

Wait, what's **simple** interest again?

When you put some savings away, say with a bank, you will often receive some money back for leaving you money with them. This is called "simple interest". For example, you might have a savings account that has an interest rate of 2% per year. If you put \$100 into that account, at the end of the year (assuming there aren't any fees and you haven't added or withdrawn anything), you would have \$102. I.e.e your original \$100 + \$2 in interest.

So, what's **compound** interest?

Compound interest is when your initial investment receives interest, which is then reinvested time and time again along with your original amount. Using the same example above, in your second year, you would receive interest on top of your \$102. This makes compound interest favourable when it comes to saving and investing - including your super.

There are two magic variables when it comes to understanding the power of compound interest: **TIME** and **RATE OF RETURN**.

TIME:

As the saying goes, the best time to plant a tree was 20 years ago. The second best time is now.

RATE OF RETURN:

Time on its own isn't going to cut it. The other important element of compound interest is the Rate of Return. That is, the rate of profit received on an investment.

These wise words can be applied to generating wealth as well. When it comes to making the most of compound interest, TIME is a significant factor. The earlier we invest our funds, the more time there is for the interest to compound.

How could compound interest work for you? [Check out MoneySmart Compound Interest Calculator](#)

Let's see how the magic of compound interest works for three friends: Amy, Benita and Chen. All women started with nothing and they each contributed \$50 a week into their future goal fund.

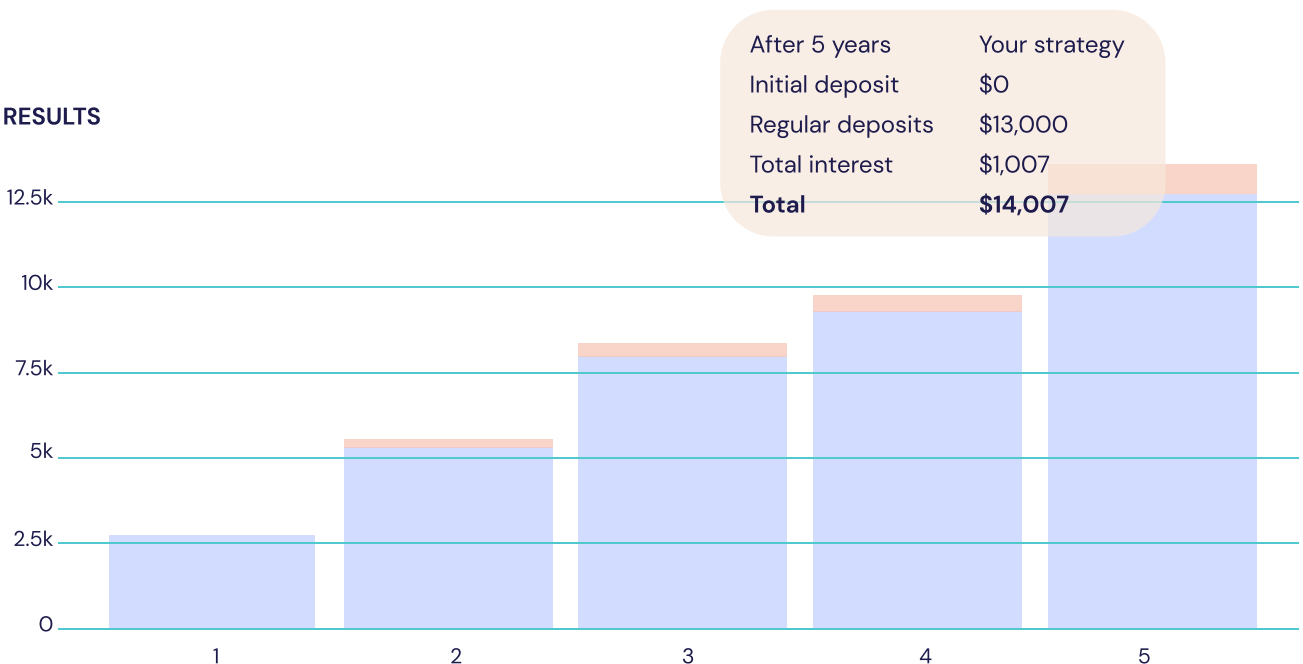
Amy deposited her \$50 a week into a savings account earning 3% p.a. for 5 years.

Compound Frequency : Monthly

of years : 5 years

Annual Interest Rate : 3.00%

RESULTS



After 5 years	Your strategy
Initial deposit	\$0
Regular deposits	\$13,000
Total interest	\$1,007
Total	\$14,007

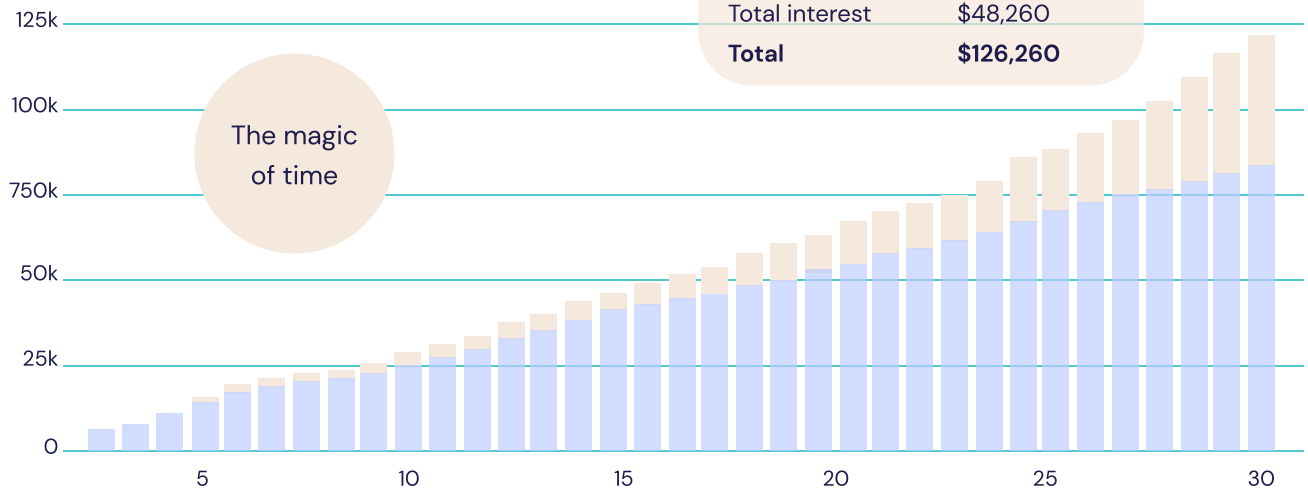
Benita also deposited her \$50 a week into a savings account earning 3% p.a. but saved for 30 years.

Compound Frequency : Monthly

of years : 30 years

Annual Interest Rate : 3.00%

RESULTS



The magic of time

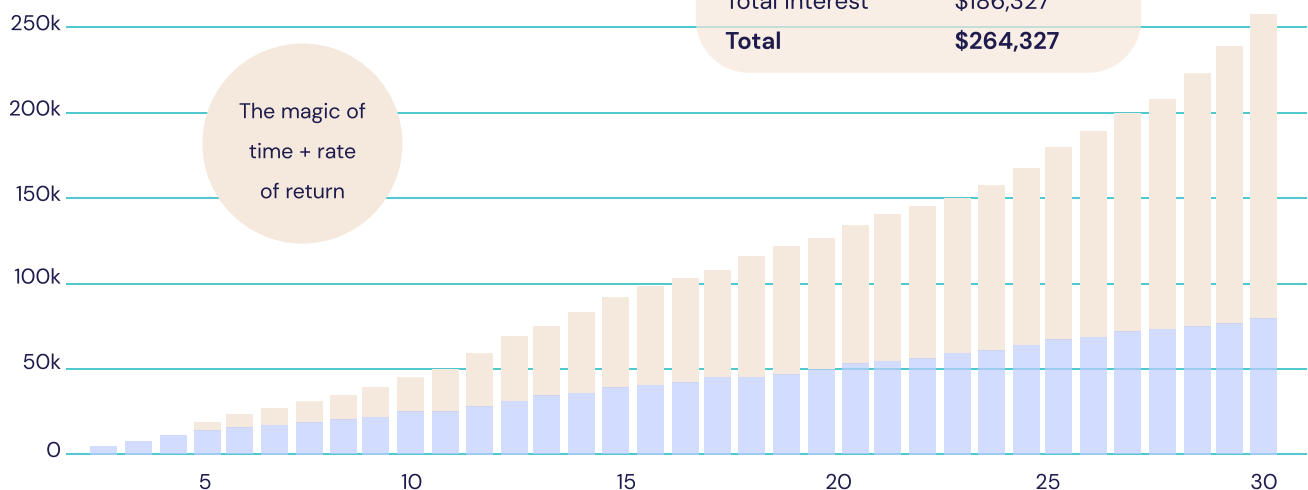
Chen deposited her \$50 a week into an investment fund earning 7% p.a. and like Benita, withdrew it after 30 years.

Compound Frequency : Monthly

of years : 30 years

Annual Interest Rate : 7.00%

RESULTS



The magic of time + rate of return

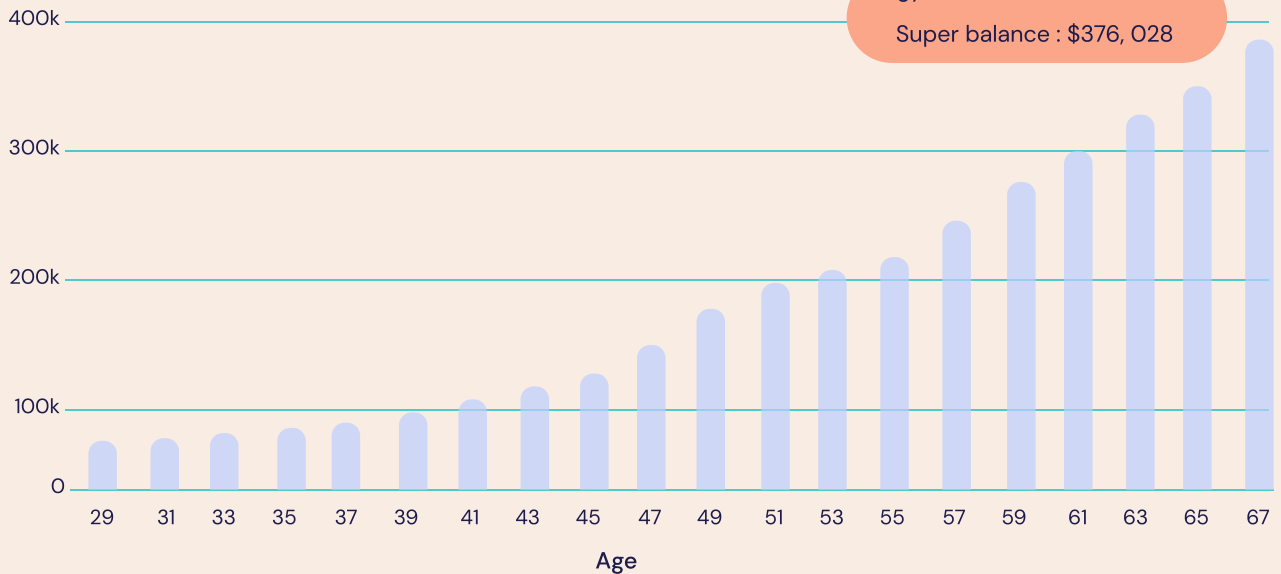
Compound interest can apply to savings accounts, share investments, as well as your super.

Regular contributions to super, either through salary sacrifice or a personal contribution, can significantly boost your savings for retirement. How? Compound interest of course!

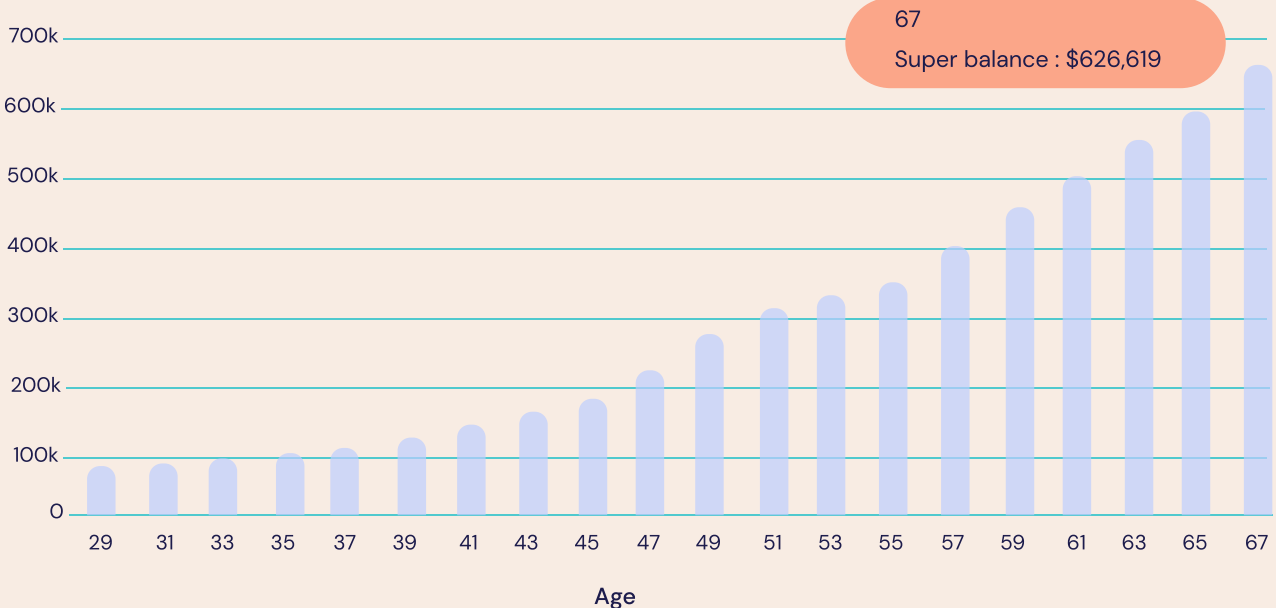
Let's check out an example:

Jade and Khadija have both just turned 30. They each have \$35,000 in their super and they both earn \$55,000 a year. Their super is in the same fund and incurs the same fees, returns and tax. They're both planning to retire at 67. The difference is that Khadija has set up a salary sacrifice of \$200 to go to her super.

Jade



Khadija



While Jade and Khadija had the same amount of time and the same rate of return, by making regular contributions to her super, Khadija was able to use compound interest to her advantage to massively boost her retirement savings!

Note: super guarantee (SG) is not outlined in this example.