**Question Number 2**The accompanying table provides the inflation rate in the year 2000 and the average inflation rate over the period 2001-2013 for seven different countries:

|  |  |  |
| --- | --- | --- |
| Country | Inflation rate in 2000 | Average inflation rate in 2001-2013 |
| Brazil | 7.06% | 6.72% |
| China | 0.4 | 2.34 |
| France | 1.83 | 1.86 |
| Indonesia | 3.77 | 7.56 |
| Japan | -0.78 | -0.23 |
| Turkey | 55.03 | 18.79 |
| United States | 3.37 | 2.43 |

a) Given the expected relationship between average inflation and menu costs, rank the countries in descending order of menu costs using the average inflation over the period 2001-2013.

b) Rank the countries in order of inflation rates that most favored borrowers with ten-year loans that were taken out in 2000. Assume that the loans were agreed upon with the expectation that the inflation rate for 2001 to 2013 would be the same as the inflation rate in 2000.

c) Did borrowers who took out ten-years loans in Japan gain or lose overall versus lenders? Explain.

1. The countries with the highest average inflation rates should have the highest menu costs. Order: Turkey, Indonesia, Brazil, United States, China, France, Japan.
2. The countries with an average inflation rate higher than the inflation rate in 2000 should favor borrowers with ten-year loans payable in 2010. The higher the dif-ference between the average inflation rate during 2001–2010 and the inflation rate in 2000, the lower the real value of the loan. Order: Indonesia, China, Japan, France, Brazil, United States, Turkey.
3. During this period, borrowers would have gained at the expense of lenders in Japan since −0.25% is greater than −0.78%.