14

CPI = 210
CPI = ?
2020
2021

You lend $100,000 (one full basket) at 9% interest in 2020 to be repaid in 2021

Loan = 100,000

The borrower returns = 100,000(1.09)=109,000

$100,000

Full Basket

Full Basket

13% inflation means that the basket in 2021 costs 13% more:

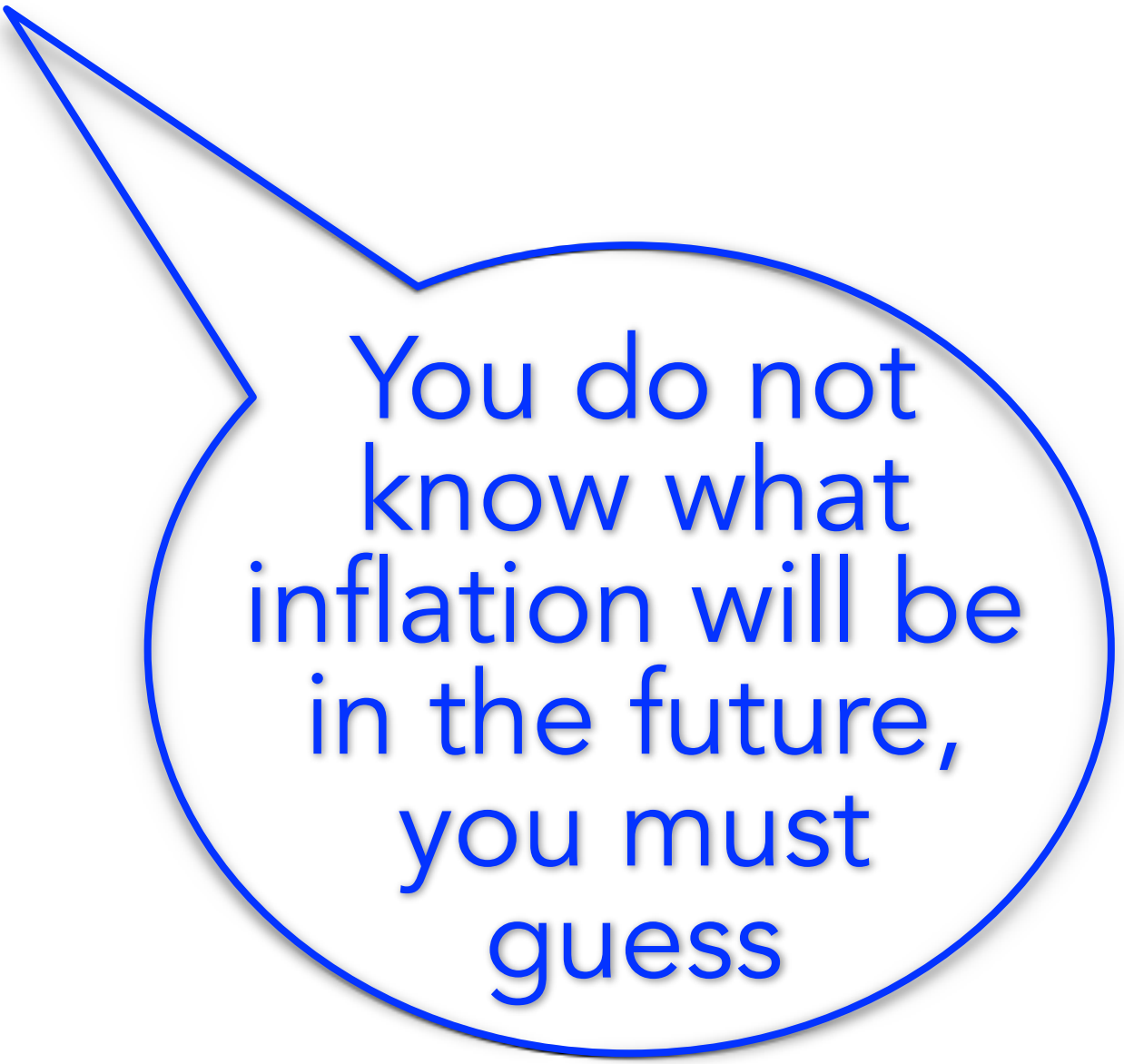
$100,000(1.13)=$113,000

$113,000

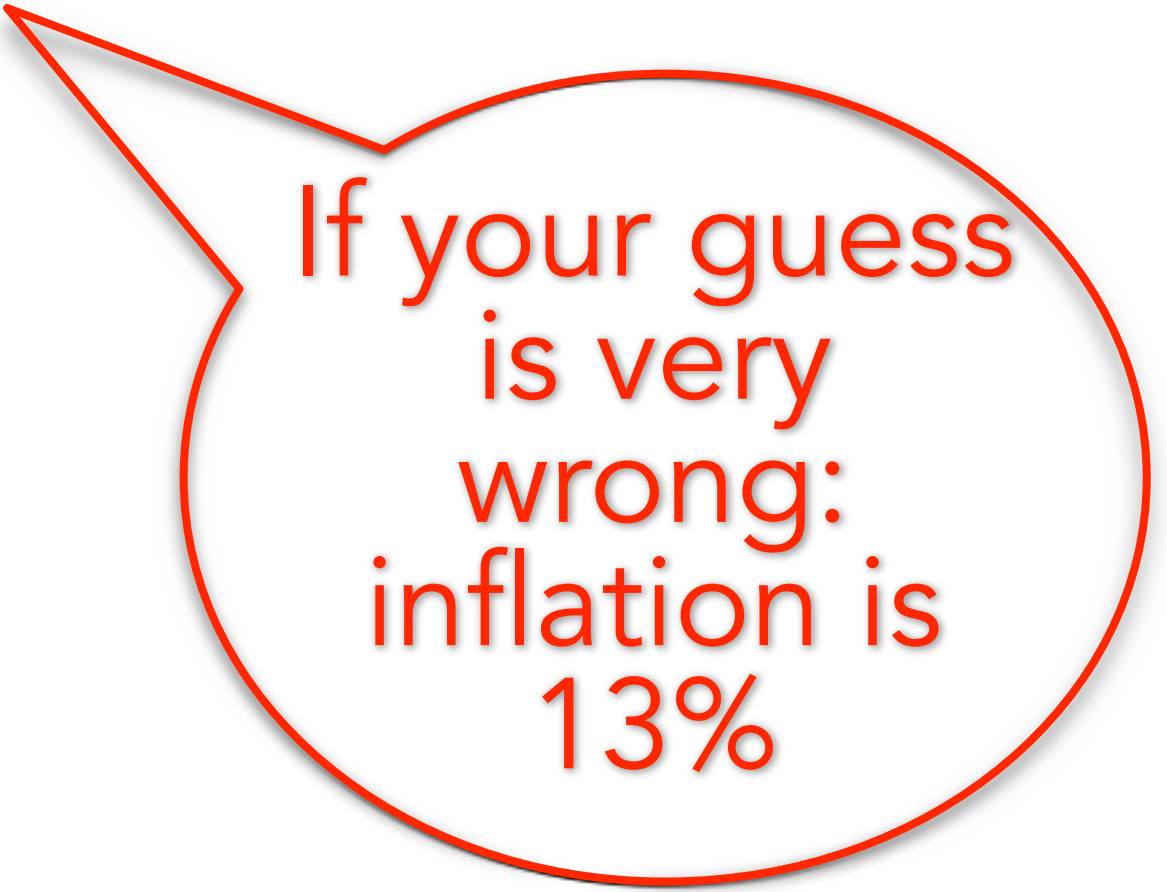
$109,000 does not buy a full basket: your are $4,000 short

The borrower returns $4,000 less than what s/he borrowed and you earn **zero** interest

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


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

You guess
Inflation will
be 5%


If your guess is very wrong: inflation is 13%

CPI = 210

2020

CPI = ?

2021

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

$100,000

Full Basket

The borrower returns $4,000 less than what s/ he borrowed and you earn **zero** interest

$113,000

Full Basket