How to Owe $40,000 by Doing Nothing

The Motley Fool
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A few months ago, I wrote a short article highlighting just how high some credit card interest rates are. The rates were so high that I have had trouble getting them out of my head. Permit me to quote myself:

"With interest rates in general on the rise, so are the punitive rates that card companies charge. According to the folks at the Coalition for Responsible Credit Practices and CardWeb.com, 'Starting (in October), punitive interest rates, among the top ten issuers, will range from 24.65% to 30.74%. Across the entire U.S. credit card market, penalty interest rates will range from none to 41.00%.' They add: 'CompuCredit, an Atlanta-based issuer of Aspire VISA card, charges an interest rate of prime +36.25% with a 41.00% minimum, to its most risky cardholders who become delinquent."

Can you imagine that? Some folks out there are carrying credit card debt that is growing at 40% per year! This made me wonder what such a situation really looks like — so let's see. Imagine that you owe a mere $8,000, which happens to be less than the average household with credit card debt. And imagine that you're being charged 2.8% per month, which will amount to close to 40% in one year:

Yowza. If you're not paying down this debt, it will advance by more than $3,000 in a single year. Will that $3,000 have bought you a large-screen TV? Nope. Will it have bought you a serviceable car? Not at all. You'll have little to show for it except that it will generate more debt.

Leave that $11,143 growing at 40% per year, and these are some numbers you may see in the years ahead: January 2006 $11,143 January 2007 $15,600 January 2008 $21,840 January 2009 $30,576 January 2010 $42,806

Yup, your debt, without your charging a single penny more to it, could grow by more than $30,000 in just a few years. Can you see bankruptcy looming? This is how it happens to many people.

Of course, minimum monthly payments are required, and they'll reduce these numbers somewhat — but not by a lot. They're not designed to help you dig out of debt. Fortunately, your friends here at the Fool are interested in helping you dig out of debt. And if you're mired in credit card debt, as millions are, don't despair — click over to our Credit Center, where we offer much guidance on getting out of debt. Start hanging out on our Consumer Credit / Credit Cards discussion board, too, where you'll regularly hear from folks like you who are successfully paying off tens of thousands of dollars of credit card debt. Really and truly.

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Some more examples

Perhaps you're not scared yet about the possible interest rates you may be charged on your card(s). Maybe you think the scary rates I mentioned are just charged by obscure firms you never deal with. If so, know that as of October 2004, these were the top penalty rates for some major card issuers, at least one of which has probably issued that card in your wallet: **Citigroup** (NYSE: C) 28.74%; **MBNA** (NYSE: KRB), 24.99%; **J. P. Morgan Chase** (NYSE: JPM), 26.74%; **Morgan Stanley's** (NYSE: MWD) Discover, 24.99%; Capital One (NYSE: COF), 25.9%; and **American Express** (NYSE: AXP), 26.74%.

Let's look at the most modest rate above, which is essentially 25% per year. Here's how $5,000 in debt will grow, at 25% per year: 2005 $5,000 2006 $6,250 2007 $7,812 2008 $9,766 2009 $12,207 2010 $15,259

It's still pretty scary. Leave your debt unattended for just five years, and it will triple in value. Are you gaining any understanding of just how profitable business has been for many credit-card issuers?

Making matters worse

I know it may seem like I'm painting unlikely pictures here, but in many ways I'm not. Consider these factors: Even if you've got a decent credit profile now and aren't charged exorbitant interest rates, that could change quickly. Card issuers have been raising rates for all kinds of seemingly unreasonable reasons — such as if you're late with a payment to another card, or even if you're late paying your mortgage or a utility bill. That's right — pay Card A late, and Card B may hike your rates.

Life isn't fair. You may have $5,000 in credit card debt and be able to gradually pay it off, but if your car suddenly dies and you charge another $3,000 on your card, your situation has just gotten much more precarious. Unexpected expenses often rear their ugly heads, which is why it's always best to live as far from the edge as possible. Learn about how to sock away short-term savings for just such events, and follow lively discussions on our Living Below Your Means discussion board.

If you're enjoying relatively low rates right now, know that in general, interest rates are rising these days and are expected to keep doing so. Many credit cards have variable interest rates, which means that you can expect to see your rates increase regardless of how good a fiscal citizen you are.

Take action!

So what should you do? Well, if you don't carry credit card debt, good for you — please remember that now is not a good time to start doing so. (By the way, if you're looking for a spiffy new card with good terms, check out our colorful Fool cards.) If you do have debt, work hard to pay it off, and let us help you, if you'd like.

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Get savvy about the credit card industry, too. You can learn all kinds of eye-opening things in our Credit Center. And in these articles, too:

The Ravages of Plastic; Living on Borrowed Dimes; Credit Counseling Crisis

Selena Maranjian's favorite discussion boards include Book Club, The Eclectic Library and Card & Board Games. She owns no shares of any companies mentioned in this article. For more about Selena, view her bio and her profile. You might also be interested in these books she has written or co-written: The Motley Fool Money Guide and The Motley Fool Investment Guide for Teens. The Motley Fool is Fools writing for Fools.