Interest Charges: The Charges for Charging

6-3

GOALS

- Recognize the many ways of using credit cards
- Determine whether and in what ways a consumer should use credit
- Explore the relationship between the monthly payment and the interest charges
- Understand the relationship between APR and interest charges

WHO GETS CREDIT AND HOW DO THEY USE IT?

- What factors determine how much credit you can get?
  - Your level of income
  - Your level of education

WHO GETS CREDIT AND HOW DO THEY USE IT?

- Who is more likely to use credit cards and incur debt with their cards?
  - Young families with children vs Families without children
  - Families in the suburbs vs families living in rural areas and in the central cities

WHO GETS CREDIT AND HOW DO THEY USE IT?

- Using credit cards as a convenience:
  - Use credit instead of carrying cash and then pay off their credit card charges ASAP.
  - Pay little to no interest.
- Taking advantage of credit cards:
  - never paying off debts
  - Making minimum payments
  - Paying interest

SHOULD YOU USE A CREDIT CARD?

- Experts say NO if ANY of the following features are true:
  - You use the card as an excuse to overspend
  - You frequently buy things impulsively that you do not need
  - You are often late making scheduled payments
  - You have no steady income

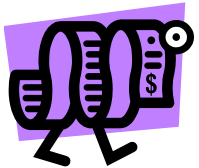
SHOULD YOU USE A CREDIT CARD?

- Experts say YES if ALL of the following are true:
  - You have handled credit responsibility in the past
  - You use the card for budgeting
  - You recognize the dangers and attractions of using credit cards

RULES OF USING CREDIT CARDS

- 1. Only keep the cards that you will use fairly often
- 2. Treat every charged purchase as if you were paying cash.
  - Can you repay the charge promptly and easily?
- 3. Do not spend more than 20% of your take home pay on credit payments.

- 4. Each month set a limit on the total amount of charges you will be able to repay
- 5. Keep your receipts until you get your statement to verify your spending



ASK YOURSELF

- What are two ways in which consumers use credit cards?

- Why is it a good idea to charge only what you can pay for each month?
  - So you can pay off the balance each month without paying interest
- What are three reasons to not use credit?
  - 1) overspending
  - 2) impulse buying
  - 3) no steady income

- Minimum Monthly Payment- minimum monthly payment that card holders must pay

- Why would you want to set your own monthly payment?
  - Length of time it will take to pay off
  - Interest that you will pay

SKILL 1 (PG 262)

- Tina Fey's VISA balance is **$635.00** and the monthly finance charge is **1.3%** of the amount owed. The bank requires a minimum monthly payment of **15%** of her unpaid balance rounded to the nearest dollar or $20, whichever is larger. If the amount owed drops below $20 the payment must equal the total amount owed.
- How much interest will she pay in the 3 months assuming she makes payments of 15% of the amount owed on the last day of the month?

- In the first month she has a balance of
  - $635.00
    - Interest charged = balance * 0.013
      = 635 * 0.013
      = 8.26
    - Amount Owed = balance + interest
      - = 635 + 8.26
    - Payment = 15 % of amount owed
      = .15 * 643.26
      = $ 96.48 = $ 96

- Second month: balance 643.26-96 = 547.26
  - Interest charge

    = 547.26 * .013 = 7.11

  - Amount owed

    = 547.26+7.11= 554.37

  - Payment Amount

    = 554.37 * .15 = 83.16

    Rounded to the nearest dollar $83

- Third month : 554.37-83= $471.37
  - Interest charge

    = 471.37 * .013 = 6.13

  - Amount owed

    = 471.37+6.13= 477.50

  - Payment Amount

    = 477.50 * .15 = 71.63

    Rounded to the nearest dollar $72

- Repeat this process if 20% of the unpaid balance is paid each month instead of 15%.
- What do you think will happen?
- How much interest will be saved if the bigger monthly payments are made?

- In the first month she has a balance of
  - $635.00
    - Interest charged = balance * 0.013
      = 635 * 0.013
      = 8.26
    - Amount Owed = balance + interest
      - = 635 + 8.26 = $643.26
    - Payment = 20 % of amount owed
      = .20 * 643.26
      = $129.00

- Second month: balance 643.26-129 = $514.26
  - Interest charge

    = $514.26 * .013 = $6.69

  - Amount owed

    = $514.26 +$6.69 = $520.95

  - Payment Amount

    = $520.95 * .20 = $104.00

    Rounded to the nearest dollar

- Third month :554.37-$104.00 = $416.95
  - Interest charge

    = $416.95 * .013 = $5.42

  - Amount owed

    = $416.95 +$5.42 = $422.37

  - Payment Amount

    = $422.37 * .20 = $84.00

    Rounded to the nearest dollar

EXAMPLE 2

- "Major Mika" and Mrs. "Major Mika" have two VISA accounts. They have balances of $300 because they both bought a Brunswick Wicked Siege Bowling Ball. One account has an APR of 24% and the other has an APR of 12%.
- They make monthly payments of 10% of the amount owed (rounded to the nearest dollar) or $20 whichever is larger, on the last day of each month on both accounts.
- How much will they pay in interest charges during the first 3 months on both accounts?

- What can we conclude about interest charge when APR is larger?
  - The interest charge is greater when the APR is larger if all other variables are the same.

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