

Student Worksheet

Names: _____

Round 1					
Period	Nominal Interest Rate	Actual Rate of Inflation	Cost of market basket at the end of the year	Borrower pay-back amount	Can lender buy the basket at the end of the loan period?
EX	4%	5%	\$10,500	\$10,400	no
1					
2					
3					

Stop, think and share: Why is it important for borrowers and lenders to know the current rate of inflation? Does it make sense that nominal interest rates would include a “cushion” to cover inflation over the life of the loan? Who wins and who loses with inflation? Explain.

Round 2

Federal funds rate: _____ Nominal interest rate: _____ Loan made? _____

Stop, think and share: At this Federal Funds rate, did the loan get made or not? Explain. Discuss the likely impact on overall lending and economic activity when the Federal Funds Rate is lowered/raised.

Round 3

Period	Nominal interest rate	Borrower payback amount (principle plus interest)	Expected rate of inflation (yearly)	Expected real interest rate (yearly)	Actual rate of inflation (yearly)	Actual real interest rate (yearly)	Cost of market basket at the end of the year	Can lender buy the basket at the end of the loan period?
1								
2								
3								

Stop, think and share: Discuss the consequences of not correctly predicting the inflation rate. Is it important for borrowers and lenders to try to figure out what prices will do over the life of the loan, i.e. to form expectations about inflation? What information could they use to make these expectations? Explain why it might be important that the Fed signal its intentions when moving interest rates?