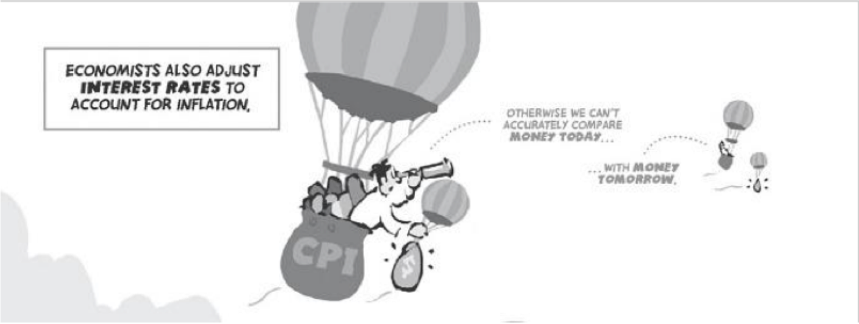
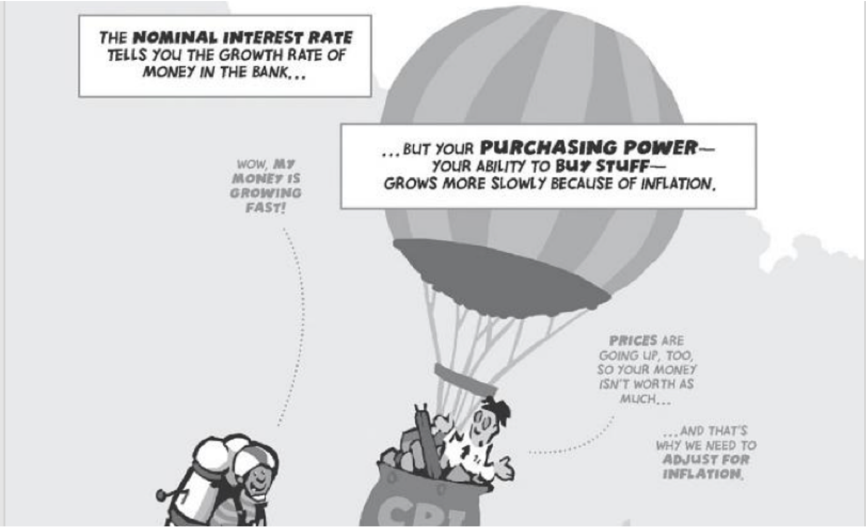
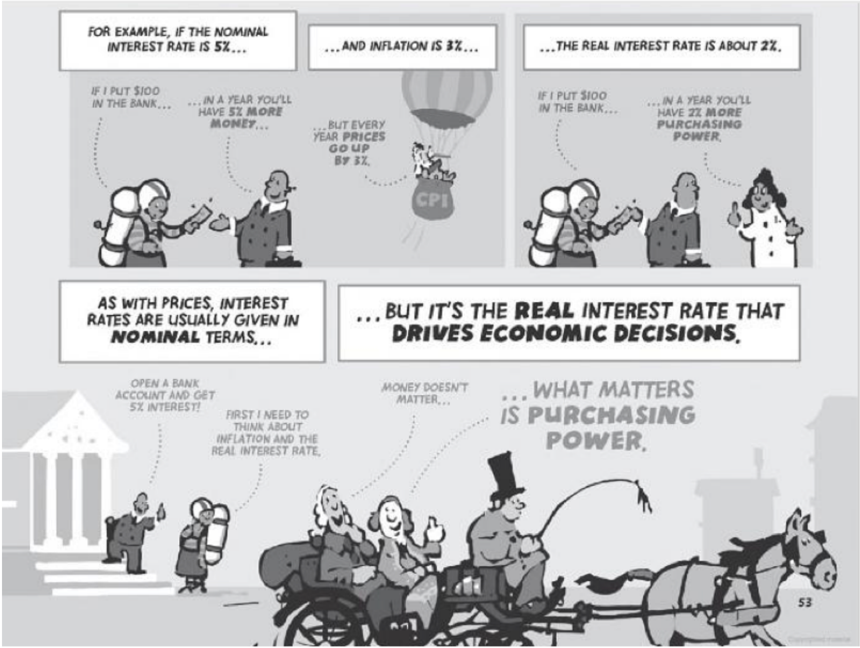
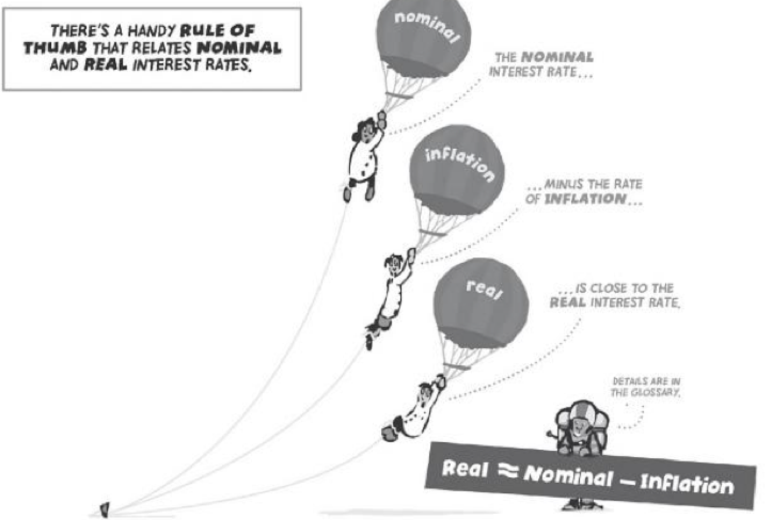

ECONOMISTS ALSO ADJUST INTEREST RATES TO ACCOUNT FOR INFLATION,
CPI
OTHERWISE WE CAN'T ACCURATELY COMPARE MONEY TODAY...
...WITH MONEY TOMORROW.


THE NOMINAL INTEREST RATE TELLS YOU THE GROWTH RATE OF MONEY IN THE BANK...
WOW, MY MONEY IS GROWING FAST!
...BUT YOUR PURCHASING POWER— YOUR ABILITY TO BUY STUFF— GROWS MORE SLOWLY BECAUSE OF INFLATION.
PRICES ARE GOING UP, TOO, SO YOUR MONEY ISN'T WORTH AS MUCH...
...AND THAT'S WHY WE NEED TO ADJUST FOR INFLATION.
CPI


THE REAL INTEREST RATE TELLS YOU HOW MUCH YOUR PURCHASING POWER IS GROWING.
52


FOR EXAMPLE, IF THE NOMINAL INTEREST RATE IS 5%...
IF I PUT $100 IN THE BANK...
...IN A YEAR YOU'LL HAVE 5% MORE MONEY...
...AND INFLATION IS 3%...
...BUT EVERY YEAR PRICES GO UP BY 3%.
CPI
...THE REAL INTEREST RATE IS ABOUT 2%.
IF I PUT $100 IN THE BANK...
...IN A YEAR YOU'LL HAVE 2% MORE PURCHASING POWER.
AS WITH PRICES, INTEREST RATES ARE USUALLY GIVEN IN NOMINAL TERMS...
...BUT IT'S THE REAL INTEREST RATE THAT DRIVES ECONOMIC DECISIONS.
OPEN A BANK ACCOUNT AND GET 5% INTEREST!
FIRST I NEED TO THINK ABOUT INFLATION AND THE REAL INTEREST RATE.
MONEY DOESN'T MATTER...
...WHAT MATTERS IS PURCHASING POWER.
53


THERE'S A HANDY RULE OF THUMB THAT RELATES NOMINAL AND REAL INTEREST RATES.
nominal
THE NOMINAL INTEREST RATE...
inflation
...MINUS THE RATE OF INFLATION...
real
...IS CLOSE TO THE REAL INTEREST RATE.
DETAILS ARE IN THE GLOSSARY.
Real ≈ Nominal – Inflation