Accepted Manuscript

Is there any dependence between consumer credit line utilization and default probability on a term loan? Evidence from bank-customer data

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PII: S0927-5398(15)00025-0
DOI: doi: 10.1016/j.jempfin.2015.03.007
Reference: EMPFIN 793

To appear in: *Journal of Empirical Finance*

Received date: 8 March 2013
Revised date: 22 December 2014
Accepted date: 16 March 2015

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19 December 2014

Abstract

We study the relationship between two financial instruments through the simultaneous analysis of personal credit line utilization and default probability on a personal term loan. We model both dependent variables in a system of simultaneous equations and find strong evidence of dependence between the two financial instruments. Individuals in the default state draw their credit line by 9 percentage points more and, depending on the specification, a 10 percentage point increase in credit line utilization decreases the default probability by 0.09 to 0.41 percentage points, on a base default rate of 1.08%. This provides evidence that borrowers may use the liquidity of the credit line to pay down the term loan in periods of financial distress and suggests that banks should manage both financial instruments simultaneously.

Keywords: Consumer finance, credit line utilization, term loan default probability, ability to pay, endogeneity, simultaneous equations.

JEL numbers: D12, D14, G01, G21, G33.