

Reducing Balance Method Explained

In reducing Balance Interest Rate method, interest is calculated every month on the outstanding loan balance as reduced by the principal repayment every month. EMI payment every month contains interest payable for the outstanding loan amount for the month plus principal repayment.

For example, if you take a loan of AED 100,000 with a reducing rate of interest of 8.5% p.a. for 12 years, then your EMI amount would reduce with every repayment. See illustration below.

**Interest paid each month falls as loan balance is reducing**

| Month | EMI   | Interest     | Principal       | Loan Balance    |
|-------|-------|--------------|-----------------|-----------------|
| 0     | -     | -            | -               | <b>1,00,000</b> |
| 1     | 8,722 | 708          | 8,014           | 91,986          |
| 2     | 8,722 | 652          | 8,070           | 83,916          |
| 3     | 8,722 | 594          | 8,128           | 75,788          |
| 4     | 8,722 | 537          | 8,185           | 67,603          |
| 5     | 8,722 | 479          | 8,243           | 59,360          |
| 6     | 8,722 | 420          | 8,302           | 51,059          |
| 7     | 8,722 | 362          | 8,360           | 42,698          |
| 8     | 8,722 | 302          | 8,420           | 34,279          |
| 9     | 8,722 | 243          | 8,479           | 25,800          |
| 10    | 8,722 | 183          | 8,539           | 17,260          |
| 11    | 8,722 | 122          | 8,600           | 8,661           |
| 12    | 8,722 | 61           | 8,661           | 0               |
|       |       | <b>4,664</b> | <b>1,00,000</b> |                 |

$708 = 1000000 \times 8.5\% / 12$   
 $364 = 51509 \times 8.5\% / 12$