Guide to Effective Rates of Interest for Investors

Looking out for ***you***®

"Effective" Versus "Nominal" Interest Rate.

Lately you may have noticed that, more and more, banks and other financial institutions advertise and quote an "effective" rate of interest (also known as "yield") and a "nominal" rate on their deposit/investment accounts.

Why & What's the Difference?

It is a simple matter but it can be most important when choosing between different accounts. The "nominal" rate is the interest rate quoted on an annual basis. It does not take into consideration how many times in a year the interest is credited/paid into your account. The "effective" rate, instead, takes the interest payments into consideration and assumes that these payments will be reinvested back into your account with the principal for a full year, resulting in a bigger return.

An Example may Help.

Let's put it another way. The 'nominal' interest rate is what you will be paid for one interest period. So, if you invest $10,000 at 12.00% p.a. for one year, you will earn total interest of $1,200 at the end of your one year investment.

If however, you invest your $10,000 at 12.00% p.a. for one year with interest paid to you monthly and you reinvest your monthly interest each time it is paid with your principal, you will harness the benefits of compounding interest. The accumulation of interest with your principal each month will give you an 'effective' return of 12.68% p.a. which will result in you earning interest of $1,268 p.a. or $68 more.

It is important to remember that to reap the benefits of compound interest, that is, interest on your interest, you need to reinvest your interest with your principal each time it is paid.

If interest is only paid once a year at the end of your investment term there will be no difference between the 'nominal' interest rate and the 'effective' interest rate.

Making the Right Investment Decision.

To help you make a clear and fair comparison when choosing the right account for you to invest in, we have provided a special 'Interest Rate Conversion Chart'.

It is important that when you are considering different investments you always look at both the interest rate and the timing of interest payments. Remember, the higher the frequency of interest payments means the more interest you can accumulate over the term of your investment which will ultimately result in a greater return being paid to you.

How to use the Interest Rate Conversion Chart.

What type of interest rate is being offered? Is it a "nominal" or "effective" rate? If the rate quoted is nominal you can use the chart to convert it to an effective rate for ease of comparison. Apply the following simple steps:

1. Refer to the first column of the chart: 'Nominal Interest Rate % p.a.'
2. Determine how often interest is paid on the investment: e.g. monthly, quarterly, half-yearly or yearly.
3. By referring to the appropriate column (that is when interest is paid), you can determine the effective rate on the investment. Take for instance a nominal interest rate of 8%, if the interest is paid monthly, the effective rate is 8.30%; if paid quarterly, the effective rate is 8.24% etc.

It is important to remember that the effective rate is calculated by assuming that the investor maintains the investment for a full 12 months and re-invests the interest as it accrues.

Simply, the effective rate is made up of the nominal rate of interest adjusted for the effect of compounding interest.

Why Interest Paid More Often is Better.

Quite simply, the greater the frequency interest is paid and then reinvested, will result in a higher return to you, which means you'll be better off.

If you Need More Information.

Having read this far, you should have a good understanding of the meaning of 'effective' rate in relation to 'nominal' rate and the principle of compounding interest. However, if you have any further questions, please contact our Wealth Team experts who will be happy to assist on **1800 818 818.**

Where to Find Accounts With High Returns.

Check out our investment choices at **latrobefinancial.com.** We have investment accounts which pay interest as often as monthly.

Open an Investment Account Today.

To start enjoying the benefits of 'effective' interest, open your investment account today by completing the account Application Form in the Product Disclosure Statement (PDS) or go online at **latrobedirect.com.**

Interest Rate Conversion Chart

Nominal Interest Rate % p.a.	**Effective** Equivalent Effective Rate % p.a. where interest is paid:			
	Monthly	Quarterly	Half- Yearly	Yearly
4.00	4.07	4.06	4.04	4.00
4.25	4.33	4.32	4.30	4.25
4.50	4.59	4.58	4.55	4.50
4.75	4.85	4.84	4.81	4.75
5.00	5.12	5.09	5.06	5.00
5.25	5.38	5.35	5.32	5.25
5.50	5.64	5.61	5.58	5.50
5.75	5.90	5.88	5.83	5.75
6.00	6.17	6.14	6.09	6.00
6.25	6.43	6.40	6.35	6.25
6.50	6.70	6.66	6.61	6.50
6.75	6.96	6.92	6.86	6.75
7.00	7.23	7.19	7.12	7.00
7.25	7.50	7.45	7.38	7.25
7.50	7.76	7.71	7.64	7.50
7.75	8.03	7.98	7.90	7.75
8.00	8.30	8.24	8.16	8.00
8.25	8.57	8.51	8.42	8.25
8.50	8.84	8.77	8.68	8.50
8.75	9.11	9.04	8.94	8.75
9.00	9.38	9.31	9.20	9.00
9.25	9.65	9.58	9.46	9.25
9.50	9.92	9.84	9.73	9.50
9.75	10.20	10.11	9.99	9.75
10.00	10.47	1038	10.25	10.00
10.25	10.75	10.65	10.51	10.25
10.50	11.02	10.92	10.78	10.50
10.75	11.30	11.19	11.04	10.75
11.00	11.57	11.46	11.30	11.00
11.25	11.85	11.73	11.57	11.25
11.50	12.13	12.01	11.83	11.50
11.75	12.40	12.28	12.10	11.75
12.00	12.68	12.55	12.36	12.00
12.25	12.96	12.82	12.63	12.25
12.50	13.24	13.10	12.89	12.50
12.75	13.52	13.37	13.16	12.75
13.00	13.80	13.65	13.42	13.00