No-Frills Money Skills Video Series

Episode 1: Growing Money—Compound Interest (7:21)

View Episode 1 at https://www.stlouisfed.org/education/no-frills-money-skills-video-series/episode-1-growing-money-compound-interest.

1. **In what way is an interest rate like a price?**

   An interest rate is like a price because the higher (or lower) the interest rate, the higher (or lower) the amount you must pay to borrow money. An interest rate tells borrowers what percentage of the amount borrowed they must pay for a loan and lenders what percentage of the amount loaned they will earn for providing the loan. The amount paid (or charged) for a loan is called interest. Interest is added to the amount borrowed. So, a borrower must repay the loan amount borrowed plus the interest.

2. **What is the general relationship between risk and potential reward when investing?**

   In general, the higher the risk of loss of principal for an investment, the greater the potential reward, and, conversely, the lower the risk of loss of principal for an investment, the lower the potential reward. To attract buyers, the seller of a potentially risky investment must offer a higher return than the buyer could potentially earn on a less-risky investment. In other words, when the risk of potential loss is high, people expect greater returns; when the risk of potential loss is lower, people are willing to accept lower returns.

3. **Why is it so important to understand and take advantage of compound interest?**

   When you earn compound interest, you earn money on the principal and on all of the interest you have earned along the way. The earlier you start saving, the more you will earn over time on the previously earned interest, so saving for a longer period can help your savings grow substantially and more quickly.

4. **Explain the opportunity cost of waiting to start a savings account and spending the money instead.**

   The opportunity cost of waiting to start a savings account and spending the money now is that you will not have money to spend later and you will not earn the extra money—the compound interest—that would have been earned with a savings account.

5. **If you have a savings account and a goal for how much money you want to save, what three factors will affect whether you meet your goal?**

   - The amount of money you save on a regular basis (e.g., per pay period or monthly)
   - The interest rate
   - Time—when you start saving and how long you save

6. **What does it mean to "pay yourself first"?**

   To pay yourself first means to put money in savings before spending it on anything else. So, for example, when you receive a paycheck, the first thing you do is put some money in a savings account. In this way, you give saving the same importance as paying a bill.

7. **What is direct deposit and how can it help you save?**

   A direct deposit is an electronic transaction in which money is deposited directly into a payee's bank account from a payer's bank account. You can use direct deposit to have your employer deposit money directly to a savings account. A direct deposit helps you save because you "pay yourself first," so money is set aside before you spend it on anything else.