

TOPIC 6a

What is borrowing?

This topic helps you to:

- ▶ appreciate the reasons why people borrow money;
- ▶ understand some of the ways that people borrow money.

WHY MIGHT WE BORROW MONEY?

Sometimes we want to buy something, but we do not have enough money.

We can:

- ▶ decide not to buy what we want;
- ▶ save until we have enough money; or
- ▶ **BORROW** the money to buy it now.



Kristina wants to buy a video camera for £400 but she has only £50. She borrows £350.

People often borrow because it would take a long time to save up enough money to buy the item. Sometimes, they really need the item straight away.



Franki's car has broken down. She needs to borrow money to fix it so she can drive to work.

HOW DOES BORROWING WORK?

Adults aged 18 and over can borrow from organisations offering 'CREDIT'. When we talk about borrowing, giving credit means lending money.

Borrowers pay back:

The amount they borrowed

+

Interest on what they borrowed

+

Any fees the lender charges

Kristina borrows **£350** for one year, at an interest rate of 5%.

$(£350 \div 100) \times 5 = £17.50$ interest

The lender charges £10 in fees.

In total, Kristina pays back:

$£350 + £17.50 + £10 = £377.50$

IN WHAT WAYS CAN PEOPLE BORROW?

PERSONAL LOAN

In Topic 3a, we saw that banks and other organisations lend money to people who want loans.

People use personal loans to pay for specific items, such as a car or

furniture. They repay the loan over an agreed time, paying off a bit each month.

Each payment is the same.

Niall borrows £1,000 for one year at 5% interest, making a total of £1,050

He pays $£1,050 \div 12 = £87.50$ per month

OVERDRAFT

An overdraft lets current account holders borrow money when their account balance gets below zero.

The money is borrowed from the account provider. Overdrafts are meant to cover quite small amounts for short periods of time.

CARL



I borrow for a few days a month before my wages are paid

- ▶ You must ask your bank or building society for an overdraft – this is an **AUTHORISED OVERDRAFT**.

Carl asks his bank for an overdraft of £100. So, he can still make payments up to £100 even if his account gets to zero.

Carl has £10 in his account.

Balance: £10

A standing order of £70 is debited.

Balance: -£60

Carl is using £60 of his authorised overdraft.

Interest is charged each day that a borrower uses their overdraft.

- ▶ If you do not ask for an overdraft but use one anyway, this is an **UNAUTHORISED OVERDRAFT**.

Lewis has £10 in his account. He has not asked for an overdraft.

Balance: £10

He withdraws £50 from an ATM.

Balance: -£40

This £40 borrowing is unauthorised.

Banks charge people fees if they use an unauthorised overdraft.

ONLINE ACTIVITY

Decide whether the overdrafts in **ACTIVITY 6A** are authorised or unauthorised.

CREDIT CARD



Credit cards are plastic cards that let you buy now and pay later. They work like debit cards but you borrow

the money from the card company, up to a set 'credit limit'.

A monthly statement shows everything bought using the card.

- ▶ If you pay off all the credit for the month, no interest is charged.
- ▶ If you only pay off some of the credit, you must also pay interest.



Watch **CREDIT CARDS AND INTEREST** to see how interest builds up if spending on a credit card is not repaid in full.

NEXT TIME ...

- ▶ How do we borrow sensibly?
- ▶ How do we choose the right lender, and which should we avoid?