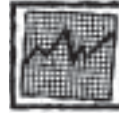


# Reinforcing Economic Skills



## Activity 7

### UNDERSTANDING INTEREST RATES

When you deposit money in a savings account, the bank pays you interest for the use of your money. The amount of interest is expressed as an annual percent, such as 6 percent. Two types of interest exist: simple interest and compound interest. Simple interest is calculated only on the amount of money you deposit, known as the principal, not on any interest earned. Compound interest is paid on the principal plus any interest that has been earned.

**Directions:** Three years ago, you earned \$2,000 working as a lifeguard. You deposited the money in a bank that paid simple interest of 4.75 percent. One of the other lifeguards with whom you worked deposited the \$2,000 she earned in a different bank. Her bank paid only 4.70 percent, but it compounded the interest annually.

1. How much money was in your account after the end of the first year?

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2. How much money was in your friend's account?

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3. How much did each of you have in the bank after the end of the second year?

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4. Why did your friend earn less in interest than you the first year but more in interest the second?

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5. How much did each of you have in the bank after the end of the third year?

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6. Which of you made the better long-term investment?

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