Understanding Key Savings Terms

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If you're new to saving, here are some key terms you should know.

Principal – the amount of money you deposit to start your savings account.

Withdrawal – when you take money out of your account, thereby reducing your principal.

Deposit – the money you add to your account, which increases the principal.

Interest Rate or Annual Percentage Rate (APR) – The interest rate is the percentage amount of your principal that the bank agrees to pay into your account. An interest rate is often referred to as an APR.

Fixed Interest Rate – An interest rate that does not change.

Variable Interest Rate – An interest rate that can do up or down, usually determined by current economic conditions.

Simple Interest – A "simple" fee paid to you on your principal, expressed as a percentage of the principal over time. It is calculated as principal x interest rate x time = interest earned. Example: You open a savings account with $1,000 at a 5% simple APR. What will you earn? $1,000 x .05 x 1 = $50 interest earned every year

Compound Interest – Interest is added back to your account and becomes part of your principal. With more principal, the account earns even more interest, which continually compounds into new principal. Depending on the type of account, interest may compound daily, monthly or annually. Example of annual compounding: In year one, $1,000 x .05 x 1 = $50 interest earned. In year two, you also earn interest on the $50 added back to your principal, so $1,050 x .05 x 1 = $52.50 interest earned.