**MGT411 GDB 1 IDEA Sol Spring 2020**

**Nominal Interest Rate**  
The nominal interest rate is the stated interest rate of a bond or loan, which signifies the actual monetary price borrowers pay lenders to use their money. If the nominal rate on a loan is 5%, borrowers can expect to pay $5 of interest for every $100 loaned to them. This is often referred to as the coupon rate, because it was traditionally stamped on the coupons redeemed by bondholders.

* KEY TAKEAWAYS  
  The different types of interest rates, including real, nominal, effective and annual, are distinguished by key economic factors that can help individuals become shrewder investors.  
  Real interest rates, unlike nominal rates, take account of inflation.  
  Investors and borrowers should also be aware of the effective interest rate, which takes the concept of compounding into account.

**Real Interest Rate**  
The real interest rate is so named, because unlike the nominal rate, it factors inflation into the equation, to give investors a more accurate measure of their buying power, after they redeem their positions. If an annually compounding bond lists a 6% nominal yield and the inflation rate is 4%, then the real rate of interest is actually only 2%.

It’s feasible for real interest rates to be in negative territory, if the inflation rate exceeds the nominal rate of an investment. For example, a bond with a 3% nominal rate will have a real interest rate of -1%, if the inflation rate is 4%. A comparison of real and nominal interest rates can be calculated using this equation:

RR=Nominal Interest Rate − Inflation Rate  
where:  
RR = Real Rate of Return  
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