Credit

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Credit is a very useful tool for both consumers and businesses. It allows people to borrow specified amounts of money for a limited amount of time. Credit availability is important to an economy because it allows people or firms to finance large purchases without having to save money upfront. But with credit comes a responsibility to use it wisely. Bad credit decisions can have a significant impact on our financial health. When we use credit, part of the agreement we enter into is to pay interest on the money borrowed until the loan is paid off. This means that when we use credit to purchase a car, we end up paying more for the car than the sticker price says. How much more depends on the interest rate and the amount of time it takes to pay off the loan.

When deciding whether to use credit, first consider if what you intend to purchase will be a good economic decision. For instance, using credit in the form of school loans to pay for your education will allow you to have a higher standard of living after you graduate. Using credit in this case is a wise decision because paying for your education yourself may not be possible and the future returns will be significant. However, eating fast food for every meal while in school and charging it to a credit card leaves you with nothing tangible and an expensive credit card bill at the end of the month. If you don't pay off your credit card at the end of every month, using credit in this case would be an unwise decision.

Credit cards are instant credit, as opposed to installment loans. Generally, credit cards have a higher interest rate than installment loans from a bank. You pay higher interest rates for the convenience of instant access to money in the form of a credit card loan. To obtain a bank loan, there are application and approval processes, which can take time. However, these loans have lower interest rates. When buying a durable good, such as a car or a house, obtaining a loan from a bank can make more sense. Since a loan for a car can take as long as six years to pay off, paying a lower interest rate can save thousands of dollars. However, if you need a new washer and dryer, you can go directly to the store and buy a new one the same day using a credit card. In each case, using credit was a wise decision because both items purchased will provide considerable convenience, especially if you pay them off quickly.

Credit card balances that are paid off during the short grace period are interest-free. Also, they are both durable goods, which means they will be around long after you finish paying them off. Just remember that the interest paid to purchase these items increases the cost of the items, so it is wise to pay them off quickly.

Many people use credit cards to pay for daily living expenses as well. Daily living expenses are things such as groceries, gas, and restaurant meals. These expenses are called consumable goods because they are consumed relatively quickly. If you use a credit card for consumable goods, it is very important to pay this amount at the end of the month.

One of the biggest mistakes made is only making the minimum payment required. Making only the minimum payment increases the cost of goods you've purchased through finance charges. Essentially, the price of groceries, gas, and restaurant meals will continue to increase, and you will end up paying for something that you consumed almost immediately for months or years to come.