

Credit

Credit (from Latin *credit*, "(he/she/it) believes") is the trust which allows one party to provide money or resources to another party where that second party does not reimburse the first party immediately (thereby generating a debt), but instead promises either to repay or return those resources (or other materials of equal value) at a later date.^[1] In other words, credit is a method of making reciprocity formal, legally enforceable, and extensible to a large group of unrelated people.^[2]

The resources provided may be financial (e.g. granting a loan), or they may consist of goods or services (e.g. consumer credit). Credit encompasses any form of deferred payment.^[3] Credit is extended by a creditor, also known as a lender, to a debtor, also known as a borrower.

Adam Smith believed that barter preceded credit in history, but most recent anthropological research^[4] proved otherwise. Barter mostly took place between those individuals who lack trust with one another e.g. hostile or unknown tribes usually made their transactions via barter. On the contrary, members of the same tribe mostly settled their transactions in credit\debt.



A credit card is a common form of credit. With a credit card, the credit card company often a bank, grants a line of credit to the card holder. The card holder can make purchases from merchants, and borrow the money for these purchases from the credit card company.



Domestic credit to private sector in 2005

Contents

Etymology

Bank-issued

Types

Trade credit

Consumer credit

See also

References

External links

Etymology

The term "credit" was first used in English in the 1520s. The term came "from Middle French *crédit* (15c.) "belief, trust," from Italian *credito*, from Latin *creditum* "a loan, thing entrusted to another," from past participle of *credere* "to trust, entrust, believe"." The commercial meaning of "credit" "was the original one in English (creditor is [from] mid-15c.)" The derivative expression "credit union" was first used in 1881 in American English; the expression credit rating" was first used in 1958^[5]

Bank-issued

Bank-issued credit makes up the largest proportion of credit in existence. The traditional view of banks as intermediaries between savers and borrower is incorrect. Modern banking is about credit creation.^[6] Credit is made up of two parts, the credit (money) and its corresponding debt, which requires repayment with interest. The majority (97% as of December 2013^[7]) of the money in the UK economy is created as credit. When a bank issues credit (i.e. makes a loan), it writes a negative entry into the liabilities column of its balance sheet, and an equivalent positive figure on the assets column; the asset being the loan repayment income stream (plus

interest) from a credit-worthy individual. When the debt is fully repaid, the credit and debt are cancelled, and the money disappears from the economy. Meanwhile, the debtor receives a positive cash balance (which is used to purchase something like a house), but also an equivalent negative liability to be repaid to the bank over the duration. Most of the credit created goes into the purchase of land and property, creating inflation in those markets, which is a major driver of the economic cycle.

When a bank creates credit, it effectively owes the money to itself. If a bank issues too much bad credit (those debtors who are unable to pay it back), the bank will become insolvent, having more liabilities than assets. That the bank never had the money to lend in the first place is immaterial - the banking license affords banks to create credit - what matters is that a bank's total assets are greater than its total liabilities, and that it is holding sufficient liquid assets - such as cash - to meet its obligations to its debtors. If it fails to do this it risks bankruptcy.

There are two main forms of private credit created by banks; unsecured (non-collateralized) credit such as consumer credit cards and small unsecured loans, and secured (collateralized) credit, typically secured against the item being purchased with the money (house, boat, car, etc.). To reduce their exposure to the risk of not getting their money back (credit default), banks will tend to issue large credit sums to those deemed credit-worthy, and also to require collateral; something of equivalent value to the loan, which will be passed to the bank should the debtor fail to meet the repayment terms of the loan. In this instance, the bank uses sale of the collateral to reduce its liabilities. Examples of secured credit include consumer mortgages used to buy houses, boats etc., and PCP (personal contract plan) credit agreements for automobile purchases.

Movements of financial capital are normally dependent on either credit or equity transfers. The global credit market is three times the size of global equity.^[2] Credit is in turn dependent on the reputation or creditworthiness of the entity which takes responsibility for the funds. Credit is also traded in financial markets. The purest form is the credit default swap market, which is essentially a traded market in credit insurance. A credit default swap represents the price at which two parties exchange this risk - the protection *seller* takes the risk of default of the credit in return for a payment, commonly denoted in basis points (one basis point is 1/100 of a percent) of the notional amount to be referenced, while the protection *buyer* pays this premium and in the case of default of the underlying (a loan, bond or other receivable), delivers this receivable to the protection seller and receives from the seller the par amount (that is, is made whole).

Types

There are many types of credit, including but not limited to bank credit, commerce, consumer credit, investment credit, international credit, public credit and real estate.

Trade credit

In commercial trade, the term "trade credit" refers to the approval of delayed payment for purchased goods. Credit is sometimes not granted to a buyer who has financial instability or difficulty. Companies frequently offer trade credit to their customers as part of the terms of a purchase agreement. Organizations that offer credit to their customers frequently employ a credit manager.

Consumer credit

Consumer debt can be defined as "money, goods or services provided to an individual in the absence of immediate payment". Common forms of consumer credit include credit cards, store cards, motor vehicle finance, personal loans (installment loans), consumer lines of credit, retail loans (retail installment loans) and mortgages. This is a broad definition of consumer credit and corresponds with the Bank of England's definition of "Lending to individuals". Given the size and nature of the mortgage market, many observers classify mortgage lending as a separate category of personal borrowing, and consequently residential mortgages are excluded from some definitions of consumer credit, such as the one adopted by the U.S. Federal Reserve.^[8]

The cost of credit is the additional amount, over and above the amount borrowed, that the borrower has to pay. It includes interest, arrangement fees and any other charges. Some costs are mandatory, required by the lender as an integral part of the credit agreement. Other costs, such as those for credit insurance, may be optional; the borrower chooses whether or not they are included as part of the

agreement.

Interest and other charges are presented in a variety of different ways, but under many legislative regimes lenders are required to quote all mandatory charges in the form of an annual percentage rate (APR)^[9]. The goal of the APR calculation is to promote "truth in lending", to give potential borrowers a clear measure of the true cost of borrowing and to allow a comparison to be made between competing products. The APR is derived from the pattern of advances and repayments made during the agreement. Optional charges are usually not included in the APR calculation.^[10]

See also

- Commercial credit reporting
- Credit bureau
- Credit history
- Credit risk
- Credit score
- Credit theory of money
- Default (finance)
- Financial literacy
- Mutual credit
- Payday loan
- Person-to-person lending
- Predatory lending
- Revolving credit
- Risk-return spectrum
- Settlement (finance)
- Social credit
- Subprime lending

References

1. *Credit* (def. 2c) (<http://www.merriam-webster.com/dictionary/credit>) *Merriam Webster Online*. Retrieved 5 March 2015.
2. Simkovic, Michael (2016). "What Can We Learn from Credit Markets?". *Proceedings of the 93rd Annual Meeting of the American Law Institute* SSRN 2782844 (<https://ssrn.com/abstract=2782844>)^[3].
3. O'Sullivan, Arthur, Sheffrin, Steven M. (2003). *Economics: Principles in Action* Upper Saddle River, New Jersey 07458: Pearson Prentice Hall. p. 512. ISBN 0-13-063085-3
4. David., Graeber, (2011). *Debt : the first 5,000 years*(<https://www.worldcat.org/oclc/426794447>) Brooklyn, N.Y.: Melville House. ISBN 9781933633862 OCLC 426794447 (<https://www.worldcat.org/oclc/426794447>)
5. "Credit" (http://www.etymonline.com/index.php?allowed_in_frame=0&search=credit) *www.etymonline.com* Online Etymology Dictionary Retrieved 17 May 2017.
6. "Bank of England Quarterly Bulletin 2014 Q1 - Money Creation in the Modern Economy"(<http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2014/qb14q102.pdf>)(PDF).
7. "Bank of England Quarterly Bulletin 2014 Q1: Money Creation in the Modern Economy"(<http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2014/qb14q102.pdf>)(PDF).
8. POPLI, G. S.; PURI, S. K. (2013-01-23) *STRATEGIC CREDIT MANAGEMENT IN BANKS* (https://books.google.co.uk/books?id=wacM4zKAle4C&pg=PA106&lpg=PA106&dq=residential+mortgages+are+excluded+from+some+definitions+of+consumer+credit&source=bl&ots=aXZkVjrrR&sig=59IJ7kdTdUFN8gwWM8yITzI7h_M&hl=en&sa=X&ved=0ahUKEwj49s742bvXAhXKxqQKHdDICjMQ6AEINAD#v=onepage&q=residential%20mortgages%20are%20excluded%20from%20some%20definitions%20of%20consumer%20credit&f=false) PHI Learning Pvt. Ltd. ISBN 9788120347045
9. Finlay, S. (2009-02-02). *Consumer Credit Fundamentals*(https://books.google.co.uk/books?id=JK2HDAAQBAJ&pg=PA13&lpg=PA13&dq=lenders+are+required+to+quote+all+mandatory+charges+in+the+form+of+an+annual+percentage+rate&source=bl&ots=4JLRqC0UGw&sig=lpmaGq3a19F9fmt_a8ClgdPmewg&hl=en&sa=X&ved=0ahUKEwifJC2rvXAhUM_qQKHQEAxSQ6AEIJjAA#v=onepage&q=lenders%20are%20required%20to%20quote%20all%20mandatory%20charges%20in%20the%20form%20of%20an%20annual%20percentage%20rate&f=false) Springer. ISBN 9780230232792
10. Finlay, S. (2009). *Consumer Credit Fundamentals*(2nd ed.). Palgrave Macmillan.
- Logemann, Jan, ed. (2012). *The Development of Consumer Credit in Global Perspective: Business, Regulation, and Culture*. New York: Palgrave Macmillan. ISBN 978-0-230-34105-0

External links

 Quotations related to Credit at Wikiquote

Retrieved from '<https://en.wikipedia.org/w/index.php?title=Credit&oldid=830281627>

This page was last edited on 13 March 2018, at 21:37.

Text is available under the [Creative Commons Attribution-ShareAlike License](#); additional terms may apply. By using this site, you agree to the [Terms of Use](#) and [Privacy Policy](#). Wikipedia® is a registered trademark of the [Wikimedia Foundation, Inc.](#), a non-profit organization.