

The Confusing World Of Credit Cards

With the wide choice in credit cards, how reliable is it to use the published interest rate as a comparison tool?

Here we discuss a report that reveals just how misleading those rates can be.

Credit card debt rose to \$38 billion in November from \$37.3 billion a month earlier, according to the latest figures from the Reserve Bank of Australia (RBA).

Looked at another way the average credit card balance rose to a record \$2,868, up from \$2,821 in October.

And with Christmas, the January sales and annual holiday spending to be reported in the next couple of months, that figure is expected to continue.

Whilst some commentators believe that that these numbers reflect strong consumer sentiment fuelled by a tight labour market, others believe that increasing home loan repayments are also encouraging some people to use their credit cards to maintain their lifestyle, particular over the expensive summer months.

It is timely, then, that Choice (the Australian Consumers Association) has just released a report entitled "Credit Card Tricks". In the report they compare a range of credit cards from most of the major providers, and come up with some surprising findings.

Interest Rates

The range of published interest rates varies widely: Cannex currently lists interest rates from 7.72% to 18.99%.

But of course these rates can't be viewed in isolation. Other items such as annual fees and interest free days need to be taken into account when comparing cards.

Surprisingly, though, the report shows that a critical aspect of the comparison is the lender's policy on how they apply interest.

Calculating Interest

There are more than 10 methods for calculating the amount of interest due for a credit card's outstanding balance! For example:

- A “fairer” card only applies interest to the net amount that is unpaid by the due date, giving you credit for partial repayments. Not so for a “meaner” card that still charges you interest on the entire amount.
- Interest can either be charged from the date the new statement was produced or it can be charged back to the original purchase date.
- An interest-free period for new purchases may not be granted if you’re carrying an unpaid debt from the previous month.

What this means is that the published interest rate of a credit card cannot be relied on as an accurate representation of how much interest is really paid.

An Example

To illustrate how significant these different policies can be, let’s examine the example that Choice gives.

Take a consumer who makes two purchases of \$1,000 and \$500 and a repayment of \$300 in November, and then pays the remaining balance off in December.

Applying the various cards’ rates and policies they show that a card advertising a 10.24% rate actually charges more interest (\$18.99) than a card advertising a 17.50% rate (\$17.60).

Other Tricks

There are also some other “tricks” that end up costing you more money than you thought:

- Interest on interest. Some cards will charge you interest on the interest you already owe,
- Balance transfers. Whilst these can dramatically reduce your interest bill, late payment fees still apply, plus any new purchases on the card will be charged at a higher rate. Further, any repayments made will normally reduce the low rated balance transfer debt first.
- Cash Advances. These are normally charged from the date of withdrawal, and additional fees may also apply.

- Fees. According to the RBA, the amount of credit card fees that consumers pay to banks has been increasing significantly over recent years – for example it increased by 18% in 2005 (and by 39% in 2003)! These fees include the annual fees plus penalty fees for being over the limit, dishonouring a transaction or making a late payment.

Choosing The Right Card

Selecting the right card for you really comes down to your spending and repayment patterns:

- Do you always pay your bill on time, or are you occasionally late?
- Do you always pay your card balance in full, or do you always have an outstanding balance?

Your answers to these questions will determine which card is the best one for you. Tools such as Choice’s “compare-a-credit card” or Cannex’s star ratings can then help you to find the best card for your needs.

And of course, don’t forget that you may have access to cheaper credit by using any available redraw or line of credit on your home loan.

Sources

1. Choice Report – Test: Credit Card Tricks – January 2007
2. Cannex web-site www.cannex.com.au
3. Credit Card Bills Rise In November - The Age - January 18, 2007
4. Rewards at a high price - Adelaide Advertiser - January 15, 2007

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