PRACTICAL AND FINANCIAL LITERACY

Credit Card Interest

Difficulty level: Intermediate

Practical and Financial Literacy

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Overview of the concept

This is how a credit card balance grows when you only pay part of it. The part you do not pay gets charged interest, and then next month you pay interest on that interest too. Pay it off slowly and you can end up paying far more than the price of what you bought. Knowing this is what keeps a small purchase from turning into a debt that takes years to clear.



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Worked examples

EXAMPLE 1

Q Your credit card balance is $1,000 at 20% a year. How much interest in one year if nothing is paid?

SOLUTION

20% means 20 out of 100, so 20% = 0.20

Interest = 1,000 × 0.20 = $200

So the balance after a year is $1,200, before fees. Real cards charge monthly, so this is a simple estimate.

EXAMPLE 2

Q Your card has a 24% APR. How much interest is charged in one month on a $1,500 balance?

SOLUTION

APR stands for Annual Percentage Rate, the yearly rate the card charges. Cards charge by the month, so first find the monthly rate: 24% ÷ 12 = 2% a month.

2% means 2 out of 100, so 2% = 0.02

Interest for one month = 1,500 × 0.02 = $30

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Practice questions

1. Your balance is $2,000 at 15% a year. How much interest is charged in one year, as a simple estimate?

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2. What is the balance after that interest is added?

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3. You owe $500. You pay $100 now. The rest is charged 24% a year. How much interest is charged on the rest in one year?

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4 **Your card has an 18% APR. About what is the monthly rate?**

- **A** 1.5% a month
- **B** 2% a month
- **C** 18% a month
- **D** 0.15% a month

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5 **You carry $1,000 at 24% APR and pay nothing for one month. Using the monthly method, how much interest is added?**

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6 What is a minimum payment?

- **A** The smallest amount the card company requires each month
- **B** The full balance every month
- **C** The interest charged each month
- **D** The credit limit on the card

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7 Why is paying only the minimum expensive?

- **A** Because the card company charges a fee every month
- **B** Because most of the balance keeps attracting interest for a long time
- **C** Because the minimum payment grows each month
- **D** Because interest stops once you pay the minimum

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8 What is the cheapest way to use a credit card?

- A Pay the full balance by the due date, every month.
- B Pay only the minimum each month.
- C Pay the balance once a year.
- D Pay with a different card each month.

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9 What does APR stand for?

- A Annual Payment Rate
- B Approved Percentage Rate
- C Annual Percentage Rate
- D Average Percentage Rate

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10 **You buy a $100 item and pay it off slowly, adding $20 interest. What did the item really cost?**

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ANSWER KEY

1. $300

2. $2,300

3. $96

4. 1.5% a month

5. $20

6. The smallest amount the card company requires each month

7. Because most of the balance keeps attracting interest for a long time

8. Pay the full balance by the due date, every month.

9. Annual Percentage Rate

10. $120

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