Money matters are complicated and personal.

One of our readers took me to task this last week over my article on saving money. He asked, “Why bother saving when you are only getting an interest rate of .1 to .25 percent?” And he is right. When a modest savings account of $1,000 only earns you a couple of cents per month, you are right to ask yourself if it is worth having it in the bank. Our current inflation rate is about 1.6 percent, making your money worth less at the end of the year than it was at the beginning of the year. However, there are some things you should take into consideration.

Everyone should have a small savings account that is easily accessible in case of emergency. Research shows us that the average emergency costs about $1,500 to $2,000. Whether it is a house repair, car repair or health emergency, you should have at least this much money in your savings account. Even if it doesn’t earn you any interest to speak of, it will keep you from tapping into some of those high-interest credit cards. If you pay for an emergency with a credit card, that same $2,000 at 15 percent interest will cost you $180.52 per month or $2,166 to pay it back in one year. In this case, the savings account will save you money, even if it doesn’t earn much interest.

Once you have established your savings account, you should look at your credit card debt. If you have high-interest credit card debt, then that is the next place your money needs to go. A $2,000 credit card account at 24 percent will cost you $189.12 per month or $2,269.44 a year. While you might only earn 20 cents if that money is in savings, it is better than the $270 you would pay in interest for the same time period.

Consider regular interest rate costs. If you have a credit card with a balance of $2,000 at 13 percent, you will pay $178.63 per month or $2,143.56 for the interest plus principal payment over the year. Again, that 20-cent gain looks good beside the cost of the interest.
Now for those low-interest loans. Let’s do a real life example. My husband bought a pickup several years ago with a wonderful interest rate of 2.6 percent. Over the course of the five-year loan, he has paid a total of $620 interest for the loan or about $10 a month. Does it make sense to pay it off rather than paying for it monthly? In some cases, it comes down to whether you want to get rid of that debt. In our case, we’ve decided to continue to pay the note each month and use our excess money on other investments.

The same scenario exists for home loans, which are long-term with low interest rates. You have to gauge your own values to see if it is more important to pay that home loan down or to put the money elsewhere. If you have any kind of credit card debt, it is far more important to pay that off than to increase your home equity.

Going back to the original question of whether we should have a savings account, I hope I’ve convinced you that everyone should have some money in case of emergency. After that, it is probably best to pay off high-interest debt first, then standard interest rate interest.

Remember that the cost of the loans and debt in the above examples has been relatively small, just $2,000. However, when the average family carries almost $16,000 in credit card debt, the interest paid increases drastically. So, take a good look at what you owe and take positive steps to decrease it.

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