

Compound Interest, what the heck is that?

Compound interest is important to understand. It can help you earn more on your savings and investments. However, it can also work against you when you're paying interest on a loan.

For this post, we are going to focus on compounding interest and how it applies to savings. *(keep an eye out for future posts on compounding interest on loans)*

Compounding interest is a bit like applying the 'snowball effect' to your savings or investment account. It starts small. However, as it builds... it gets bigger at a faster rate. This happens because interest is earned on the original principal plus accumulated interest. Not only are you earning interest on your beginning deposit, you're earning interest on the interest being deposited to your account.

Here's a quick example:

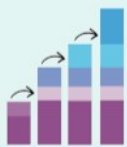
If you have \$1,000 in an account earning 5% interest annually, you'll end up with \$1050 at the end of the year. If your interest is compounded monthly, your balance at the end of the year would be about \$1,795.00 . As you can see, every month the amount of interest increases because it is growing from the interest deposited on the balance from the month before.

Month	Interest	Total Interest	Balance
0	--	--	\$1,000.00
1	\$50.00	\$50.00	\$1,050.00
2	\$52.50	\$102.50	\$1,102.50
3	\$55.13	\$157.63	\$1,157.63
4	\$57.88	\$215.51	\$1,215.51
5	\$60.78	\$276.28	\$1,276.28
6	\$63.81	\$340.10	\$1,340.10
7	\$67.00	\$407.10	\$1,407.10
8	\$70.36	\$477.46	\$1,477.46
9	\$73.87	\$551.33	\$1,551.33
10	\$77.57	\$628.89	\$1,628.89
11	\$81.44	\$710.34	\$1,710.34
12	\$85.52	\$795.86	\$1,795.86

Deposit accounts such as savings, money market, and Certificates of

Deposit (CD's) typically compound interest on a monthly, quarterly or semi-annual basis. The more often the interest compounds, the faster your balance grows.

Why Does Compound Interest Matter?



Compound interest = interest earned on money that was previously earned as interest.



Compound interest causes interest and account balances to grow.



Good for savings and investments, but can work against you in paying interest on a loan.



Frequency, time, interest rate, deposits, and the starting amount all make compound interest powerful.

Paying attention to the number of times interests compounds on an account helps you make decisions about where to invest your money. Compounding frequencies vary depending on type of account and which financial institution is offering the account. For more information on this topic please email us at: info@journeycu.org.