Personal Loan vs Credit Card: Making the Choice

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One of the most common dilemmas for borrowers is whether to go for a personal loan or just use their credit card in filling their financial needs. While both options are viable, a decision must be made depending on individual circumstances. However, the general rule of thumb is, the lower the interest you pay, the better. In order to put us in a better perspective, let us start by comparing the two, mainly on their differences.

Difference between personal loan and credit card

Personal loans and credit cards are both types of credit provided by financial institutions. They can be for similar amounts, but personal loans are for a specific timeframe, whereas credit cards are a continuous line of credit. Personal loans are available for terms of between one and seven years and they provide you the entire loan amount at the beginning of the term. You then make regular fixed payments to repay the loan in full.

On the other hand, credit cards do not come with similar specified loan periods . You are offered a credit limit and required to make ongoing repayments. You can continually spend up to the that limit as needed. You are however required each month to repay a minimum percentage of whatever you spend.

Credit cards and personal loans are similar in structure. They are both forms of credit and they both require a minimum monthly repayment. The difference are the features and fees. Credit cards offer interest-free days, balance transfers and rewards but personal loans are more suitable for debt consolidation, longer term purposes and have a maximum loan term so the debt is always repaid via predictable monthly payments. While annual fees and payment fees are common with credit cards, personal loans typically have application and monthly services fees.

Which is right for you?

Now that we are aware of the main differences between the two, we can move on with identifying which product is likely to best meet your needs . As mentioned earlier, there is no absolute answer to this question. Choosing the right product depends mostly on individual circumstances. Nevertheless, the items below should serve as a guide in coming to a decision.

- **Reason for the need of funds.** If you need money immediately to pay for a once-off 'lumpy/larger' purchase, then a personal loan might be right for you. If you want a continuous access to credit with an "on-demand" kind of payment facility, then a credit card is probably more suitable.
- **Plan on repaying the debt**. Credit cards are an ongoing form of credit while personal loans have an end date. If you think both are viable options for you, then you might want to consider how disciplined you are in making repayments. Personal loans force you to pay a certain amount on a regular basis and make sure you will repay the full amount by the end of an agreed period. A credit card, on the other hand, gives you more flexibility in repayments which in turn requires more self discipline.
- **Are you consolidating debt**? How much debt do you have including loans and credit card accounts? Make sure you will be able to consolidate everything – only some providers allow you to balance transfer loans to a credit card. You can also consolidate your credit card to a personal loan, which may help you save money.
- **Amount you want to borrow.** Credit card and personal loan limits differ from lender to lender. Normally, you will have access to a higher loan limit with personal loans. There are times that credit cards provide high credit limits but this will also mean stricter eligibility criteria. The amount of money you can borrow also depends on your credit rating.

Things to consider when deciding between personal loan and credit cards

- **Interest and comparison rates.** Generally personal loans have lower interest rates and the scheduled repayments include both principal and interest payments which reduce the loan balance. The real overall cost for comparison is best seen using the 'comparison rate' as you need to also consider any application or service fees as part of any comparison. Credit cards, on the other hand, don't display the comparison rate so when comparing you should include the annual card fee in your calculations and the different interest rates that apply for cash advances from the credit card and purchases (the differences can be as high as 4%).
- **Fees.** Personal loans may have an application and service fee, whereas credit cards usually just have the annual fee but noting that sometimes, there isn't any.
- **Your financial situation.** If you are a disciplined spender and you are able to pay the balance of your credit card completely during the interest free period and stick to your budget, then a credit card is probably better for you. Personal loans may also charge you an early repayment fee depending on your lender if you choose to repay early but a personal loan does give the predictability of knowing what the scheduled payments (which include interest and principal) will be over the longer loan term .

No matter what your situation is, spending within your means and sticking to a budget is still the best approach.

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