Name ______________________ Date ________________ Class ________________________

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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