Getting Ahead

CERTIFICATES OF DEPOSIT

By Patricia Jones, Alliance Community Task Force: Creating Opportunity

For the past year the Federal Reserve has been raising interest rates. This isn't great news if you have to borrow money—that's the point. But it is great news for your savings, especially if you buy a certificate of deposit.

A certificate of deposit (CD) is a savings product that earns interest on a lump sum for a fixed period of time. Higher interest is paid because the money must remain untouched, or penalty fees are charged for early withdrawal.

Like a savings account, CDs provide a way to put money away for a specific goal—such as the down payment on a house, a new vehicle, or a big trip—or to park funds that you simply don’t need for day-to-day expenses. CDs can be purchased at any local bank or credit union or online, and it is worth it to shop around to check interest rates.

A CD locks your money away for a set term, ranging from three months to ten years. The minimum amount to invest is usually $500. A larger investment and the longer time period usually mean higher interest rates. The amount you've saved will earn at that interest rate for the term of the CD, so if you think rates will go higher, you should look for shorter terms.

CDs are a safer and more conservative investment than stocks because they guarantee a rate of return. And they are insured by FDIC for banks or NCUA for credit unions. When you open a CD with an FDIC- or NCUA-insured institution, up to $250,000 of your funds are protected by the U.S. government if that institution fails.

One of the things we've learned through Bridges Out of Poverty is that it is incredibly difficult for low-income people to save money. Those things that take the largest part of the budget of a person in poverty are the things that have had the biggest price increases: rent, groceries, utilities, gas.

There are also cultural differences with how an influx of money should be dealt with. If you get a bonus at work, a tax refund, an inheritance, or even lottery winnings, a middle-class reaction would be to save that money and plan something special in the future. It might be a retirement fund, college fund, plans for a new home or vehicle, even a vacation.

A person in poverty would see that money as something that should be spent immediately. They'll go out and buy a new television or put a down payment on a car or truck. They live in the present.

Why aren't they planning for the future? Because there are too many claims on their limited money, so it might disappear without them seeing any benefit. Friends or relatives may ask for help, and they can't refuse because they've all been there, needing assistance for something. So they spend and offer to share.

A better option, regardless of economic class, is to buy that CD! It forces the owner to leave that money alone and let it earn interest. If the money is truly needed, it can be tapped into in a true emergency, or the CD can be pledged to get a good interest rate on a personal loan.

Regardless of your financial situation, now is the time to look into a certificate of deposit.