

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:

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

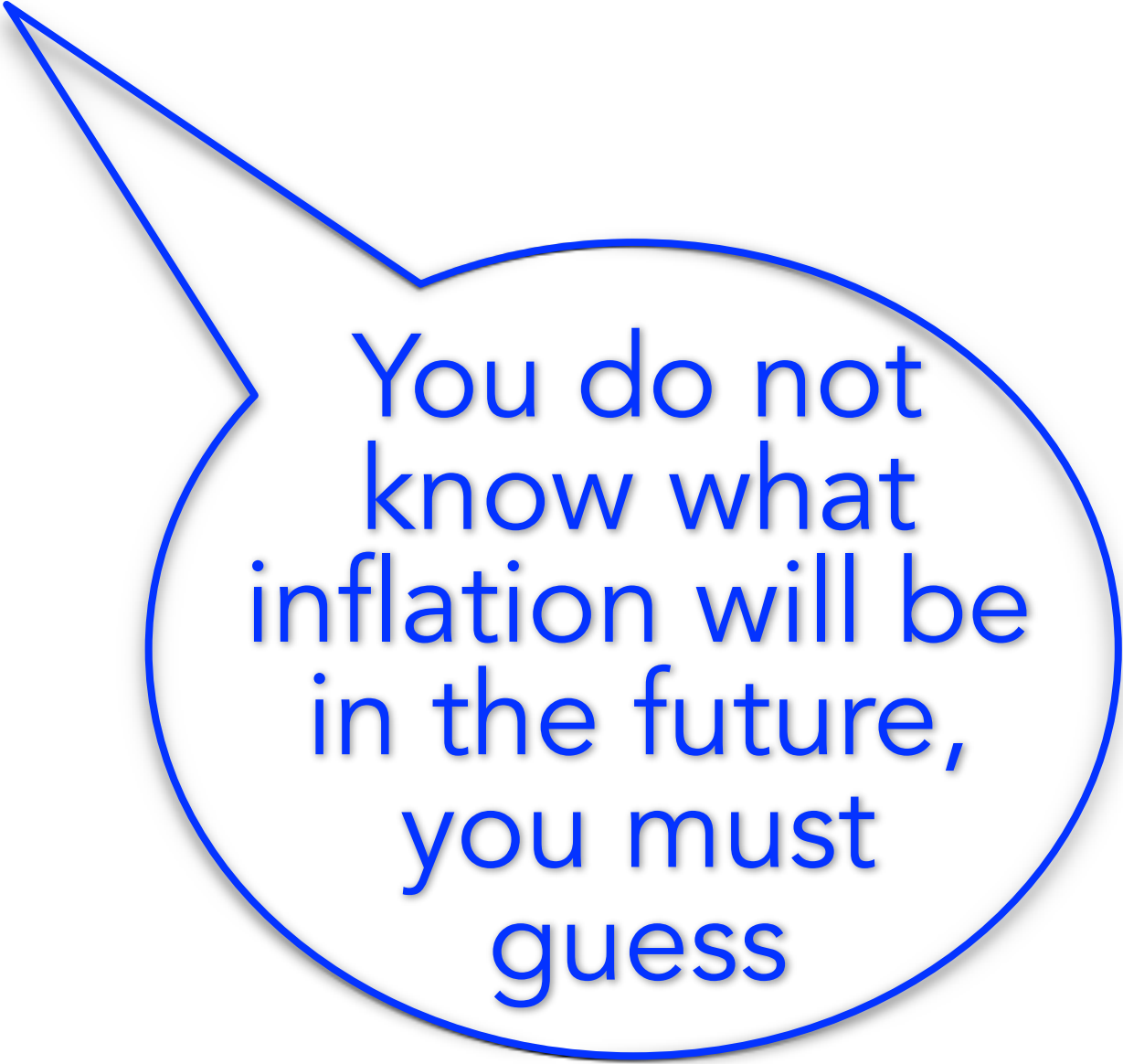
\$105,000

\$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



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

\$105,000





\$100,000

Full Basket