What is interest, and what are interest rates?

1. Terms

Watch the film "What is interest, and what are interest rates?"

a) Whilst you watch, make notes on the following terms:

Interest	
Interest rate	
Deposit rate	
Lending rate	
Effective annual interest rate	
Key interest rate, key rate, policy rate	
Nominal interest rate	
Real interest rate	

b) Compare your notes with your partner's and add to them if necessary.

c) In small groups or in front of the class, take turns explaining one of the terms listed above without saying which one it is. The person who guesses it correctly goes next.

© Deutsche Bundesbank 2026

What is interest, and what are interest rates?

2. Factors influencing interest rates

Interest rate levels depend on a variety of different factors. Consider whether these factors make a difference to the deposit rate or to the lending rate and place a cross in the left or right column accordingly. Some factors can have a bearing on both rates.

Influences deposit rate	Factor	Influences lending rate
	Key interest rate	
	Amount of the deposit	
	Amount of the loan	
	Investment term	
	Term of the loan	
	Creditworthiness: likelihood of loan being repaid	

3. Effective annual interest rate

a) What are the advantages of the effective annual interest rate?

_____

_____

_____

_____

© Deutsche Bundesbank 2026

What is interest, and what are interest rates?

b) You wish to take out a loan of €1,000 and repay it in three years. Which of the following loan options would you pick? Explain your answer.

Loan offer 1
Interest rate: 4% nominal p.a.
Amount paid out: 95%
Processing fee: 0%
Monthly instalment (interest and repayment): €29.53
Effective annual interest rate: 7.70% p.a.

Loan offer 2
Interest rate: 6.6% nominal p.a.
Amount paid out: 100%
Processing fee: 0%
Repayment in one lump sum at the end of the loan term / until then, only monthly interest payments of €5.50
Effective annual interest rate: 6.80% p.a.

Loan offer 3
Interest rate: 5% nominal p.a.
Amount paid out: 100%
Processing fee: 3% of original loan amount
Monthly instalment (interest and repayment): €30.87
Effective annual interest rate: 7.36% p.a.

Loan offer 4
Interest rate: 5% nominal p.a.
Amount paid out: 100%
Processing fee: €15
Monthly instalment (interest and repayment): €30.43
Effective annual interest rate: 6.20% p.a.

© Deutsche Bundesbank 2026

What is interest, and what are interest rates?

4. Chain of effects following a change in the policy rate

The film explains the impact of a change in the key interest rate. Sort the terms in the box into the correct order so that the table shows the sequence of cause-and-effect produced. This is referred to as the "transmission mechanism". The arrows represent the effects of a policy rate adjustment in each case.

Demand for loans

Commercial banks' interest rates (for customers)

Saving ratio

Demand in the economy

Inflation rate (price developments)

Key interest rate

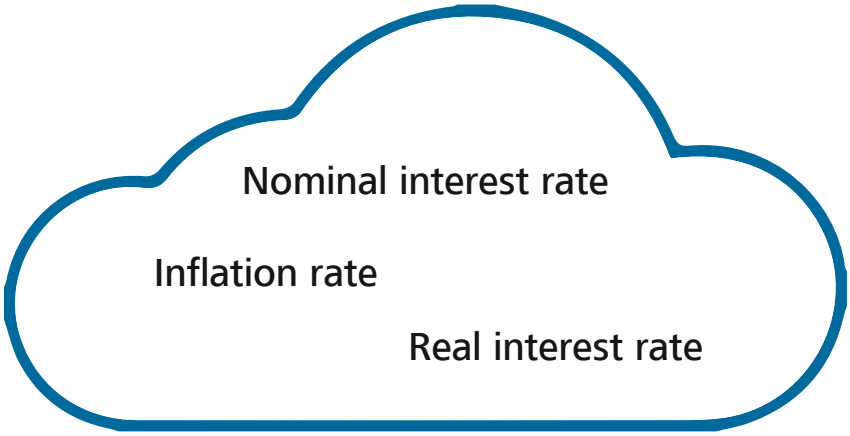
↑		↓
↑		↓
↑		↓
↓		↑
↓		↑
↓		↑

Chain of effects

© Deutsche Bundesbank 2026

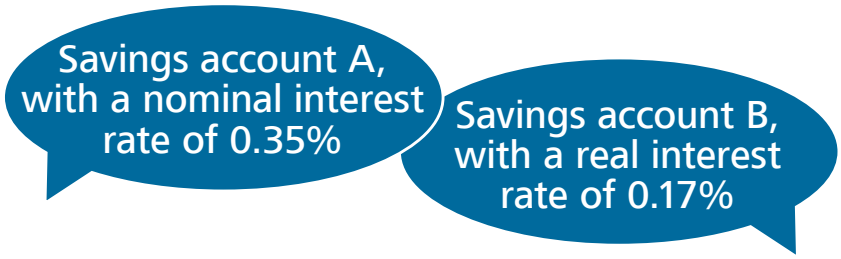
5. Real vs. nominal interest rate

a) Fill in the equation using the words in the cloud.



_____ = _____ – _____

b) Bearing in mind the equation above, which of these offers would you opt for and why? The rate of inflation is 1.9 %.



	Nominal interest rate	Real interest rate
Savings account A		
Savings account B		

© Deutsche Bundesbank 2026

What is interest, and what are interest rates?

6. Interest rates – doing the maths

You deposit €100 at your bank for one year at a rate of interest of 1%.

a) How much money do you have in the account at the end of the year?

b) The inflation rate this year was 2%. Can you buy just as much, more, or less with the money in your account? Explain your answer.

© Deutsche Bundesbank 2026