

## 1.16. INTEREST AND RENT

**Payment** for the use of someone else's money, or **capital**, is called *INTEREST*.

One of the main reasons to **place** your savings in a bank is to earn interest, the reward or return for allowing someone else (the bank) to use your capital. The **rate of return** is expressed as a percentage of the amount on deposit for a period of one year. For example, a deposit of \$ 100 in an account paying 5 percent would earn a total of \$ 5 in interest over a year. The \$ 5 is the return; the rate of return is 5 percent. Most accounts offer **compound interest**.

This is interest computed on the principal plus the previously paid interest – assuming it is left in the account.

The rate of return offered by banks and savings institutions is different and depends on economic conditions and the length of time they hold your money. It is also important to **distinguish** between rate of return and **yield**, the actual amount of interest earned. Yield depends on the rate of return and the **frequency of compounding**. For example, the First National Bank pays 8 % compounded quarterly (four times a year), on its savings accounts. The Second National Bank pays 8 % annually. A \$ 1 000 deposit in the First National would earn \$ 82.43 by the end of the year, but the same amount deposited in the Second National would only earn \$ 80. The rate of interest was the same at both banks, but more frequent compounding at First National resulted in a yield that was \$ 2.43 greater.

### *RENT*

The price paid for the use of land is called rent. Rent is income to the owner of the land. Da Vinci painted only one Mona Lisa, and if you could pay for its temporary use, you would pay rent. If you were hiring the services of some actors or singers, you would be paying rent for their talents.

The concept of rent **applies** to any factor that is fixed in supply. Any payments for the use **unique** factors of production are *RENT*.

### *Answer the following questions*

1. What is interest?
2. What is one of the main reasons to place your money in a bank?
3. What is the rate of return?
4. What is the compound interest?
5. What does the rate of return depend on?
6. What is the difference between the rate of return and yield?
7. What does yield depend on?
8. What is rent?