

Personal Finance

Week 1: Credit card interest adds up

When paying off credit cards, pay as much as possible

Compiled by Bill Pinkovitz, Professor, UW-Extension.

QUESTIONS? Contact Pinkovitz at bill.pinkovitz@ces.uwex.edu.

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It's that time again, time for New Year's resolutions. For many of us, that means resolving to get our financial house in order. Over the next month, Economic Snapshots will focus on several personal financial issues.

This week, we start with that higher-than-expected credit card balance that seemed to add up faster than anyone would imagine.

If one of your New Year's resolutions is to pay off your credit card balance, the Federal Reserve has a very easy online calculator that will dramatically demonstrate why it is better to pay the balance as soon as possible.

In this example, the cardholder enters the New Year with a \$5,000 credit card balance. One option is to stop using the card and simply pay the minimum payment each month until the balance is fully paid. According to the Federal Reserve calculator, it will take the cardholder 35 years to pay off the balance and \$12,863 in interest will be paid assuming an 18 percent APR, the cardholder makes no other charges and only pays

Time required to pay \$5,000 credit card balance

(interest paid in parenthesis)

	10% APR	18% APR
Minimum monthly payment	17 years (\$3,157)	35 years (\$12,863)
\$100	5 years (\$1,495)	8 years (\$4,312)
\$250	22 months (\$493)	24 months (\$990)

Note: the Federal Reserve computes the minimum monthly payment as 2 percent of the balance or \$20, whichever is greater.

the minimum required each month.

If the interest rate is a more modest 10 percent, it will take 17 years to pay off the balance.

Here's the good news: If the cardholder pays \$100 each month instead of only paying the minimum, it will take eight years to pay the debt. At \$250 per month, the balance will be paid in 24 months and the interest will total \$990.

The following chart illustrates the impact of increasing monthly payments on the amount of time it takes to repay the \$5,000 credit card balance and the interest the cardholder will pay.

The Federal Reserve online calculator is available free online at: <http://www.federalreserve.gov/creditcardcalculator/>