Trade Credit Default

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Recent micro evidence shows that default on trade credit repayments is substantial. What is the role of trade credit default in the transmission of macroeconomic shocks? We build a heterogeneous-firms quantitative model where an intermediate input is purchased by final-goods producers partly on trade credit before observing the realisation of their productivity. A bad productivity shock may ex-post induce final good producers to skip payment to suppliers or, alternatively, liquidate via bankruptcy. Aggregate trade credit delinquency and liquidation are taken into account by input suppliers; the individual liquidation risk is priced in by lenders supplying bank credit. The response of trade-credit delinquency and bankruptcy, via their effect on intermediate input supplier's markups, provides an amplification mechanism of aggregate shocks. We consider productivity, financial and volatility shocks. In a calibrated version of the model, the surge in trade-credit default that follows a negative shock accounts for a large portion of the fall in output and employment, and feeds into further firm liquidation and delinquency. For instance, trade-credit default accounts for about one third of the impact of a volatility shock.