



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:

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

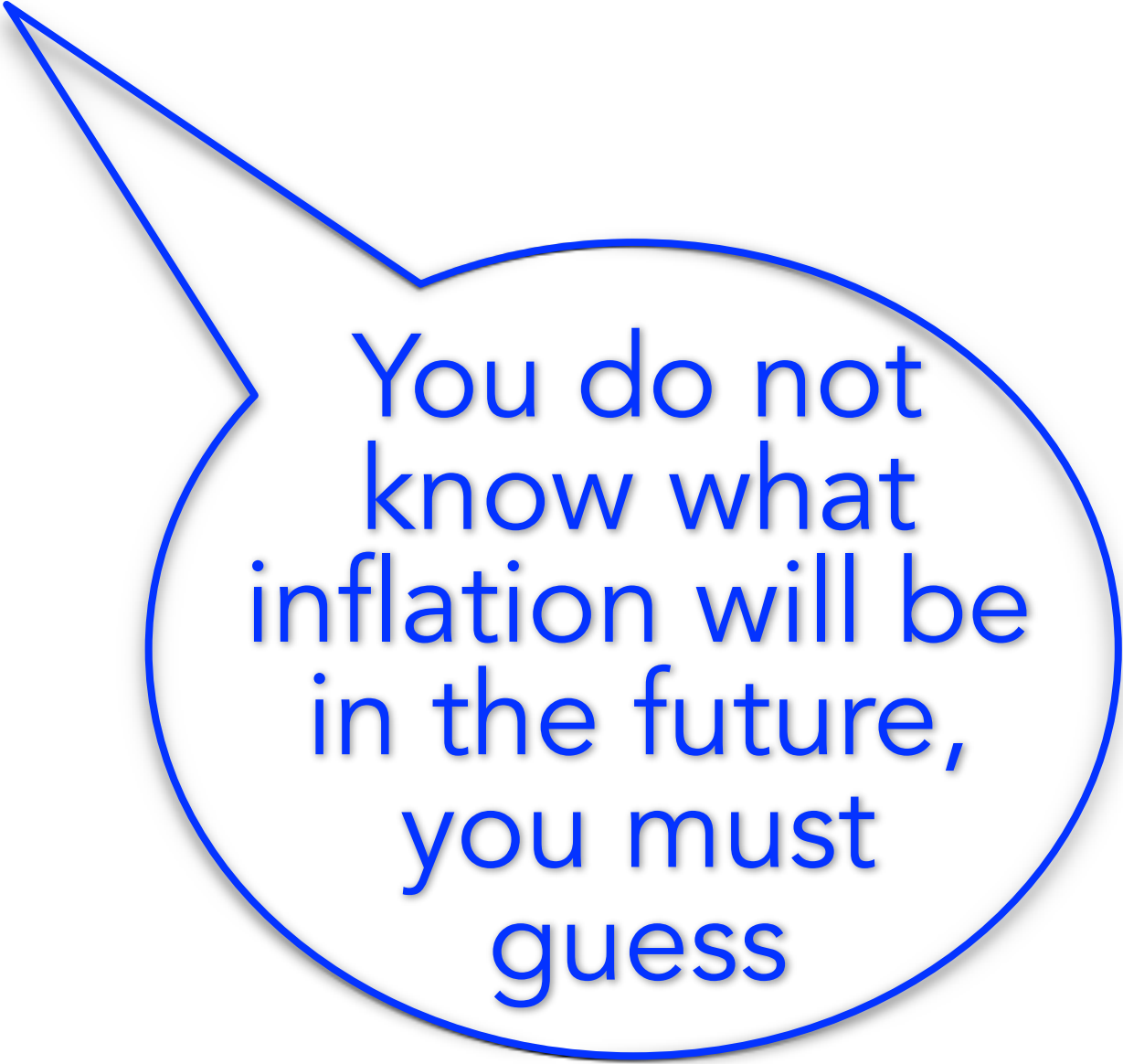
\$109,000

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



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

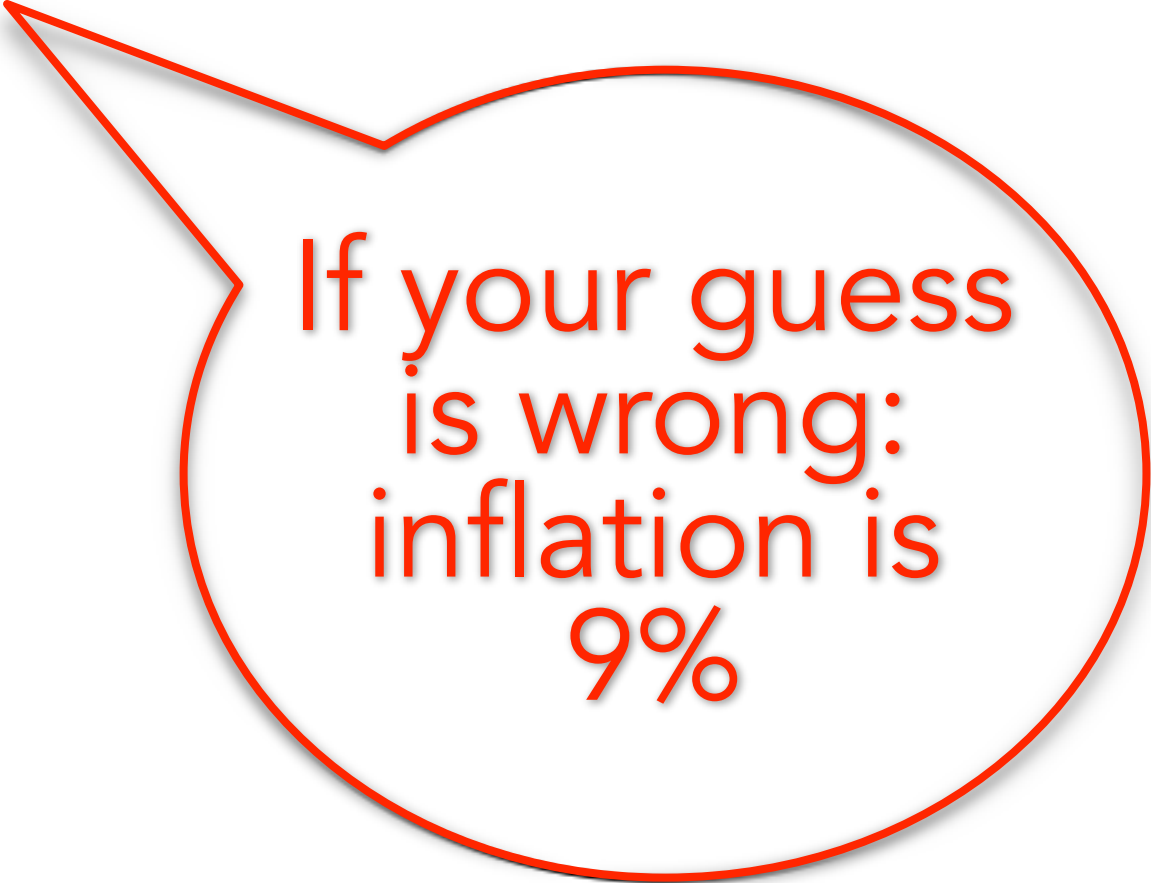
If lenders guess inflation wrong they could end up  
earning zero interest



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



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 could end up earning zero interest



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

\$109,000







\$100,000

Full Basket