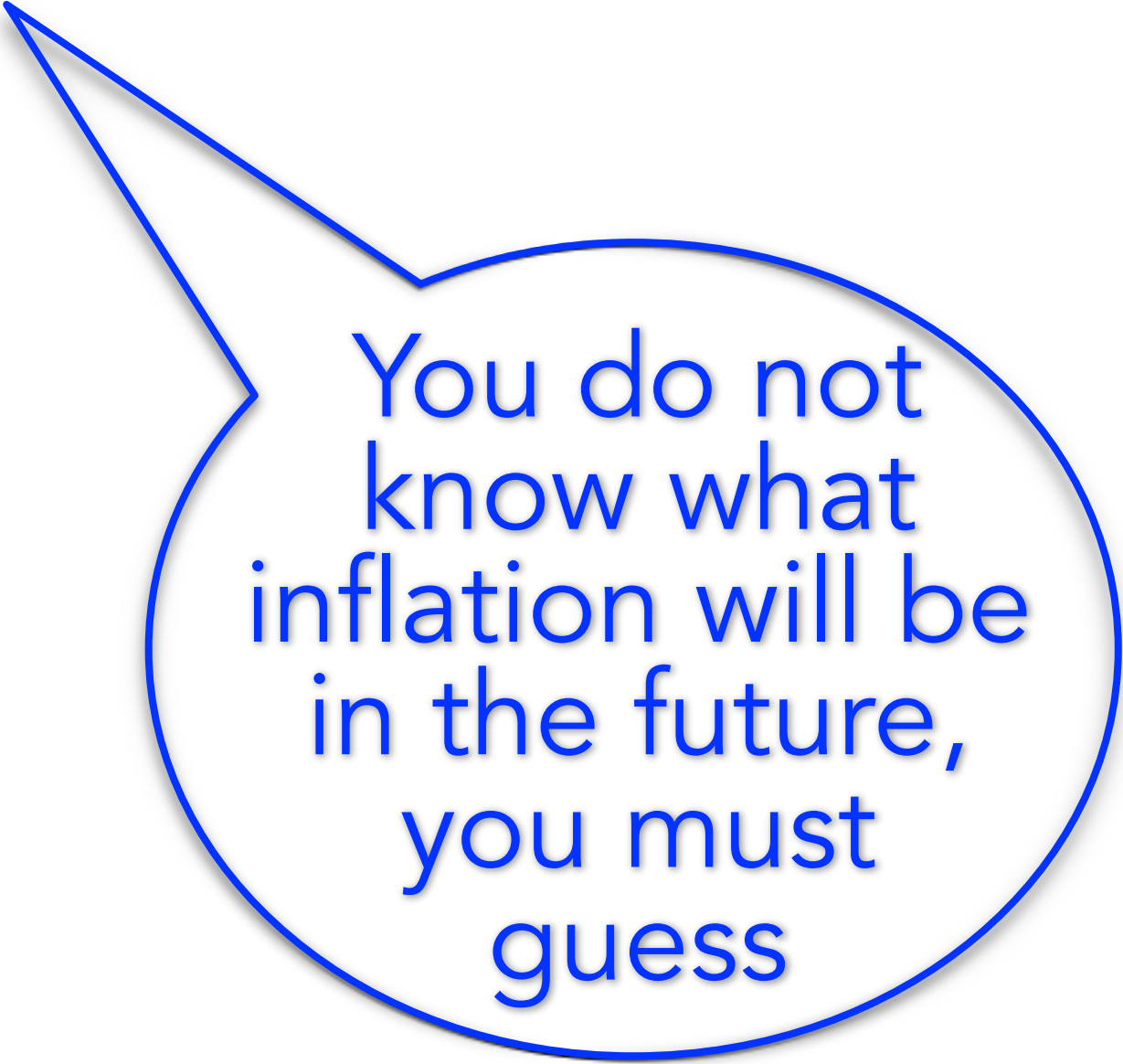
\$109,000 buys a full basket
but there is no money left



The borrower returns
a full basket, but **you**
earn zero interest

If lenders guess inflation wrong they end up earning

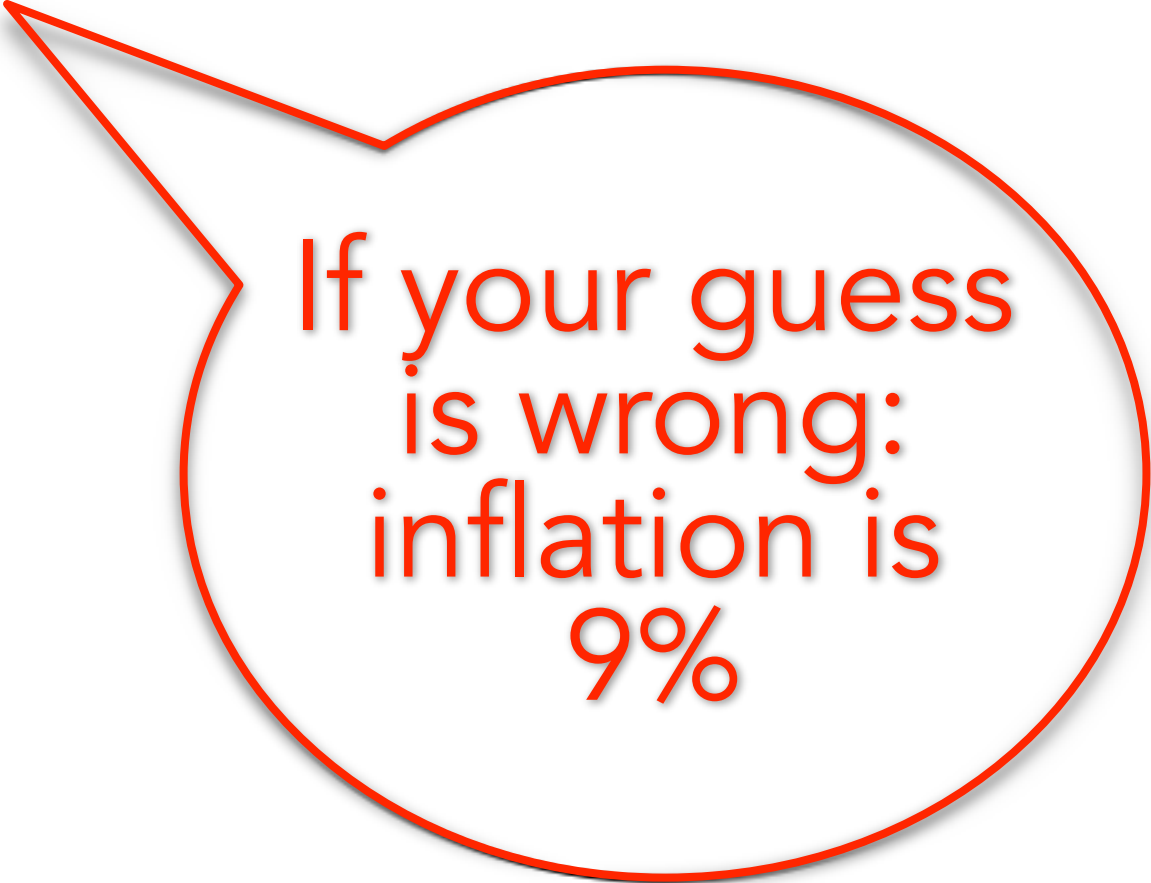
zero interest



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

A crystal ball is held by two hands, one on the left and one on the right. Inside the crystal ball, various currency symbols are floating, including the dollar sign (\$), the Euro symbol (€), and the Yen symbol (¥). The background is a dark, starry space. Overlaid on the crystal ball is the text "You guess Inflation will be 5%" in a yellow, sans-serif font.

You guess
Inflation will
be 5%



If your guess
is wrong:
inflation is
9%

CPI = 210

2020



CPI = ?

2021

If lenders guess inflation wrong they end up earning zero interest



\$100,000

Full Basket



The borrower returns a full basket, but **you** earn **zero** interest

\$109,000



Full Basket



\$100,000

Full Basket