

Transcript

The True Cost Of Paying Only The Minimum Payment On Your Credit Card

Let's say that on January 1 of some year, you go out and you buy yourself a nice computer for \$1,000. And you buy it on your credit card. And what I'm curious about is, what's the effect of paying just the minimum balance on your card each month vs. paying the minimum balance plus some amount? And in this case we'll look at the minimum balance plus \$10. And we're going to assume that your credit card has an annual percentage rate of 22.99% and that the minimum balance is calculated by taking the interest for that period and then adding 1% of your balance, your ending balance of that period.

So for example, the interest on the first period is \$19.53, and then 1% of \$1,000 is another \$10. So your minimum payment would be \$29.53. Now in this scenario right over here, once again, you still have a balance for that first billing cycle, that January period. It's still \$1,000. Your interest for that period is still going to be the same. But here, we're paying the minimum, which is \$29.53, plus \$10. So we're paying \$39.53. And so this spreadsheet right over here calculates off of each period, and I'm assuming I'm doing no other purchasing on this credit card; I'm just, in this scenario right over here, paying the minimum balance, here I'm paying the minimum plus \$10. And so you see here, that in the period 2, I haven't made any purchases, but I carry whatever I hadn't paid over from the previous period.

From the previous period, I made a payment of \$29.53, but only \$10 of that went to actually pay down the balance. The rest of that was interest. And so now my balance is \$990. For that period, that would be February of that first year, interest is \$17.46, and then I pay another 1% of \$990. In this case, I pay \$9.90 on top of what I have right over here. And notice – now my balance has gone down by exactly \$9.90.

So let's see what happens, using this spreadsheet, how much I pay in interest if I just keep paying this minimum balance, the interest plus 1%.

And I want to be clear – different credit cards have different ways of computing minimum balances. Some places, they'll take your interest plus, let's say, 1% or 2% of your actual balance. Some places will just be a straight 2%. Some places will be the higher of what I just said and some dollar amount, maybe it's \$20 or \$30, but let's just go with this one, just to see what it would be.

So if I scroll down, so let's just keep scrolling down all the way...if we scroll down all the way, to 240 months later. Just to be clear – we have 12 months in a year. So 240 months is 20 years later. The two-hundred and fortieth billing cycle, this is 20 years later. If we only pay the minimum balance, so if we only pay the interest plus 1% on my balance, we still have \$90 left to pay for that computer we bought 20 years ago, that computer that we probably stopped using 14 or 15 years ago.

We still have \$90 to pay on it, but what's really shocking is that the total amount of interest that we paid on that \$1,000 computer that we're not even using anymore, 20 years later, is

\$1,743. And to see the big difference that just paying that extra \$10 in your payment can have, we go to this scenario right over here, where we're paying the minimum payment plus \$10. And you see that here, we get done paying in 42, 43 months.

So this is still not a very short period of time. This would be on the order of three and a half years, but three and a half years is much, much shorter than 20 years – 20 years and we still didn't even finish paying it, and the total interest that we've paid is substantially lower.

Now, there are different scenarios. There are different credit cards that might say, well your minimum balance is the larger of whatever the calculation would be with this 1% plus interest and something like \$10 or \$15 or \$20. And in that case, yes – you would have finished paying this off

earlier, and you would have paid less in interest. But the general principle still applies, that typically, just paying the minimum payment will not make a lot of progress into your debt and you'll end up paying a lot in interest, oftentimes more in interest than what the original actual purchase was.