Automobile Loans: The Determinants of Borrowing and Size of the Loan

Assuming that borrowing for an automobile was an application of the life cycle hypothesis, the study examined the determinants of automobile loan users. A multivariate regression using data from the 1995 Survey of Consumer Finances showed that younger households, with less education, and those who were married were more likely to borrow for an auto. Size of the loan was positively related to income and education and negatively related to the interest rate.

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The life cycle hypothesis assumes that households borrow when they are young, increase the amount of savings during mid-life, and spend down their savings during retirement. Home equity loans were used to illustrate the life cycle hypothesis (Salandro & Harrison, 1997). The purpose of this study was to apply the life cycle hypothesis to an automobile loan to see if it was comparable to a home equity loan. Thus, the same factors were selected for analysis, i.e., age, education, income, marital status, financial assets, interest rate, and amount of the loan. Using data from the 1995 Survey of Consumer Finances, the study found that among the 4,299 households, 1,047 borrowed to finance an automobile. A typical borrower was 42 years old, with a household income of $47,000, and $25,400 in financial assets. The average automobile loan amount and interest rate were $11,300 and 9.7%, respectively.

Logistic regression was used to examine the probability of borrowing to purchase an automobile. Results showed that households younger than 35 and between 35 and 45 were more than twice as likely to borrow as households who were 55 and over. Household heads with some college education were more likely to borrow than college graduates were. Married households were three times as likely to borrow as were unmarried households. Ordinary least squares regression showed a positive relationship between size of the loan and household income and education of the household head. Interest rate was negatively related to size of the loan indicating that a lower interest rate meant a larger loan.

The study provides support for applying the life cycle hypothesis to auto loans. A contribution of the study is the insight provided for developing educational programs for consumers. Automobile loans are usually provided by automobile companies and financial institutions. Based on the findings, the target audience for consumer education programs is younger households without a college degree. Information should be easily understood. Print materials should be clearly written and designed to appeal to the appropriate audience.

Future research on this topic could involve other variables. Race, household size, and the ratio of debt to income could provide additional insight for consumer educators. Non white households may be more likely to use loans. The debt to income ratio could be compared to suggested guidelines to show which consumers are likely to be granted credit to purchase an auto.

Reference

Salandro, D. & Harrison, W. B. (1997). Determinants of the demand for home equity credit lines. The Journal of Consumer Affairs. 31. (2), 327-345.

Endnotes

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