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# Interest rates and default in unsecured loan markets

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## Abstract

This paper investigates how interest rates affect the probability of default (PD) in a general equilibrium incomplete markets economy. We show that the PD depends positively on the loan interest rate and negatively on the economy base interest rate. Empirically, this finding is confirmed by estimation of the Cox proportional hazard model with time-varying covariates using a sample of 445 889 individual contracts from a large Brazilian bank. Among the controls are macroeconomic variables and specific characteristics of the contracts and borrowers. A lower base interest rate, implied by easing monetary policy, leads banks to lend more money for riskier borrowers, increasing the PD.

 Keywords: [Default probability](#) [Incomplete markets](#) [Survival analysis](#)

 JEL Classification: [C81](#) [D52](#)

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