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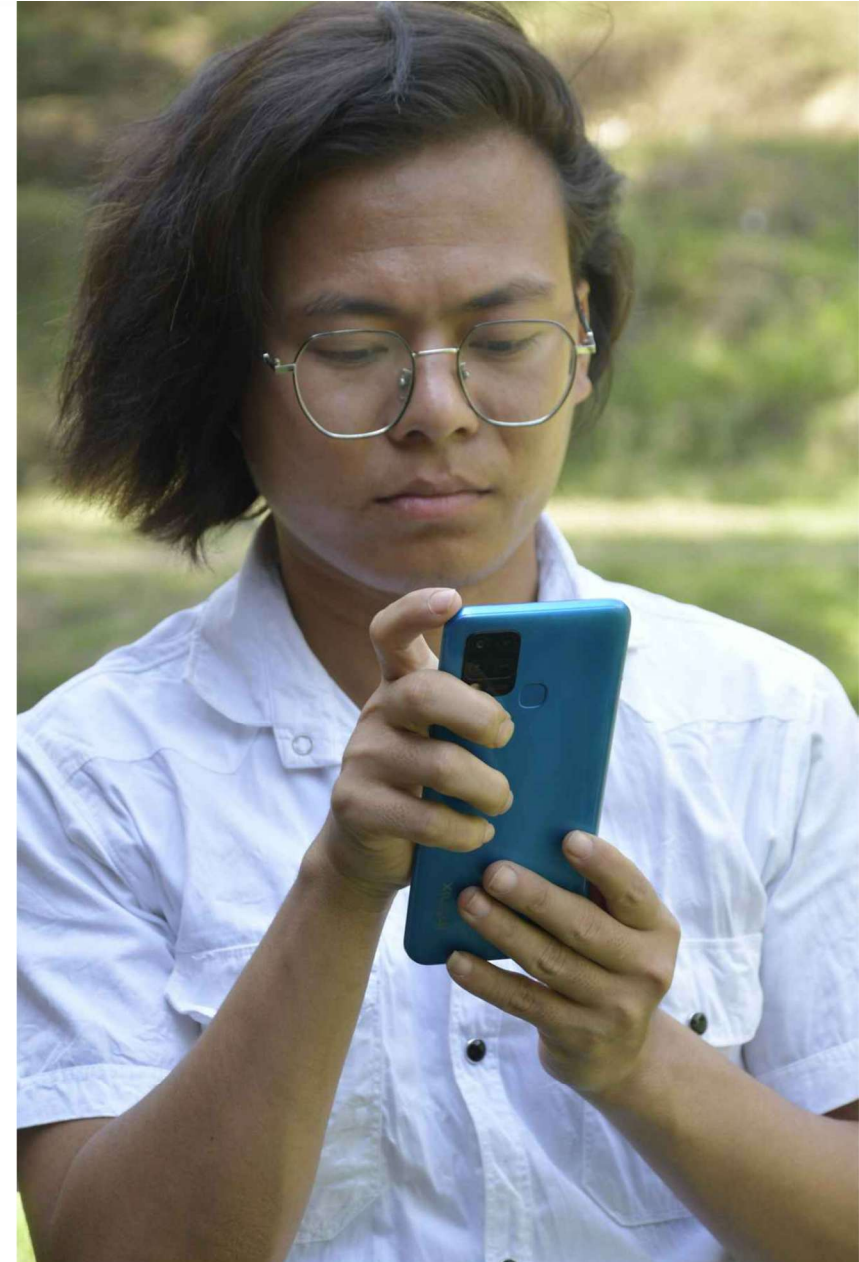
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# Credit, Loans, and Interest Mechanisms

Have you ever wanted a new phone, laptop, or car but didn't have the money saved up? Perhaps you're dreaming of attending university or moving into your own place. That's where credit and loans come in - letting you get what you need now and pay for it over time.

Credit isn't free money. You pay extra - called interest - on top of what you borrowed. How you use credit now affects your future financial freedom. This comprehensive guide will teach you how credit works, why it matters, and how to make smart choices that keep more money in your pocket.

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# Why You Should Care About Credit

## Immediate Access

Get what you need now - phones, laptops, education - without waiting to save the full amount

## Future Opportunities

Build your financial reputation for better loan terms, rental applications, and career prospects

## Emergency Safety Net

Access funds during unexpected situations like car repairs or medical bills

In the EU, total household debt reaches a staggering €15 trillion. Around 40% of young people aged 18-24 have used credit cards or debt, but only 15% feel confident managing it. Learning to use credit wisely is crucial for your financial future.





# Learning Objectives

By the end of this module, you'll understand:

01

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## Core Concepts

What credit, loans, and interest actually mean in practical terms

02

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## Credit Types

Different types of credit from student loans to credit cards and their purposes

03

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## Interest Mechanics

How interest works and why it can grow rapidly if you're not careful

04

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## Credit Scoring

How your credit score works - your adult financial report card

05

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## Smart Usage

How to use credit wisely so it helps rather than hurts your financial future



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# What Is Credit?

Credit is borrowing money that you promise to pay back later. Whether you're buying a hoodie online with "Buy Now, Pay Later" or using a student loan for tuition, you're using credit. When someone gives you credit, they're trusting you'll pay them back - usually with a little extra called interest.

## The Trust Factor

Credit is fundamentally about trust. Lenders assess your reliability based on your history of repaying borrowed money. This trust translates into better rates and opportunities.

## The Cost of Convenience

The convenience of getting what you need now comes with a price - interest. Understanding this cost helps you make informed decisions about when credit makes sense.





# What Is a Loan?

A loan is a specific kind of credit where a bank or person gives you money now, and you agree to repay it in chunks over time. Unlike flexible credit, loans have fixed amounts and structured repayment schedules.

1

## Fixed Amount

You borrow a set amount of money all at once - €5,000 for a car, €20,000 for education

2

## Structured Repayment

Clear payment schedule - €210 per month for 2 years, for example

3

## Defined Timeline

Fixed duration with a clear end date when the loan is fully paid off

**Example:** You take a €5,000 loan to buy a second-hand car. You agree to pay €210 per month for 2 years. That monthly amount includes the loan amount plus interest.



# Credit vs Loan: Key Differences

Aspect	Credit	Loan
Flexibility	Borrow what you need, like with a credit card	Fixed amount borrowed all at once
Duration	Often renewed yearly, ongoing access	Clear start and end date
Interest	Pay only on what you use	Pay on full borrowed amount
Rates	Higher interest rates (more flexible, riskier)	Usually lower interest rates
Best For	Short-term needs, small purchases	Big purchases, long-term planning
Examples	Credit card, Buy Now Pay Later	Car loan, student loan, mortgage



# Understanding Interest

Interest is the "extra" you pay for borrowing money. Lenders don't let you borrow for free - they charge a percentage called the APR (Annual Percentage Rate). It's how they make money and cover the risk of lending.



## Interest Rate

The base cost of borrowing money, expressed as a yearly percentage



## Fees

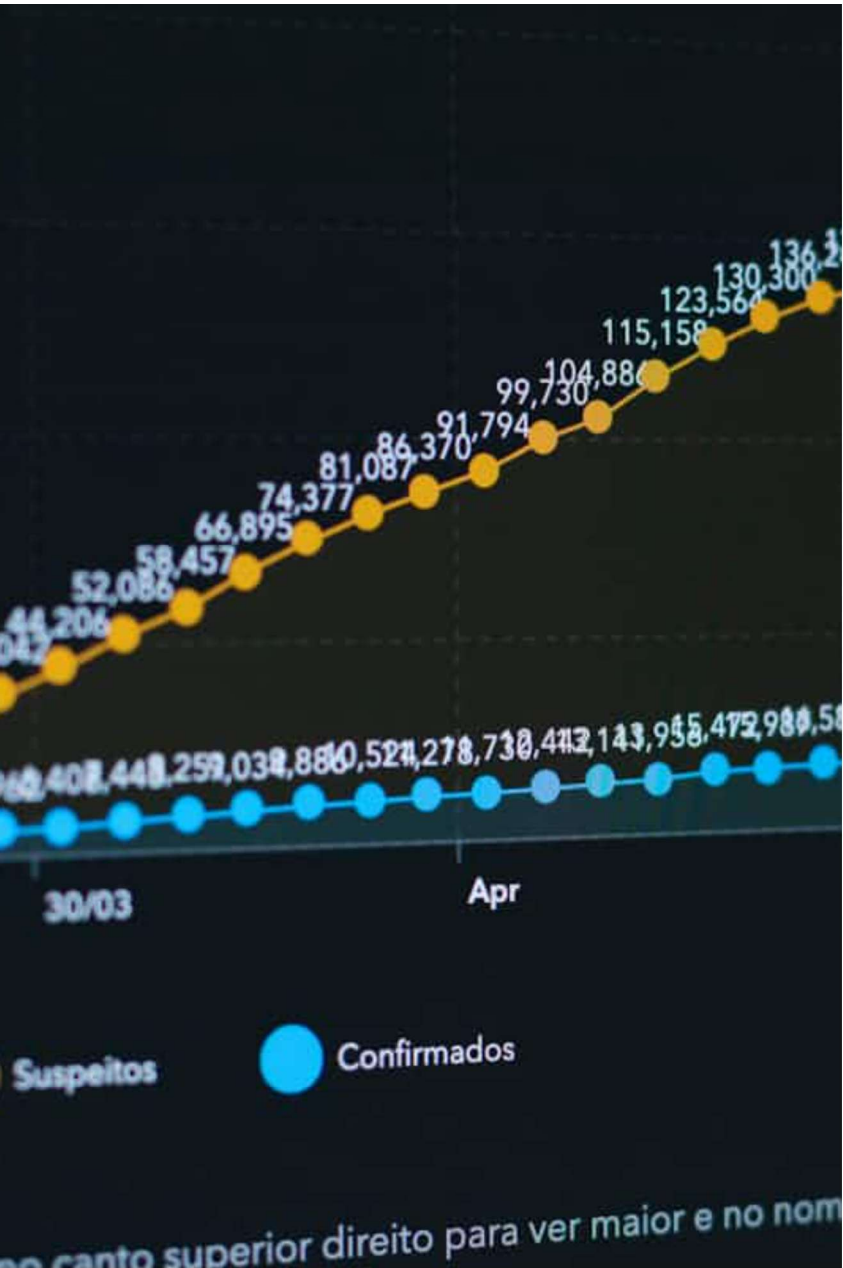
Processing, setup, or maintenance costs added to your loan



## APR

The true cost combining interest rate and all fees - use this to compare loans

**Example:** You borrow €10,000 for school at 5% interest for 5 years. That's €500 per year in interest → €2,500 total interest. If there's a €200 fee, your total cost becomes €12,700.



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# The Scale of Consumer Debt

€15T

£75B

£3K

EU Household Debt

UK Credit Card Debt

Average UK Debt

Total combined debt across Europe including mortgages, personal loans, and credit cards

Total amount owed on credit cards across the United Kingdom

Average credit card debt carried by adults in the UK

These figures show how easy it is for people to fall into debt if they aren't careful. Around 30% of people with debt say it causes them anxiety, which is why managing credit wisely is super important. Knowing the APR helps you compare loans and avoid nasty surprises.



# Borrowing and Lending Explained

## Borrowing

Receiving money from someone else - usually a bank or lender - with a promise to pay it back later, often with interest. You're using someone else's money to meet your needs today.

**Example:** If you borrow €200 today with a payday loan, you might have to pay back €250 in just a week or two. That's how payday loans can lead to high interest very quickly.

## Lending

The flip side - giving money to someone else with the expectation they'll pay you back, often with extra (interest). Banks and financial institutions are the most common lenders.

**Quick Fact:** Banks across the EU have been lending more in recent years, offering loans to students, young entrepreneurs, and first-time home buyers.



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# Secured vs Unsecured Loans

## Secured Loans

You're borrowing money using something valuable (like a car or house) as collateral. If you can't repay, the lender can take that asset.

- Lower interest rates (less risk for lender)
- Risk of losing your collateral
- Example: Car loans, mortgages

## Unsecured Loans

Loans that don't require collateral. You're borrowing based on trust that you'll pay it back.

- Higher interest rates (more risk for lender)
- Won't lose assets if you miss payments
- Example: Personal loans, credit cards





# Revolving Credit vs Installment Loans



## Revolving Credit

Borrow up to a limit, pay it off, then borrow again. Think credit cards - spend what you want up to your limit, pay it back, and keep using it. Pay interest only on what you use.



## Installment Loans

Borrow a set amount and pay it back in fixed monthly payments. For bigger purchases like cars or education - agree on fixed monthly payment for a set period.

The key difference: revolving credit offers flexibility for ongoing needs, while installment loans provide structure for major purchases. Choose based on your specific financial situation and goals.



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# Debit Cards vs Credit Cards

## Debit Cards

When you use a debit card, you're spending your own money that's already in your bank account. If you try to spend more than you have, you'll usually get an alert and the transaction won't go through.

- Uses your existing money
- No interest charges
- Prevents overspending
- No credit building

## Credit Cards

With a credit card, you're borrowing money from the bank or lender, and you have to pay it back later (usually with interest). It's like getting a short-term loan every time you make a purchase.

- Borrows money from lender
- Interest if balance carried
- Can lead to debt
- Builds credit history





# Common Types of Loans



## Student Loans

Help pay for education. Example: Kasia takes €40,000 for 5 years of university. She'll pay back over 20 years with interest, making total cost much higher.



## Mortgages

Used to buy homes. Borrow €150,000 for a house, pay back over 25 years. Lower interest rates because house secures the loan.



## Business Loans

For starting or expanding businesses. Max takes €20,000 for coffee shop equipment, rent, and inventory. Pays back over several years.



## Payday Loans

Short-term, high-interest loans until next paycheck. Borrow €200 today, repay €250 next week. Avoid unless absolutely necessary.



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# Why Credit Matters for Your Future

Credit is more than just borrowing money - it's a tool that shapes your financial future. Whether it's getting approved for loans, paying lower interest rates, or even landing better job opportunities, how you manage credit makes a huge difference in your life.



## Big-Ticket Items

Buy laptops, phones, or bikes with installment plans instead of waiting to save the full amount



## Education & Career

Student loans help pay for education, opening new career opportunities with higher earning potential



## Build Wealth

Mortgages let you buy homes and build equity over time, creating long-term wealth



## Emergency Support

Access funds during unexpected expenses like car repairs or medical bills





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# Credit for Business Growth

Credit doesn't just help individuals - it's essential for businesses too. Companies use credit to grow by providing funds needed to expand, whether small businesses or large corporations.

## Equipment Purchase

Buy necessary machinery, computers, or vehicles to operate and grow the business

## Staff Expansion

Hire additional employees to handle increased demand and business growth

## Product Development

Launch new products or services to capture market opportunities

## Survival Support

Navigate tough financial times and maintain operations during challenging periods

**Example:** A small café wants to expand by adding a second location. They need €50,000 for rent, furniture, and staff. A business loan provides the funds, paid back over time as the business grows.





# Individual Credit Types Overview

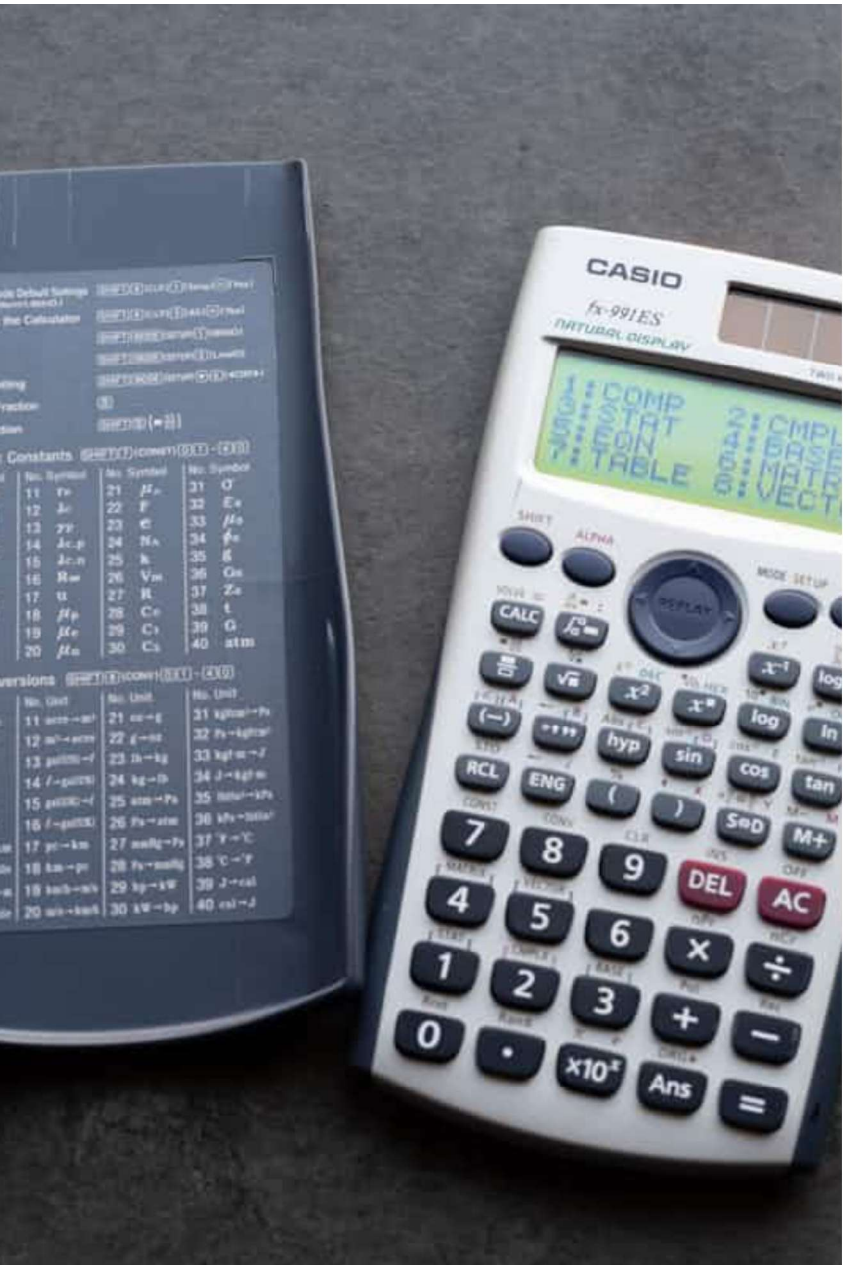
Type	Purpose	Example Use	Pros	Cons
Credit Card	Daily purchases, flexible borrowing	Groceries, clothes	Flexible, rewards, builds credit	High interest, debt risk
Personal Loan	Larger, one-time expenses	Car repair, medical bills	Lower rates, fixed payments	Fees, credit requirements
Student Loan	Education expenses	University tuition, books	Low interest, deferred payments	Long-term commitment
Mortgage	Home purchase	First apartment	Investment, lower rates	Huge commitment
BNPL	Short-term online purchases	Shoes, gadgets, gaming	No interest if paid on time	Late fees, debt accumulation



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# Business Credit Types Overview

Type	Purpose	Example Use	Pros	Cons
Line of Credit	Daily cash gaps	Paying bills between client payments	Flexible, easy access	High interest, fees
Term Loan	Big investment/expansion	Opening new location	Fixed terms, long-term funding	Rigid payments
Equipment Loan	Buying machines/vehicles	Bakery getting new oven	Secured, lower rates	Collateral risk
Trade Credit	Buying goods with delayed payment	Store stocking inventory	No immediate payment	Short-term, late fees
Invoice Financing	Getting money from unpaid invoices	Business getting paid faster	Quick cash access	High fees, dependency risk



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# Simple vs Compound Interest

## Simple Interest

Calculated only on the original amount borrowed (principal). Straightforward and doesn't change over time.

**Formula:** Interest = Principal × Rate × Time

**Example:** Borrow €1,000 at 5% for 1 year = €50 interest. Total owed: €1,050

**Good for:** Short-term loans with predictable costs

## Compound Interest

Calculated on both principal and accumulated interest. Amount owed grows faster because interest is added to interest.

**Formula:**  $A = P \times (1+r/n)^{(n \times t)}$

**Example:** Same €1,000 at 5% compounded monthly = slightly higher than €50

**Important:** Can work for or against you - great for savings, costly for debt



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# Nominal vs Effective Interest Rates

1

## Nominal Interest Rate

The rate stated on your loan, but doesn't account for compounding frequency. It's the "headline" rate you see advertised.

**Example:** 5% nominal rate compounded monthly

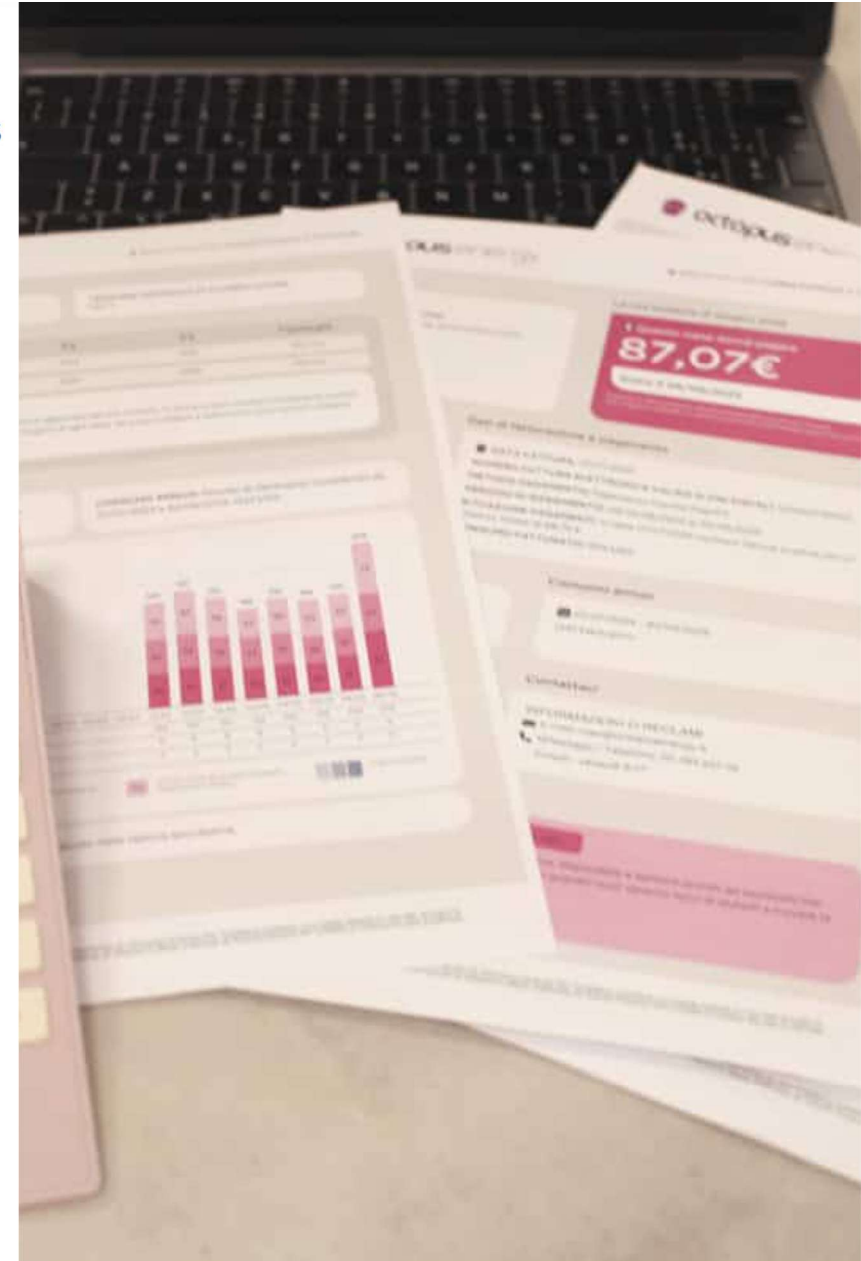
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## Effective Interest Rate (APR)

Shows the true cost including interest rate and compounding frequency. More accurate picture of total borrowing cost.

**Example:** 5% nominal becomes 5.12% effective when compounded monthly

**Key Takeaway:** Always look at the effective interest rate (APR) rather than just the nominal rate. It gives you a clearer picture of what you'll actually pay in interest.





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# Fixed vs Variable Interest Rates

## Fixed Interest Rate

Rate stays the same for the entire loan term. No matter what happens in the economy, your rate won't change.

- **Stability:** Payments won't change
- **Predictability:** Know exactly what you'll pay
- **Best for:** People who prefer certainty

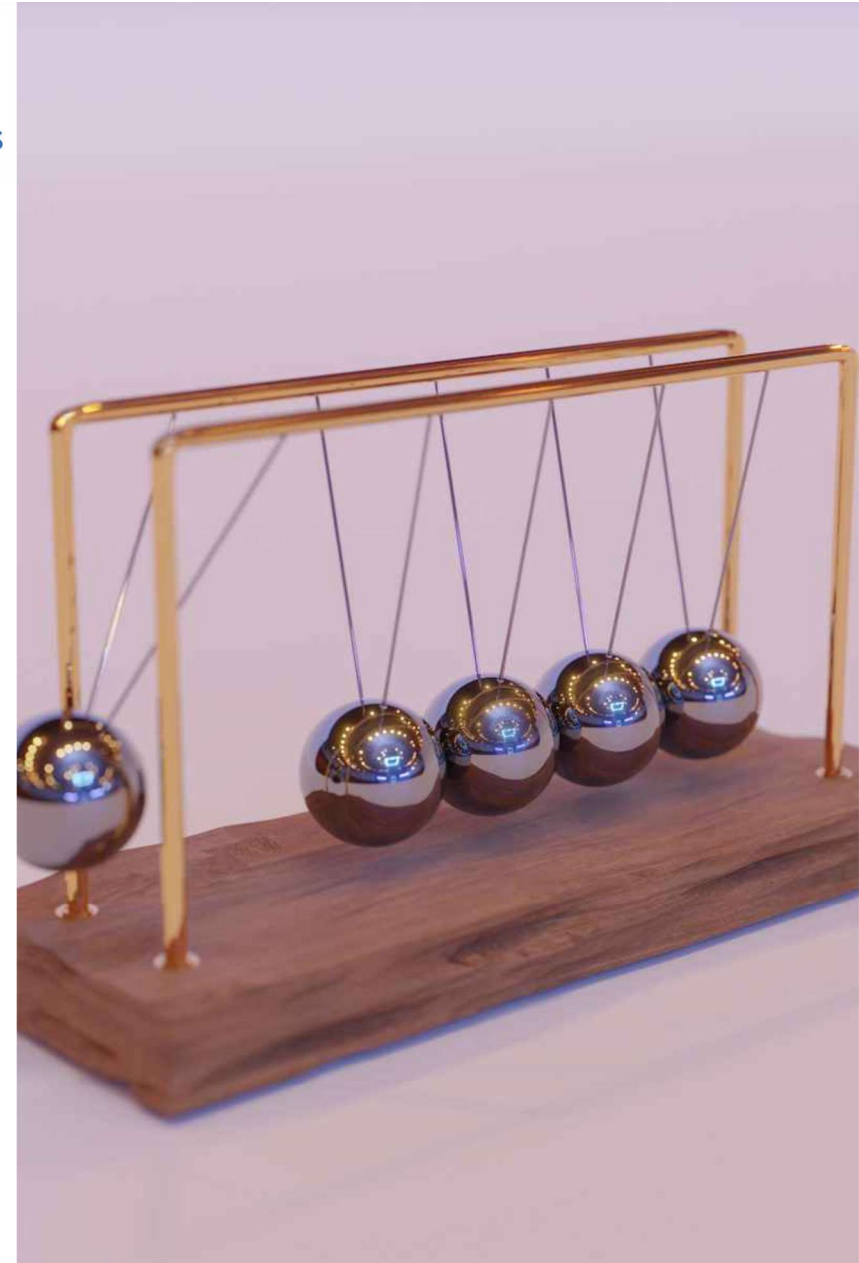
**Example:** €10,000 at 5% fixed for 5 years - rate stays 5% throughout

## Variable Interest Rate

Rate can change over time, usually responding to central bank rate changes. Payments can increase or decrease.

- **Uncertainty:** Payments might change
- **Risk:** Could end up paying more
- **Best for:** Those comfortable with risk

**Example:** Student loan starts at 2% but might rise to 4% if rates increase





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# Time Value of Money

Money today is worth more than the same amount in the future. Why? Because you can use it right now, invest it, or avoid inflation, which means things might cost more in the future.

1

Today

€1,000 received now can be invested or used immediately

2

One Year Later

€1,000 received later has less purchasing power due to inflation

**Smart Choice:** If someone offers you €1,000 today or €1,000 in a year, take it today! You can invest it wisely and potentially have more than €1,000 by year's end. Plus, inflation might make that future €1,000 buy less than it would today.

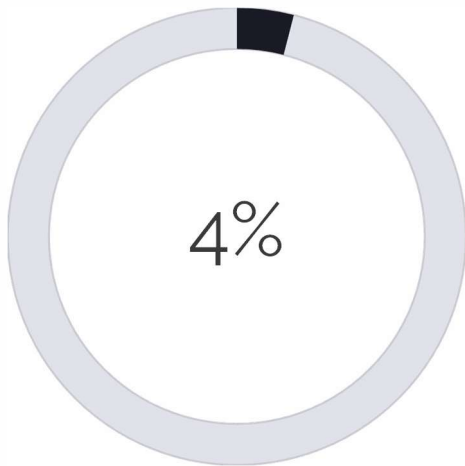


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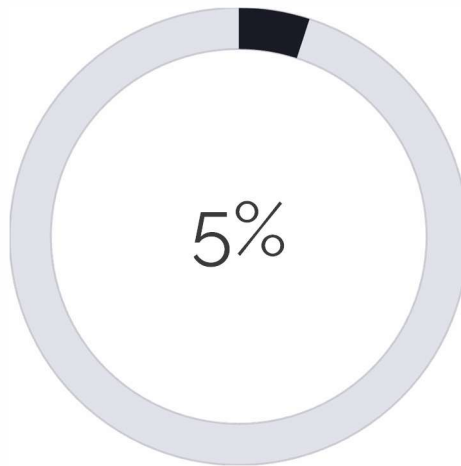
# Inflation and Real Interest Rates

Inflation is when prices increase over time, meaning money loses value. Real interest rates show what you actually pay after accounting for inflation - crucial for understanding true borrowing costs.



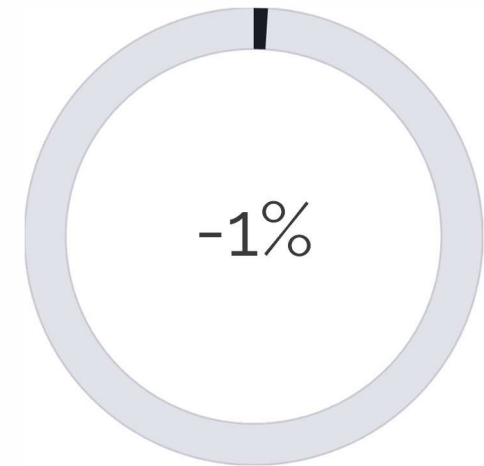
Loan Interest Rate

The rate you're charged on your loan



Inflation Rate

How much prices are rising annually



Real Interest Rate

Your actual cost after inflation (4% - 5% = -1%)

**Example:** With 4% loan interest and 5% inflation, your real rate is -1%. The money you repay is worth less due to inflation, making borrowing cheaper in real terms. However, if inflation is 2% and loan rate is 5%, your real cost is 3%.



# Central Bank Policy Rates

## Federal Reserve (USA)

Controls the Fed Funds Rate - the rate banks charge each other for overnight loans. When Fed raises rates, borrowing becomes more expensive to slow inflation. When lowered, borrowing becomes cheaper to boost the economy.

**Example:** In 2020, Fed cut rates to near zero during COVID-19 to stimulate the economy.

## European Central Bank (EU)

Sets the main refinancing rate for Eurozone banks. Like the Fed, ECB raises rates to fight inflation and lowers them to encourage growth.

**Example:** In 2011, ECB raised rates to fight rising inflation, making loans more expensive for consumers.

When central banks adjust policy rates, it affects your ability to borrow money and the cost of credit. They use these tools to stabilise the economy.



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## Benchmark Rates: SOFR, EURIBOR, SONIA

1

### SOFR (USA)

Secured Overnight Financing Rate - benchmark for US financial markets. Based on actual transactions using Treasury securities as collateral. More stable than old LIBOR system.

2

### EURIBOR (Europe)

Euro Interbank Offered Rate - rate at which Eurozone banks lend to each other. Used for mortgages and business loans across Europe. Set daily based on panel bank rates.

3

### SONIA (UK)

Sterling Overnight Index Average - UK benchmark rate for overnight unsecured lending. Based on actual transactions between banks, making it reliable.

**Why It Matters:** These rates directly impact your loan costs. If your loan is SOFR + 2% and SOFR rises 0.5%, your interest increases by the same amount.

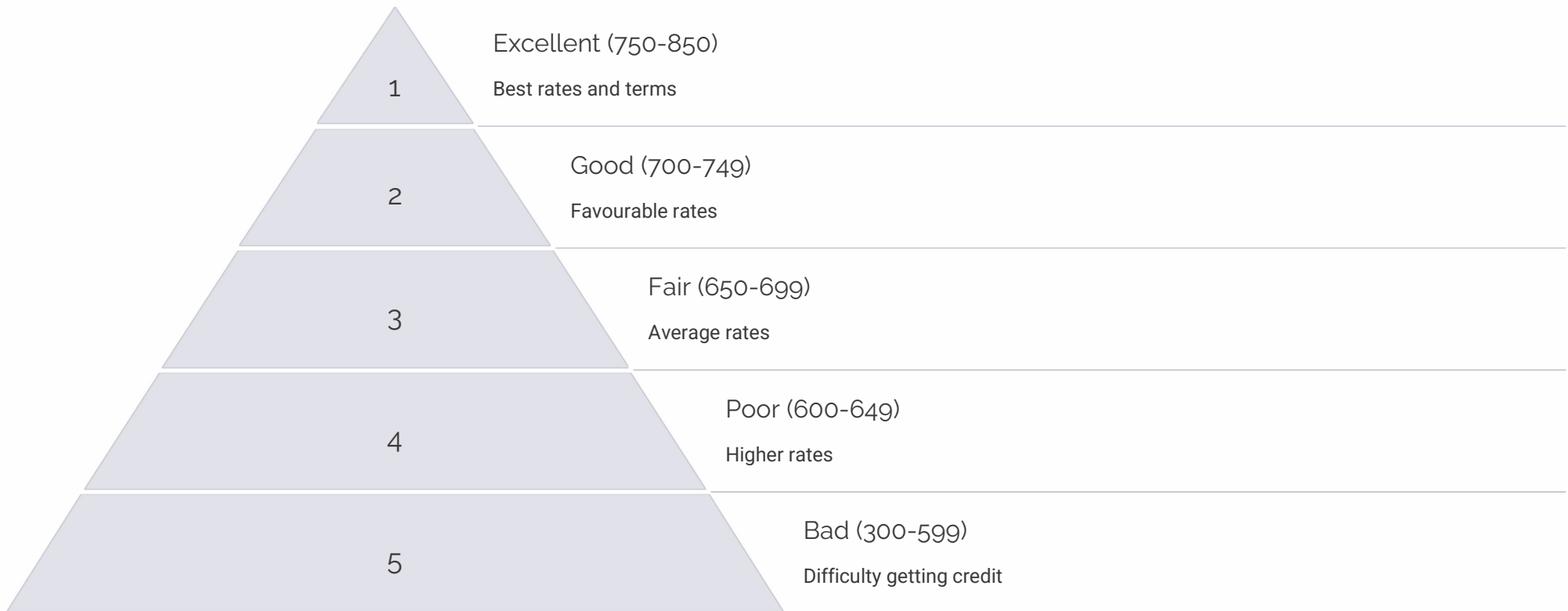


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# What Is a Credit Score?



Your credit score is like your financial reputation - a number between 300 and 850 that tells lenders how trustworthy you are with borrowed money. Higher scores mean better rates and opportunities; lower scores can mean rejection or higher costs.



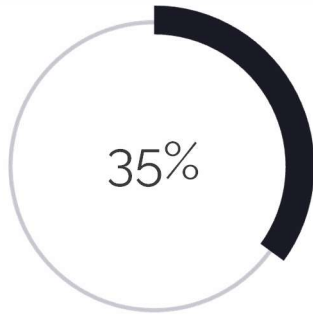
Think of it as a "grade" for how well you handle borrowed money. The better your record, the more opportunities you'll have.



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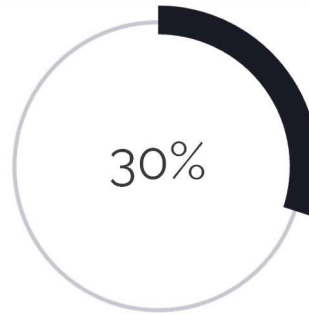


## What Makes Up Your Credit Score?



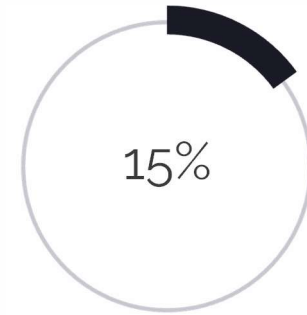
Payment History

Most important factor - tracks whether you pay bills on time



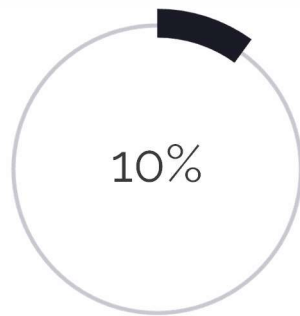
Amount Owed

How much debt you have compared to available credit



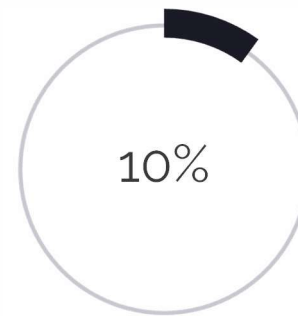
Credit History Length

How long you've been using credit responsibly



New Credit

Recent credit applications and new accounts



Credit Mix

Variety of credit types you can manage

**Key Point:** Payment history is crucial - always pay on time. Keep credit usage under 30% of your limit. Don't apply for too many credit cards at once.



# The Credit Approval Process

01

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## Application

Fill out form with personal information - name, address, income, employment details

03

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## Credit Check

Review your credit history and score to assess past debt management

05

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## Decision

Approval or denial with terms including interest rate and payment schedule

02

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## Verification

Lender checks your details including job and income to ensure repayment ability

04

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## Underwriting

Evaluate overall risk considering job, income, existing debts, and credit history

06

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## Funding

Sign agreement and receive money or credit access



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# Building Good Credit Habits



## Borrow Only What You Can Repay

Credit isn't free money. Before buying with credit, ask: "Can I pay this off before the next payment is due?"



## Always Pay on Time

Set up automatic payments to avoid late fees and credit damage. Even one missed payment can leave a mark.



## Keep Usage Under 30%

If your credit limit is €1,000, use no more than €300. Shows lenders you're in control.



## Check Your Statements

Review monthly to spot fraud, mistakes, and track spending. Catch errors early to save money.



## Think Before You Borrow

Ask: Do I need this or just want it? Avoid credit for fast food, trendy clothes, or impulse purchases.



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# Credit Mistakes to Avoid

## → Paying Only the Minimum

Keeps you in debt longer and costs more in interest. €500 balance with €15 minimum payments could take years to pay off.

## → Maxing Out Credit Cards

Makes you look desperate to lenders and damages credit score. Stay well below your credit limit.

## → Ignoring Due Dates

Leads to late fees, higher rates, and credit damage. Missing by one day can hurt you.

## → Taking Too Many Loans

Multiple applications make you look desperate and lower your credit score.

## → Using Credit for Non-Essentials

Avoid credit for entertainment, dining out, or items that lose value quickly.



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# Consequences of Not Repaying Credit

## 1 — United Kingdom

Late fees accumulate, credit score drops. Legal action possible, with rare cases of jail time for fraud (deliberately lying about income).

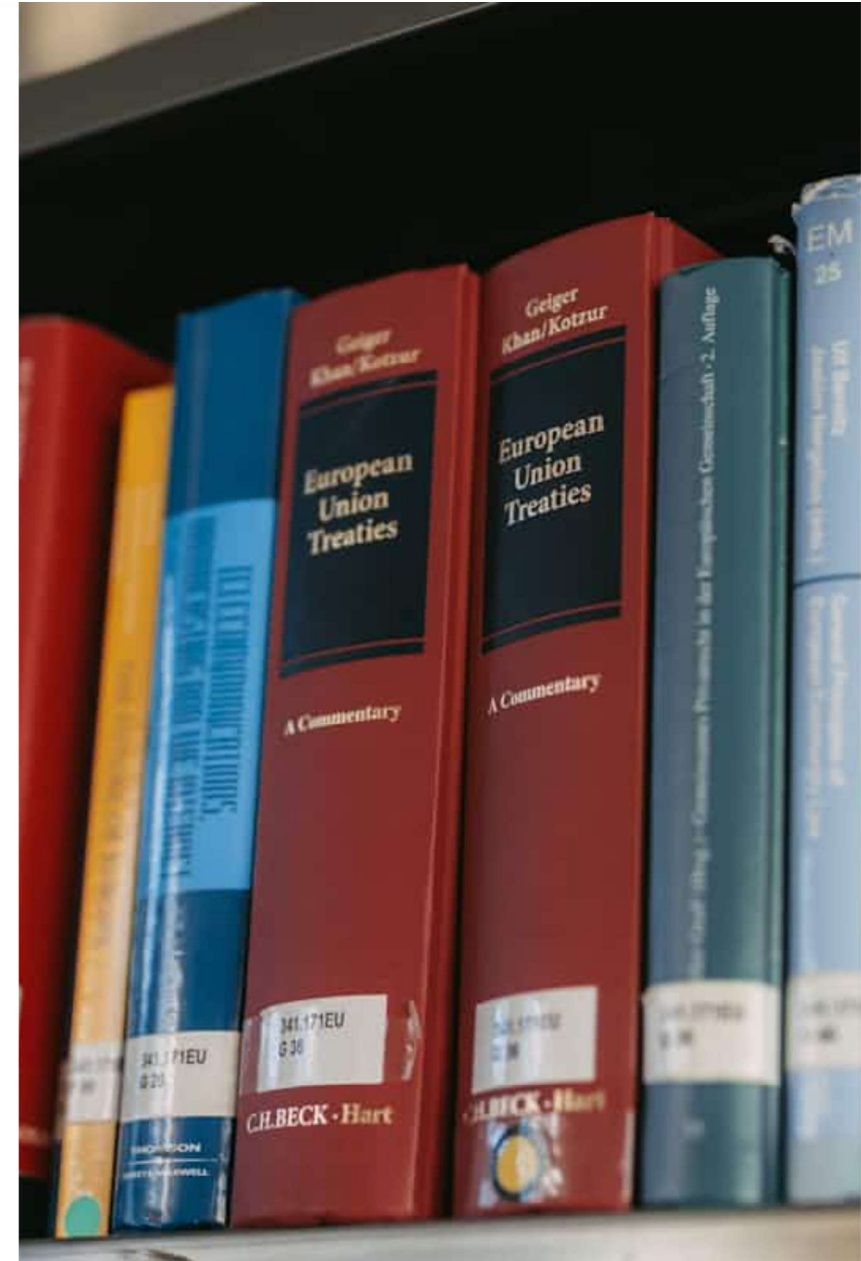
## 2 — Germany

Credit score affected, debt collection procedures. Court action possible. Jail time unlikely but financial future severely damaged.

## 3 — France

Debt sold to collection agencies, credit score drops, higher future interest rates. Legal action for persistent non-payment.

**Key Takeaway:** Missing payments starts a snowball effect leading to fees, damaged credit, or legal action. Always communicate with lenders if you're having trouble - most will try to work with you.





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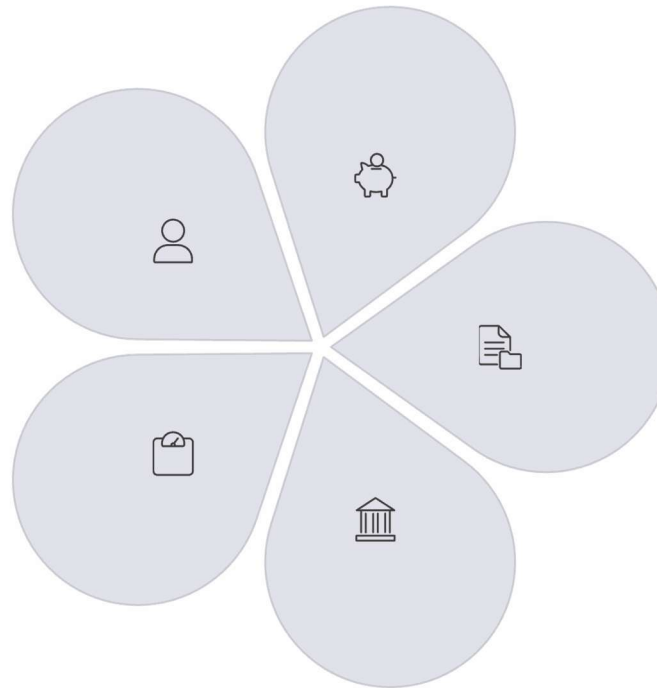
# Stakeholders in the Credit System

## Borrower (You)

Expected to repay borrowed money plus interest. Your behaviour affects credit history and future opportunities.

## Government

Creates laws regulating credit to ensure fairness and protect consumers from predatory lending.



## Lender

Banks, credit unions, online platforms providing funds. Expect repayment with interest to make profit.

## Credit Bureau

Companies tracking your credit history and creating credit scores for lenders to assess risk.

## Central Bank

Government institution controlling interest rates that influence borrowing costs across the economy.



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# Case Study: The Phone That Cost More

Lea, 17, found the perfect smartphone for €800 but couldn't afford it. The website offered "Buy Now, Pay Later" - four payments of €200 with no interest. Seemed perfect!



**Lesson:** BNPL plans seem convenient, but missing payments leads to fees and credit damage affecting future loans and credit cards.

**Solution:** Set payment reminders, use automatic payments, or contact lender for payment extensions before missing payments.



# Case Study: Simple vs Compound Interest

Alex, 19, borrowed €1,000 from a family friend for professional training. Two options offered:

Simple Interest (5%)

€500 interest over 10 years

Total cost: €1,500

Compound Interest (5%)

€629 interest over 10 years

Total cost: €1,629

Alex chose compound interest without understanding the difference, costing him an extra €129. Compound interest adds interest on top of interest, making debt grow faster.

**Lesson:** Always understand how interest is calculated before agreeing to loans. Simple interest is cheaper for borrowers.

**Solution:** Research loan terms, ask questions about interest calculation methods, and choose the option that costs less over time.

# Case Study: The True Cost of Homeownership

Jana, 24, bought her first flat for €200,000 with a 20-year mortgage at 3% interest. Monthly payments seemed manageable at €1,110.

€200K

Purchase Price

Initial cost of the flat

€266K

Total Paid

Amount paid over 20 years

€66K

Interest Cost

Extra paid beyond purchase price

Mortgages make homeownership possible but come with massive total costs. Plan for total loan cost, not just monthly payments.

Shop for better rates, pay extra monthly to reduce principal faster, make additional payments when possible to reduce total interest.



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# Your Credit Journey Starts Now

Understanding credit, loans, and interest is crucial for your financial future. Whether you're buying your first phone, planning for university, or dreaming of homeownership, credit will play a role in achieving your goals.

## Start Small

Begin with manageable credit like a student credit card or small BNPL purchase. Build positive payment history gradually.

## Stay Informed

Monitor your credit score, understand interest rates, and keep learning about financial products and economic changes.

## Use Wisely

Treat credit as a tool, not free money. Borrow only what you can repay, pay on time, and avoid unnecessary debt.

Remember: Good credit habits built now will open doors to better opportunities, lower interest rates, and greater financial freedom in the future. Your financial journey starts with the choices you make today.