

## **Real Interest Rate formula**

Real interest rate is defined as the interest rate that has been calculated after making adjustments such as removing the inflation from the nominal interest rate.

It gives a clear picture of the actual or real cost of funds for the borrower and the actual or real yield that is obtained by the lender.

As per the time preference theory of interest, the real interest rate is a reflection of the extent to which the customer prefers current goods in comparison to future goods.

The real interest rate is described appropriately by the Fisher Equation, which represents it as the value obtained after subtracting the inflation rate from the nominal interest rate.

Therefore, the real interest rate formula can be expressed as

Real Interest Rate = Nominal Interest Rate – Inflation

$$R = [(1 + r) / (1 + i)] - 1$$

Where

R = Real Interest Rate

r = Nominal interest rate

i = Inflation

Understanding the real rate of interest is helpful for the investors as it gives a clear view of the growth of the investment after adjusting for inflation.