

# The Cost of Credit

## Key financial ideas

- ★ People who lend you money (give you credit) usually charge you interest.
- ★ Borrowing money has financial consequences (positive or negative).
- ★ Credit cards can be an expensive way to borrow money.

## You need

- ★ a copy of the credit card payment sheet (see copymaster)
- ★ a calculator or a spreadsheet program
- ★ a classmate

## Activity

Look at this advertisement I've just found! We could use a credit card to pay for our holiday instead of doing all this extra work and saving.

We'd still have to pay the money back afterwards, and they charge high interest. I wonder how long it would take us to pay off \$5,000?

### Want a fabulous holiday?

It's as easy as swiping your InstantBuys credit card! You only have to pay back \$150 a month!

We charge interest of 24 percent per annum, calculated monthly on your outstanding balance.  
Loan limit: \$5,000

We'd only have to pay \$150 a month, though. And 24 percent interest a year is only 2 percent a month, so that wouldn't be much, would it?

- What is "interest"?
- Is Oscar right in his statement about interest? How do you know?
- If someone lent the Murphys \$5,000 interest free, how long would it take them to pay that back at \$150 a month?
- If the Murphys borrowed \$5,000 on this credit card, how much of their first \$150 would be interest (at 24 percent per annum or 2 percent per month)?
- If the Murphys paid back the minimum amount of \$150 at the end of the first month, how much would they still owe?

Two ways to find 2 percent of the total amount owing each month:

- Work out 1 percent (one-hundredth) in your head and double it.
- On your calculator, multiply the amount owing by 0.02.

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- a. If the Murphys didn't use the credit card for purchases after the holiday and paid \$150 each month, how much would they owe after 6 months? Use your calculator or a spreadsheet to work out the answer.

Date	Balance owed	Monthly interest at 24% per annum	Amount paid	New balance
April	\$5,000.00	\$100.00	\$150.00	\$4,950.00
May	\$4,950.00	\$99.00	\$150.00	\$4,899.00
June	\$4,899.00	\$97.98	\$150.00	\$4,846.98
July	\$4,846.98			
August				
September				

- b. \$150 a month for 6 months is \$900. How much of that would go towards paying off the \$5,000?

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Caitlyn investigated what they'd still owe on a credit card debt of \$5,000 after a year if they paid back only the \$150 minimum payment each month and didn't use the credit card after the holiday for any more spending.

- a. How much would the Murphys have paid the credit card company after 12 monthly payments of \$150?
- b. i. How much of that amount would have come off their original \$5,000 debt (the principal)?
- ii. How much of that amount would be interest?

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With a classmate:

- a. Make a list of the advantages and disadvantages of using the InstantBuys credit card to pay for some or all of the holiday.
- b. Discuss whether you think the Murphys should use the InstantBuys credit card instead of saving all the money they need for their holiday.

At the end of 12 months, we'd still owe \$4,329.40. It'd take us forever to pay it all off!



**Reflective questions**

- ★ Some people think that credit cards provide "easy money". What do you think?
- ★ How can credit cards be used effectively?