

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:

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

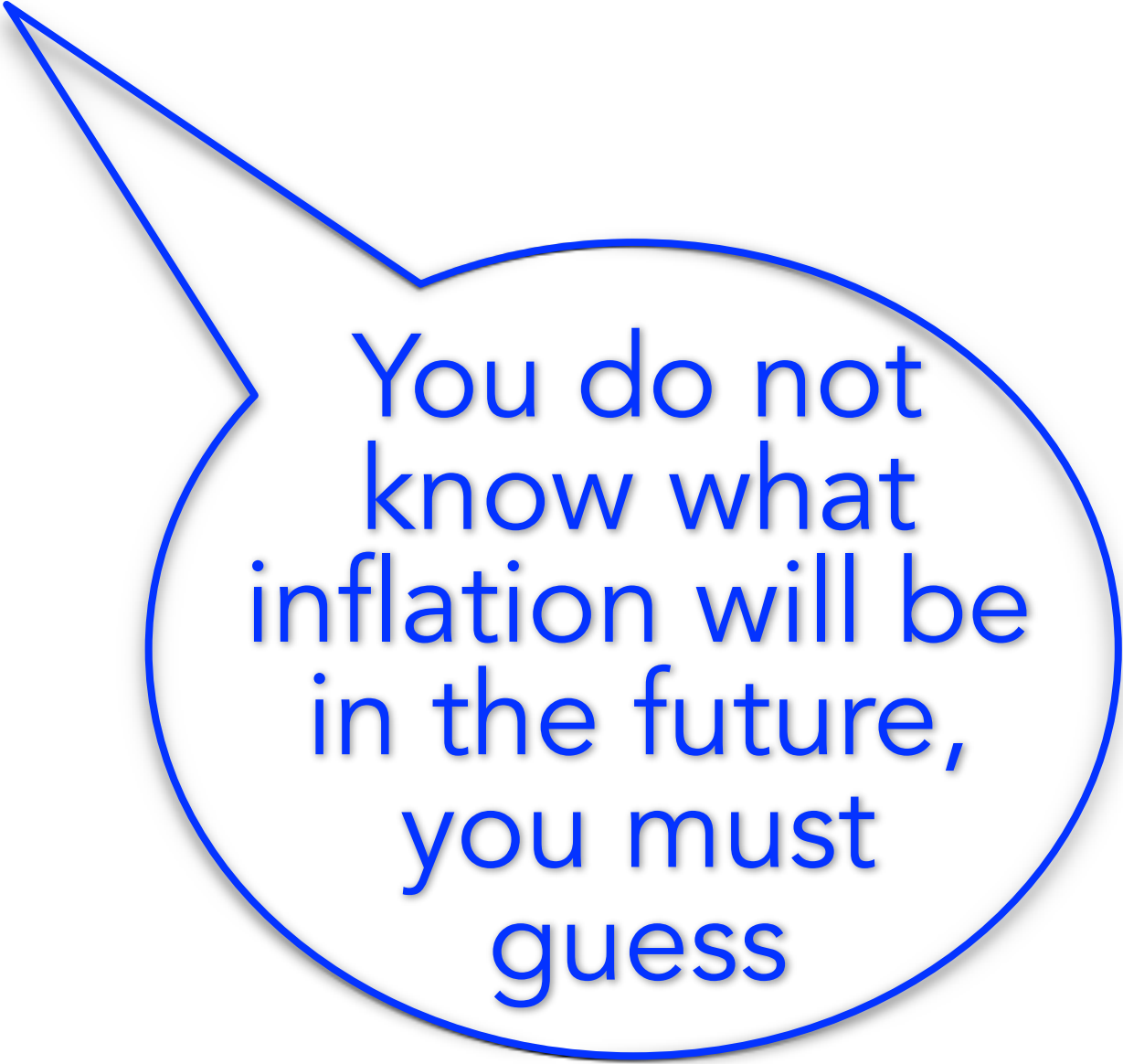
\$109,000

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



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

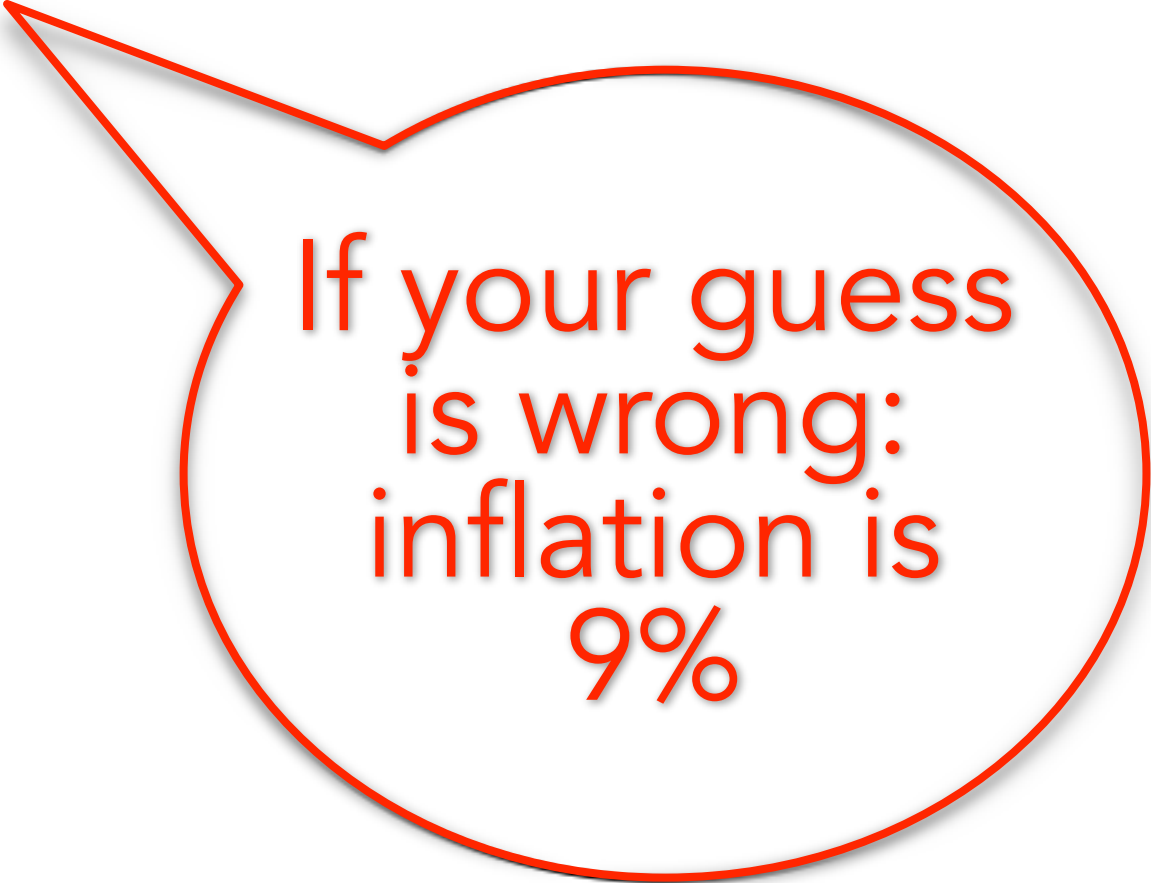
If lenders guess inflation wrong they could end up
earning zero interest



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



\$100,000

Full Basket



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

\$109,000



Full Basket



\$100,000

Full Basket