

How Much Money Do I Need to Live Off of Interest?

Description

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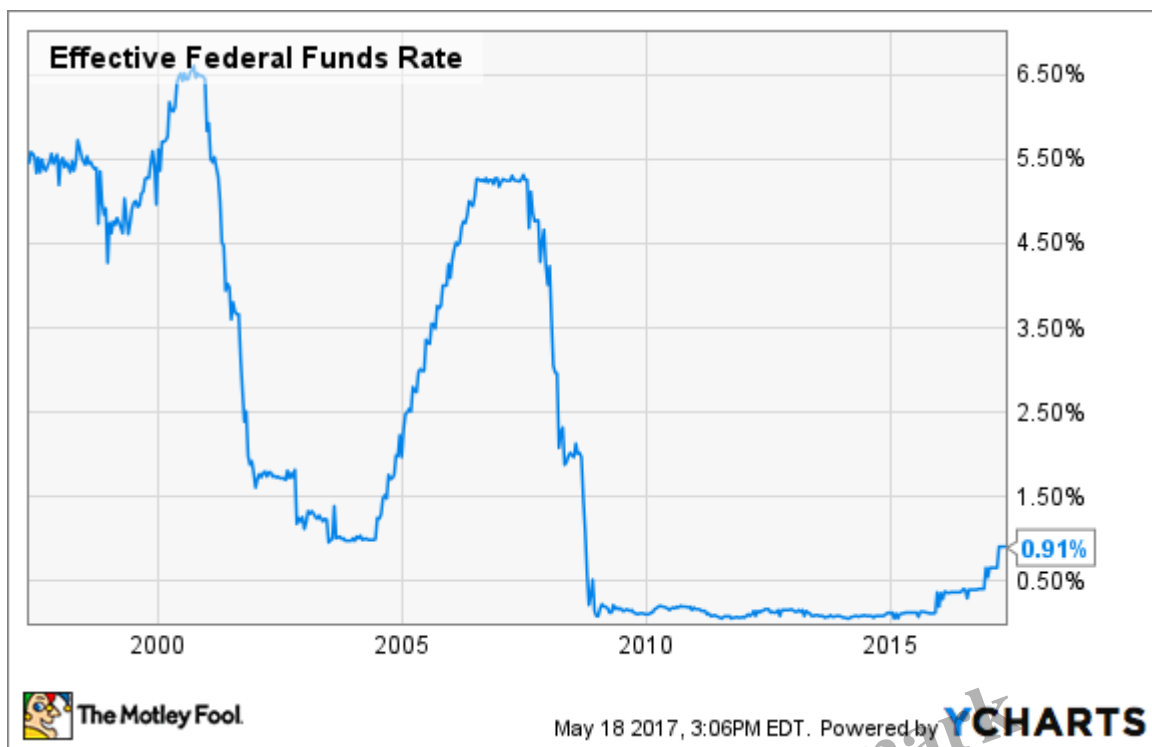
If you have enough money in a savings account, it can be possible to live off the interest. Here's how to determine how much you would need in the bank to do this, how much you can expect to save at your current rate, and another way of building a million-dollar nest egg that could be a better idea.

How much money do you need to live off the interest?

The answer to this question depends on a couple of variables — specifically, how much income you'll need to live comfortably, and what interest rate you're getting on savings.

Having said that, here's a quick (but imperfect) calculation method. Simply take the amount of annual income you want, and divide it by the interest rate you expect to receive, expressed as a decimal. For example, if I need \$40,000 per year to live comfortably, and expect to receive 4% interest on my savings, \$40,000 divided by 0.04 shows that I'll need \$1,000,000 to live off my interest.

As I mentioned, though, this isn't a perfect calculation. Specifically, it doesn't account for inflation — in other words, if you're 30, \$50,000 today will not have nearly the same buying power when you're ready to retire. And it doesn't consider the fact that interest rates fluctuate over time, which can cause your income to fluctuate from year to year. Just take a look at how dramatically the Federal Funds Rate, which is a good predictor of savings account interest rate fluctuations, has changed over the past 20 years.



[EFFECTIVE FEDERAL FUNDS RATE](#) DATA BY [YCHARTS](#).

How much interest will your savings produce?

As long as you understand the limitations of calculating how much money you'll need to live off the interest, it can still be useful to have a long-term savings goal in mind, and to know whether or not you're on track to achieve it.

For example, let's say your income goal is \$50,000, and you expect to earn 4% on your savings. We'll say that you currently have \$100,000 in the bank, and that you're 40 years old. If you're saving at a rate of \$10,000 per year and expect to increase this amount by 2% per year, you can expect to have \$676,145 by the time you're 65.

If you're willing to use some of your principal as well, it's estimated that you'll be able to withdraw an annual income of \$34,496 per year for 30 years. Of course, this gives you the risk of running out of money, but it's a common retirement strategy to withdraw a combination of interest and principal. The often-cited "[4% rule](#)" is a common example.

A better idea than living off of savings account interest

As a final thought, it's generally a bad idea to keep significant sums of money in savings accounts. You can read a thorough discussion of why I say this [here](#), but over time, savings accounts earn such low interest rates that they tend to not even keep up with inflation.

Consider the previous example of a \$100,000 savings balance at age 40, and a savings rate of \$10,000 per year. Instead, let's assume you earn an 8% rate of return, which is actually conservative compared with the stock market's historical performance. In this case, you'd end up with more than \$1.1 million at age 65, and what's more, you could reasonably expect to withdraw \$82,222 per year for 30 years without running out of money, more than double what you could withdraw from a savings account, even assuming an optimistic 4% interest rate.

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