

How to Use the Cash Envelope System to Master Your Budget

By [Sarah](#). Updated on September 8, 2020

A cash envelope system can be an effective way to budget for anyone that needs a visual budget to stay on track. Not only will this method help keep your spending in check, but it might also lead to less spending overall. In fact, [studies](#) have shown that spending cash may lead to spending between 15 to 20% less! Although [this budgeting method will not work for everyone](#), it can be a great option for anyone that needs to see exactly where their money is going.



What is the cash envelope system?

The cash envelope system is exactly what it sounds like. You put your cash into different envelopes based on the budget categories. You'll decide exactly what amounts go into each cash envelope based on your spending goals.

For example, you might put \$300 in the grocery budget and \$150 in the fun budget. The key is that you'll only be able to spend the cash out of these envelopes for the specific budget category until the next cycle of your budget.

The categories are only meant to encompass your variable spending. Variable spending are defined as variable because the amount you **spend** may vary each month. Although **variable** costs are quite often discretionary expenses, some may be necessities. Buying gas for your car each month is a **variable** expense, as are car repairs and maintenance. Grocery shopping is also a **variable** expense. This includes things like beauty, household supplies, groceries, and fun. Fixed expenses are those items where the payments are fairly consistent every month. Fixed expenses include such things as your mortgage, cell phone payment, utilities, and car payment. Fixed expenses are budgeted, however they are not meant to be included in your cash envelope budget. You can continue to pay these fixed expenses as you normally would.

How the cash envelope system can transform your finances

With the cash envelope system, you'll be able to easily see how much you are spending in each category. Instead of simply swiping your debit or credit card and forgetting about it, you'll be forced to hand over cash in exchange for your purchase.

The physical action of handing over cash can make you stop to think about exactly how much you are spending in the checkout line. It is a more tangible process to spend cash as opposed to plastic funds. As you spend down the money in each cash envelope, you'll be forced to watch your cash funds dwindle.

Simply seeing where your money is going can be a transformative process. You might be less likely to overspend when you can see your cash flying out of the envelope. For example, you might skip an impulse buy towards the end of your shopping trip because you know that you only have so much money to spend on that category each month. If you have a habit of overspending, then the cash envelope system might be a useful budgeting strategy to try.

How to use the cash envelope system

When you first start to develop your cash system, it is important to remember that every budget is unique. You have the freedom and flexibility to choose your cash amounts for each category.

With that, the amount of cash you place in each envelope is a reflection of your personal values. So it will likely be different than anyone else's. For example, you might put a large portion of your cash into your 'hobby' envelope while others may put a large portion of their cash into a 'pet envelope.' Don't compare yourself to others because you are the person who will need to stick to the budget.

It can feel like a complicated process for the first couple of months. But once you get the hang of it, you might find it infinitely more effective than your previous budgeting methods. The key is to stick to the plan and work out the kinks for the first couple of cycles.

Get a handle on your budget

The first thing you need to do is create your budget. In order to successfully use your cash envelope system, you'll need to do create a successful budget. If you put too much or too little cash into your envelopes, your whole financial life might go haywire.

Step 1: Determine your Net Income

Step 2: Determine your Expenses that are fixed. These are those bills that must be paid monthly to survive and the payment is normally the same every month. These your do not meant to have an envelope

Step 3: Determine your Variable expenses – Track your spending for at least a month, you can separate this spending into categories. Find out how much you have spent in each category.

A few variable expense categories you may want to include are:

- Groceries
- Restaurants
- Gas
- Fun
- Beauty
- Pet
- Vacations
- Clothes
- Hobby
- Anything else that needs to come out of your variable expenses.

After you've determined how much you've spent in each category, make sure that you can actually afford this level of spending. It might surprise you to find out that you've spent more than you've earned in a given month. If you've spent more than you've expected, then the cash envelope system could be the perfect solution. It will force you to think about your spending before you make the purchase.

Step 4. Set limits for each category

Next, you'll need to set spending limits for each of your variable spending categories. Start with what you are able to spend in a given cycle, then take your previous spending into account. Base your spending limits on what you can actually afford, not what you would like to spend in a given category.

If you've consistently spent more than your income, then your new spending limits might seem harsh. However, living within your means is critical to long-term financial wellbeing so it is important to be honest with yourself about this.

If you cannot stick to the spending limits, then it might be time to start thinking about a [flexible side hustle](#) to supplement your income.

Step 5. Fill your envelopes with cash

After you've set your spending limits for each cycle, filling your cash envelopes is the easy part. You can choose to fill your envelopes with each paycheck or once a month. Find a cycle that works best for you and try to stick to it. Make sure to avoid any unnecessary ATM fees while taking out cash.

Once the money is in [designated cash envelopes](#), you'll need to diligently spend out of the appropriate categories. If you have leftover money at the end of a cycle, then you can roll it into the next cycle or put it into your savings.