

MONEY MOVES:

The Basics of Credit



What is Credit?

Throughout life, you will have important financial milestones like buying a house or a buying car. These are large purchases, and most of the time, people do not have enough cash available to cover the full price.

This is where “credit” comes in: allowing people to pay for large purchases over time, rather than all at once.



How Does Credit Work?

There is a difference between paying with cash or credit:

1

Cash



When you pay with cash, you spend only the money you have at the time of your purchase.

2

Credit



When you use credit, you are required to pay back the amount, and possibly extra, at a later date.

Credit is used to describe borrowed money that you can use and then pay back.

Credit is a Real-World IOU

Imagine that Joe wants to buy a new bike for summer, but he has not saved up enough money yet. He asks his parents if he can borrow money from them to buy the bike, promising to pay them back when he earns enough money from his summer job. Joe buys the bike with his parents' money.

Joe's parents have given him credit to make the purchase, and then Joe will pay back the loan by an agreed-upon date.



Where Do You Get Credit?

Some of the places that can give you credit are banks and credit card companies.

When making a milestone purchase, like buying a house or car, people can get credit from a bank to help them pay for the big expense upfront.

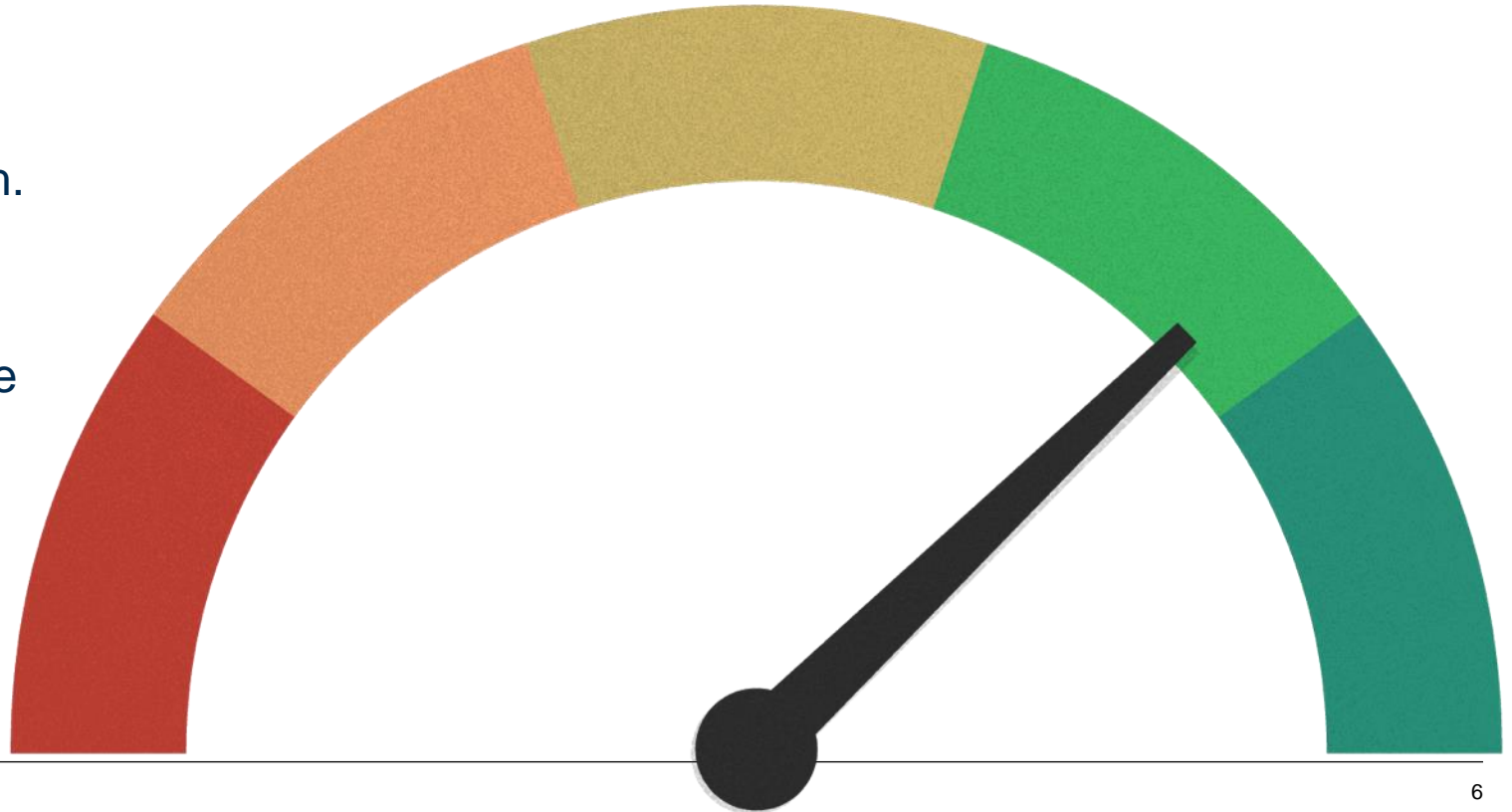
When you use a credit card to buy something, you're purchasing that item with credit given to you by the credit card company. Instead of paying for it with your own money, the credit card company pays for your purchase, trusting that you will then pay them back at the end of the month.



Creditworthy, the Ultimate Complement

The people or businesses offering credit are taking a risk by lending you money, so they want to make sure you are “creditworthy.”

To be “creditworthy” means that when you agree to pay someone back, you treat that agreement as a promise and follow through. Being creditworthy is a very important part of being financially responsible. Paying back what you owe, on time, shows you are trustworthy when it comes to money.



A Card is Born



Did you know??

The first credit card was created by Frank McNamara, who had forgotten his wallet while at a restaurant in New York City in 1949. He came up with the idea for the “Diners Club” card, allowing members to show a card at a restaurant instead of paying for their meal with cash. The restaurant would then charge the Diners Club, and the Diners Club would send the customer a bill at the end of every month with all the meal charges they owed.¹



[1] NerdWallet. What the First Credit Cards Were Like, December 17, 2024. Available at <https://www.nerdwallet.com/article/credit-cards/first-credit-cards>.

Types of Cards

Credit Cards

When you use a credit card, you are spending the credit card company's money.

At the end of the month, they add up all the purchases you made on the card and send you a bill for the amount you owe them.

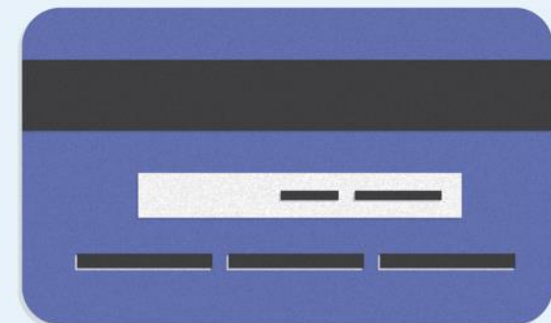
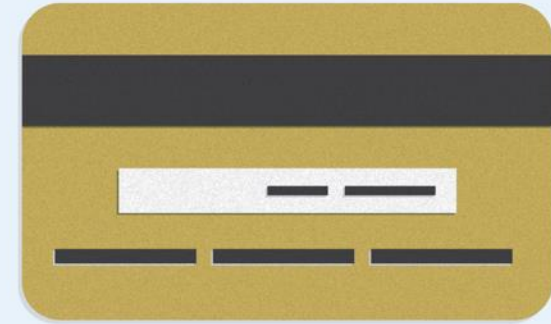
You have the option to pay back the full amount, or only a portion of what you spent. However, if you don't pay back all the money, you will be charged extra money.

Debit Cards

When you use a debit card, you are spending money directly from your bank account.

Since the card is linked to your account, you cannot spend more money that you have saved in your account.

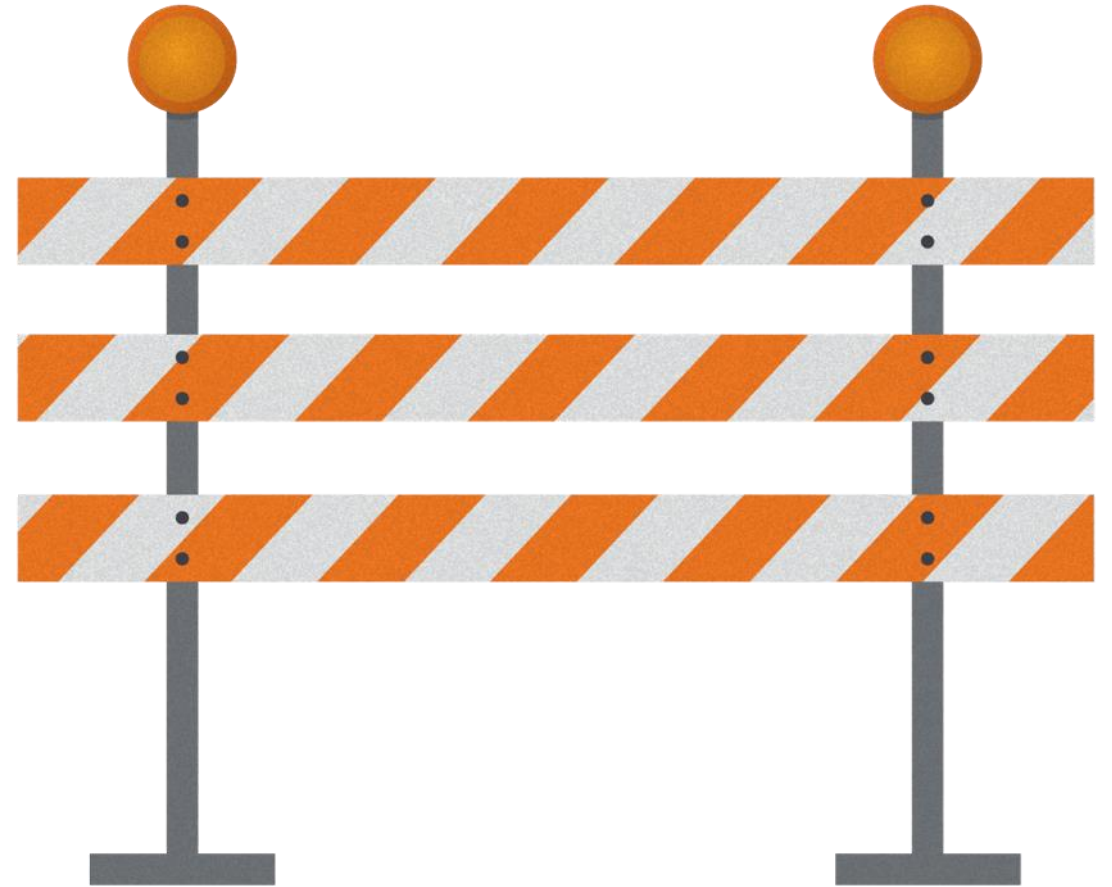
Debit cards can also be used to get cash from your account by using an ATM machine.



Make it a Habit — Treat Your Cards with Care

Cards allow you the convenience of spending money without having to carry cash. However, the easier money is to spend, the easier it can be to lose track of.

Since cards can get lost and potentially used by someone else, they should be treated with just as much caution as money in your wallet.



Going into Debt

Credit cards and debit cards can be very convenient by allowing you to pay with a simple “swipe” or “tap.” Since credit cards may allow you to borrow more money that you are able to pay back, it can be easy to overspend.

Owing more money than you have is considered being in “debt”.



The Cost of Credit

When you get a credit card bill, you can either pay back the full balance (the responsible thing to do!) or you have the option to pay back only part of it.

Credit cards give you a minimum amount that they require you to pay back each month but allow you to keep the rest of the balance on the card if you'd rather pay it back later.

Here is the catch: any money that you do not pay back in full is left as an outstanding balance on your card and you will be charged extra for that outstanding balance the following month!

The Dangers of Credit Card Debt

When you choose to keep a balance on a credit card (instead of paying the full amount), the buildup of money that you owe is called **credit card debt**, which can be very dangerous.



This is because of INTEREST.

Remember how compound interest helps your savings grow over time? **Credit card companies can use the same principle of compounding, except with money you owe.**

Interest Can Build Up Quickly

Imagine that you owe \$1,000 on a credit card that has a 12% annual interest rate that is compounded monthly. For ease of example, let's say that you would incur a 1% interest charge per month.



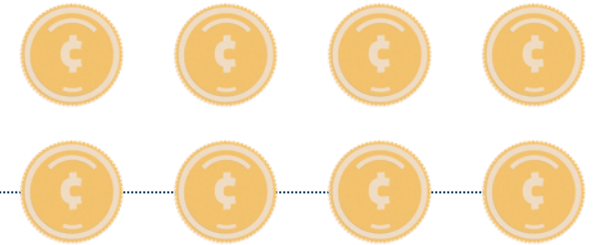
Your bill arrives after the first month, and instead of paying back the \$1,000 in full, you only pay back \$100. You leave the other \$900 you owe on the card balance.



The next month you will owe \$909 ($\$900 + (1\% \text{ interest} \times 900) = \909). So even though you paid back \$100, the amount you owe keeps increasing due to interest.



If you only pay back \$100 the following month (toward the \$909), you would then owe \$817.09 ($\$909 + (1\% \times \$909)$). So while you have paid back \$200 over two months, you have also been charged additional interest of over \$17.



Now imagine that you continue to spend money on that card, while still only paying back a portion of what you owe every month; you can see how your credit card balance can climb significantly and quickly when you add on interest.

Watch Out For Fees

In addition to interest, there are a variety of other fees and charges associated with credit and debit cards:

Penalty Fees

Some credit cards may charge a penalty fee if your payment is late or only partially paid off.

ATM Fees

Many debit cards have restrictions on which ATM machines you can use for free, charging you a fee for using a machine that is not part of their network.

Overdraft Fees

If you try to withdraw more money from an ATM than you have in your account, you'll be charged an overdraft fee.



Example:

If you only have \$2 left in your bank account, and you try to buy a \$3 drink, the bank could charge you a \$35 overdraft fee. Suddenly your \$3 purchase just cost you \$38 dollars.

Make it a Habit — Avoid Racking Up Fees

To steer clear of additional fees, make sure you:

1

Pay Bills in Full and On Time

2

**Use ATMs Associated
with Your Bank**

3

**Keep Track of How Much Money
is in Your Account**

Store Cards

You may have heard someone at the register of a retail store offer 15% off for people who sign up for the store's credit card. Or you may have seen credit card offers arrive in the mail from airlines.

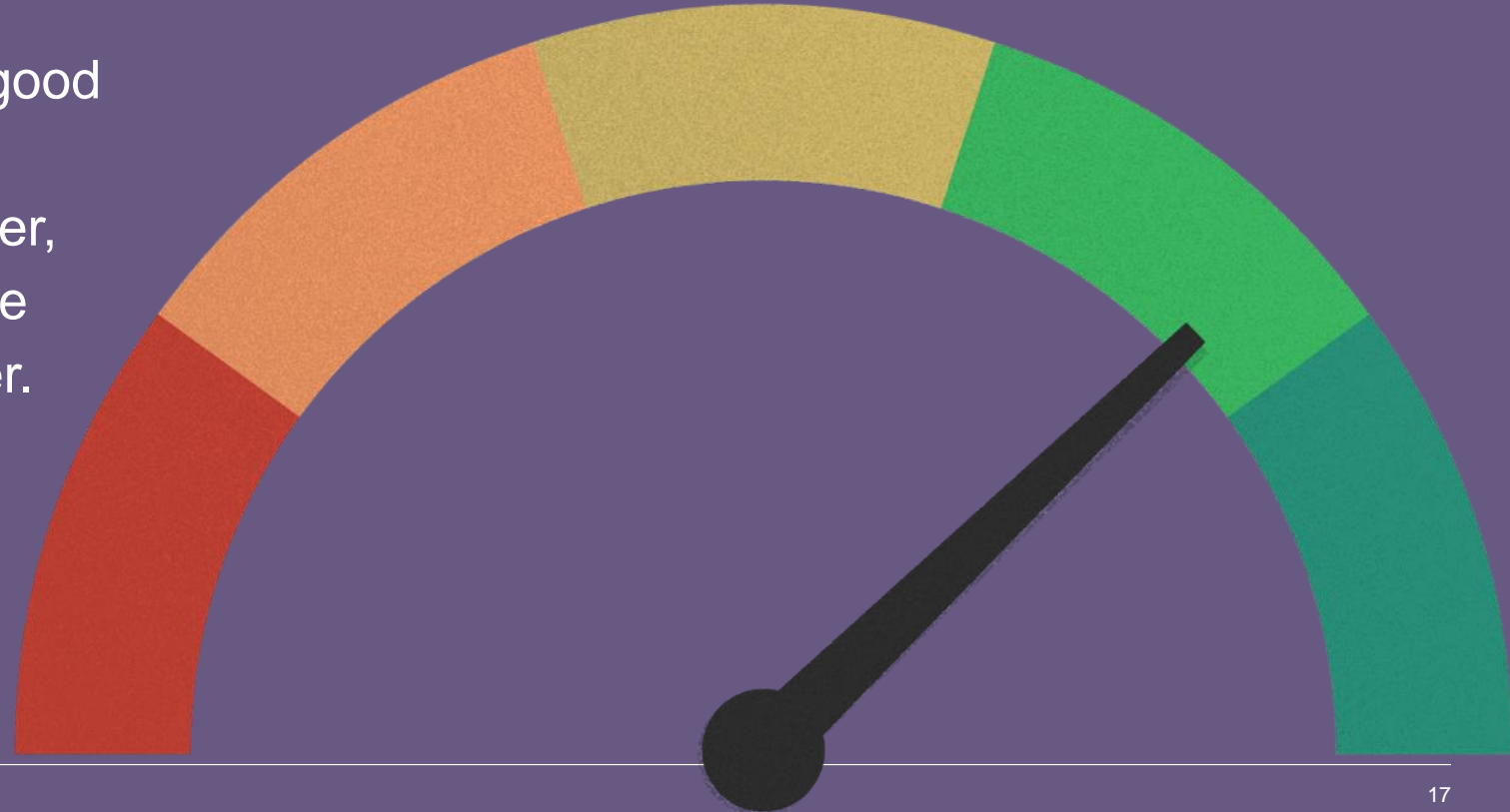
These cards offer perks when it comes to using them with that particular brand, such as discounts on store purchases or bonus miles for booking flights. But remember that nothing comes free! These cards make it easy for people to sign up, but they can also have consequences, such as high fees, if not used responsibly.



Establishing a Track Record

As you get older, your track record for paying things on time, or “credit history”, is shown by a credit score.

Consider it your financial report card. A good credit score helps position you as “creditworthy” and a responsible customer, whereas someone with a low credit score may be considered a “high risk” borrower.



When Does Your Credit Matter?

Your “creditworthiness” can be measured by your credit score.

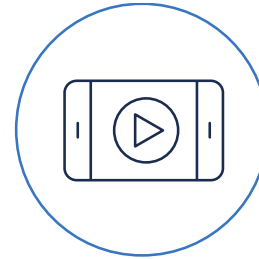
There are many points in your life when you will be asked about your credit score, including:



BUYING A HOME



BUYING A CAR



**SIGNING UP
WITH A NEW
INTERNET
PROVIDER**

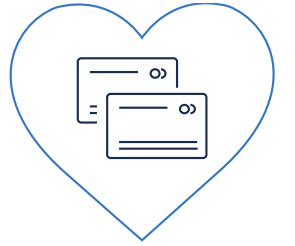


**GETTING A LOAN
FROM THE BANK**



**OPENING UP A
CREDIT CARD**

Caring For Your Credit



Here are some tips to keep your credit in good shape:

1

Pay on Time!

Paying your bills on time has the greatest impact on your credit. Every time you pay your credit card balance or repay a loan, it is reported and counts toward your credit score.

2

Automate Payments

Set up automatic payments for your credit cards to avoid being penalized for late payments

3

Open & Close Cards with Caution

Avoid applying for several credit cards at once, as multiple inquiries within a short amount of time can suggest that you might be “high risk,” which may have a negative impact on your score. Canceling a card may also impact your credit, even if you have no balance on the card.

Disclosures

This material has been prepared for educational and informational purposes only and is not an offer to buy or sell or a solicitation of any offer to buy or sell any security or other financial instrument or to participate in any trading strategy. Past performance is not necessarily a guide to future performance. This material should not be viewed as advice or recommendations with respect to credit or any particular credit strategy.

© 2025 Morgan Stanley Smith Barney LLC. Member SIPC. CRC 4327680 03/25