Debt
Management

Definition of debt

Is the amount of money you borrow or you owe to a person or an institution in case you do not have enough cash available to satisfy your own needs. In addition, when you take the decision to borrow, you have to put into consideration that the amount you borrow will be paid back later with interest.

Therefore, it is very important for every individual especially young people to learn more about borrowing money and managing his or her debts and that is what we are going to discuss.

1. What drives people to borrow?

- **Price Increase:**
  As prices rise, the need to borrow may increase especially if prices rise at rates faster than incomes.

- **Unexpected Expenditures :**
  In case of arising emergencies such as your car breaks down without cash availability, you need to think of borrowing as an option to face such unpleasant sudden situation.

- **Investments:**
  People will go for investments if they believe that the return from investments will be more than the cost of borrowing itself. However, there are always some risks when it comes to investments, as the high returns can seem amazing when the market flourishes but the losses can be huge when the market stagnates.

- **Education & Training:**
  People often borrow to pay for their education and training to get a job or a career they dreamed about allowing them to secure better financial future through their careers.

- **Start a Business:**
  Some people seek for improving their welfare, as well as the living standard of their families by opening their own businesses that is why they need to borrow to launch, start up a business or even expand an existing one.

These are just some of the reasons for borrowing. In fact, borrowing money has to be well managed according to the borrower's needs and affordability.

2. Considerations before taking the decision to borrow:

- **How much do I need to borrow?**
  This is a very important factor you need to think about, you should only aim to borrow exactly what you need and no more than this.

- **Why do I need to borrow money?**
  Often things that seem necessary really are not. That is why you have to ask yourself what are you intending to spend the money you borrow on? Is it for something important you really need or something recreational which can wait?

- **Where should I borrow money from?**
  You will need to determine which bank or firm you intend to borrow money from, it should always be from a reputable, trusted lender.

- **Can I purchase something less expensive instead?**
  Often when you are making a big purchase, you want to buy the best thing. However, you can achieve the same results by determining how much you really need depending on your priorities.

- **What is my level of debt right now?**
  If you are already having other debts or paying high interest rate on credit card debts, for example, you will not be able to apply for other debt until you pay it off.

- **How fast can I pay it off?**
  When you take out a loan or borrow money, you should focus on paying it off as quickly as possible to avoid late payments fees.

- **What happens if I can’t pay it off?**
  You have to put into consideration that there is a possibility to lose the collateral you put up for the debt if you will not be able to pay it off to the lender and the collateral might be your home, your car. Moreover, any late payments or skipped payments will affect your credit score, which indicates to lenders your ability to repay the debt.

3. Tips for managing your debts:

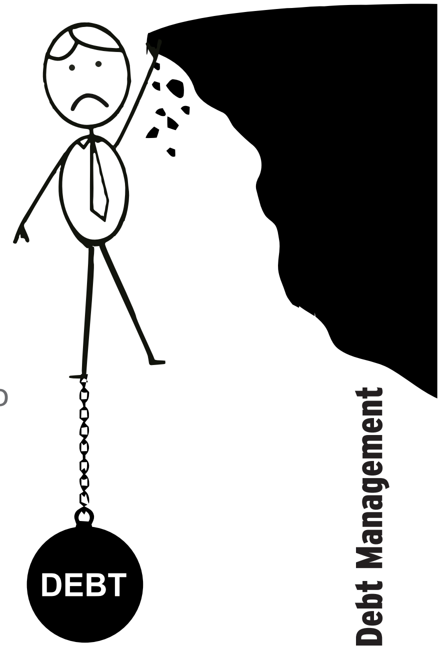
There are steps you can take to manage your debt better; these steps listed as follows:

- Begin budgeting to determine your basic needs rather than spending all what you earned. Budgeting is an essential tool to understand where your money is going and where should you spend your money on depending on your priorities.
- Pay your bills immediately on the due date as late payments bills may affect your credit score or could increase the amount you have to pay due to Interest accumulation.
- Check your monthly statement regularly to verify that it accurately lists the expenses you made. In addition, you have to call your lender immediately if you suspect any errors in your statement.

- Think about the cost difference between purchasing what you need with cash versus purchasing it with credit.
- Prioritize your debts to determine which debts should be on the top of your payment list, they are not necessarily to be the largest ones or the debts with the highest interest rates; examples of these debts might be : Loans secured against a property, income tax, national insurance, gas and electricity bills.

4. The Cost of Debt

The cost of borrowing is the total charge for applying to get a debt that include interest payments. In other words, the amount you borrow is called “the principal” while the cost you pay for using someone else’s money is called “interest” and it is stated as percentage. Therefore, when you take the decision to borrow, you will have to pay back both the principal and interest. In addition, the rate of interest can be either fixed or variable as follows:

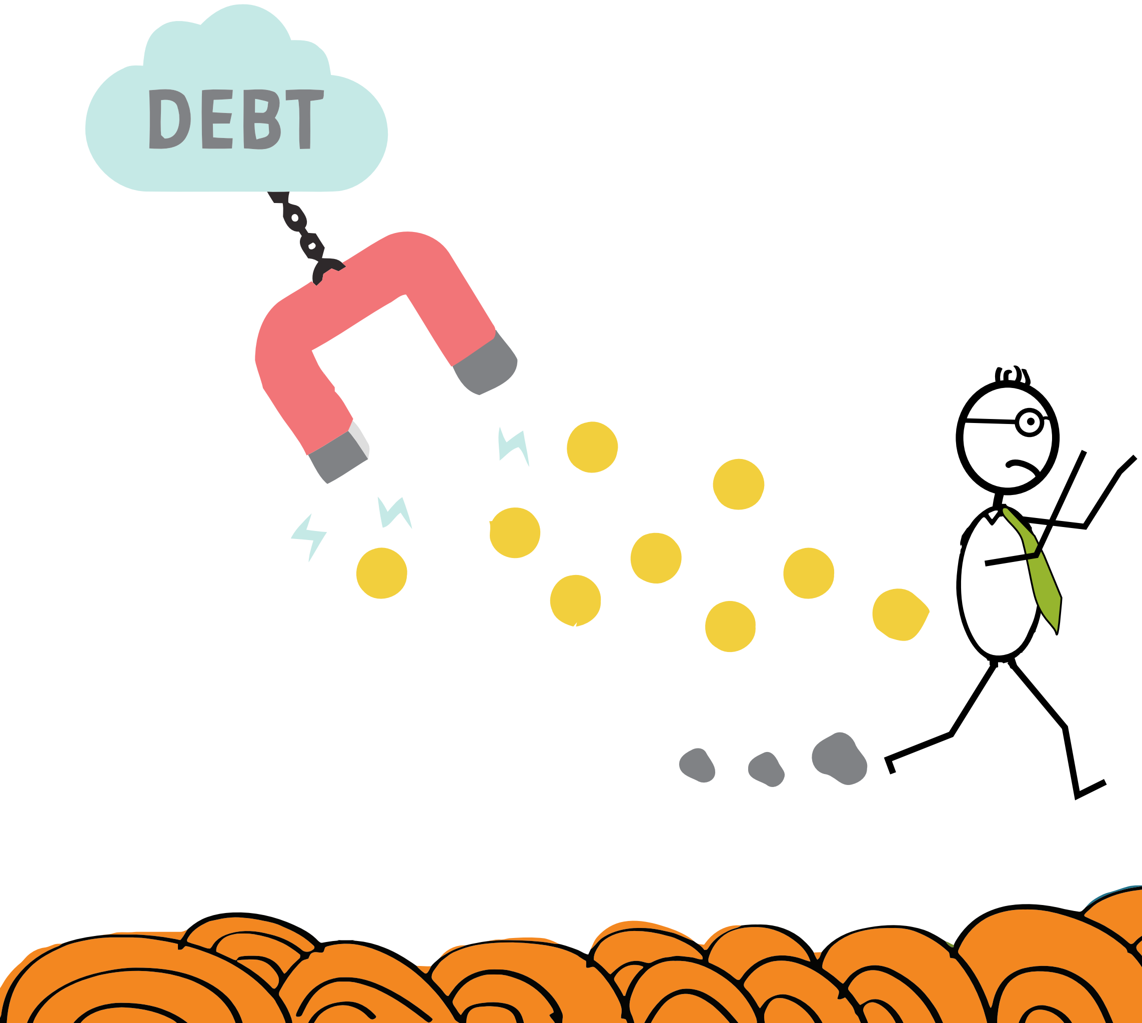


- **Fixed rate:** means the interest rate stays exactly the same without any changes during the debt’s term.
- **Variable rate:** means that there might be changes on the interest rate during the debt’s term. In this context, the debt agreement will show the details of any changes in the rate.

Conclusion

Actually the most important thing when it comes to borrowing is to ask questions to get the information you need for making accurate decision such as: questions about the interest rate, whether it will be fixed or variable and includes penalties for late payments or not. Borrowing money means we are using tomorrow's income to get what we need today.

Therefore, we need to be careful before borrowing and think about how long it will take from us to pay our debts off. In other words, you should think about the maturity date of repaying your debts in order not to effect negatively your financial situation in the future.


DEBT

CENTRAL BANK OF EGYPT
Egyptian Banking Institute

Accredited by ACCET
A Partnership for Quality®

Shaping the Future
Financial Literacy Initiative

www.ebi.gov.eg