Consumer Credit: Learning Your Customer's Default Risk from What (S)he Buys

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November 11, 2009

Abstract

Using a novel panel data set for half a million customers of a large Mexican retail chain I study determinants of consumer credit default. I document that information about which products a customer buys can provide substantial information about potential default losses on a given loan. Differences in default losses across product categories are robust to controlling for characteristics of the loan contract, demographics and more standard measures of credit risk and do not diminish substantially with how long the borrower has been a customer. The differential loss rates across product categories are driven mainly by which types of individuals buy particular products, as opposed to being product-specific features. High loss products tend to be luxuries and tend to be purchased by individuals who consume abnormally large fractions of luxuries given their income. I discuss several possible explanations for why loans to people who consume more luxuries incur higher loss rates (self-control problems, lower risk aversion). I propose that providers of consumer credit could benefit from adjusting credit terms (down-payment requirements, interest rates, or credit limits) as a function of product mix purchased to date, and thus that product mix should be an important component of credit scoring.