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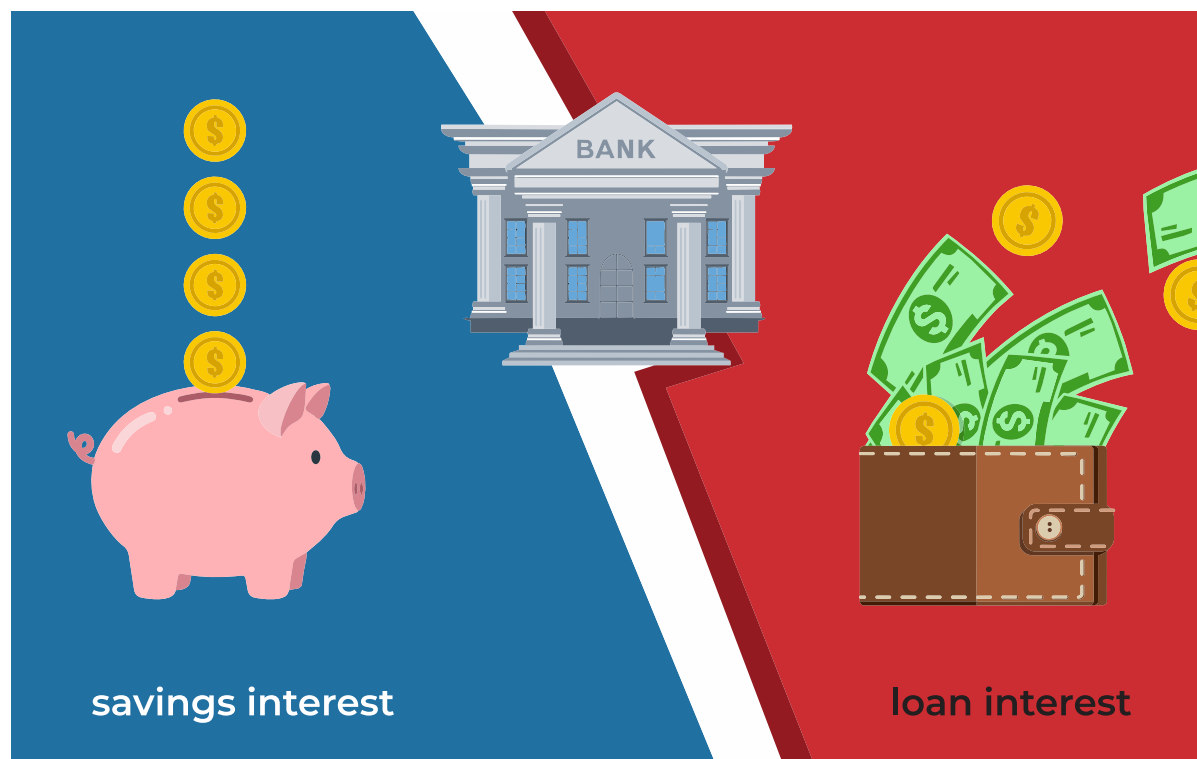
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VIDEO

The Price of Borrowing

What + Why: You'll explore why banks pay interest on savings and charge interest on loans so you can better understand how borrowing and saving decisions affect cost.

In a world where money is constantly moving, interest is everywhere. You can earn it. And you can pay it. Sometimes it feels like a reward. Sometimes it feels like a cost. But it always plays by the same rules. Behind every dollar earned (and every dollar owed) there's a system deciding who pays and who gets paid. And at the center of it all is a business.

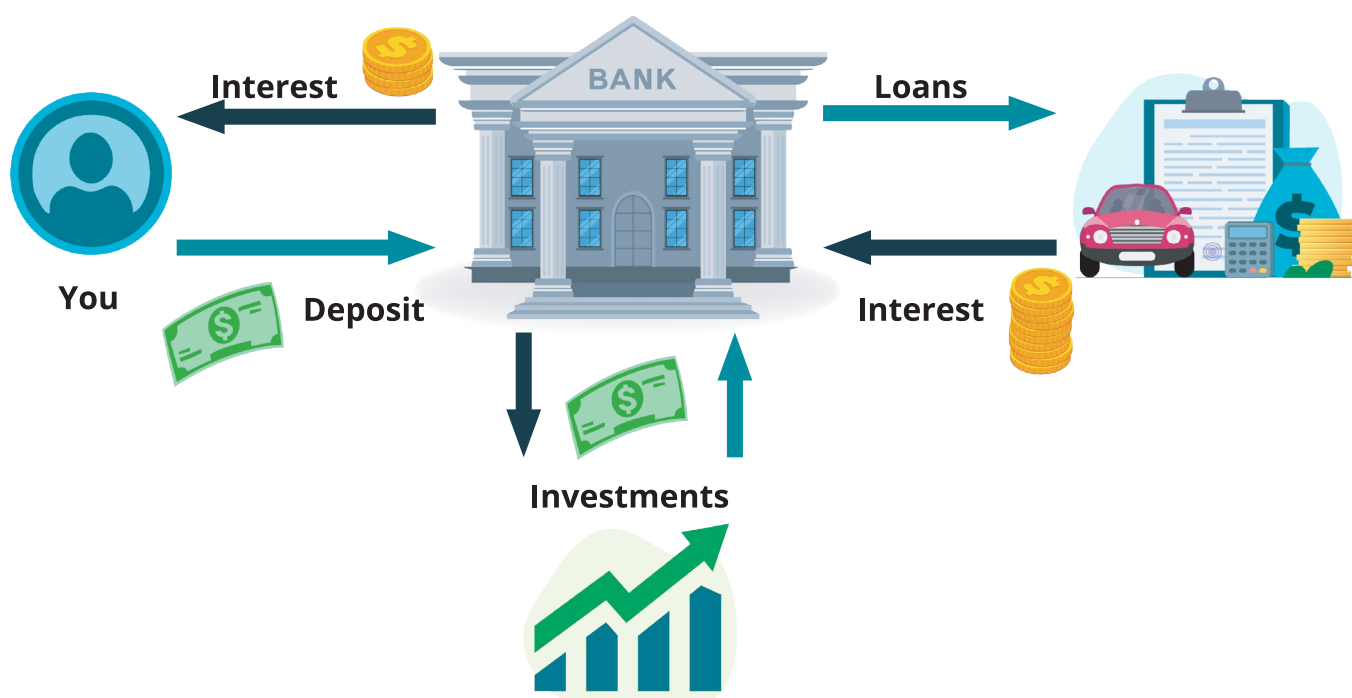


So how does interest really work from both sides? Let's start with this side of the story: savings interest. Have you ever wondered why banks pay you interest? Aren't they losing money? When you deposit money into a savings account, the bank doesn't just lock it in a vault. You're actually loaning it to the bank.

What does the bank do with that money?

- They loan it to other people.
- They invest it.
- They put it to work.

Paying you interest is how banks convince people to leave money there. The more money people deposit, the more money the bank has to work with. And more money to work with means more chances to earn income. Think of it like this. You're loaning the bank your money. And interest is what the bank pays you for that loan.



Banks also compete with each other. They offer different savings accounts with different interest rates. High enough to attract customers, but not so high that the bank won't make a profit. (It is a business after all.)

Question 1

If a bank is a business that must make a profit, why do they pay interest on savings accounts?

- ☐ a. Banks want to help people make money.
- ☐ b. Banks incentivize people to deposit money so they can get a financial advantage.
- ☐ c. Banks are required by federal law to pay interest.
- ☐ d. Banks have unlimited money.

Answer: b. Banks pay interest to encourage people to deposit money. Those deposits give the bank funds to loan to others and invest. And if they earn more than they pay out, banks make a profit.

Why do banks charge interest when people take out loans?

When someone borrows money from a bank, they're using the bank's money. And that money didn't appear out of nowhere. It came from depositors, people who put their savings into the bank, or from their hard-earned investments. The bank is responsible for that money and wants to keep it safe.

When financial institutions loan it to you, they're taking on risk.

- What if you don't repay?
- What if you're late?
- What if something goes wrong?

Loan interest is the price of borrowing money. It covers risk. It covers operating costs. And it helps banks make a profit. They charge more interest on loans than they pay on savings.

So there's more money coming in than going out. That's how they stay in business.

Question 2

Why do banks charge interest on loans?

- ☐ a. To punish people for borrowing money.
- ☐ b. To make loans harder to pay.
- ☐ c. To cover risk, operating costs, and earn a profit.
- ☐ d. To match the interest they pay on savings accounts.

Answer: c. Interest is the price of borrowing money. It helps cover the risk of providing loans, operating costs, and allows the bank to earn more than it pays out.

Question 3

A bank wants to grow its business and increase the amount of money it invests. To do that, the bank needs more funds available to invest. What should the bank do?

- ☐ a. Increase deposits into the bank.
- ☐ b. Stop providing high-interest accounts.
- ☐ c. Increase the number of loans the bank provides.
- ☐ d. Take out loans to fund additional investments.

Answer: a. Banks need deposits to have money available to loan to others and invest. More deposits mean more funds the bank can put to work.

Think about this scenario.

Bryan deposits money into a savings account earning 2% interest. The bank loans that money to someone else and charges 7% interest. Which explanation describes how the bank earns money in this situation?

- ☐ a. The bank receives government funding for every loan.
- ☐ b. The bank earns money only from monthly account fees.
- ☐ c. The bank keeps the difference between the loan interest and the savings interest.
- ☐ d. The bank does not earn money when it pays interest.

Answer: c. Banks earn profit by charging more interest on loans than they pay on savings.

Key Terms

- **financial aid:** any money given or loaned to students to help them pay for college
- **deposit:** to put money into a bank account for safekeeping
- **profit:** the amount of money left after all business expenses have been paid
- **savings account:** an account that usually earns interest and is often used to hold money that is not needed right away
- **loan:** money borrowed that must be repaid, usually with interest
- **risk:** the probability of making a profit or losing money on an investment
- **interest:** a fee received or paid for the use of money
- **interest rate:** the price paid, expressed as a percentage, for using someone else's money to spend, produce, or invest now, using credit