The finances of American households I the Past Three Recessions: Evidence from the Survey of Consumer Finances

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OVERVIEW

- **Evolution of US household networth following three peaks in economic activity:**
  - July 1990
  - March 2001
  - December 2007
    - *(pre-peak periods not considered)*

- **Recessions differ in:**
  - Magnitude of asset price drops:
    - *Dec. 2007 most severe (real estate prices and stock market)*
  - Household exposure (debt). Dec 2007
    - Increase in home ownership / housing-related indebtedness
    - Home ownership.

1. The (very clever) strategy

- **Project aggregate net worth drops combining**
  - Portfolio shares in the latest SCF before the peak
  - Asset prices (real estate and stock market)
- **Project aggregate net worth drops by key covariates:**
  - Age and income quartiles.
- **W(2007) can be written as:**

$$W_{2007} = \sum_{h} (p_{real}^{2007} real\_est^{2007} + p_{stock}^{2007} stock^{2007} + p_{other}^{2007} other^{2007})$$

- **Project W(2009) and counterfactual wealth by reweighting expression with different prices**
  - Holding constant the shares in 1990
  - Change in wealth in 1990-1992 with the 2007-2009 asset revaluation? W_{2007}
- **FINDINGS: Widespread drops in networth:**
  - Large changes in prices in 2007-2009 play prominent role
  - Changes in portfolios play a (minor) role.

COMMENT 1: INTERPRETATION OF RESULTS?

A. Welfare point of view

- **Is the interpretation of the results sensitive to the model of wealth accumulation?**

Two extremes:

Buffer stock model of saving: wealth held for precautionary purposes, drops documented are important, but *perhaps* transitory

Life-cycle model, drops may have devastating consequences on welfare (specially on the elderly).

Can we assess what scenario?

B. Further detail on the consequences of the distribution of wealth losses

- **Portfolio composition as a channel of transmission into consumption?**
  - Different groups of the population have different MPC's out of wealth (Maki and Palumbo, 2001)
  - Age, income, home ownership relevant channels
- **A financial vulnerability story?**
  - Are discontinuities in behavior at certain threshold, the distribution of net worth matters.
  - For example: something distinctive happen when Home equity<0

2. COMMENT 2: MACRO FEEDBACK

- **Projections (and counterfactuals) typically assume no feedback effects from the variable measured (wealth) into prices.**
  - 30% of households below 45 are predicted to have negative home equity in July 2009

- **Real estate prices affected by the fall in home equity?**

- **Assume that for a substantial share of the population, Home equity<0, d(home equity)/d(time)<0 & costs of foreclosure are low**
  - A natural reaction is to default on loans.
  - In turn, more houses in the market.
  - In turn, house prices will fall
- **Is it possible to sign the bias?**
  - Scenario 1: Behavioral responses mitigate the measured impact of housing prices on financial distress:
    - *we are predicting negative equity when households would end up with zero wealth if they foreclose*
  - Scenario 2: Foreclosure is such large shock that depletes wealth above and beyond estimated amounts.

COMMENT 3: Alternative benchmark?

- **Net worth drops look very different from those in previous recessions.**
- **"Those latter developments appear to have left many households without significant buffers"**
  - Statement about wealth *level*, but results on *percent changes*.

- **Could one use the *same methodology* to examine (imputed) consumption responses?**
  1. Gauge impacts of changes in wealth on welfare (and on
  2. Compare to existing estimates of the marginal propensity to consume out of wealth?

- **2004/2007 SCF contains (some) consumption data:**
  - Food: Successfully used to impute total non-durable consumption
    - *Blundell, Preston and Pistaferri (AER, 09), Skinner (EL 88).*
  - Some durables (cars)
- **Proposal:**
  1. Estimate using 2004/2007 SCF

     C(2007)=f[Housing(2007), Financial wealth(2007), age(2007), income(2007)]

  a. Use projections of changes in Housing and Financial wealth to come up with a predicted C(2009)

  b. The ratio of C(2009)-C(2007) to W(2009)-W(2007) gives a way to understand the contribution of asset revaluations to consumption.

a. **Can be compared to existing estimates of the MPC out of wealth**

b. **Permits assessing welfare consequences.**

COMMENT 4: Alternative outcomes.

- **Transmission of asset revaluation into wealth changed through differences in asset ownership.**
  - –Home and stock ownership.
- **Aggregate asset ownership changed by**
  - –Concern about the (un)observed characteristics of recent home-owners
  - –Apparently riskier, lower incomes, higher LTV (Gerardi et al, 08).
- **Make sense to go finer than broad age groups and income quintiles**
  - – Examine outcomes outcomes by interactions between income, age and home ownership and reweighting

- **Paper looks at changes in financial distress measured by**
  - –1(Debt>.4*income)*1(Household net worth down by more than 20%)

- **Replace: "Household net worth down by more than 20%" vs "Negative housing equity".**
  - –Negative housing equity and severe debts may be stronger predictor of foreclosure
  - –Specially if those consumers have limited means of coping with income drops (rather than default).

OTHER COMMENTS

- **More detail on the projections?**
  - –How is indirect stockholding dealth with?
  - –401(k), IRAs and so on
- **Standard errors of the magnitudes?**
  - –Shares are estimates.
- **Interest rate drops?**
  - –Affect the return of certain assets, aggravating the wealth drop.
  - –Can compensate some debts (if cost is adjusted to market rates)?

5. CONCLUSIONS

- Very clever way of using micro data to explore the distribution of welfare losses.

- Use of portfolio compositions in past recessions to assess the relevance of changes in household vulnerability very inspiring.

THANKS FOR YOUR ATTENTION!