Saving and Borrowing

What are interest rates?

Whether you are saving or borrowing money, you need to consider the interest rates. These are the percentages you either pay or earn on your money. The way that most banks and building societies make their money is by charging higher interest rates to people who borrow money than they offer to people saving.

Here's a simple example:

Someone **saves** £100 with interest of 4% per annum so the bank pays them £4 at the end of the year, making their new balance £104.
Someone else **borrows** £100 with interest of 7% per annum. At the end of the year they owe the bank £100 as well as an additional £7 in interest.

But you need to consider whether the interest is 'compounded'. Compound interest on savings is when interest is paid on the original amount saved **and** any interest that has already been paid. See Work Sheet WB7 – Money Maths – Compound Interest for more information.

AER (saving)

Annual Equivalent Rate (AER) shows the percentage of compound interest that would be paid on your savings **once a year** if you didn't withdraw or add anything. The AER is the official rate for savings accounts, and allows you to compare rates fairly.

You might also see the 'Gross' interest rate shown – which will be less than the AER because it doesn't show compound interest, just the flat rate of interest you'd get for the original amount you saved.

APR (borrowing)

Annual Percentage Rate (APR) shows the percentage you would have to pay on the money you borrow over the time it takes you to pay back the full loan. This is broken down into a rate per year.

APR is interest **and** any additional fees or charges added together. This means it's a true reflection of what the debt will cost you, but it does mean you don't know how much of the APR is interest, and how much is made up of charges.

e.g. The APR on two different loans is 15%. **Loan A**'s interest is 12% with charges of 3%. **Loan B**'s interest is only 9%, but with charges of 6%. The loans cost the same, even though the interest rates are very different.

TIP Whether you are saving or borrowing, shop around for the best interest rates. You need to consider the percentage rate as well as the terms and conditions involved. You also need to consider whether the rate is fixed (staying the same) or variable (moving up and down in accordance with the 'base rate' set by the Bank of England).

Activity

Look online or go to your local bank or building society branches. Investigate the different accounts available. Look at their interest rates as well as the terms and conditions.

- Which account would be the best for putting money that you need to access regularly?
- Which would be the best for keeping money that you are saving for a holiday?
- Remember to compare using the AER so you are comparing like with like.