



Finance and Economics Discussion Series: Risk-Based Pricing of Interest Rates in Household Loan Markets

By Wendy Edelberg

Bibliogov, United States, 2013. Paperback. Book Condition: New. 246 x 189 mm. Language: English . Brand New Book ***** Print on Demand *****.Focusing on observable default risk's role in loan terms and the subsequent consequences for household behavior, this paper shows that lenders increasingly used risk-based pricing of interest rates in consumer loan markets during the mid-1990s. It tests three resulting predictions. First, the premium paid per unit of risk should have increased over this period. Second, debt levels should react accordingly. Third, fewer high-risk households should be denied credit, further contributing to the interest rate spread between the highest- and lowest-risk borrowers. For those obtaining loans, the premium paid per unit of risk did indeed become significantly larger over this time period. For example, given a 0.01 increase in the probability of bankruptcy, the corresponding interest rate increase tripled for first mortgages, doubled for automobile loans and rose nearly six times for second mortgages. Additionally, changes in borrowing levels and debt access reflected these new pricing practices, particularly for secured debt. Borrowing increased most for the low-risk households who saw their relative borrowing costs fall. Furthermore, while credit access increased for very high-risk households, the increases in their...



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