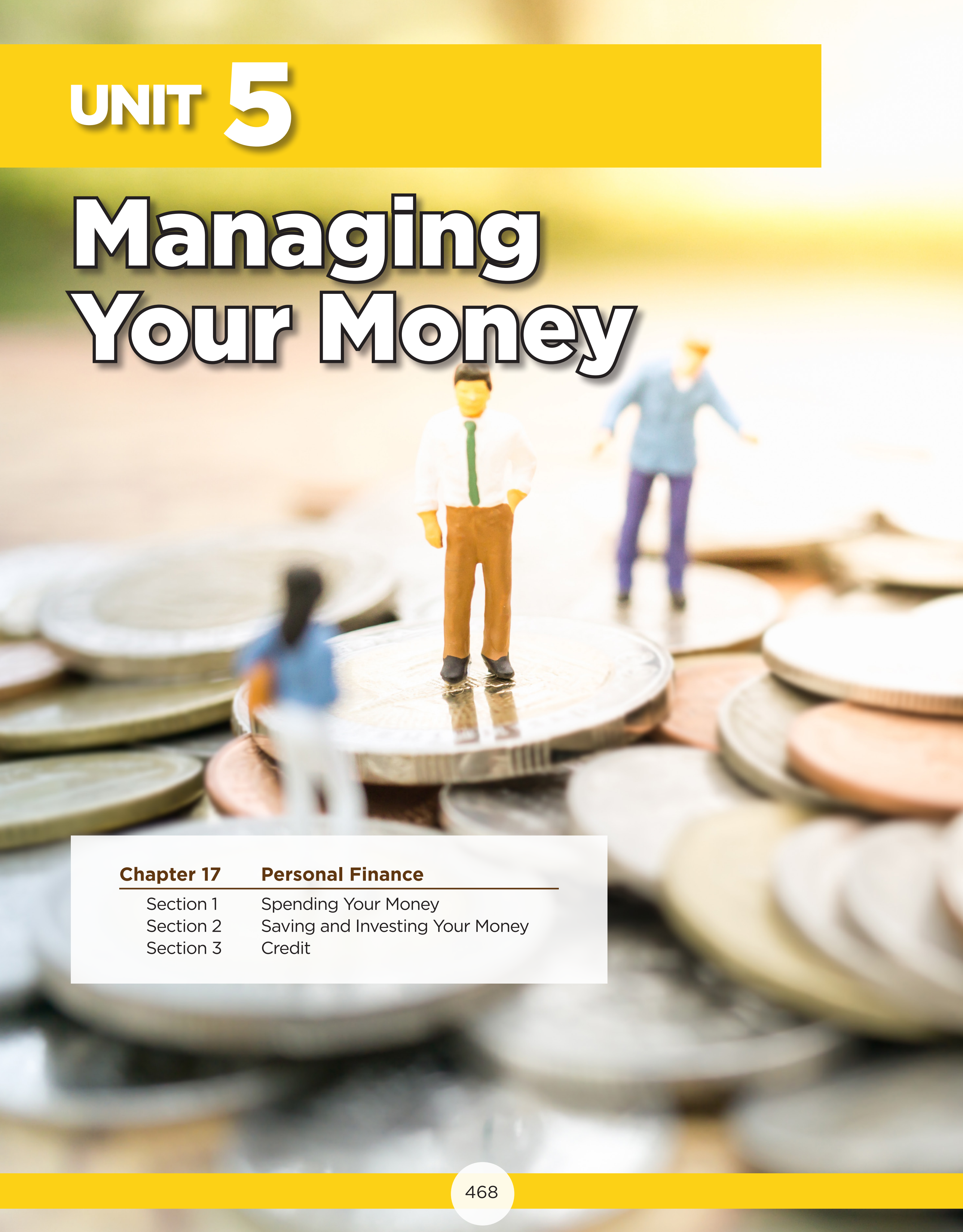

UNIT 5

Managing Your Money

Chapter 17	Personal Finance
Section 1	Spending Your Money
Section 2	Saving and Investing Your Money
Section 3	Credit


Chapter 17
Personal Finance

Chapter Preview

Terms

personal finance, income, expense, fixed expense, variable expense, overdraft, budget, charitable giving, philanthropy, interest, investment, financial investment, real investment, certificate of deposit (CD), bond, stock, mutual fund, credit, mortgage, repossess, credit history, credit score

Top: US currency includes both banknotes and coins such as these.

As a student, you play a part in the economy of your community. You may have an after-school job or earn an allowance. You may get money as a gift for birthdays or holidays. Your family may provide for your needs, but you may have wants that you fill yourself. You may use money that you have earned or been given to satisfy those wants. You may also participate in other voluntary exchanges. You may trade the service of fixing a friend's bicycle in exchange for the friend mowing your lawn. All of these types of exchanges are examples of how you as a student are participating in an economy.

As the ways you can earn money increase, it is to your advantage to learn to manage your money well. You may have a bank in your bedroom to save money for a new game system or cell phone. You may have a savings account at a bank to save some of your money for things that cost more such as a car, technical school, or college education. All of these ways of saving are a part of managing money. It is easy to spend money to satisfy every want. However, our wants are endless, but for most people, the money supply is not.

Our country's economy is affected by the actions and decisions of individual citizens. In this chapter, you will learn about **personal finance**, or the decisions individuals make in the management of their money. You may think the management of your own finances affects only you and your family. However, good or bad decisions not only affect individuals, but, added together, they also affect the overall economy of entire communities.

Above and Background: A summer job is one way a student can earn money.

Section 1

Spending Your Money

Setting a Purpose

As you read, look for

- the ways people earn income;
- the difference between fixed and variable expenses;
- the purpose of a budget;
- why people donate money to charities;
- terms: **income, expense, fixed expense, variable expense, overdraft, budget, charitable giving, philanthropy.**

Income and Expenses

The money an individual obtains is called **income**. In other words, income is money that is "coming in." The source of income could be a gift or prize, money earned from performing a specific task, an allowance given by a parent or guardian, earnings at a regular job, or earnings from an investment. **Expenses** are the spending of some or all of that money for various purposes. Some income may be spent for basic *needs*, including food, clothing, and shelter. Expenses can also be for *wants*—items or services not absolutely necessary, but desired. Examples of wants could include smartphones, games, concert tickets, tablets, or hobbies. The amount of an expense is either fixed or variable. A **fixed expense** is when the expense costs the same every month, like a car loan payment or rent. A **variable expense** is when the expense costs different amounts every month, like the grocery bill.

People with a regular income usually deposit some of their money in a checking account at a bank or credit union so they can pay their expenses. A check is simply a written document from an account holder that allows a person or business to have access to a specific amount of the account holder's money. Instead of writing checks, many people today use debit cards or online transfers to move money from their checking account to the account of another person or business. It is important for a checking account holder to keep a record of all checks, either on paper or online, and deduct the amount of each check from the balance (total amount) in the account.

Above Right: Individuals and families use checking accounts to pay bills. **Background:** A person may have income as a result of working at a job.

A person who writes checks that total more than the amount they have in their bank account will have problems. A check that is not backed up by enough money is known as an **overdraft**, or "bounced check." Overdrafts usually result in several fees. One fee is charged by the bank, and one is charged by the person or company to whom the check was written. If each of these fees was $25, an account holder would face $50 in fees for the overdraft. A person working for $10 an hour who bounced a check and had to pay fees of $50 would have to work more than five hours just to pay the overdraft fees.

The best way to manage money is to have a **budget**, or plan for how money will be used. The most important rule is that amounts for expenses should never be more than the amount of income. The first items in a budget should always be for necessary expenses. If there is any money left, some of that money can be used for other purposes.

Charitable Giving

Another use, or purpose, of money is for **charitable giving** to help other people. Charitable giving can be challenging if an individual's entire income is being spent for a summer vacation, or being saved for college or even a new winter coat. But there are many reasons that charitable giving is good: the donation helps people in the local community, people feel happier about themselves when they donate to charities, and the giver receives the benefit of an income tax deduction. Some studies even show that giving improves a person's health and reduces stress. People give to charities such as the Red Cross, United Way, Salvation Army, religious institutions, universities, and other nonprofit organizations whose main goal is to help other people. The act of giving money for charitable purposes is called **philanthropy**.

DID YOU KNOW?

Most people prepare a budget based on the calendar year, January 1 to December 31. Governments and businesses often work on a year that runs from July 1 to June 30 called a fiscal year.

Reviewing the Section

1. What is income? What are the different ways people get income?
2. What are expenses? What is the difference between fixed and variable expenses?
3. Why is it important for people to keep track of their expenses?
4. What is an overdraft? Why is it something people try to avoid?
5. What is charitable giving? What are different reasons people do it?
6. Deeper Thinking: Why is creating and following a budget important?

Top: A budget helps to establish how much money you have available to spend on different items. **Above:** Donations to the community do not have to involve money. One life-saving blood donation can help as many as three people.

Section 2

Saving and Investing Your Money

As you read, look for

Setting a Purpose

- why people save money;
- the two main types of investment;
- the costs and benefits of different types of saving and investing options;
- terms: **interest, investment, financial investment, real investment, certificate of deposit (CD), bond, stock, mutual fund.**

Saving and Investing

Saving or investing money means that, rather than spending all income on goods or services now, some income is budgeted for something that will bring a future benefit or will earn more money. Saving should be part of any budget. The simplest saving method is through a savings account. A savings account usually pays a small amount of interest on the amount deposited. **Interest** is money paid regularly by the bank to the account holder for money being saved. Saving can be important for several reasons. One is to provide an emergency fund in case of a job loss or unexpected expenses such as car repairs or medical bills. Financial managers recommend that a person have enough money saved to cover up to three months of expenses. Saving can also be a way of achieving a future goal. For example, many people save to buy a new car, pay for a college education, or buy a new home.

Above: Establising a budget enables you to save for purchases such as buying a car. **Right:** A family budget helps ensure that there is enough income to cover expenses for the family.

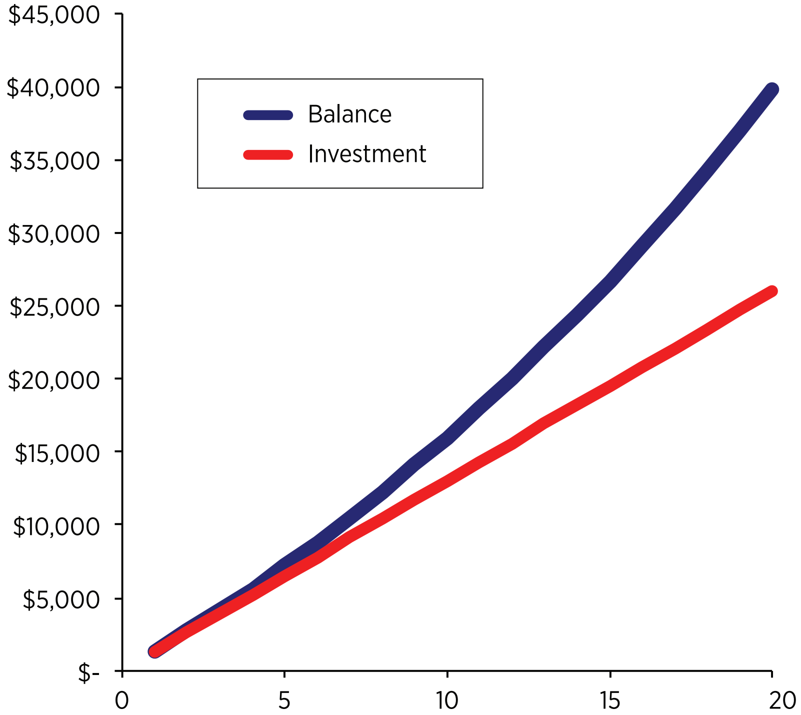

Figure 17.1

Savings Projection @$25/week for 20 Years at 4%

Types of Investments

An **investment** is money spent on something with the goal of making a profit (more money). **Financial investments** involve putting money into things like stocks and bonds as a way to make money in the future. **Real investment** involves putting money into something physical such as real estate (land or a house) or equipment. Investments can be beneficial, but they can also be risky. For example, the value of property can go down if the market for it goes down. If a company does not make a profit, its stock can lose value. Some investments are safer than others. Safer investments do not earn as much profit, but they guard against loss. People need to think carefully about how much they can afford to risk when they invest.

One safe investment is a bank's **certificate of deposit (CD)**. Money invested in a CD must be left in place for the full time specified, but interest rates for CDs are usually higher than for savings accounts. For example, suppose a person bought a $10,000 CD for one year with an interest rate of 3 percent. At the end of that year, the CD would be worth $10,300. The interest rates on CDs and savings accounts depend on what is happening in the national economy. CDs are a safe investment because the money in them, just like money in an insured bank's checking and saving accounts, is protected up to a certain dollar amount by the Federal Deposit Insurance Corporation (FDIC).

Another type of investment is a **bond**. The investor lends money to the government or to a company. That loan will be paid back with interest on a specified date. US Savings Bonds and US Treasury Bills are bonds issued by the US government. At the end of a specified period, investors will receive all the money they invested plus interest. Cities also issue municipal bonds, and school boards issue school bonds if they need money for building projects such as constructing a new school building.

Above: A "real" investment includes the purchase of a house.

Stocks are another kind of investment. A corporation issues shares of stock (ownership shares in the company) to raise money. The investor who buys stock is actually buying a part of the company. If a company issues 100,000 shares of stock and an investor buys one of them, the investor owns 1/100,000th of the company and becomes a shareholder. Stocks can be very risky; if a company goes out of business, investors can lose everything they invested. On the other hand, stocks may bring the highest return on investment. If the company makes a large profit, then the investors get a portion of this profit based on the number of shares of stock they own. An investor can also make money when the price of the stock goes up. Selling the stock for more than the purchase price earns the investor a profit. It is important to do careful research before investing in stocks to avoid losses.

Mutual funds are usually safer than individual stocks. A **mutual fund** puts together money from many investors and buys many different stocks and bonds. Because the money is spread out in different investments, the risk is reduced. Mutual funds often include investments with different levels of risk. The stock of one of the companies in the fund might go down, but it is unlikely that every investment will go down. Mutual funds are managed by professionals who charge investors a fee for managing their accounts.

All of these investments are ways of letting money earn more money. These investments are also good for the overall economy because investment is what enables businesses to become established, to expand, and to grow. Banks use money from savings accounts and CDs to make loans to others to buy cars and houses or to start businesses. A healthy economy depends on all of these investments.

Top: The New York Stock Exchange on Wall Street in New York City is the world's largest stock exchange. **Above:** Investments are a way to make your money grow.

Reviewing the Section

1. Why is saving money an important thing to do?
2. Define investment. What are the two main types of investment? Explain each.
3. What are the problems and benefits with certificates of deposit?
4. What is a bond?
5. What are the costs and benefits of owning stock?
6. Why are mutual funds safer than stocks?
7. Deeper Thinking: Why is it important for people to invest their money? Which way of investing money do you think is the best? Why?

Section 3

Credit

Setting a Purpose

As you read, look for

- the different ways people use credit;
- the importance of an individual's credit history and credit score;
- why it is important to use credit wisely;
- terms: **credit, mortgage, repossess, credit history, credit score.**

The Importance of Credit

Credit is an arrangement by which a buyer can take possession of something now and pay for it in the future, usually with interest. Credit is an important part of the modern economy. Credit enables businesses to start up and expand. It allows families to buy homes and other products such as cars and furniture. All of this keeps the economy going by keeping money circulating. When people buy homes, builders get to build them or repair those already built. Builders buy supplies. Suppliers earn money they then spend on other things, keeping more people employed, and so on. Common forms of consumer credit include personal loans, **mortgages** (home loans), and credit cards.

The Responsible Use of Credit

Taking out a loan or buying something on credit can cause a financial hardship if a person borrows or spends too much. Payments on loans and credit cards are usually made monthly. The monthly payments need to fit into a person's monthly budget. The amount of a monthly payment a buyer can afford often affects what type of car or house the buyer purchases. The lender keeps a claim to the title, or ownership, of a car or house until the entire debt is paid. If the buyer fails to make payments, the lender can **repossess** (take possession of) the item.

Credit cards make it easy to purchase things, but they also make it easy to spend too much. Credit card rules vary. Some credit card companies require individuals to pay the balance owed in full each month. Others allow individuals to make minimum payments each month, but the companies charge interest on the unpaid amount. Most credit cards charge fees for late payments. It is best to pay the entire amount owed when the credit card bill arrives. Making just the minimum payment each month can lead to additional debt and can cause financial ruin. Over an extended period of time, the interest charges can add up to more than the value of the item that was purchased.

Top: Using a credit card makes purchasing at a store quick and easy. **Above:** Using a credit card is a type of borrowing. A responsible credit user plans for how the borrowed money will be repaid.

Making payments on time and in full is important to a person's **credit history**. Based on credit history, each individual earns a **credit score** (a number assigned to a person that indicates his or her capacity to repay a loan). Financial institutions and businesses check credit scores to decide whether or not a person qualifies for a loan or a credit card and, if so, how much credit that person deserves. Although the practice is controversial, insurance companies and potential employers often check credit histories to see if a person uses credit responsibly. People with poor credit histories and low credit scores may find it difficult or impossible to get additional credit. If they can get credit, they may be charged a higher interest rate.

Figure 17.2
Cost of Buying a Home

Median Home Price in Georgia (2016) $152,000 30-year mortgage		
	High Credit Score	Low Credit Score
Interest rate charged	3.50%	4.50%
Monthly payment	$693	$781
Total cost of borrowing	$97,551	$129,337

Many of these aspects of personal finance may be in your future. Begin now to develop good financial habits. Saving for the future, investing wisely, buying only what you can afford, and building a good credit history will be important to your quality of life. Good financial decisions are important to communities, the state, and the country. Poor financial decisions can affect the entire economy, because businesses lose money, causing people to lose jobs, which means individuals and families do not have the income to meet their needs.

DID YOU KNOW?

The most widely used consumer credit scores in the United States are the FICO scores (pronounced fī-kō). The name comes from the creator of the scores, the Fair Isaac Corporation.

Reviewing the Section

1. Why do people use credit? What are the different ways people use credit?
2. Why would a bank repossess an item from a borrower? How can repossession be avoided?
3. Why is credit helpful for the economy of a community?
4. What is credit history? Why is it important?
5. Deeper Thinking: Why is it important to use credit wisely?

special Feature

The Cost of Credit

Credit can be defined as the opportunity to borrow money in return for a promise to pay later. The use of credit often comes with a cost known as a finance charge, which includes interest and fees charged to the borrower. Credit allows a person to purchase an expensive item when there is not enough cash available to cover its cost. Most people use credit to purchase a house or car. Some people also use credit to pay for things such as medical treatment or college.

A borrower must pay back borrowed money (principal) plus money paid to use the borrowed money (interest). Interest is charged for the privilege of borrowing money. Let's look at an example of how interest increases the cost of using credit. Let's say you borrowed $30,000 to purchase a car at an interest rate of 10 percent for five years. The lender will expect monthly payments of $637. After five years you will have paid the lender $38,245. That means you paid the lender $8,245 for the privilege of using the credit.

Credit cards provide an easy way to make everyday purchases, like food, clothing, or fuel. Some people prefer using credit cards instead of cash. Ideally, credit cards should be paid in full at the end of each month. This prevents other costs such as fees and interest. Because credit cards are easy to use, many people use them carelessly. They may, in fact, borrow more than they can pay back at one time. A person who owes a very large amount might choose to make only a small minimum payment. People who only make minimum payments soon discover that their total debt keeps rising even if they do not make additional purchases. The card holder may end up owing more money than the amount of the original purchases. Another caution when using credit cards is that the interest rates are generally much higher than the rates for regular loans.

Here are some examples of the cost of credit.

Amount Borrowed	Years to Payoff	Interest Rate	Payment per Month	Total of Payments
$1,000	1	3%	$84.69	$1016.32
		10%	$87.92	$1054.99
		19%	$92.16	$1105.88
	2	3%	$42.98	$1031.55
		10%	$46.14	$1107.48
		19%	$50.41	$1209.81

There are many websites that can calculate the cost of credit for you. A wise borrower will know the cost before borrowing. How can you begin preparing for being debt-free in adult life?

Chapter Review

Chapter Summary

Section 1: Spending Your Money

- Income is the amount of money obtained including money earned by working as well as gifts of money and money made from investing.
- Expenses are the goods and services bought to satisfy a person's needs and wants.
- Expenses can be fixed (same amount) or variable (changing amount) every month.
- It is important to make a budget and track expenses to ensure you do not have an overdraft in a checking account.
- Philanthropy, or charitable giving, helps people in the community and makes the giver feel good.

Section 2: Saving and Investing Your Money

- Opening a savings account is an easy and important way to accumulate savings for future expenses or emergencies.
- A certificate of deposit (CD) is a safe investment because it is insured. CDs earn higher interest than money in a savings account, but the investment is tied up for a period of time.
- Money can be used to make a profit by investing in financial and real investments. This can be risky but also helps the economy.
- Bonds allow people to loan their money to the government and companies in order to earn interest.
- Stocks are another way to invest in a company but can be risky.
- A mutual fund makes investing in stocks safer by making multiple investments with many people's money.

Section 3: Credit

- Credit is important to the economy, but people must be careful not to borrow more than they can afford to pay back every month.
- Credit cards help build a credit history, which shows banks a person can be trusted with money by not overspending and by paying on time.
- A credit score grades a person's credit history so financial institutions can decide how much money a person deserves and what interest rate to charge.

Activities for Learning

Reviewing People, Places, and Things

Create a crossword puzzle with the following words. Create clues for each of the words.

budget
philanthropy
interest
stock
credit
income
expenses
investment

Understanding the Facts

1. Name some different ways to receive an income.
2. What is the difference between a fixed and variable expense?
3. What is the best way to manage money?
4. Why is it important to save enough money to cover at least three months of expenses?
5. What is the difference between saving and investing?
6. Give an example of a financial investment.
7. What can happen if a buyer cannot pay back a debt?
8. Why is a high credit score important?

Developing Critical Thinking

1. Decisions people make about their personal finances can affect the economy of entire communities. Based on your readings from this chapter, give an example of how bad credit scores could hurt a community's economy.
2. The most important rule of budgeting is that expenses should never be more than the amount of income. However, sometimes people find themselves in a situation where they have little or no income. What are some solutions for a person whose expenses are more than their income?

Writing across the Curriculum

Write a short report about the three kinds of financial investments discussed in this chapter. Describe how they work, how the investor makes money, and the level of risk associated with each.

Applying Your Skills

Imagine you are planning a birthday party for your friend. However, you have a tight budget of $80. Make a list of items you want to get for the party, and do some research to compare prices. Write out your budget for each item to make sure you do not spend too much. How does your budget affect what you can buy and how many guests you can invite?

Exploring Technology

Watch this video about two small businesses in Oklahoma: www.kansascityfed.org/education/entrepreneurship-video-pie. What economic terms from this chapter did you hear in the video? How did the owners of Pie Junkie and Kaiteki Ramen invest money wisely?