Is it Bad to Have a $0 Balance on Your Credit Card?

Description

Are you the type of shopper who carries around a credit card but is never inclined to use it? Whether you're buying a cup of coffee or a used car, your first instinct is to whip out your debit card to make the payment or even just plain cash.

Some people are more comfortable with cash instead of credit, and that's perfectly fine. There aren't any rules dictating you MUST use your credit card.

But could it be a bad thing to have a $0 balance on your credit card?

The answer is "maybe." In some cases, maintaining your card balance at $0 can work to your advantage and help get your financial house in order. However, neglecting it for a prolonged period can bring about negative consequences as well. It all depends on your circumstances and financial goals.

When a $0 credit card balance can be a good thing

There are two main reasons why not charging anything to your card can work in your favour:

You're rebuilding your finances

Drastically curbing your credit spending when you're heavily in debt is a reliable way to get your finances back in shape. Sometimes, it requires following a strict budget that permits you only to use cash or a prepaid debit card. Eliminating credit card usage, at least temporarily, may be necessary for financially distressing situations. At the very least, it prevents debt and spending problems from escalating any further.

You wish to lower your credit utilization ratio

Your credit utilization ratio measures the amount of outstanding debt you carry relative to your available credit limit. It's one of the factors that credit bureaus evaluate when they assign your credit score.

The higher your credit-utilization ratio, the more lenders will perceive you as a high-risk borrower, since it signals excessive credit usage. As a result, it will negatively affect your credit score, thus hindering you from qualifying for personal loans, mortgages, lines of credit, etc.

Lowering your credit utilization ratio to a "safer" level (typically below 35%) can improve your credit score. And one way to reach this target is to immediately pay off the balance on one or more of your credit cards. At least in the short run, carrying a zero balance may help repair a tarnished credit score.

When a $0 credit card balance can be a bad thing

Though a $0 credit card balance seems pretty innocuous, it may yield some negative results over the long run.

Your card issuer may lower your credit limit

Suppose you abstain from using your credit card for a considerable length of time. In that case, your card issuer may decide to lower your credit limit, as they assume you do not need the extra spending cushion. This action can result in a couple of unfavourable consequences for you.

Let's say a financial emergency arises, and the situation necessitates you charging a sizable amount to your card. You'll shockingly discover you're unable to process the transaction, as your credit limit is too low.

Your credit score may also take a hit. Suppose your outstanding debt remains the same, but your available credit diminishes. In that case, your credit-utilization ratio will instantly increase, putting downward pressure on your credit score.

Your card issuer may close your account

Should you leave your credit card dormant for an extended period (typically beyond a year), your card issuer may elect to shut down your account entirely. This action will only serve to compound the problems associated with a mere credit limit reduction.

Now you're unable to charge any amount, which could be disastrous during an emergency when you need instant access to credit. And, since your entire credit limit card has evaporated, your credit utilization ratio will rise that much higher, further impairing your credit score.

Losing your account also results in losing any prior credit history you've built up on that card, which is another factor that determines your credit score. That's not good.

You may hurt your credit diversity

By consistently carrying a $0 balance, you also risk damaging your credit mix, which refers to the diversity of loan products you currently utilize or have utilized in the past. Certain lenders like to see borrowers with a credit profile that showcases their ability to handle diverse credit products. A good credit mix includes revolving debt, such as a credit card or line of credit, and secured debt, such as a personal loan or auto loan. Though your credit mix is not a significant aspect of your overall credit score, it still counts under specific circumstances.

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