Simple Interest vs Compound Interest on Loans

Simple Interest means that you pay a fixed amount over time.

For example, John takes out a personal loan for $4000 (principal) at an annual percentage rate of 8% for 4 years. Over the four years of John's loan, he will re-pay **$4690.11**.

Compound Interest, on the other hand, charges interest on top of principal and accrued interest to date. So let's say John charged $4000 to his credit card instead, since most credit cards use compound interest. Let's also say that this card has 12 payment cycles per year. Each month that he does not pay off the entire balance, his remaining debt and the amount of interest he has yet to pay is added together and more interest is charged. If John made no additional charges and only made the minimum payments he would end up paying **$5796.24** and it will take him 15+ years to pay it off. *That's a difference of over $1,100, not to mention the additional 11+ years*. Don't you have something better to do with your $1,100?

Compound interest can increase your debt even if you're making payments. A simple interest loan does not grow, as long as you're making payments on time and for the full payment amount (otherwise penalties are likely to apply).

External Sites & Resources:

- http://www.basic-mathematics.com/simple-vs-compound-interest.html
- http://betterexplained.com/articles/a-visual-guide-to-simple-compound-and-continuous-interest-rates/
- http://www.bankrate.com/