PRACTICAL AND FINANCIAL LITERACY

Loan Interest

Difficulty level: Intermediate

Practical and Financial Literacy

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Overview of the concept

This is how you work out the true cost of borrowing money, so you know what a loan or a credit card balance will really cost you before you agree to it. The amount you borrow is only part of the story, because the interest on top can add hundreds or thousands of dollars by the time you finish paying. Knowing how to work it out means you can compare two loans, see what a credit card balance really costs if you only pay the minimum, or decide whether borrowing for something is worth it at all.



Rule

Simple interest: $I = P \times r \times t$.

Turn the rate into a decimal first, then multiply. The total repaid is P + I.

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Worked examples

EXAMPLE 1

Q You borrow $2,000 at 6% simple interest for 2 years. How much interest do you pay, and what is the total repaid?

SOLUTION

This is a simple interest question, and the one rule to remember is: interest = principal x rate x time, with the rate as a decimal and the time in years.

The rate is 6%, which is 0.06 as a decimal. Interest = $2,000 x 0.06 x 2 = $240

The total repaid is the principal plus the interest: $2,000 + $240 = $2,240

EXAMPLE 2

Q You borrow $1,200 at 10% simple interest for 6 months. How much interest do you pay?

SOLUTION

The time must be in years, and 6 months is half a year, so t = 0.5.

Interest = $1,200 x 0.10 x 0.5 = $60

You pay $60 in interest, for a total of $1,260. Forgetting to turn months into years is the mistake that makes this question go wrong.

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Practice questions

1. Maya borrows $3,000 at 5% simple interest for 3 years. How much interest does she pay?

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2. Maya borrows $3,000 at 5% simple interest for 3 years. What is the total she repays?

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3. A shop borrows $5,000 at simple interest for 3 years and pays $600 in interest. What annual interest rate (as a percent) was charged?

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4 A shop borrows $5,000 at 4% simple interest and pays $600 in interest. How long, in years, was the loan?

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5 Sammy pays $340 interest over 2 years at 10% per year. How much did he borrow?

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6 Leo borrows $800 at 5% simple interest for 5 years. How much interest does he pay each year?

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7 Priya borrows $900 at 8% simple interest for 6 months. How much interest does she pay?

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8 What happens to total interest if a loan runs twice as long, at the same rate and principal?

A It doubles

B It stays the same

C It halves

D It quadruples

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9 **Loan A: $1,000 at 5% for 2 years. Loan B: $1,000 at 10% for 1 year. Which costs more interest?**

- A Loan A costs more
- B Loan B costs more
- C They cost the same
- D Neither charges interest

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10 **A loan advertises low monthly payments over many years. What should you check?**

- A Only the monthly payment
- B The total repaid, including all interest
- C Only the interest rate
- D Only the loan term

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ANSWER KEY

1. 450

2. 3450

3. 4

4. 3

5. 1700

6. 40

7. 36

8. It doubles

9. They cost the same

10. The total repaid, including all interest

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