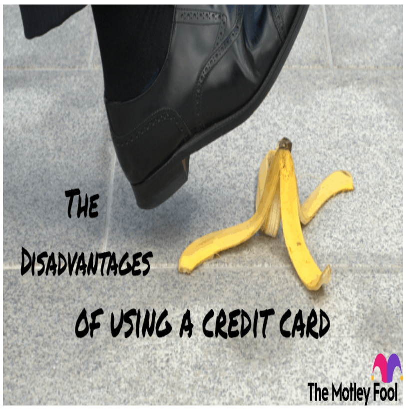

The Disadvantages of Using a Credit Card

Description

Credit cards can be extremely powerful financial tools. Rewards and cashback cards, for instance, can help you earn money while you spend. Secured credit cards can help you rebuild bad credit. And balance transfer cards can make a bad situation — high credit card debt — a little less stressful with low introductory APRs.

But with more power, comes more risks, too. A late payment here, a missed payment there, and you could find yourself accumulating high-interest charges and fees at an alarming rate. So, to help you understand the full power of credit cards, here are some disadvantages to using one.

1. It's easy to rack up charges

The first disadvantage to using a credit card is also one of its most marketed benefits: it's super easy to use. For those who are prudent with money, this may not pose any serious problems. But, if you're already undisciplined, a credit card could make matters worse.

That's because the credit limits on credit cards can easily make you think you have more money than you do. For example, you may have only $500 to spend on non-essentials per month. But when your credit card has a credit limit of $5,000, $10,000, even $20,000, you might be tempted to make a big purchase you can't afford.

2. Interest charges are high

When you rack up charges on your credit card, you risk facing another disadvantage: high-interest rates.

Most credit cards come with annual percentage rates (APRs) that range from 20% to 30%. Your credit card issuer will break this APR into a daily charge and apply it to any unpaid balances. If you carry a balance on your card, you'll begin paying interest on your charges from the day you first made the charge to the day you finally pay it in full.

Of course, credit card interest is easy to avoid. Simply pay your statement balance in full before your statement's due date. When you pay it in full, you benefit from your card's interest-free grace period. Your statement balance will go to zero, and your credit card issuer won't charge you interest.

When you don't pay the balance in full, however, you carry a portion over into the next billing cycle. Your credit card issuer will charge you interest, starting from the day you made the unpaid charge. This interest works like an investment in reverse: on day one, you'll accrue interest on your unpaid charges. On day two, you'll accrue interest on your unpaid charges *plus* the interest you accrued the day before, and so it goes until you finally pay the balance.

This is how people fall ever deeper into credit card debt. The interest charges accumulate, growing larger and larger over time. Interest could get so high, in fact, you may find yourself paying more in interest than the actual charges themselves.

3. Fees can get high

Along with high-interest rates, credit card fees can be another source that drains your hard-earned cash. And we're not talking annual fees either, those one-time payments you make to secure certain luxury credit cards. We're talking about the most frustrating fee of all — the *late* fee.

When you miss a payment, as in you don't pay the minimum payment on your statement balance, your credit card issuer will automatically apply a penalty fee. The fee is usually not expensive — around $20 to $30 — but coupled with the new penalty APR, you could easily feel like you're throwing money out the window.

In addition to late fees, credit cards can come with a slew of other fees, too: balance transfer fees, cash advance fees, and foreign exchange fees.

4. You could hurt your credit score

Credit cards are an effective way to build credit. They could also damage your score in a short period of time.

One quick way to hurt your score is to be more than 30 days late on a payment. After 30 days, your credit card issuer will report the late payment to credit bureaus, who will then dock your score. Considering that payment history makes up 35% of your score, missing just one credit card payment could easily have an adverse effect.

Another way to hurt your score is to use too much of your credit limits. While, yes, credit limits tell you how much you could borrow, that doesn't mean you should borrow the maximum. Doing so will raise your credit utilization ratio, which rates you on how much credit you're using versus how much credit card issuers have extended.

In general, a credit utilization ratio of 30% or lower is considered safe. Anything above that could start to hurt your score.

5. Credit card fraud

Finally, credit cards come with the possibility of someone stealing your identity and making fraudulent charges. Fortunately, most credit card companies offer zero-liability fraud protection. Under this perk, you won't pay for fraudulent charges (at most, you could pay $50). The only real disadvantage is the time it takes to report the fraud, receive a new card, and create a new PIN or password.

Credit card disadvantages depend on your habits

At the end of the day, credit cards are neither good nor bad. The advantages (or disadvantages) depend on how you use them. If you pay your balance in full and on time every month, a credit card won't hurt your finances and could in fact help them. You'll build credit, and you may earn rewards or cashback on purchases. If you carry balances on your card, however, you'll start accumulating interest charges, which can drag your budget and finances down.

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