**The impact of interest rates**

**Task one:**

Bonny has set up a new restaurant selling burgers and milkshakes. She bought a run down property and renovated it.

Bonny used finance to start the business. Like many small businesses starting out she needed a mixture of long term and short term finance.

1. She borrowed £150,000 over 20 years on a variable rate mortgage. She borrowed this to buy and renovate the restaurant.
2. She arranged an overdraft for a year of £5000. This was to help with running costs such as staff wages and buying stock until the restaurant was established.

Logo onto <http://www.thisismoney.co.uk/loan-repayments-calculator>

and calculate the repayments for each of her finance options on the following interest rates.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Type of finance | Amount borrowed | Interest Rate | Length of time | Monthly Repayment | Total amount repaid |
| Mortgage |  | 5% |  |  |  |
| Overdraft |  | 15% |  | No monthly repayment  |  |

**Task two**

The Bank of England decided to increase the base rate over the next few months. Interest rates increased rapidly which made Bonny worry. Interest rates rose by a total of 3% over the space of a couple of months. Calculate the new repayments for Bonny’s finance.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Type of finance | Amount borrowed | Interest Rate | Length of time | Monthly Repayment | Total amount repaid |
| Mortgage |  | 8% |  |  |  |
| Overdraft |  | 18% |  | No monthly repayment  |  |

As you can see, as interest rates have gone up, so have Bonny’s mortgage and overdraft repayments. However she was not making any more money as a business so this left her some decisions to make.

**Task three**

If you owned Bonny’s business, what changes would you make to help deal with the increase in interest rates? Explain how each change would help solve the problem.

Change 1:

Change 2:

Change 3:

**Task four**

Explain how a fall in interest rates would benefit Bonny as the owner of a new business.

**Task five**

Harry decided to start a new business as a DJ in clubs. He had all of the records and equipment he needed as he had been practising at home for years. Therefore he didn’t need to borrow any money. Harry also had very few overheads as he did not have to buy premises or hire staff. Therefore nearly all of the money that Harry made was profit. Harry was booked out at least 3 times a week making around £1000 per week. Harry put this money each week into a savings account and lived off the money he made from a day job.

Help Harry to work out how much money he will make on his savings.

Log onto the following website <http://www.savingscalculator.org.uk/>

* You start off with £0 investment
* You save £1000 each month
* You are going to save for 2 years

|  |  |  |
| --- | --- | --- |
|  | 5% | 8% |
| Interest earned |  |  |
| Final Account Balance |  |  |

**Task six**

For the following questions use Bonny’s and Harry’s business to answer. Give a reason for your answers.

1: Which of the business would benefit from an increase in interest rates and why?

2: Which of the businesses would benefit from a fall in interest rates and why?

**Task seven**

Just as a business will borrow money on loans and overdrafts, so will consumers. People will use mortgages to buy houses, loans to buy cars and household appliances, and borrow money on overdrafts and credit cards to help get through difficult times such as Christmas. As interest rates go up so do the payments on consumers’ loans, overdrafts and credit cards.

In relation to consumer spending, what impact do you think an increase in interest rates would have on Bonny’s burger bar?

In relation to consumer spending, what impact do you think a decrease in interest rates would have on Bonny’s burger bar?

Hannah wants to buy a new car from Alfie’s used cars. She needs to get a loan from the bank of £15,000 to buy the car. In recent months interest rates have increased rapidly. How might this affect Hannah’s decision to buy the car?

If a number of consumers decided not to borrow money due to high interest rates, how could this affect Alfie’s business?

**Fixed and Variable rates of interest**

Some business loans have variable rates of interest and some have fixed.

Explanation of a variable rate of interest.

A variable interest rate would be suitable for a business or consumer that is happy for their payments to increase or decrease as interest rates go up or down. This will make it more difficult to budget for the business as the repayments may change. The business or consumer will need to be sure that they can still afford the loan if interest rates were to go up, before taking out the loan.

Advantages of a variable rate of interest:

Disadvantages of a variable rate of interest:

Explanation of a fixed rate of interest:

A fixed interest rate means that a business will know exactly how much money they are going to be paying out each month.

Advantages of a fixed rate of interest:

Disadvantages of a fixed rate of interest:

Which type of business would a fixed interest rate be suitable for?

Look at each of the following examples. Decide for each whether you would advise the owner to take a **fixed rate** or **variable rate** loan.

Yvette LePlonk wants to borrow £25,000 to buy a new van so she can start to add deliveries to her business of selling fine French wine. She has seen that on a variable rate the payment is currently £300 per month and on a fixed rate it is £330 per month. Money is tight at the moment and the maximum Yvette could afford would be £335 per month. Which would you suggest and why?

Shelly Isfit is having a very good year of business and is getting more clients all the time. To do this she has recruited another member of staff and now needs to buy them all of the required equipment and clothing. She has decided to borrow £5,000 from the bank. On a variable rate this is £150 per month and on a fixed rate this is £170 per month. Shelly is making a good profit at the moment and both payments are easily affordable. Which would you suggest and why?