Discussion of
“The Current State of U.S. Household Balance Sheets”
and
“Why Did So Many Economically Vulnerable Families Enter the Crisis with Risky Balance Sheets?”

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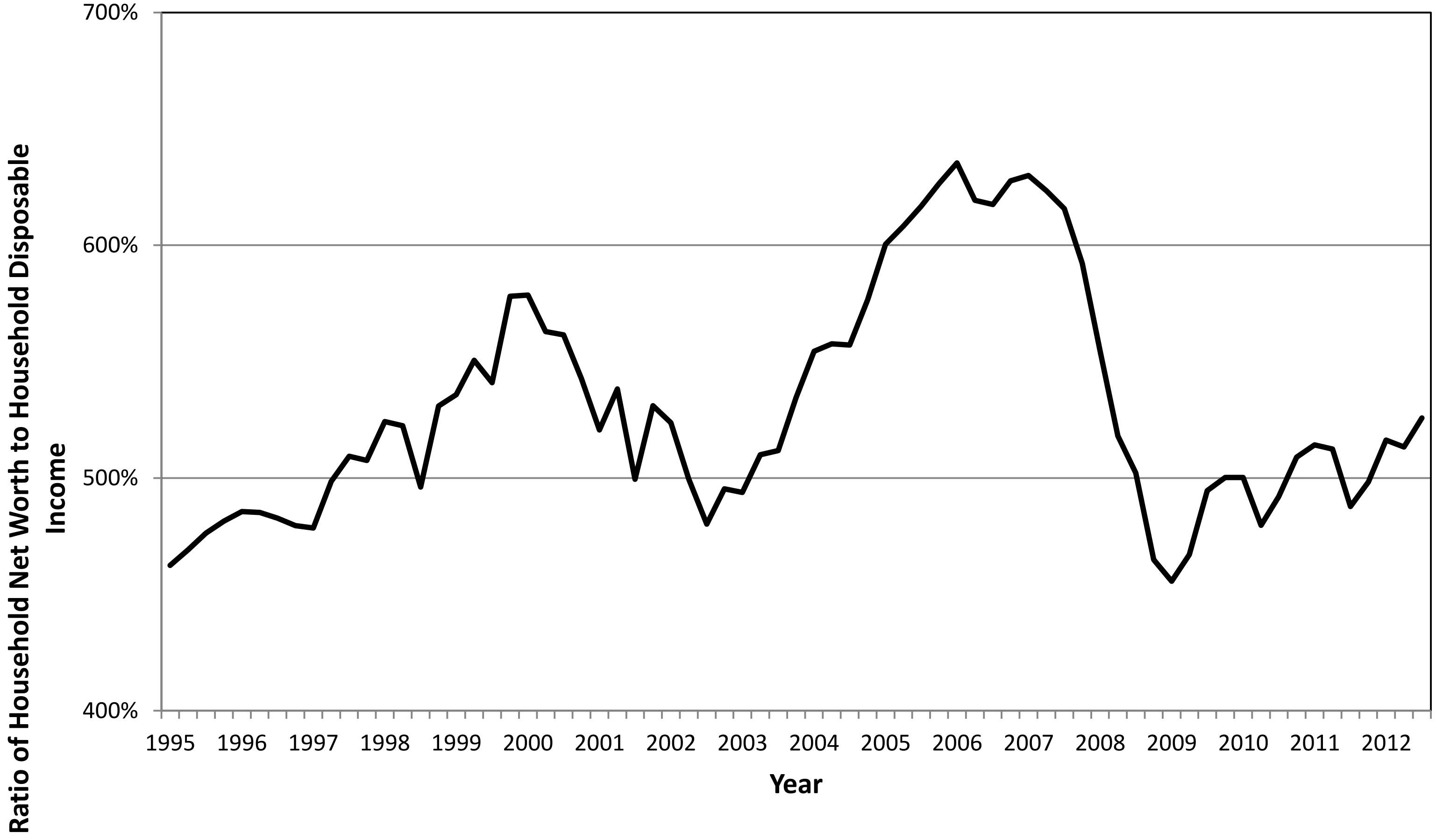
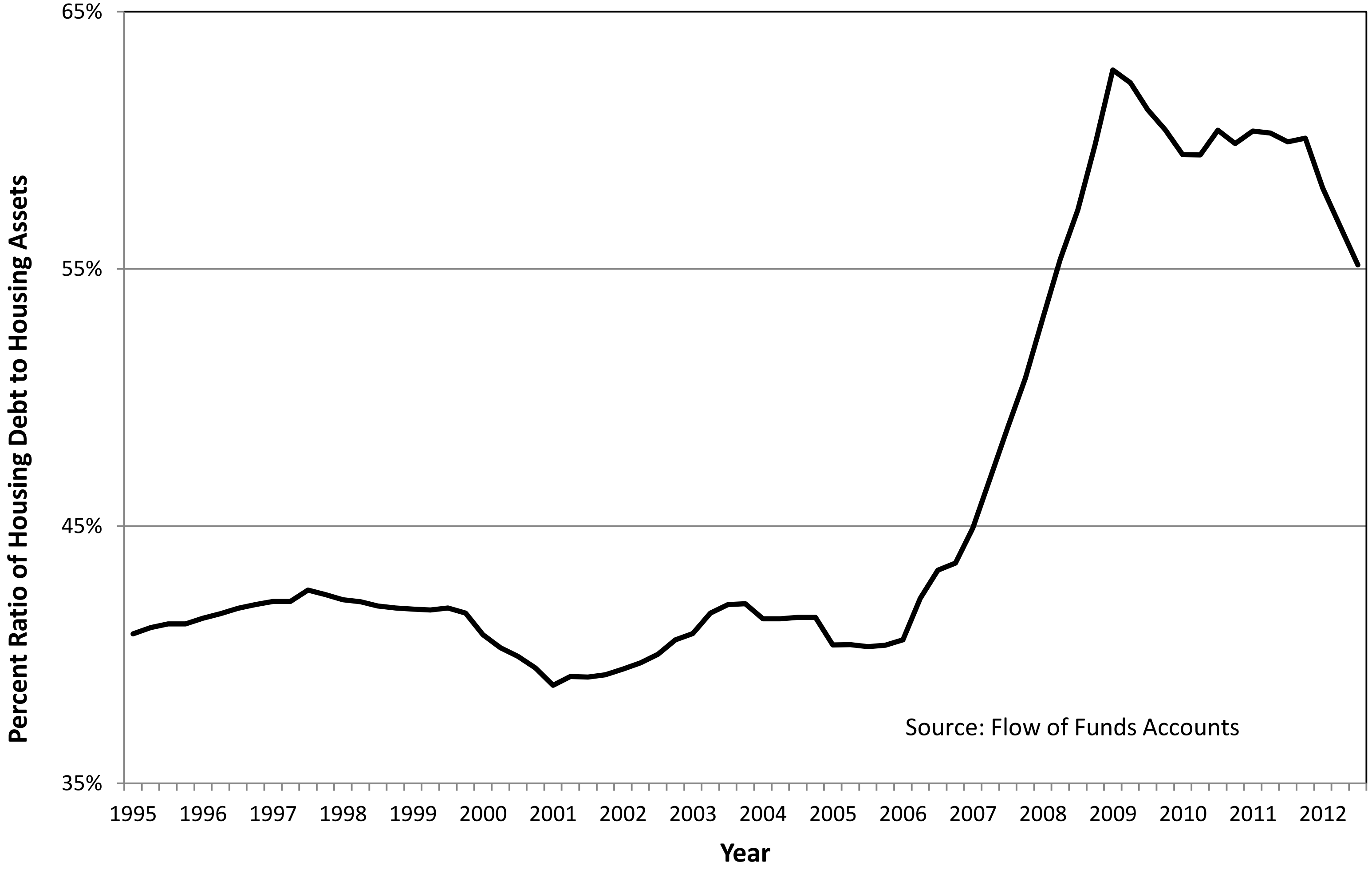
Disclaimer. The views expressed in this discussion are mine alone and do not necessarily represent the views of the Board of Governors or its staff.

Net worth relative to disposable income



Aggregate housing debt to housing assets (LTV)



Which groups were most affected?

- Households with the biggest *decreases* in wealth from 2007 to 2010:
  those with "normal incomes" in the 0^{th} to 20^{th} percentiles and in the 40^{th} to 80^{th} percentiles

- Households with the biggest *increases* in wealth from 2010 to 2012:
  those with "normal incomes" in the 90^{th} to 100^{th} percentiles

Which groups have the weakest balance sheets?

- Younger families, families with less education, and minority families are more likely to have:
  - fewer safe and liquid assets relative to their income
  - more of their portfolio invested in housing.

A broader definition of "household balance sheet"?

- The most important asset for most households is their human capital and lifetime earnings
- The most devastating shocks are those that threaten income:
  - Disability; death of a spouse; permanent job loss
- Other assets:
  - Social safety net benefits such as unemployment insurance and Social Security
  - Ability to borrow from friends or family

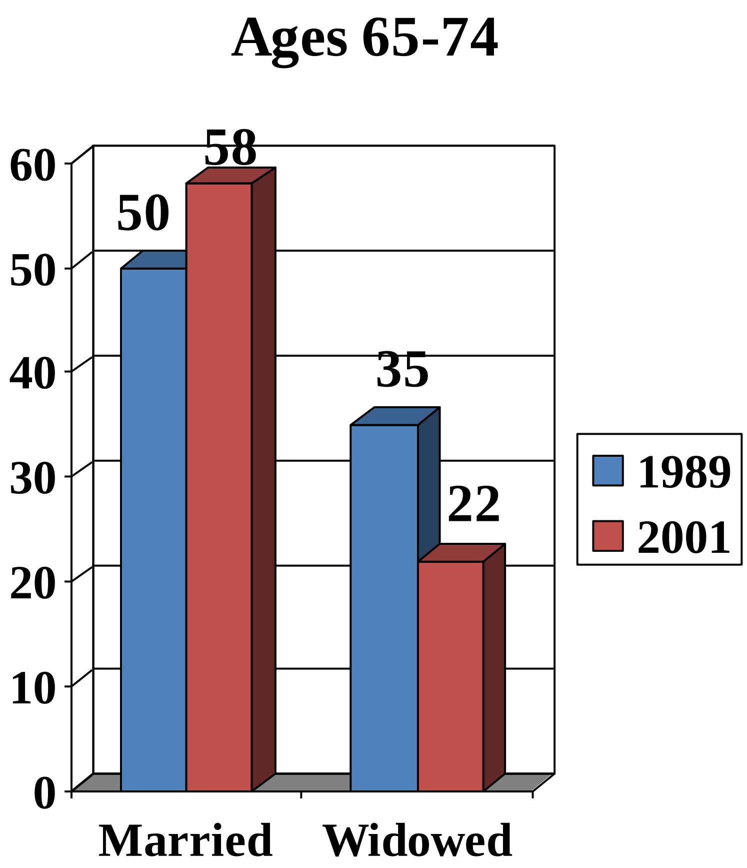
Increase in wealth among older households, 1989 to 2001

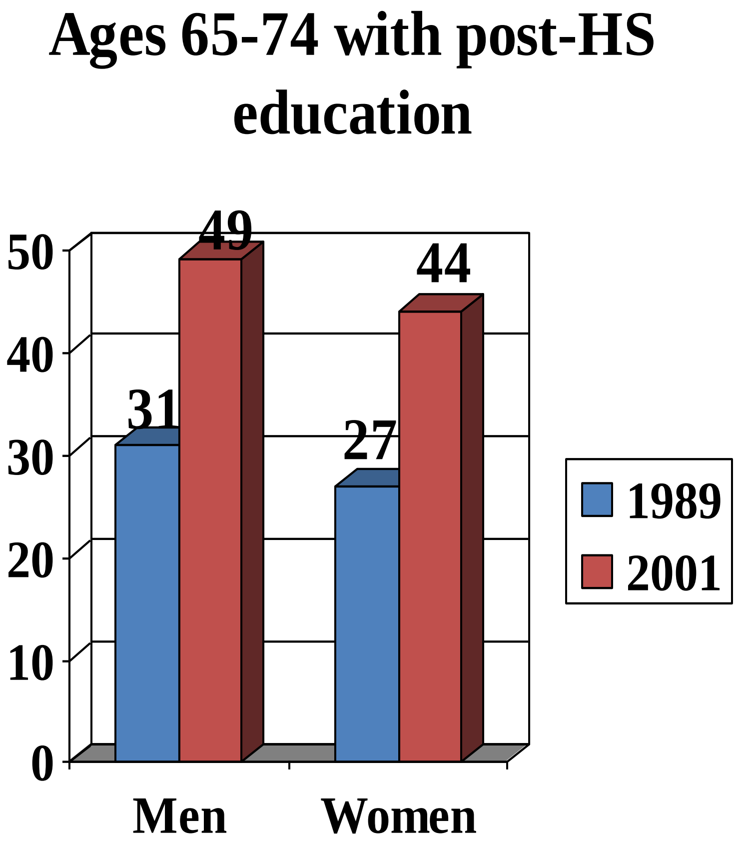
- The stock market and housing market posted strong gains in the1990s
- The biggest beneficiaries appeared to be older households
- Households ages 65 to 74 in 2001 had nearly $100,000 more wealth than households ages 65 to 74 in 1989
- Other groups had smaller gains

Net worth	1989	2001
10th percentile	$7,000	$19,000
25th percentile	$61,000	$87,000
50th percentile	$169,000	$264,000
75th percentile	$405,000	$709,000
90th percentile	$1,042,000	$1,351,000

Source. Gale and Pence, *Brookings Papers on Economic Activity*, 2006.

The increase can be fully explained by increases in health and education





Balance sheet definition can affect our views on household vulnerability

- Older households may be more vulnerable because they cannot earn more income.
- Lower-income households may be less vulnerable because safety-net benefits replace a larger share of their income.
- Affluent households may be less vulnerable if they have affluent family members or friends.

My financial education curriculum

- Life is risky. No one asset (even cash) will protect you from everything that might happen. Stay diversified to increase the chances that at least one asset is there when you need it.
- Your biggest asset is your ability to earn money. Keep your job skills up-to-date. Stay in good health. Learn emotional intelligence skills in the workplace.
- Buy insurance against risks that could financially destroy you.
- Invest only in things that you understand.
- Strip your finances of emotional meaning.
- Learn basic math and the power of compounding.

Note. I have opinions but no professional qualifications in this area.

Wall Street house price forecasts

- Lehman Brothers: "U.S. ABS Weekly Outlook," August 15, 2005.
- "HEL Bond Profile Across HPA Scenarios"

#	Name	Scenario	Loss	Probability
(1)	Aggressive	11% HPA over the life of the pool	1.4%	15%
(2)		8% HPA for life	3.2%	15%
(3)	Base	HPA slows to 5% by end-2005	5.6%	50%
(4)	Pessimistic	0% HPA for the next 3 years 5% thereafter	11.1%	15%
(5)	Meltdown	-5% for the next 3 years, 5% thereafter	17.1%	5%

As it turned out, house prices declined at an annual rate of 8 percent for the next three years, and 2 percent thereafter.

Source. Paul Willen.

Authors' policy prescriptions seem sensible but incomplete

- The belief that house prices could only rise was widespread even among highly educated and affluent people.
- Households with "normal income" in the 60th to 80th percentiles lost more net worth than households in the 20th to 40th percentiles from 2007 to 2010.
- If economists could not agree in real time whether a bubble was underway, how can we expect households to know?
- How do we guard against house price bubbles in the future?