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BORROWING

Beware of the interest-free trap

Zero per cent credit cards are a great way of getting a cheap loan, but you need to manage them carefully



People on zero interest end up with more debt because there's no rush to repay
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There's no such thing as free money, yet many people think otherwise when it comes to zero per cent credit cards. What may seem like an enticingly good deal can easily land you in more debt. This week banking executives said that the cards were a ticking time bomb, not only for borrowers, but lenders too.

Analysts fear that a growing culture of "buy now, pay later" is perpetuating bad spending habits. Statistics from the Bank of England show there has been a dramatic rise in borrowing on credit cards, and it shows no sign of slowing down.

Consumer demand is particularly high for balance transfers to zero per cent credit cards. According to the British Bankers' Association, there were 609,000 transactions totalling £1.34 billion in March. Andrew Hagger, a personal finance analyst and the founder of Money Comms, the financial analysis group, says: "Although these zero per cent deals are popular, you have to wonder how many people are simply treading water with a balance they are struggling to make real inroads into."

What are the risks?

Interest-free credit cards are often not conducive to financial wellbeing, says Antony Elliott, the chief executive of the Fairbanking Foundation.

"Many customers end up with more debt because there is no incentive to repay, and they can easily be caught out by not being able to transfer the balance to another product at the end of the interest-free period," he says. "There are also traps in that if a payment is missed, or a limit exceeded, the zero per cent interest phase ends immediately."

Lenders are offering increasingly competitive deals to attract customers, with interest-free periods getting longer. At the turn of the year a zero per cent balance transfer term of 43 months was available from MBNA and Halifax. MBNA is still offering the deal and Sainsbury's and Nuba offer 42-month terms, with Virgin and Halifax offering 41 months.

Similarly, many card providers allow interest-free purchases for at least 20 months, with AA and Halifax offering up to 30 months. "There are hundreds of credit cards with eye-catching zero per cent deals on purchases and balance transfers for a significant amount of time," says Charlotte Nelson of Moneyfacts, the financial data analyst.

"If used correctly, they can be money savers. However, if a borrower fails to pay off the balance before the deal ends they can end up with high charges on the remaining debt," she adds.

One late payment during the zero per cent promotional period can result in your interest rate being raised immediately to 18 or 19 per cent APR. (The average credit card APR is 22.6 per cent, according to Moneyfacts.)

Low-rate credit cards may not grab your attention, but they are a good alternative, says Ms Nelson, because even though there is a rate to pay, it is consistent.

How to borrow responsibly

To take advantage of interest-free credit cards, you need to be financially disciplined.

Zero per cent balance transfer cards can be used to consolidate debt and spread out payments, but consumers should be aware of the high “go to” rates that they face on any debt carried beyond the introductory period, says Kevin Mountford, a banking expert at Moneysupermarket.

“The best thing to do is to divide the debt into the number of zero per cent months and set up a direct debit to pay this each month.

“It’s also worth noting that there may not be a ready-made option after the introductory period, so don’t count on being able to move the outstanding debt easily on to another zero per cent offer.”

Too many people get caught out by trying to shift from deal to deal, and applying for credit cards frequently can damage your credit score.

The key to the best deal is the balance transfer fee — the lower the better. With cards offering zero interest on purchases, there is no one-off fee, so you should consider three factors for distinguishing the best deal: the reward or cashback scheme, the maximum interest-free days, and the “revert to” interest rate that kicks in once the promotional offer ends.