



1

2

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




5% inflation means that the basket in 2021 costs 5% more:

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

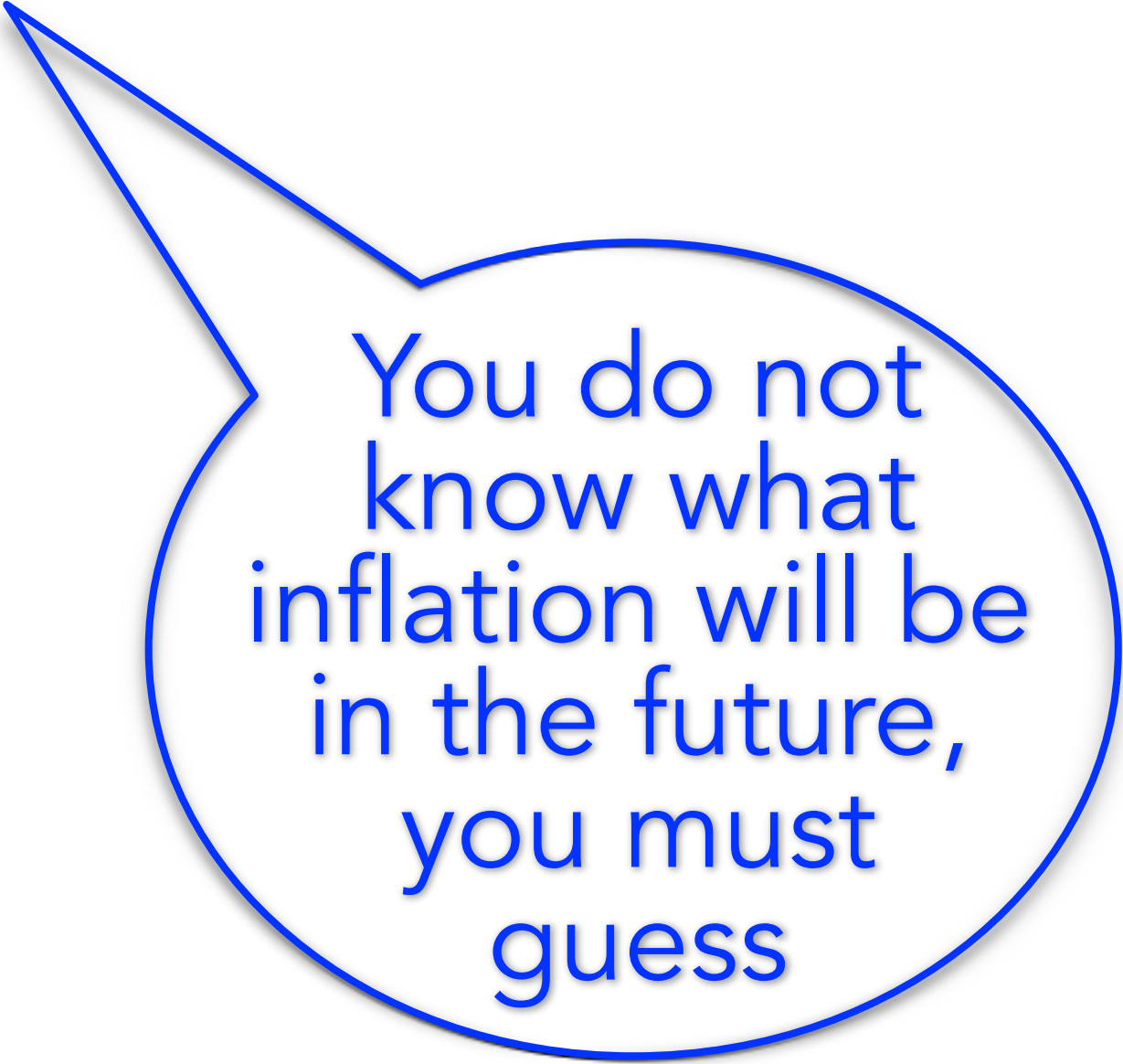
\$105,000

\$109,000 buys a full basket  
plus an extra 4,000



The borrower  
returns what s/he  
borrowed + 4,000

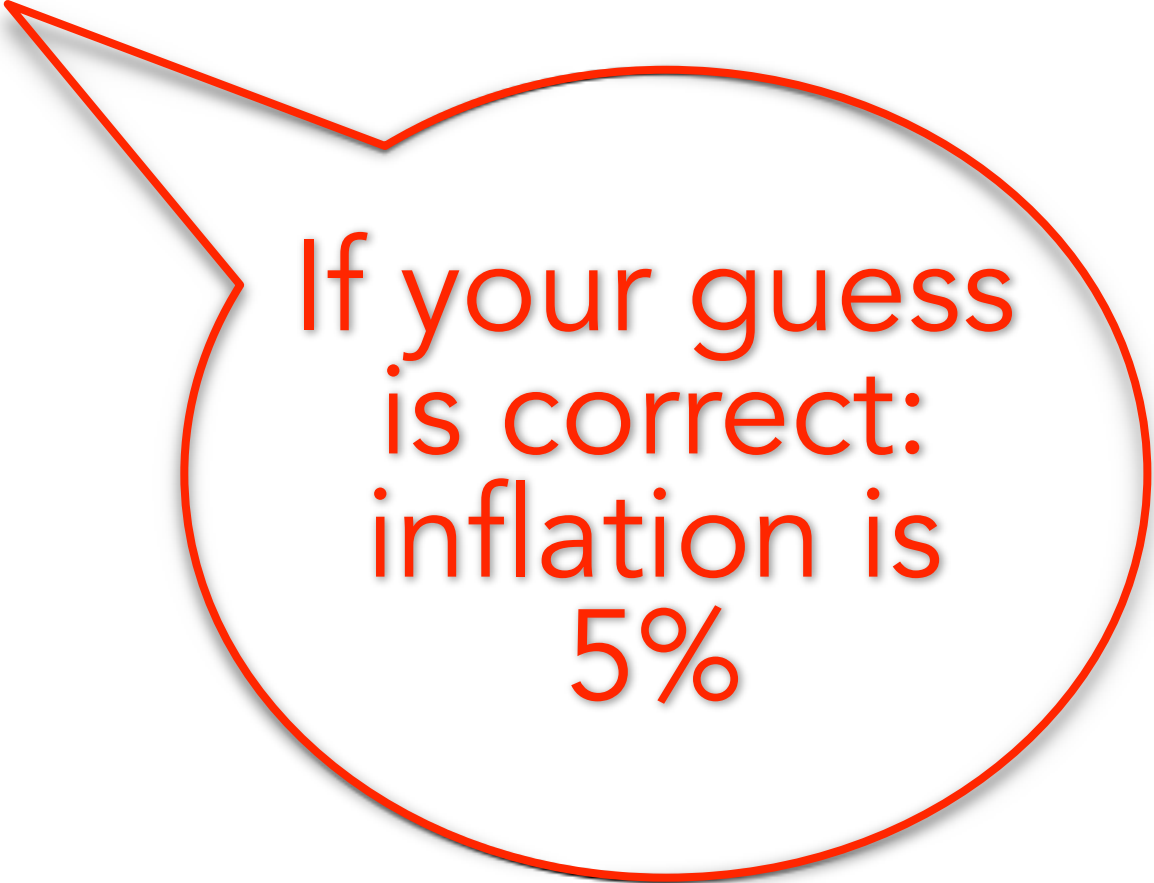
If lenders guess inflation correctly they are not hurt  
by inflation



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



You guess  
Inflation will  
be 5%



If your guess  
is correct:  
inflation is  
5%



CPI = 210

2020



CPI = ?

2021

If lenders guess inflation correctly they are not hurt by inflation



\$100,000



The borrower  
returns what s/he  
borrowed + 4,000

\$105,000





