UNDERSTANDING INTEREST

What is an interest rate?

An interest rate is the cost of borrowing money or the reward for saving money shown as a percentage.

* **Compound interest** – Compound interest is a type of interest that is calculated not only on the principal amount but also on any interest earned or accrued over time. Compound interest allows for exponential growth of investments or loans and is ideal for a long-term investment or loan.

* **Simple Interest** – Simple interest is a type of interest that is charged only on the principle of a loan or investment. It does not take into account any interest earned or accrued over time. Simple interest is a straightforward way to calculate interest, and it's commonly used for short-term loans or investments.

While simple interest is easier to understand and calculate, compound interest can lead to higher overall returns over time. By carefully considering interest rates and taking advantage of compound interest, you can make the most of your money and achieve your financial goals.

We use interest rates when:

- Borrowing money for; personal loans, car loans, mortgages, credit cards
- Saving money
- Investing
- Superannuation accounts

Understanding interest rates can help you make informed decisions about borrowing, saving, and investing, helping you to manage your finances effectively.

Common words you might hear:

* **Principal** – The original amount of money borrowed, saved or invested.

* **Interest** – Interest is the amount of money a lender charges you for borrowing, on top of the loan.

MY MONEY Dream

MEET *Emu*

Emu borrowed
$100,000
for a big purchase over 10 years, with monthly repayments, and the interest rate was
6 per cent

Emu now makes repayments to pay off the $100,000, **plus** the 6 per cent interest over the
10 years

She pays
$1,000
per month for the loan, plus around
$110.00
in interest

Over the life of the loan, Emu will pay just over
$33,000
in interest.

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