

How Does Credit Work?

A credit card can be convenient and helpful. Used wisely, it can help you become conscious of what you spend. It can help you establish a credit rating, and demonstrate a record of sound financial planning.

Used unwisely, the amount of money that you spend on credit can add up quickly and leave you in financial troubles that are hard to surmount. A little knowledge about how credit cards work can prevent you from falling into a credit crisis, or can help you out if you are already in one.

Most credit card companies calculate your payment due by using an average daily balance. This number is determined by adding each day's balance, or amount that you owe to date from purchases, and then dividing that total by the number of days in a billing cycle. The average daily balance is then multiplied by your card's monthly periodic rate, which is calculated by dividing the annual percentage rate (APR) by 12.

A card with an annual percentage rate, or yearly rate of interest that includes fees and costs paid to acquire the loan, of 18 percent would have a monthly periodic rate of 1.5 percent. If that card had a \$500 average daily balance it would yield a monthly finance charge of \$7.50.

Many credit card companies do not require you to pay off all of your balance at the end of each month. Rather they will require a minimum payment for you, which is typically two percent of your account balance.

Paying off minimum monthly balances will not get you very far in paying off your credit. In most cases, you will be simply paying off a portion of the interest that you owe, and not even touching your principle-or the money that you actually spent on your purchase.

So what does this mean to you? Paying only the minimum payment will leave you in debt for a long time. Credit card companies know this, and they make a great deal of their money on people who only make minimum payments. The amount of money that you can save by paying off your credit cards can be enormous. There are many resources available on the Internet to help you calculate what you owe, and to help you set up a schedule for effectively, and efficiently paying off your debt. Many of these sites also provide information on how credit cards and loans work, and where you can go to find help if you need it.

For online credit calculators, as well as more information on credit cards and ways to manage your finances, visit the following websites:

Bankrate.com:

http://www.bankrate.com/brm/rate/cc_home.asp?nav=left_nav_credit_cards

Cardweb.com

<http://www.cardweb.com/cardtrak/>

Kiplinger.com

www.kiplinger.com/tools