0%

10% - 0% = 10%

10%

$$10\% - 10\% = 0\%$$

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

Real Interest Rate =

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

The lender earns a positive (10%)real interest

The lender earns zero real interest

The lender earns a negative (-10%) real interest

Lenders need to guess inflation correctly


Nominal
rate


10%

All lenders have to do is charge the **correct** Nominal rate…

The lender earns a negative (-10%) real interest

Real Interest Rate = 10% - 20% = -10%

20%

Nominal Interest Rate – Inflation Rate

If inflation is 20% during the life of the loan

All lenders have to do is charge the **correct** Nominal rate…

Lenders need to guess inflation correctly

Investment: Purchase of Capital Goods