

$\sqrt{\%}$
Nominal
rate

0%

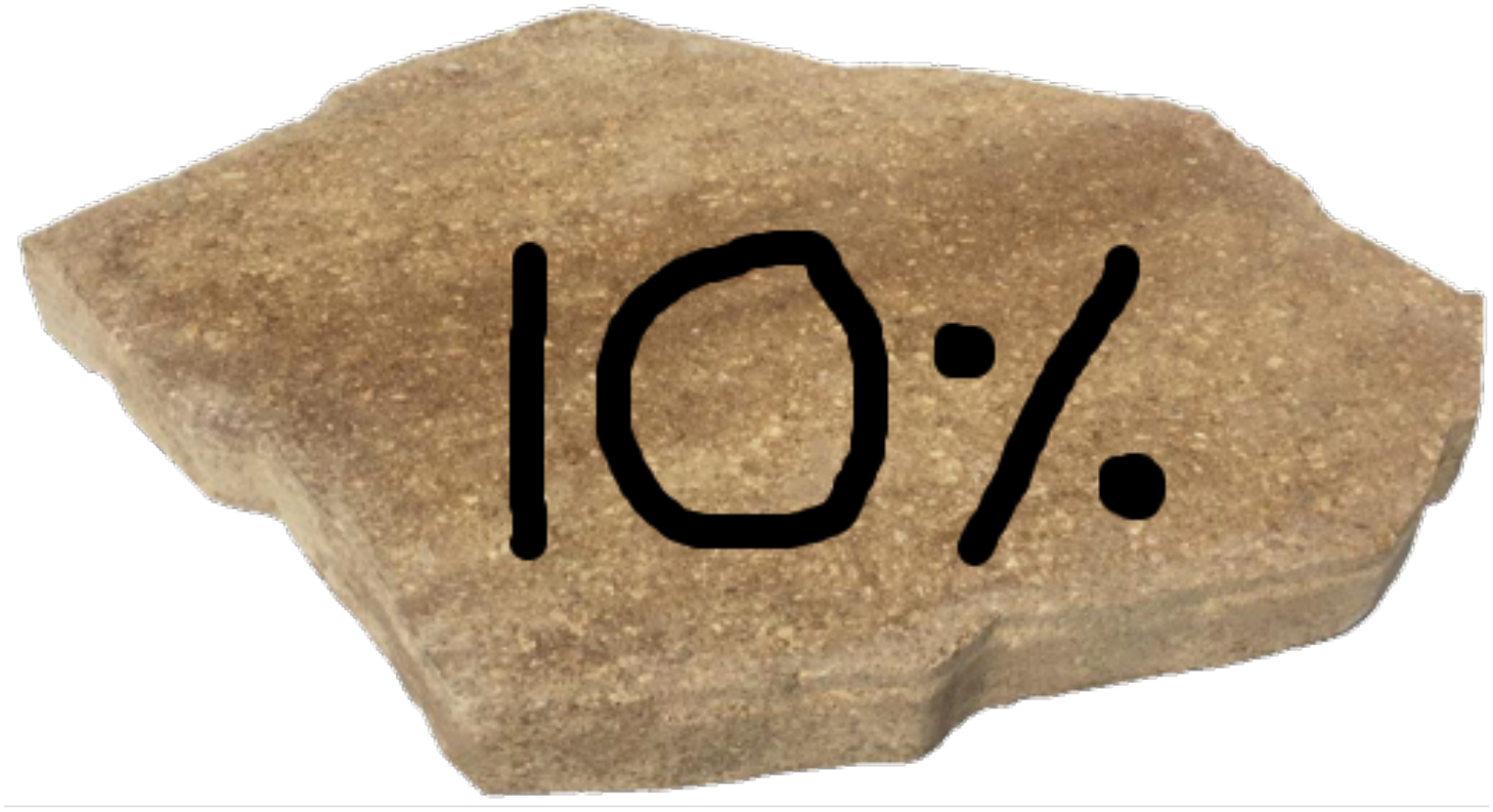
10% = 10%

10%

10% = 10% = 10%

$$10\% - 20\% = -10\%$$

Real Interest Rate =

A piece of brown, textured material, possibly a rock or a piece of wood, with the text "10%" written on it in a large, black, handwritten font. The material has a rough, granular surface and irregular edges. The text is centered on the surface.

10%

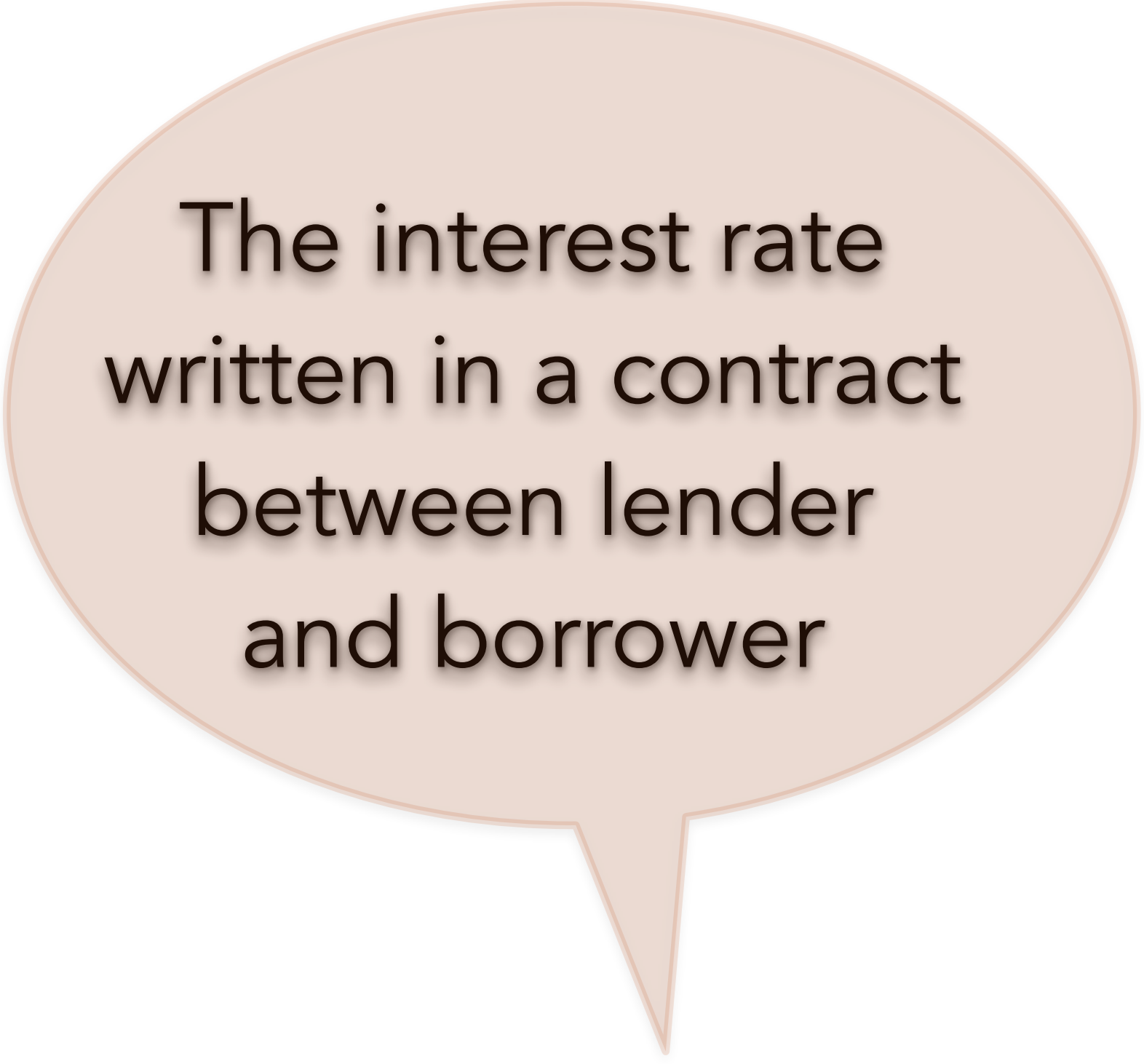
Nominal Interest Rate – Inflation Rate

If inflation is 0% during
the life of the loan

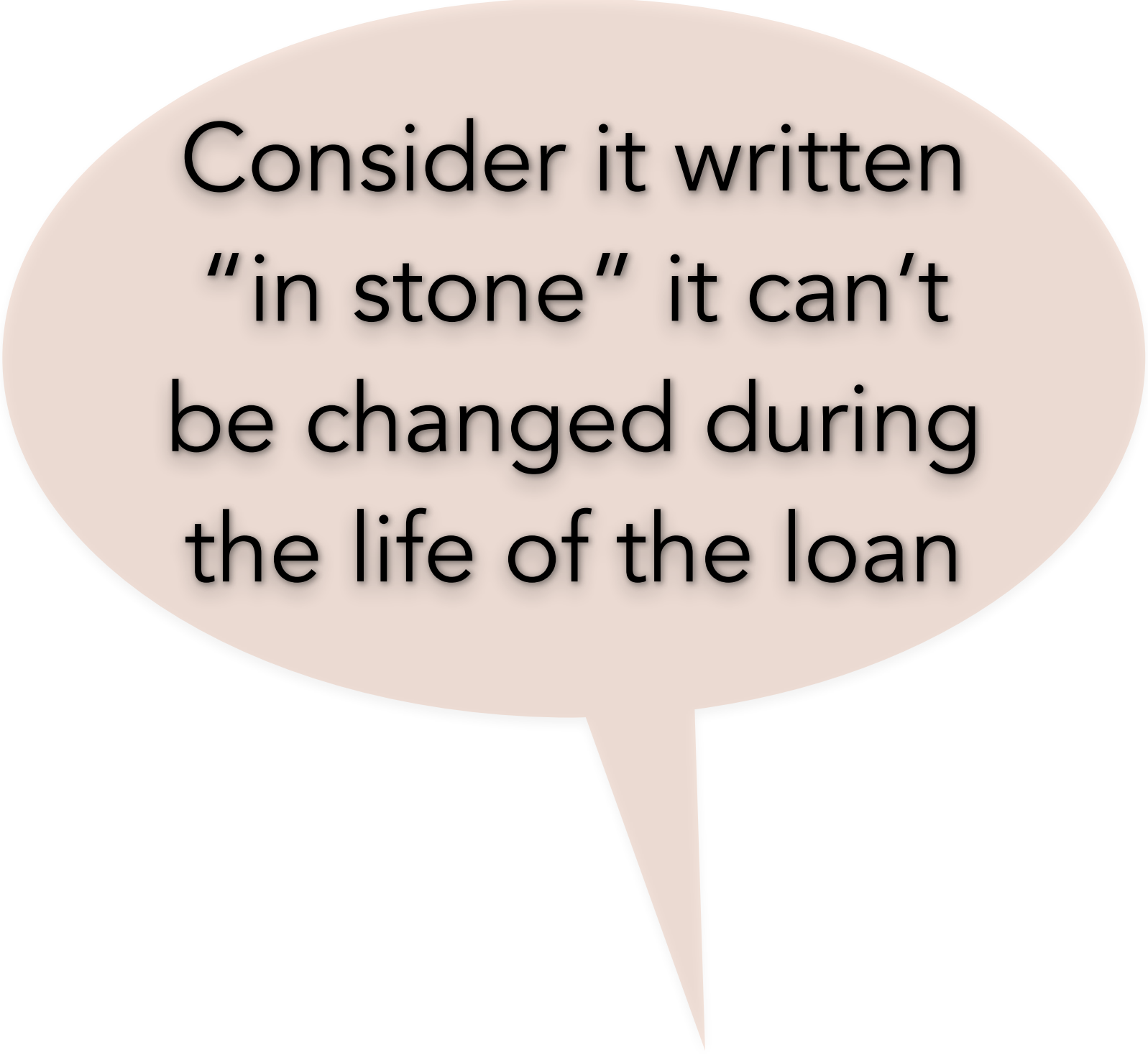
20%

If inflation is 10% during
the life of the loan

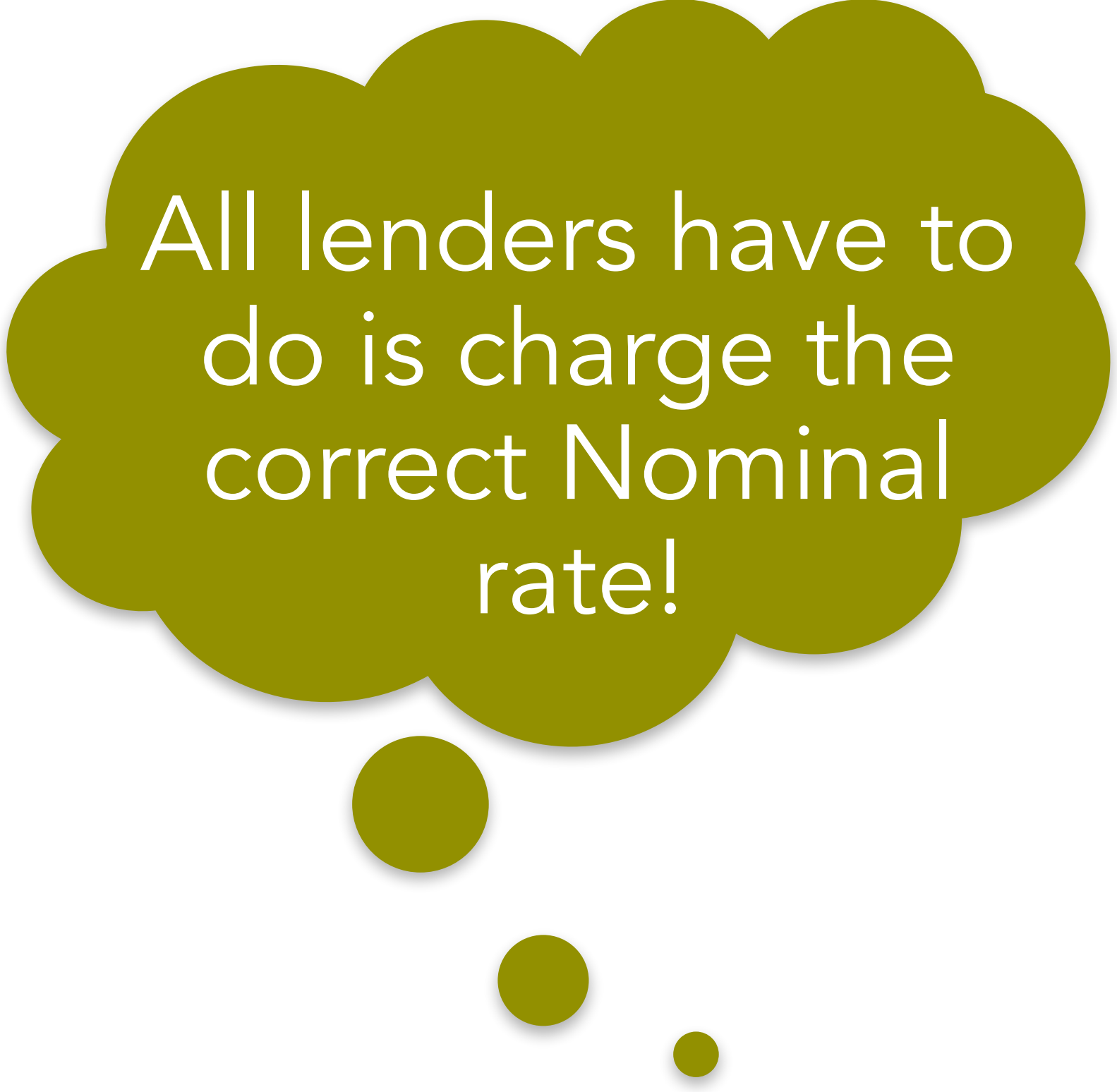
If inflation is 20% during
the life of the loan



The interest rate
written in a contract
between lender
and borrower



Consider it written
"in stone" it can't
be changed during
the life of the loan



All lenders have to
do is charge the
correct Nominal
rate!

The lender earns a
positive real interest

The lender earns
zero real interest

The lender earns a
negative real interest



All lenders need
to do is guess
inflation correctly

All lenders have to do is charge the correct Nominal rate!

All lenders need to do is guess inflation correctly

negative real interest

$$\text{Real Interest Rate} = 10\% - 20\% = -10\%$$

Nominal Interest Rate – Inflation Rate

20%

If inflation is 20% during the life of the loan



U.S. Inflation Since 1914

