

**Today: you
lend \$100**

**Borrower
returns
\$110**

CPI = 100

CPI = 105

Chargge 10% interest

A stylized illustration of a woven basket, likely made of straw or reeds, shown in a cross-section or open-top view. The basket has a light brown, textured appearance. A black, elongated oval label is centered on the front of the basket, featuring the text "Basket \$100" in a bold, white, sans-serif font.

Basket \$100

A woven basket with a dark interior and the text 'Basket \$105' in red.

Basket \$105

+

\$

5



$$35\% \text{ Tax on Interest} = 0.35 \times \$10 = \$3,50$$

Interest Income \$10

Real Interest income \equiv \$5

Real Tax = \$3,50 / \$5 = 0.7

70% tax instead of 35%!

**Borrower
returns
\$110**

**Inflation
increases the
effective tax you
pay**

$CPI = 110$

Real Interest income = \$0

**You still have to pay Tax = \$3,500 even
though your (real) income was zero!**

+


\$0

Basket \$110




**Borrower
returns
\$110**

Tax on Interest Income = 35%



**You must pay
the government
\$3,50 in taxes**



**You earned
only \$5 in
(real) interest
income**

CPI = 100

Today: you
lend \$100

Charge 10% interest

Interest Income \$10

Real Interest income = \$0

**Borrower
returns
\$110**

CPI = 110



**Inflation
increases the
effective tax you
pay**



Basket \$110

+ \$0

Tax on Interest Income = 35%

35% Tax on Interest = $0.35 \times \$10 = \$3,50$

**You still have to pay Tax = \$3,50 even
though your (real) income was zero!**

Inflation Costs