

1

4

CPI = 210

2024



CPI = ?

2025

You lend \$10,000 (one full basket) at 7% interest in 2024 to be repaid in 2025

Loan = 10,000

The borrower returns $= 10,000(1.07) = 10,700$



\$10,000

Full Basket




Full Basket

10% inflation means that the basket in 2025 costs 10% more:

$$\$10,000(1.1) = \$11,000$$

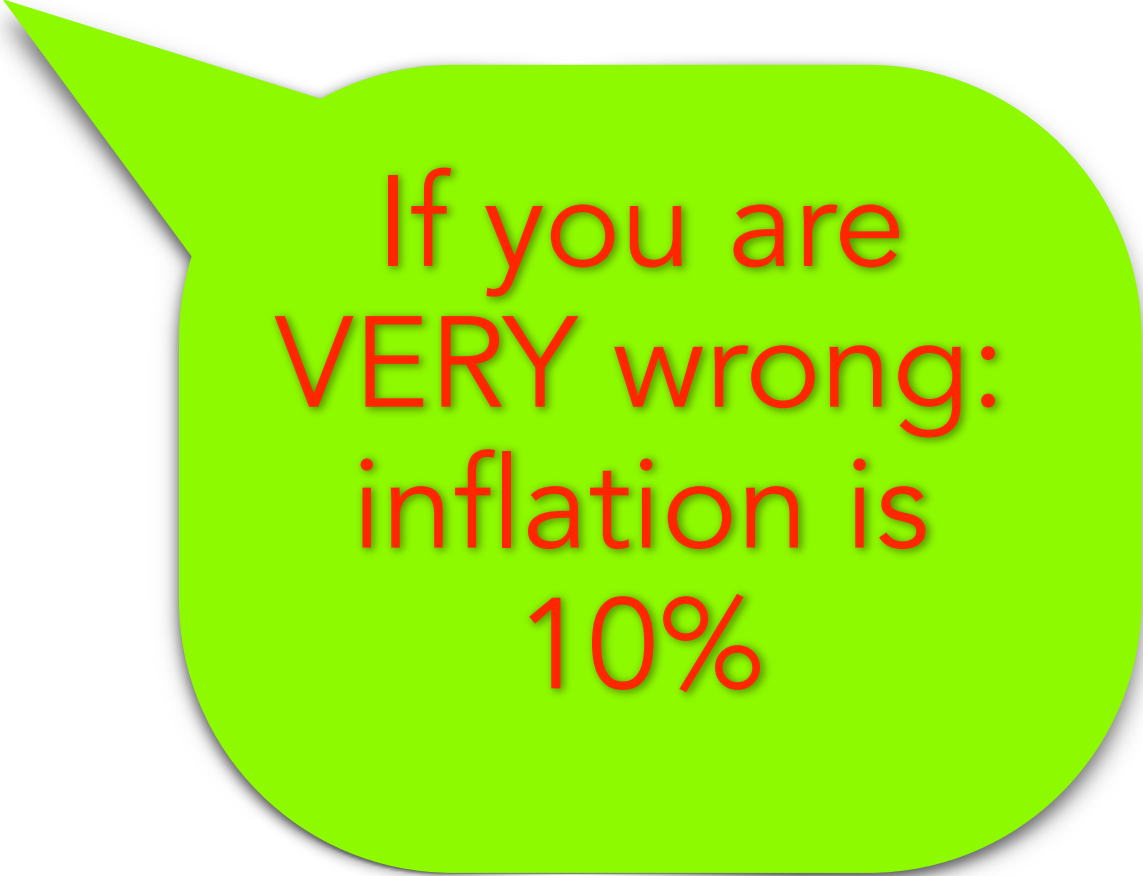
\$10,700 is NOT enough
to buy a full basket



The borrower paid
back **less** than s/he
borrowed



**You guess
Inflation will
be 5%**



If you are
VERY wrong:
inflation is
10%



\$11,000

If lenders guess inflation **very** wrong they end up giving
money away!

CPI = 210

2024

You guess
Inflation will
be 5%

CPI = ?

2025

If lenders guess inflation **very** wrong they end up giving money away!



\$10,000

Full Basket



The borrower paid
back **less** than s/he
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\$11,000

