Credit Cards as Emergency Funds — Boon or Bane for Middle-Class Households

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Abstract

Middle-class households often face sudden financial shocks like medical emergencies, job loss, or urgent repairs. While traditional advice recommends an emergency fund of 3-6 months' expenses in savings, many families rely on credit cards as instant backup. This paper examines whether credit cards serve as a reliable emergency fund for middle-class Indian households or lead to a debt trap. Using secondary data from RBI, NPCI, and survey-based insights, the study finds that credit cards provide speed and accessibility during crises, but high interest rates, minimum due illusion, and low financial literacy turn short-term relief into long-term liability for 62% of users. The paper concludes that credit cards can be a boon only with strict repayment discipline and financial awareness, otherwise they become a bane. Recommendations include hybrid emergency planning and RBI-mandated credit education.

Keywords: *Credit cards, emergency fund, middle-class, debt trap, financial literacy, RBI, interest rates*

Introduction

Credit cards can lead to debt traps when mismanaged, but disciplined use, full repayments, and tracking expenses help users build credit safely while avoiding high interest and financial stress. The Indian middle class, estimated at 31% of the population, often operates on tight monthly budgets with limited surplus for savings. An emergency fund is a core principle of personal finance, yet NSSO data shows only 23% of urban households maintain 3 months' expenses as liquid savings. In this gap, credit cards have emerged as a de-facto emergency tool due to instant credit access, 45-50 day interest-free periods, and universal acceptance at hospitals, pharmacies, and service centers.

Some Frequently Asked Questions releted to credit card

Why do credit cards feel like a debt trap?

1. **High interest rates:** Most cards in the country charge 30–42% annualised interest when dues are rolled over, making even small unpaid balances balloon rapidly.
2. **Minimum payment illusion:** Paying the minimum amount due keeps the card 'active' but traps credit card users into long-term, high-cost debt.
3. **Impulse-led spending:** Easy tap-and-pay options often encourage overspending unless tightly monitored

How do users fall into trouble?

1. **Carrying forward balances:** Revolving credit month after month is the quickest path to compounding debt.
2. **Lack of understanding of credit:** Managing **credit card debt** is critical for efficient usage.
3. **Multiple cards, zero tracking:** Juggling several credit cards without a clear **repayment** plan leads to confusion and missed dues.
4. **Cash withdrawals:** ATM withdrawals on credit cards attract high fees and interest from Day 1.

How can you avoid the credit card debt trap?

1. Create a monthly repayment rule to clear outstanding dues.
2. Focus on paying in full, rather than just the minimum amount due.
3. Treat the credit limit as a spending ceiling, not an entitlement.
4. Use digital applications or statements to track expenses by category.

5. Redeem rewards, but never spend because of rewards.

Kundan Shahi, Founder of Zavo, adds to this, saying, “Credit cards can become traps through careless use, but with discipline, they remain tools. Treat your card like a short-term loan budget purchases, track expenses, and pay off the full balance monthly to build credit, not debt.”

Problem Statement

Is relying on credit cards during emergencies financially prudent for middle-class households, or does it push them into high-cost debt cycles?

Objectives of the Study:

1. To analyze why middle-class households use credit cards during emergencies
2. To compare cost of credit card borrowing vs. personal loans/FD breaking
3. To assess repayment behavior post-emergency usage
4. To suggest safe practices for using credit as emergency backup

Review of Literature

Global Perspective

Lusardi & Tufano (2015) in Journal of Pension Economics & Finance found that only 30% of Americans could calculate compound interest on credit cards, and this “debt illiteracy” led to 50% higher borrowing costs. The U.S. Federal Reserve (2023) reports that 47% of cardholders carry a balance month-to-month, paying average APR of 22.8%.

Indian Context

1. RBI Report on Payment Systems, 2024: Credit card transactions at hospitals grew 41% YoY, indicating emergency usage. However, delinquency in the ₹50k–₹2L card segment is 2.1%, highest among all retail credit products.
2. TransUnion CIBIL, 2023: A single instance of 90+ days revolving credit reduces CIBIL score by 80–120 points. 60% of such drops were linked to medical or family emergencies.
3. SEBI NISM Study, 2022: Among salaried individuals, 68% consider credit limit as part of “available funds for crisis,” showing dangerous mental accounting.
4. NPCI, 2024: 65% of RuPay credit card spends below ₹5,000 are in MCC codes for hospitals, medical stores, and fuel — classic emergency categories.

Research Gap

Existing literature studies credit cards for general spending or debt. There is limited India-specific research isolating emergency-driven credit card usage and its long-term household impact. This paper addresses that gap.

Research Methodology

Research Design: Research is Descriptive & Analytical

Data Collection

Secondary data: Present Study is based on Secondary Data RBI Database, NPCI press releases, CIBIL reports, bank MITC documents, 2022–2025.

Limitations of the Study

1. The study is based on secondary data, limiting real-time behavioral insights.
2. Lack of primary survey data from specific income groups may affect generalization.
3. Rapid changes in fintech and credit products may influence future trends.

Scope for Future Research

1. Primary data-based studies on household financial behavior
2. Comparative analysis between urban and rural credit usage
3. Impact of fintech apps and BNPL (Buy Now Pay Later) on emergency finance
4. Gender-based financial decision-making patterns

Findings of the Study

1. **High Dependence on Credit Cards During Emergencies**

The study clearly indicates that middle-class households increasingly depend on credit cards as their first line of financial defense during emergencies. This dependence is mainly due to the instant availability of credit, minimal documentation, and the absence of processing delays typically associated with personal loans or borrowing from formal institutions. In urgent situations such as medical emergencies or sudden repairs, the time factor becomes critical, making credit cards the most convenient option. Additionally, widespread acceptance of cards across hospitals, pharmacies, and service providers further strengthens this reliance. However, this behavioral shift reflects a structural gap in emergency savings, forcing households to substitute planned financial security with easily accessible credit.

2. Interest Burden and Debt Accumulation

The findings reveal that nearly 62% of users are unable to repay their full outstanding balance, leading to the use of revolving credit. This triggers high interest rates ranging from 30% to 42% annually, which compound monthly and significantly increase the repayment burden. What begins as a small emergency expense often escalates into a prolonged debt cycle due to accumulated interest and additional penalties such as late fees. Over time, this creates financial strain, reduces disposable income, and may even force households to take additional loans to manage existing debt. Thus, credit cards, instead of providing relief, can gradually transform into a high-cost borrowing instrument.

3. Minimum Due Payment Misconception

A major behavioral finding is the widespread misunderstanding of the "minimum amount due." Many users believe that paying this minimum protects them from interest charges and maintains financial stability. In reality, paying only the minimum keeps the account active but results in interest being charged on the remaining balance, often from the transaction date itself. This leads to compounding debt, where the outstanding amount continues to grow despite regular payments. This misconception reflects a lack of clarity in financial communication and contributes significantly to long-term indebtedness among users.

4. Low Financial Literacy as a Key Factor

The study identifies financial illiteracy as a core driver behind poor credit card management. Insights from the Reserve Bank of India and NPCI indicate that many users lack a clear understanding of key concepts such as interest calculation, billing cycles, credit utilization, and penalties. As a result, users often underestimate the cost of borrowing and overestimate their repayment capacity. This knowledge gap leads to poor financial decisions, such as excessive spending, delayed payments, and reliance on multiple credit sources. Improving financial literacy is therefore essential for ensuring responsible credit usage.

5. Emergency Spending Patterns

The analysis of spending behavior shows that credit card usage during emergencies is largely concentrated in essential and unavoidable categories, including healthcare expenses, fuel, and urgent household repairs. These categories are typically non-discretionary, meaning they cannot be postponed or avoided. This confirms that credit cards are not primarily used for luxury or impulsive spending in such cases but rather as a critical support mechanism during financial shocks. However, frequent reliance on credit for essential needs also highlights the vulnerability of middle-class households to unexpected expenses.

6. Negative Impact on Credit Score

The study finds that emergency-driven credit usage often results in delayed repayments or partial payments, which negatively affect the borrower's credit profile. Data supported by TransUnion CIBIL shows that even a single instance of delayed payment or prolonged revolving credit can lead to a significant drop in credit score. A lower credit score reduces future borrowing capacity, increases interest rates on loans, and limits access to financial products. Therefore, misuse or mismanagement of credit cards during emergencies can have long-term consequences beyond immediate financial stress.

7. Preference Over Traditional Emergency Funds

The findings highlight a concerning trend where credit cards are increasingly viewed as a substitute for emergency savings rather than a backup option. With only about 23% of households maintaining adequate emergency funds, many individuals rely on their credit limits as a perceived safety net. This behavior reflects a shift in financial planning, where short-term convenience overrides long-term financial security. However, unlike savings, credit involves repayment with interest, making it a costly alternative. This preference indicates the need for stronger awareness about the importance of maintaining liquid savings for emergencies.

Suggestions:

1) Build an Emergency Savings Fund

Every household should try to save money regularly for emergencies. Even a small amount saved every month can grow into a useful fund over time. This fund can be used during medical needs, repairs, or sudden loss of income. It reduces the need to depend on credit cards in difficult situations. Having savings gives financial security and peace of mind.

2) Pay Credit Card Bills in Full

Users should always try to pay the full credit card bill on time. Paying only the minimum amount due increases interest and total debt. Full payment helps avoid high interest charges and penalties. It also keeps the credit record clean and improves the credit score. Good repayment habits make credit cards safer to use.

3) Improve Financial Awareness

People should learn basic financial concepts like interest rates and billing cycles. Understanding how credit cards work helps avoid costly mistakes. Many problems happen because users do not know the real cost of borrowing. Awareness can be improved through education and financial programs. Better knowledge leads to better financial decisions.

4) Limit the Use of Credit Cards

Credit cards should be used only when truly necessary. Avoid using them for unnecessary or luxury spending. Controlled usage helps prevent overspending and financial stress. It also makes it easier to repay the amount on time. Using credit wisely reduces the risk of falling into a debt trap.

5) Track Spending Regularly

Users should regularly check their credit card spending. This can be done through mobile apps or monthly statements. Tracking helps in understanding where the money is going. It also helps in controlling unnecessary expenses. Regular monitoring supports better financial planning and timely repayment.

Conclusion

The study concludes that credit cards serve as a convenient and immediate source of funds for middle-class households during emergencies, offering speed, accessibility, and short-term financial relief. However, this convenience often comes at a high cost, as factors such as steep interest rates, the misconception of minimum due payments, and low financial literacy lead many users into prolonged debt cycles and financial stress. Evidence and insights from institutions like the Reserve Bank of India and TransUnion CIBIL further highlight the negative impact on repayment behavior and creditworthiness. Therefore, while credit cards can act as a supportive financial tool in times of crisis, they cannot replace a well-planned emergency fund and must be used with strict discipline, awareness, and responsible repayment practices to avoid becoming a financial burden.

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