



Compound Interest

So What is Compound Interest:

With Compound Interest, you work out the interest for the first fixed period of time, add it to the total, and then calculate the interest for the next fixed period of time, and so on, like this:

Investment: You have an amount of money invested, for example £1.

Interest rate: An interest rate, for example 10%.

Time period: A fixed period of time, for example a week.

Result: At the end of the week you have earned interest of 10% of £1 so **10p**.

Next: For the next time period you simply then add the interest to the original £1 and your amount of money to invest is now **£1.10**.

At the end of the second week you'll have received interest of 10% of £1.10 so **11p**.

At the end of the third week you'll have received interest of 10% of £1.21 so **12.1p** and so on.

Exercise:

Here's a way for your parents to help you understand compound interest on your savings. Interest rates are not high at the moment, but this will help you understand the principles of compound interest:

Day 1: Ask your parent or carer to put £1 into a jar – this is the amount of 'money invested'.

Interest rate: Agree a daily interest rate of say 20% or 50% to keep things simple.

Time period: In this example the fixed time period is 1 day.

Next: Each day (remember the day is the fixed time period, it could be each week, month, year) they will add your interest on your money invested...

So now you can do the maths:

Day					
2	3	4	5	6	7
You'll receive: £1+ =					

- ! If every day you receive the same amount of interest
- then you've forgotten that the interest is paid on the previous day's total, not the original £1 investment.

How much money will you have at the end?

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