How to escape the ‘Credit Card’ debt trap

According to the Australian Securities and Investment Commission (ASIC), Australians owe a total of $45 billion in credit card debt, and about half of us continue to make low repayments and remain in debt month after month.[1]

Did you know that a $2,000 credit card debt would take 17 years to repay if you only pay the minimum repayment?[2]

Having debts that are out of control can be stressful and overwhelming. If you find yourself in this situation it can be reassuring to know that there are some steps you can take to escape the debt trap.

How to reduce credit card debt

Although credit cards are an easy and convenient way of paying for goods and services they can be risky and expensive. It can be tempting to use credit cards for impulse purchases or to buy things you may have otherwise avoided if you had to save in advance. If you find yourself struggling with credit card debt, here are some strategies may help in paying it down.

Pay off a small balance to get started. It can feel quite rewarding to clear a small debt and this may provide you with further encouragement to clear other debts.

Prioritise high interest rate debt first. If you have several credit cards pay down the card with the highest interest rate first, while making the minimum monthly repayment amount on the others. This will limit the overall impact of compound interest and reduce the growth of the debt. Once you have paid off the card with highest interest rate, move on to the card with the next highest interest rate, adding the cash repayment from the first and so on.

Pay more than the minimum monthly repayment. If you can’t afford to pay off your entire monthly credit card balance, try paying more than the minimum monthly repayment amount. This will help to reduce the amount of interest charged.

Consolidate high interest debt onto a low interest rate card. Many credit card providers offer a 12-month interest-free period when you transfer an existing credit card debt. Take advantage of this interest-free period to focus on paying down the outstanding balance, although be wary of the interest rate charges that apply after the interest-free period expires.

Set up an automatic payment. Setting up an automatic payment can help you to avoid late payment penalties.

If you find that you are struggling to stay on top of your credit card repayments there are other options that may assist. One option to consider is debt consolidation.

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[1] ASIC Credit card lending in Australia report July 2018
[2] Based on average credit card interest rates of 17 per cent. Source ABC News, based on Canstar data

Debt Consolidation

The option of rolling your existing credit card debt into a single loan can be an effective way to get your credit card debt under control.

There are however a number of things that need to be considered before doing so. Debt consolidation often involves cancelling your credit cards and moving the credit card debt into a low-interest debt consolidation loan. The interest rate on the new loan needs to be lower than the credit card interest rate otherwise you aren't going to make any progress reducing the outstanding debt.

The aim here is to focus on eliminating your debt and refraining from using credit cards in the future. However make sure you check the terms and conditions of the loan carefully. For example, you need to be able to service the loan, so the new repayments need to be affordable.

As with any lending arrangement, make sure you do your research carefully and explore all your options before making a decision.

Source: Capstone Financial Planning