

New Perspectives on Household Balance Sheets: What is the State of Household Balance Sheets, and Why They Matter for Families and Economic Growth

www.stlouisfed.org/hfs

November 7, 2012

Organized by the Federal Reserve Bank of St. Louis

The **Connecting Communities**[®] audio conference series is a Federal Reserve System initiative intended to provide timely information on emerging and important community and economic development topics with a national audience. The audio conference series complements existing Federal Reserve Community Development outreach initiatives that are conducted through our regional Reserve Bank offices and at the Federal Reserve Board of Governors in Washington, D.C.

Welcome

Thank you to everyone for joining this session.

For today:

- This call is being recorded.
- An archived recording of this session will be available on the **Connecting Communities**[®] web site shortly after the session has taken place:
www.stlouisfed.org/connectingcommunities/
- We will be taking questions via email during this session. Please direct your questions to communities@stls.frb.org. These questions may be part of the recorded archive for this session.
- In connection with this session, several of our Reserve Bank offices have posted links to a variety of additional resources on this topic. We encourage you to browse through this list and to contact your regional office if you would like additional information on any of these items.

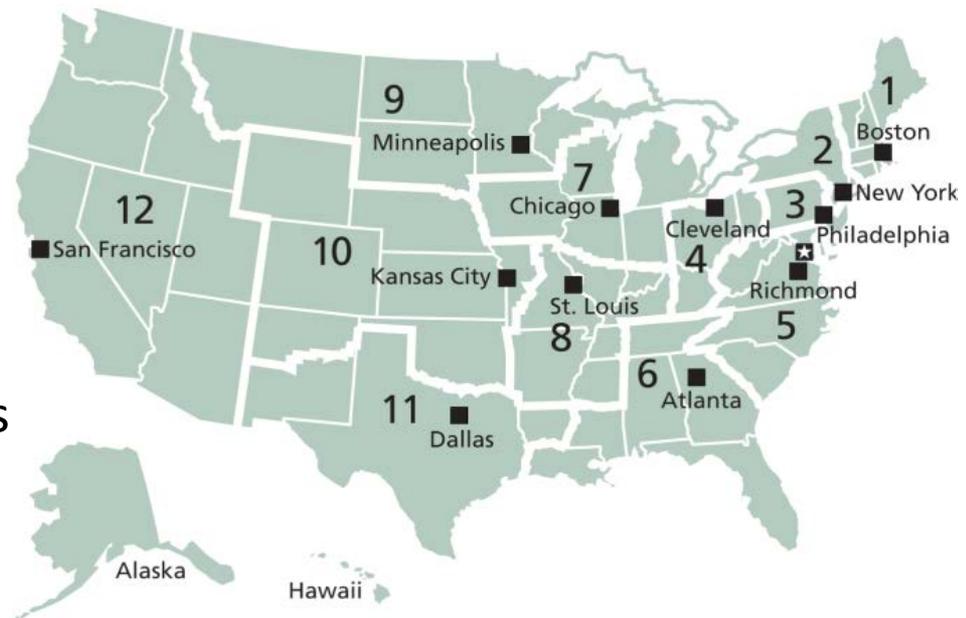
Legal Notices and Disclaimer

The information, analyses, and conclusions set forth are those of the presenters and do not necessarily indicate concurrence by the Board of Governors of the Federal Reserve System, the Federal Reserve Banks, or members of their staffs.

Community Affairs

Community affairs programs at the Federal Reserve Board and the 12 Federal Reserve Banks support economic growth by promoting community development and fair access to credit.

Community affairs offices at the Board and Reserve Banks engage in a wide variety of activities to help financial institutions, community-based organizations, government entities, and the public understand and address financial services issues that affect low- and moderate-income people and geographic regions.



Community Affairs (continued)

- Each office responds to local needs in its district and establishes its own programs to:
 - Foster depository institutions' active engagement in providing credit and other banking services to their entire communities, particularly traditionally underserved markets
 - Encourage mutually beneficial cooperation among community organizations, government agencies, financial institutions, and other community development practitioners
 - Develop greater public awareness of the benefits and risks of financial products and of the rights and responsibilities that derive from community investment and fair lending regulations
 - Promote among policy makers, community leaders, and private-sector decision makers a better understanding of the practices, processes, and resources that result in successful community development programs

Today's Presenters

- **Ray Boshara**, *Senior Advisor and Director, Household Financial Stability*, Federal Reserve Bank of St. Louis
- **Bill Emmons**, *Assistant Vice President and Economist*, Federal Reserve Bank of St. Louis
- **Bryan Noeth**, *Policy Analyst*, Federal Reserve Bank of St. Louis

New Perspectives on Household Balance Sheets

Ray Boshara

Senior Advisor and Director, Household Financial Stability
Federal Reserve Bank of St. Louis



Household Balance Sheets

- Household balance sheets include:
 - Quality of financial services and credit scores
 - Savings
 - Assets
 - Consumer and mortgage debts
 - *Net worth*: Savings plus assets minus all debts
- **Balance sheets** (what you own and owe) versus **income** (what you earn and consume)
- See Sherraden, *Assets and the Poor* (1991)

Why Household Balance Sheets?

Strong balance sheets lead to better family outcomes.

- While race, income, job status and net worth all tend to vary hand-in-hand, careful statistical parsing shows that it is really net worth that drives opportunity for the next generation¹.
- Financial capital is one of the three strongest predictors of economic mobility².
- Small amounts of wealth at the right moments can have a “transformative” effect on the life course³.

Sources:

¹Conley, 2009

²Butler, Beach, and Winfee, 2008

³Shapiro, 2004

Why Household Balance Sheets? (continued)

Strong balance sheets lead to better family outcomes.

- Households that are “liquid-asset poor” are two to three times more likely than those with liquid assets to experience “material hardship” after a job loss, health emergency, death in the family, or other adverse event¹.
- Liquid and non-liquid assets are positively associated with later college completion, while unsecured debt is negatively associated with college completion².

Sources:

¹McKernan, Ratcliffe, and Vinopal, 2009

²Zhan and Sherraden, 2009

Why Household Balance Sheets? (continued)

Strong balance sheets lead to better family outcomes.

- Savings, and sometimes simple account ownership, can have a meaningful “asset effect” - a change in attitudes or behaviors that leads to better social, economic, and educational outcomes later in life¹.
- Among adults in the bottom income quartile from 1984 to 1989, 34 percent left the bottom by 2003 to 2005 if their initial savings were low, compared with 55 percent who left the bottom if their initial savings were high. Also, 71 percent of children born to high-saving, low-income parents move up from the bottom income quartile over a generation, compared to only 50 percent of children of low-saving, low-income parents².

Sources:

¹Shanks *et al.*, 2009 and Elliot and Beverly, 2010

²Cooper and Luengo-Prado, 2009

Why Household Balance Sheets? (continued)

Strong balance sheets contribute to economic growth.

- During the three decades preceding the financial crisis, consumer spending contributed nearly 71 percent of the nation's economic growth.¹
- Weak household balance sheets suppress consumer spending, which leads to higher unemployment, which further suppresses consumer spending, and so on.²

Sources:

¹Emmons, 2012

²Emmons, 2011

Why Household Balance Sheets? (continued)

Strong balance sheets contribute to economic growth.

- The decline in aggregate demand driven by household balance sheet weakness is a key driving force explaining the recession. Roughly two out of every three (4 million out of 6.2 million) jobs lost between March 2007 and March 2009 were attributable to household balance sheet weakness¹.
- This is the first recession in U.S. history where deleveraging really matters².

Sources:

¹Mian and Sufi, 2011

²Bullard, 2012

Why Household Balance Sheets? (continued)

Strong balance sheets contribute to economic growth.

- It is the combination of declining housing prices *and* over-indebtedness that explains the severity of the contraction¹.
- Highly leveraged homeowners had larger declines in spending between 2007 and 2009 than other homeowners, despite having smaller changes in net worth; in other words, debt-overhang effects appeared to dominate pure wealth effects².

Sources:

¹International Monetary Fund, 2012

²Dynan, 2012

Why Household Balance Sheets? (continued)

Strong balance sheets contribute to economic growth.

- Increases in housing market wealth have had positive effects upon household consumption, but declines in housing market wealth have had negative and somewhat larger effects upon consumption¹.

Source:

¹Case, Quigley, and Shiller, 2011

Why Household Balance Sheets? (continued)

If weak balance household balance sheets have suppressed economic growth, strong household balance sheets can help create jobs and grow the economy.

Household Balance Sheets: Looking Back

- Four household balance sheet “failures” ...
 - Too many Americans:
 - Relied on wealth-depleting financial services. About 29 percent of U.S. households are unbanked or under-banked¹.
 - Had low levels of savings. In 2005, net household savings reached its lowest level (1.3%) since the 1930s².
 - Incurred high levels and risky types of consumer and mortgage debts. By 2007, the household debt exceeded GDP for the first time; more household debt was accumulated between 2001-2007 than in the previous 45 years³.
 - Did not diversify their assets sufficiently beyond housing. By 2005, we reached the greatest concentration of wealth in housing (30%) ever recorded⁴.

Sources:

¹FDIC, 2012

²Federal Reserve, Bureau of Economic Analysis

³Federal Reserve, Bureau of Economic Analysis; Sufi and Mian, 2010

⁴Federal Reserve

Household Balance Sheets: Looking Back

- Plus, misguided faith in ever-rising asset values...
 - Helped drive the financial crisis and ensuing economic downturn.

Household Balance Sheets Now: Savings

Roughly half of all Americans lack sufficient savings or report feeling “financially fragile”:

- The number of families reporting having at least \$3,000 in liquid savings has declined from nearly 53 percent in 2007 to around 48 percent in 2010; despite the fact that households reported in 2010 that liquid savings, instead of retirement savings, is now their top savings priority¹.
- 43 percent of Americans households do not have sufficient liquid assets to subsist at the poverty level for three months in the absence of income. If considering household net worth, the asset poverty rate falls to 27 percent, which is still substantially higher than the 2011 official income poverty rate of 15 percent².
- Nearly half of all Americans consider themselves financially fragile, meaning that they would “probably” (22.2 percent) or “certainly” (27.9 percent) be unable to come up with \$2,000 in 30 days from *any* source to cope with a financial emergency³.

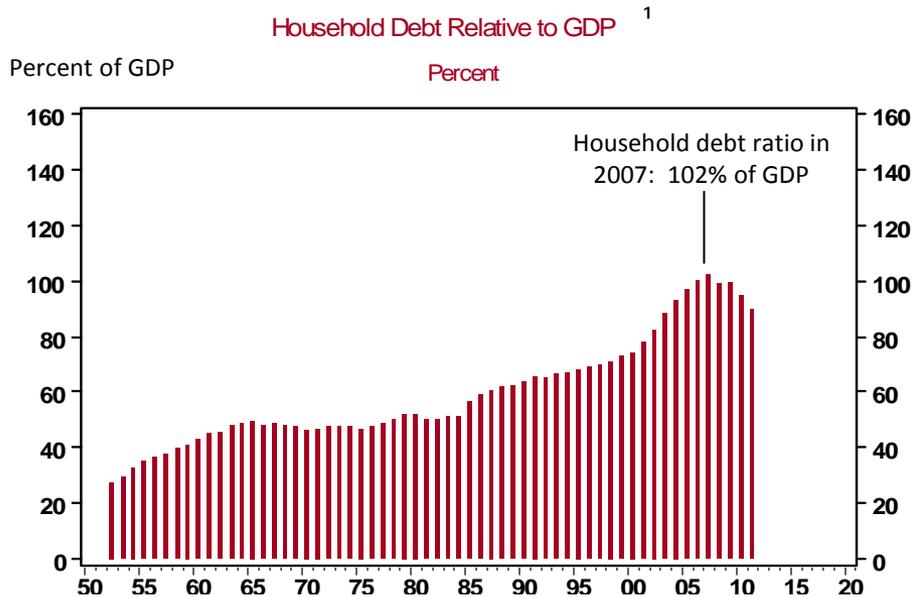
Sources:

¹Federal Reserve Survey of Consumer Finances, 2012

²Corporation for Enterprise Development (CFED), 2012 and Census Bureau, 2012

³Lusardi, Schneider, and Tufano, 2011

Household Balance Sheets Now: Debt



Sources:

¹Federal Reserve, Bureau of Economic Analysis and Haver Analytics

²Federal Reserve, 2012 and Haver Analytics, 2012

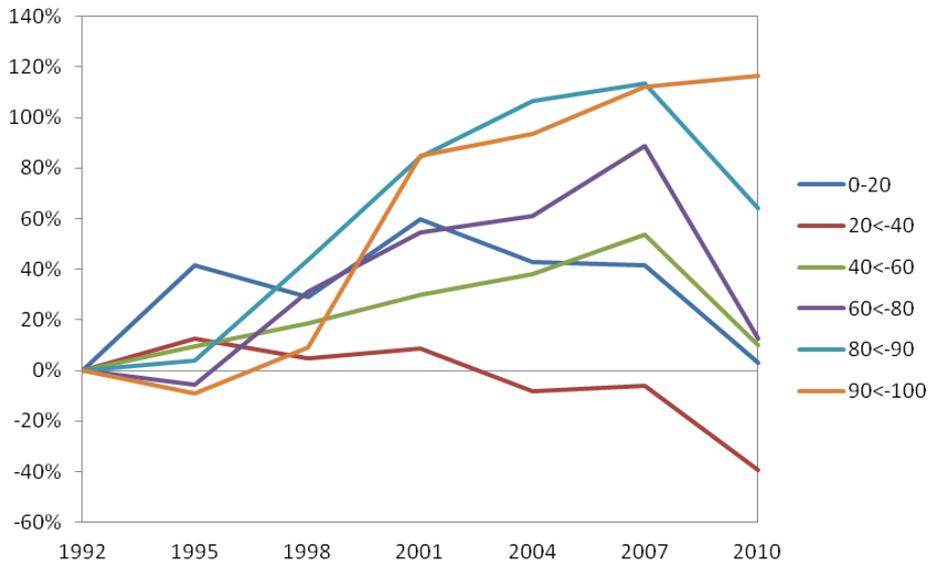
³Sufi and Mian, 2010

⁴Federal Reserve. 2011 and CoreLogic, 2011

- By 2007, the ratio of household debt to gross domestic product (GDP) reached its highest level since the 1950s².
- More household debt was accumulated between 2001 and 2007 than in the previous 45 years³.
- Roughly three-quarters of total household debt is mortgage debt, and approximately 22 percent of homeowners nationwide, including almost half of homeowners under age 40, have negative equity⁴.

Household Balance Sheets Now: Net Worth by Income

Cumulative Net Worth Gains By Income Grouping¹



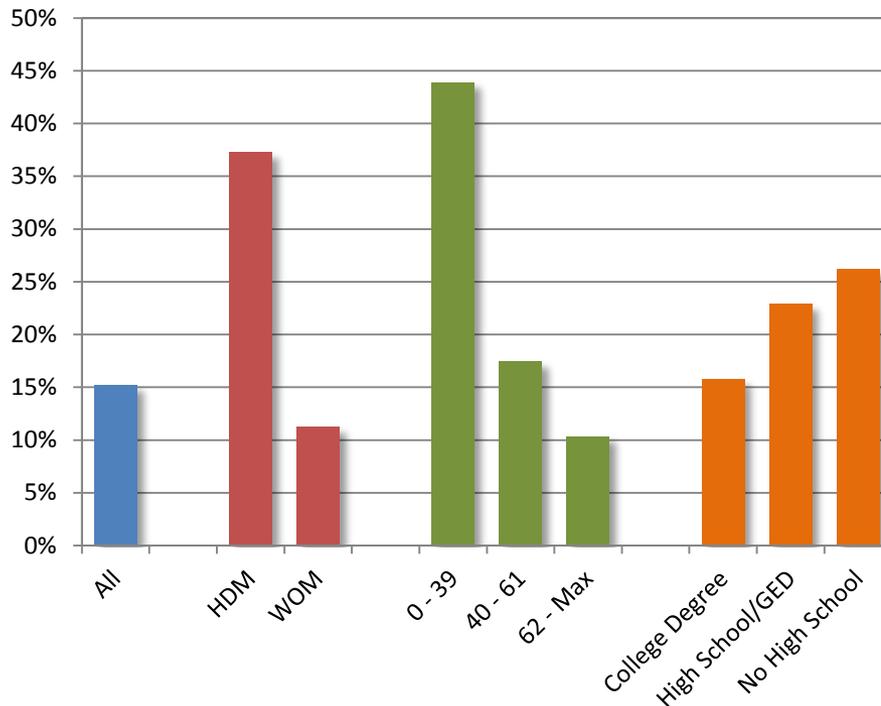
Source:

¹Survey of Consumer Finances and notes from Data from SCF Bulletins

- Between 2007 and 2010, the typical (median) family lost 39 percent (\$49,539) of its net worth.
- Except for the top 10 percent, every income group has lost wealth since 2007.
- Overall, the bottom 80 percent of households has lost two decades worth of wealth.
- Those in the 20 to 40 percent income quintile — the “working poor” — have had 40 percent less wealth than they did in 1992.
- How do we manage downside risk, at both the household and national level?

Household Balance Sheets Now: Net Worth by Age, Race, and Education¹

Percentage Losses In Mean Net Worth
2007-2010²



Who lost the most wealth from the Great Recession (means)?

- Overall: -15.2 percent
- By age group:
 - Under 40: -43.9 percent
 - Age 40-61: -17.4 percent
 - 62 or older: -10.3 percent
- By race or ethnicity:
 - Historically disadvantaged families (HDM; African-American and Hispanics of any race) : -37.2 percent
 - Whites, Asians, and other minorities (WOM): -11.2 percent
- By educational attainment:
 - Less than HS degree: -26.1 percent
 - High-school grads: -22.9 percent
 - College grads: -15.7 percent

Sources:

¹Emmons and Noeth, 2012

²Survey of Consumer Finances

Household Balance Sheets Now: The Racial Wealth Gap

The Racial Wealth Gap¹

Year	Overall Wealth Gap (Net Worth)	Wealth Gap Without Home Equity (Net Financial Assets)
1984	\$85,000	\$30,000
2009	\$236,000	\$106,000

- Income, home ownership, and inheritance are the biggest contributors in the rising racial wealth gap while demographic and cultural factors appear to account for insignificant amounts, if any¹.
- A \$1.00 increase in income results in \$5.00 of wealth for whites, but only \$0.70 for African-Americans¹.
- In 2009, median net worth was \$113,149 for whites, \$6,325 for Hispanics, and \$5,677 for blacks².
- About one-third of black (35 percent) and Hispanic (31 percent) households had zero or negative net worth in 2009, compared with 15 percent of white households².

Sources:

¹Shapiro, 2012

²Pew Research Center, 2011

Household Balance Sheets Now: Looking Ahead

- Four balance sheet failures → Four balance sheet challenges
- We will proactively research and help rebuild household balance sheets, in four ways:
 - As a conceptual framework, adding coherence and power to existing and future research and analysis
 - As a barometer of the financial health of struggling families and communities, whose numbers now reach well into the middle class
 - As a way to develop, not just protect, families
 - As more conspicuous contributors to economic growth, better connecting the health of households to the health of the broader economy
- “Our overall economic stability relies ultimately on the collective financial health of all American households.”
 - *Fed Governor Sarah Bloom Raskin, June 2011*

Household Balance Sheets: Three Core Questions

- *What is the state of the American balance sheet?*
 - What can we say, quantitatively, about the overall health of household balance sheets?
 - Ongoing research and publications
 - Household balance sheet index
 - Household balance sheet clearinghouse

Household Balance Sheets: Three Core Questions (continued)

- *Why does it matter?*
 - What are the economic and social outcomes, at both the household and macro levels, associated with varying levels of savings, assets, and net worth?
 - “Why Household Balance Sheets Matter” Research Symposium, February 5-7, 2013, St. Louis, in partnership with our Research Department and Washington University in St. Louis

Household Balance Sheets: Three Core Questions (continued)

- *What can we do to improve household balance sheets?*
 - What are the implications of our research for future research, public policy, community practice, financial institutions, and households?
 - Testimony to the U.S. Senate Banking Committee, Oct. 2011
 - Promising Pathways to Wealth Building Financial Services Forum, October 25-26, 2012, St. Louis
 - Various “Household Balance Sheet” forums in the 8th District, and beyond
 - Co-sponsor: CFED Assets Learning Conference; New America Foundation “Assets@21” Symposium; Federal Reserve System 2013 CD Research Conference; Speaker Series with Washington University in St. Louis

Who Suffered the Most During the Crisis and Why?



William R. Emmons

Assistant Vice President and Economist
Federal Reserve Bank of St. Louis

Bryan J. Noeth

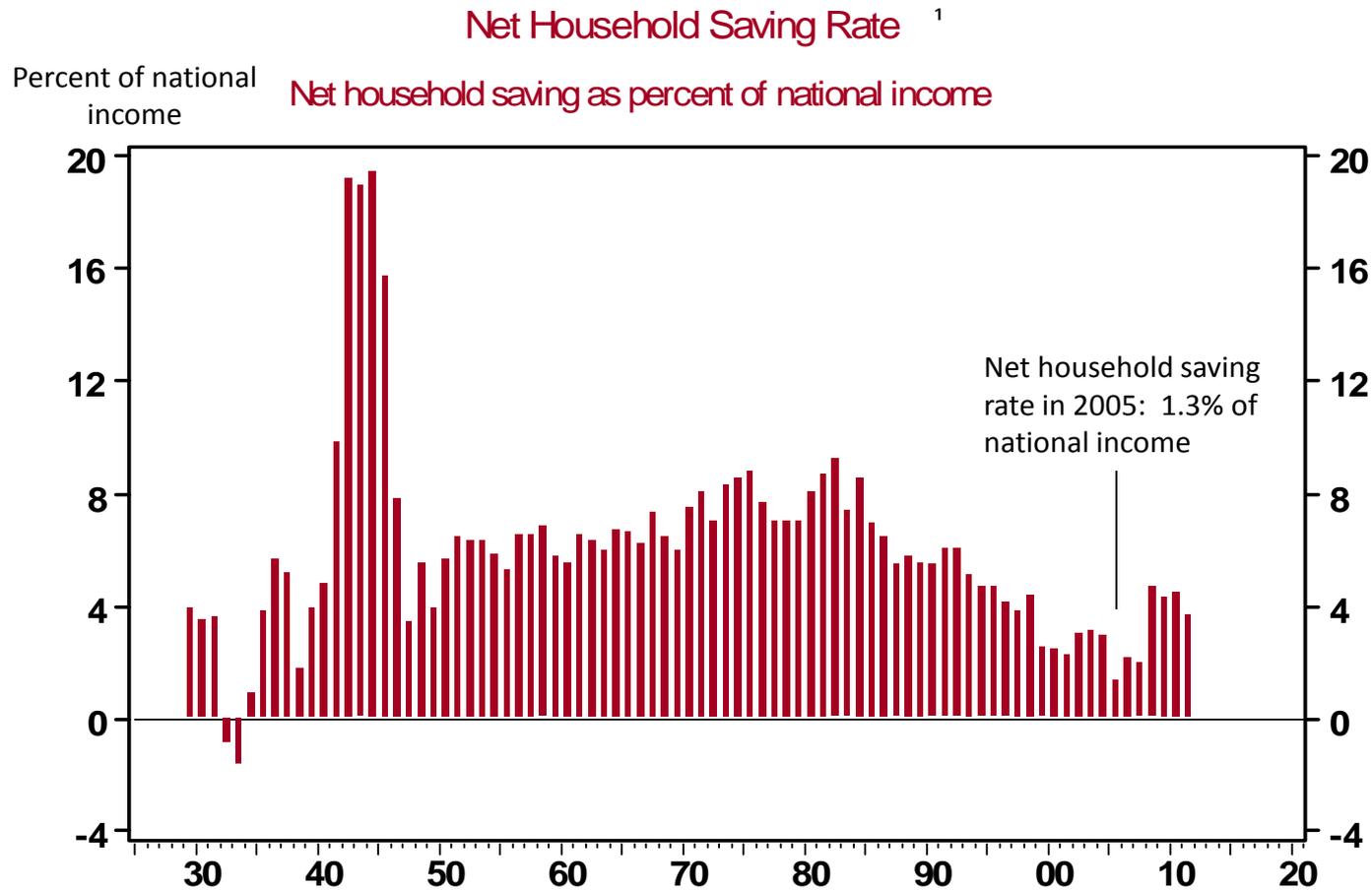
Policy Analyst
Federal Reserve Bank of St. Louis



Who Suffered the Most During the Financial Crisis and Why?

- Wealth losses across the population during the crisis (2007 to 2010)
 - Historically disadvantaged minorities
 - Families without college degrees
 - Young families
- Why did young homeowners lose so much wealth?

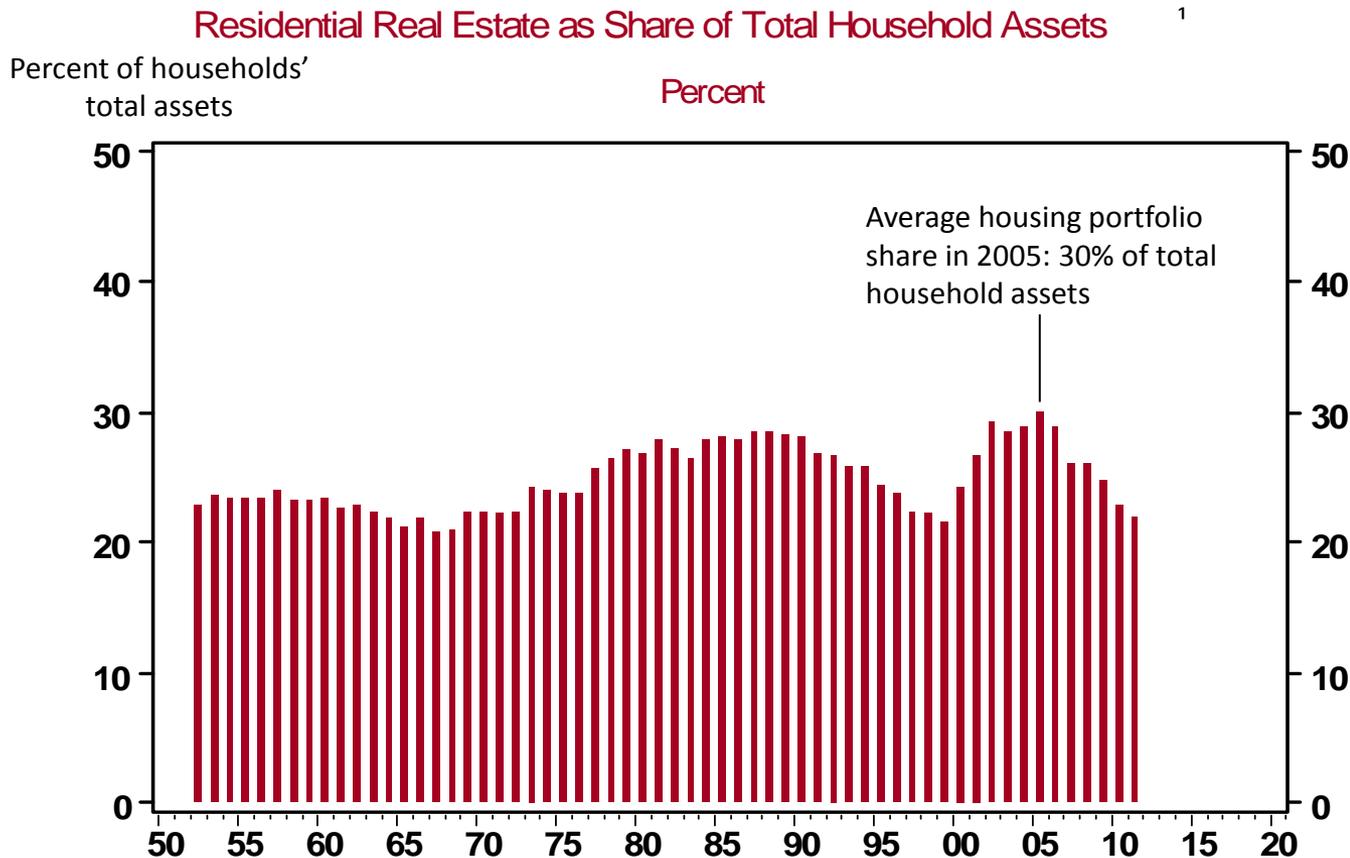
Household Saving Rate in 2005-07 at Lowest Level Since the 1930s



Sources:

¹Haver Analytics and Bureau of Economic Analysis, annual data 1929-2011

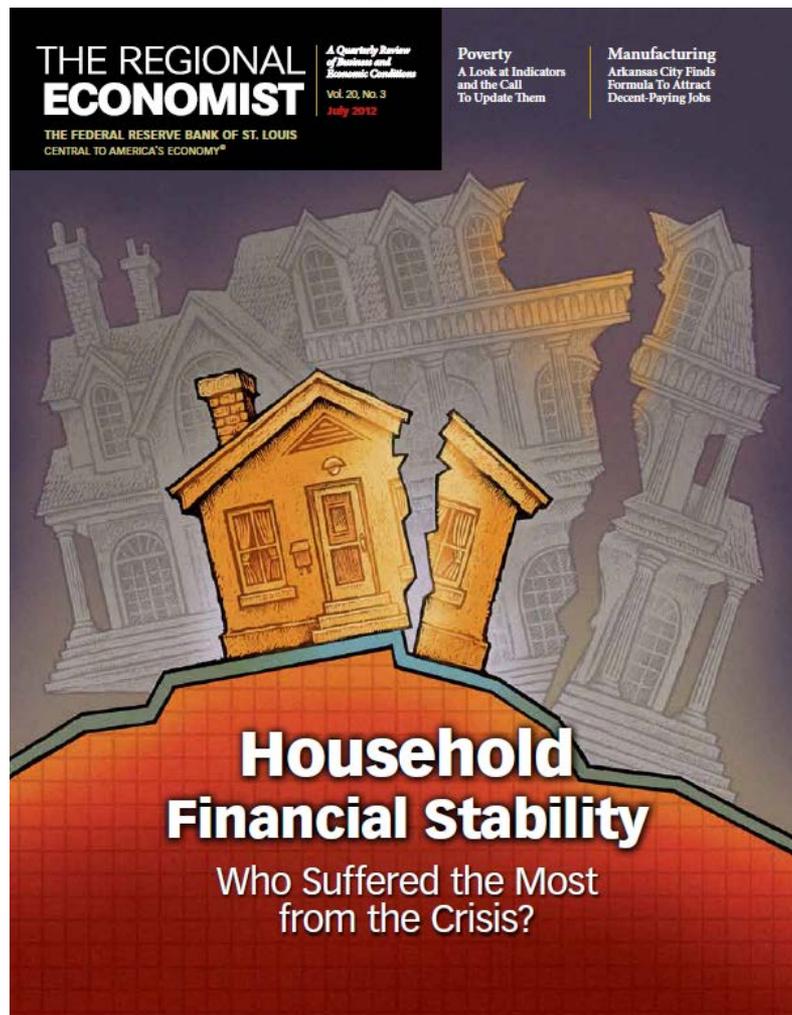
Peak Concentration of Household Portfolios in Housing in 2005



Sources:

¹Haver Analytics and Federal Reserve, annual data 1952-2011

Wealth Losses During the Crisis: Findings from the Survey of Consumer Finances



Wealth Losses During the Crisis: Change in Average Family Net Worth Between 2007 and 2010

- Federal Reserve's Survey of Consumer Finances
 - Eight cross-sectional samples, 1989 to 2010 (tri-ennial)
 - Panel study, 2007 to 2009
- “Average family” lost 15 percent (-\$88,464)
- Largest average losses
 - Young families (under 40): -44 percent
 - Historically disadvantaged minority families (African-American and Hispanic): -37 percent
 - Families with low levels of education (less than high school degree): -26 percent

Changes in Average Family Net Worth Between 2007 and 2010¹

Family group		Percent change in average family net worth between 2007 and 2010
All families		-15%
All older families (62 and older)		-10%
All middle-aged families (40 to 61 years old)		-17%
All younger families (under 40)		-44%
	All younger whites, Asians, and other non-disadvantaged minorities	-41%
	Younger Historically Disadvantaged Minorities: African-Americans and Hispanics of any race	-59%
	Young HDM college grads	-66%
	Young HDM high-school grads	-53%
	Young HDM high-school drop-outs	-64%

Source:

¹Survey of Consumer Finances (2012)

Wealth Losses During the Crisis: Change in Median Family Net Worth Between 2007 and 2010

“Median family” lost 39 percent (-\$49,539)

Median wealth losses—

By age group:

- Young families (under 40): -38 percent
- Middle-aged families (40-61): -43 percent
- Older families (40-61): -7 percent

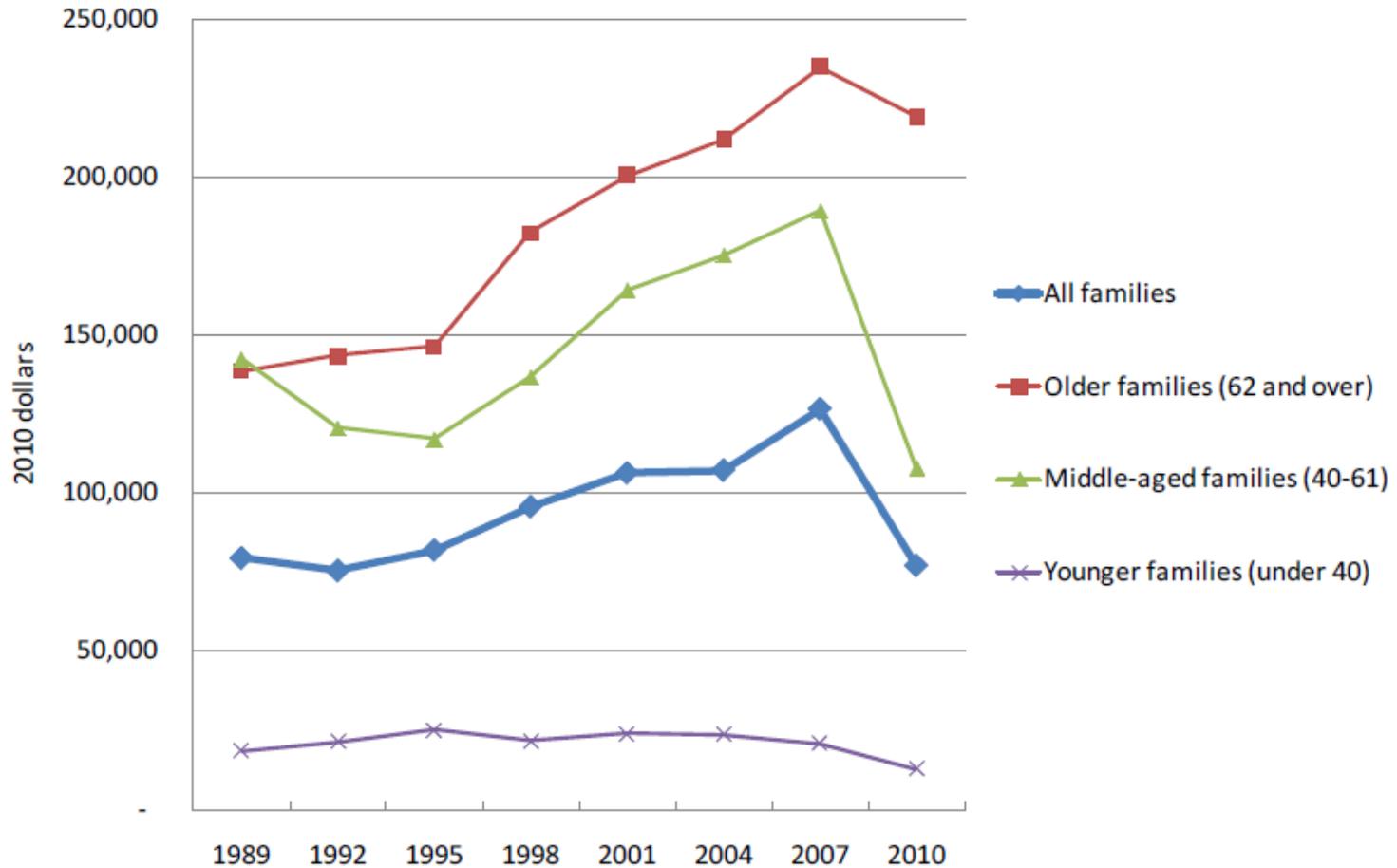
By race or ethnicity:

- Historically disadvantaged minority families (African-American and Hispanic): -29 percent
- Whites, Asians, and other minorities: -30 percent

By educational attainment:

- Less than HS degree: -53 percent
- High school grads: -37 percent
- College grads: -35 percent

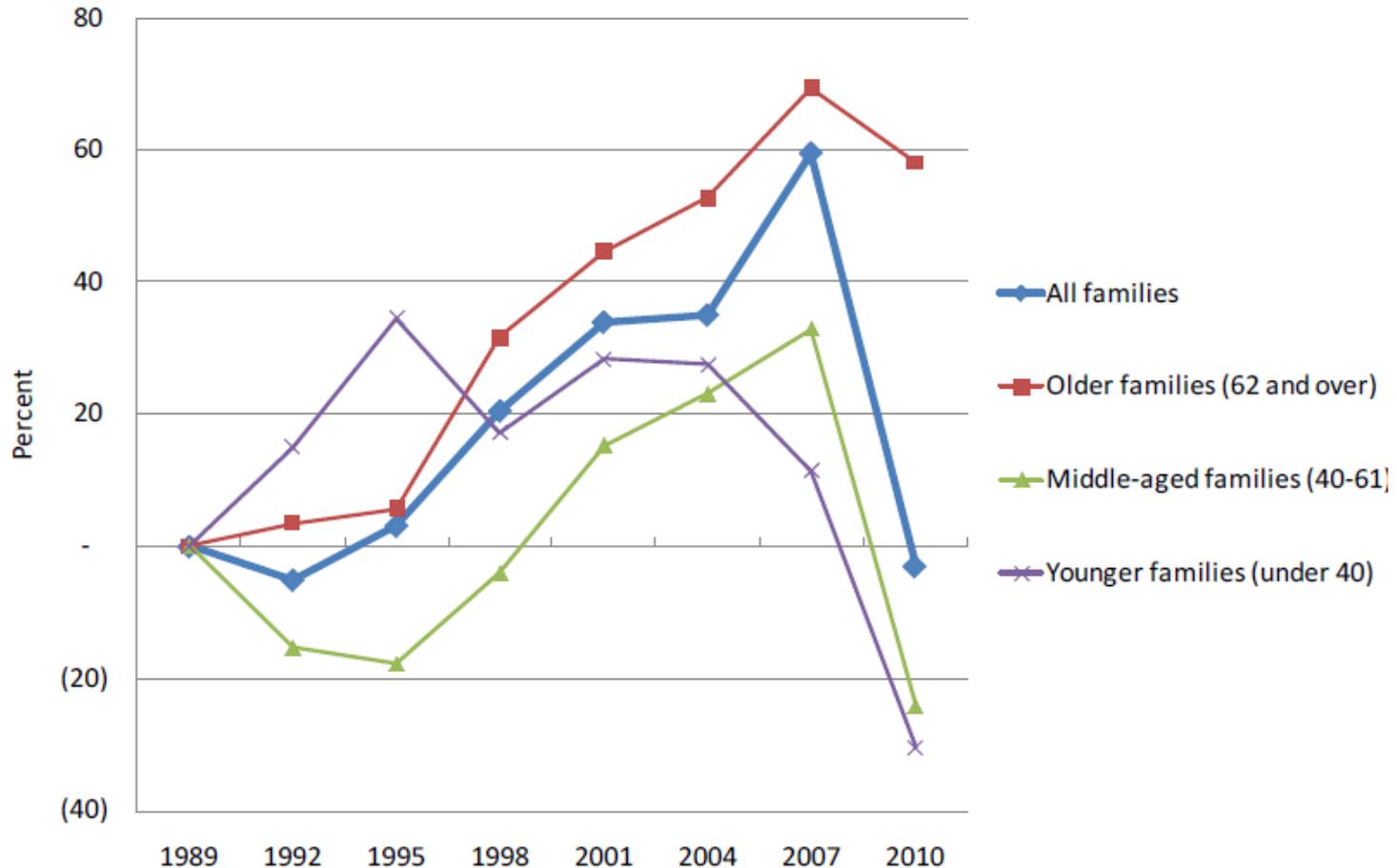
Median Net Worth by Age Group Since 1989¹



Source:

¹Survey of Consumer Finances

Cumulative Percent Change in Median Net Worth by Age Group Since 1989¹



Source:

¹Survey of Consumer Finances

Wealth and Income Losses During the Crisis

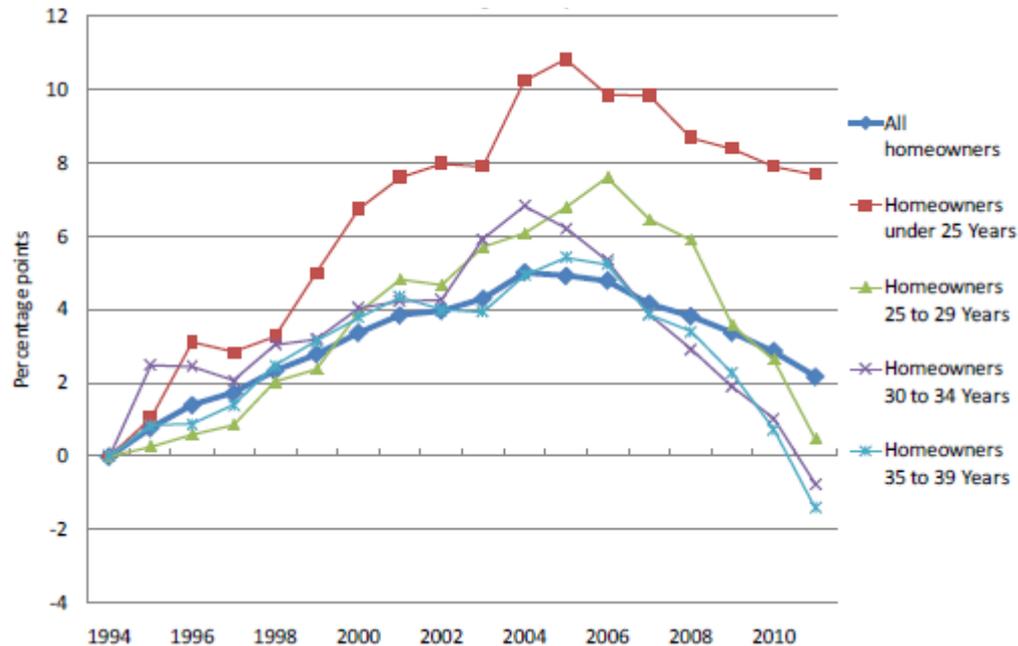
To learn more:

- “Household Financial Stability: Who Suffered the Most During the Crisis?” by William R. Emmons and Bryan J. Noeth, Regional Economist,
www.stlouisfed.org/publications/re/articles/?id=2254
- “Shifting Fortunes: Wealth Trends in the Federal Reserve’s Survey of Consumer Finances,” by William R. Emmons and Bryan J. Noeth, In the Balance, Issue 1-2012,
www.stlouisfed.org/publications/itb/articles/?id=2276
- “Unsteady Progress: Income Trends in the Federal Reserve’s Survey of Consumer Finances,” by William R. Emmons and Bryan J. Noeth, In the Balance, Issue 2-2012,
www.stlouisfed.org/publications/itb/articles/?id=2277

Why Did Young Homeowners Lose So Much Wealth?

- Isn't homeownership a safe way to build wealth and strong communities?
- Not necessarily: we're experiencing the most profound homeownership crisis since the Great Depression; communities are being torn apart.
- How did the "American Dream" turn into a nightmare, especially for young homeowners?

Cumulative Change in Homeownership Rate Since 1994 by Age Group: All Five-Year Age Groups Under 40¹

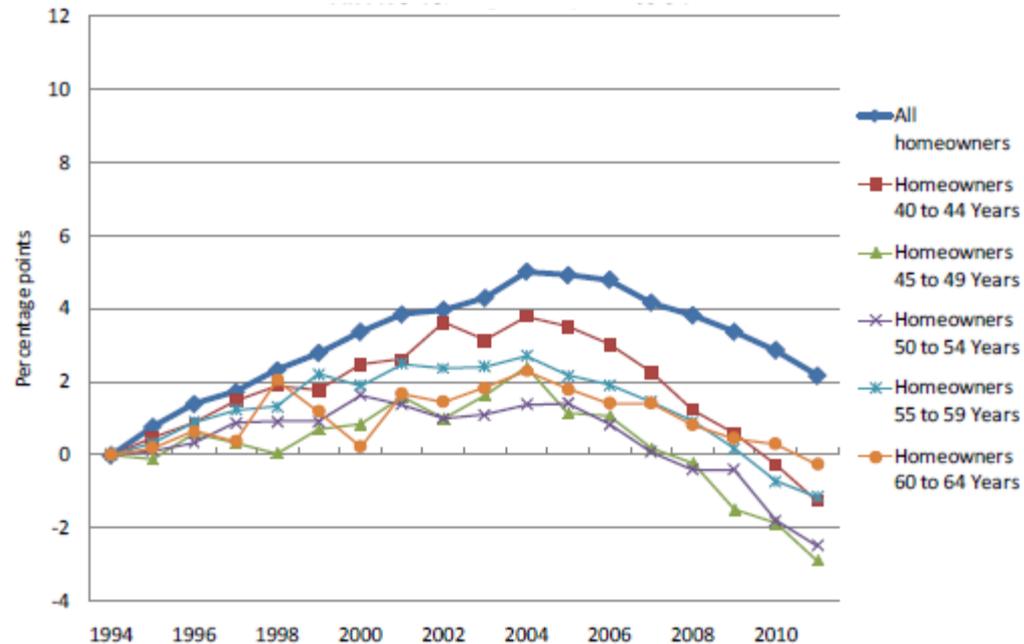


Homeownership rates surged among younger families until 2004 to 2006, then plunged.

Source:

¹Census Bureau

Cumulative Change in Homeownership Rate Since 1994 by Age Group: All Five-Year Age Groups 40 to 64¹

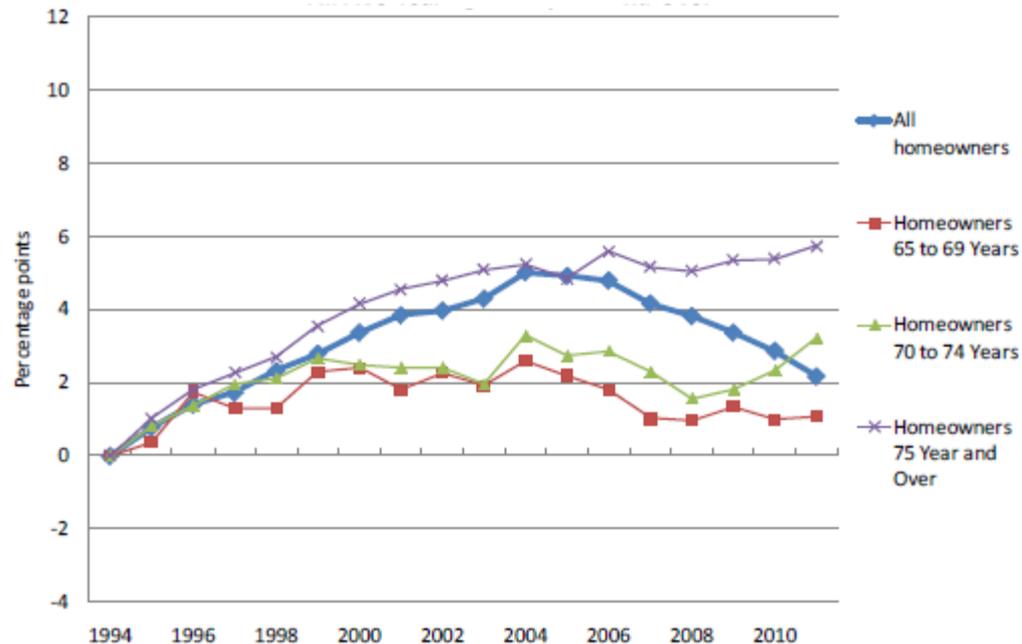


Middle-aged homeownership rates were high already, so they increased less before falling.

Source:

¹Census Bureau

Cumulative Change in Homeownership Rate Since 1994 by Age Group: All Five-Year Age Groups 65 and Over¹

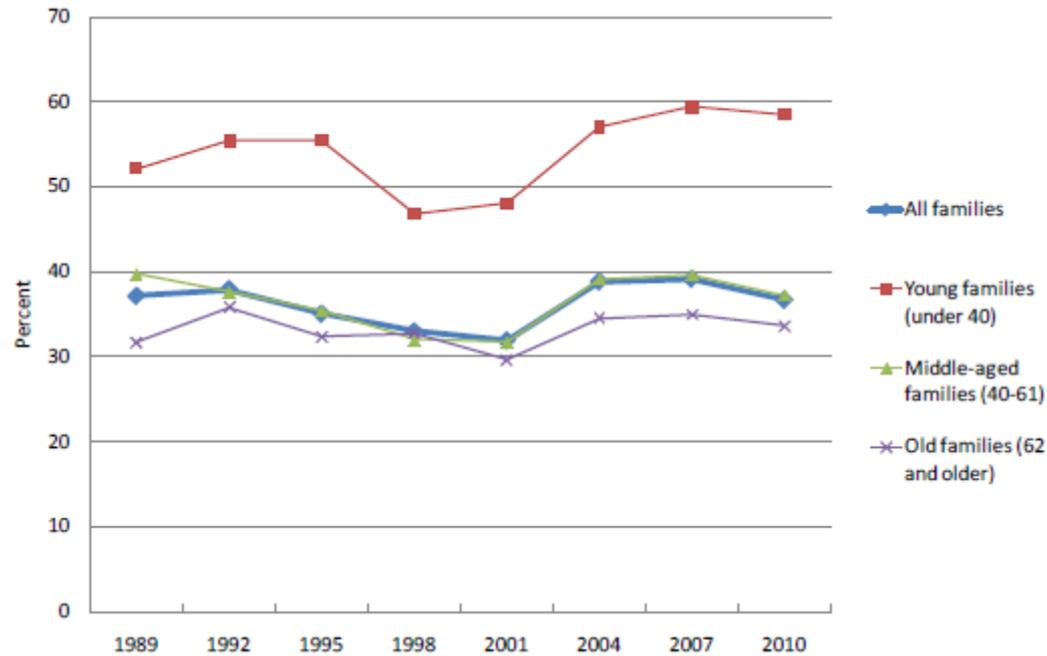


Older households are different: homeownership rates are rising!

Source:

¹Census Bureau

Average Portfolio Share of Residential Real Estate Among All Families¹

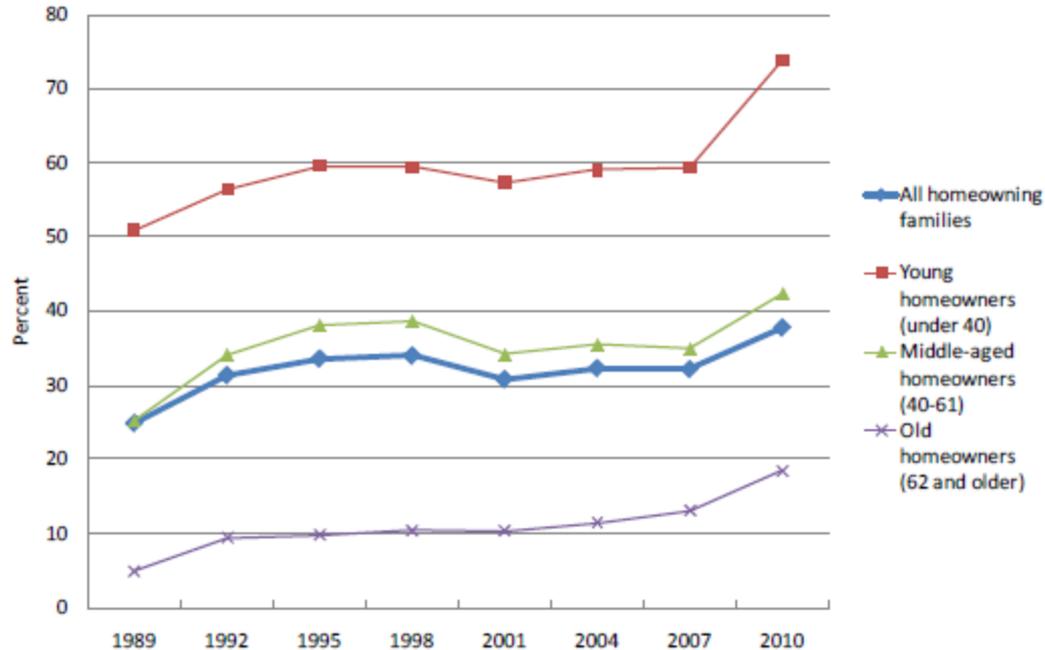


Young families had the most exposure to housing before the crash.

Source:

¹Survey of Consumer Finances

Average Mortgage Loan-to-Value (LTV) Ratios Among Homeowning Families

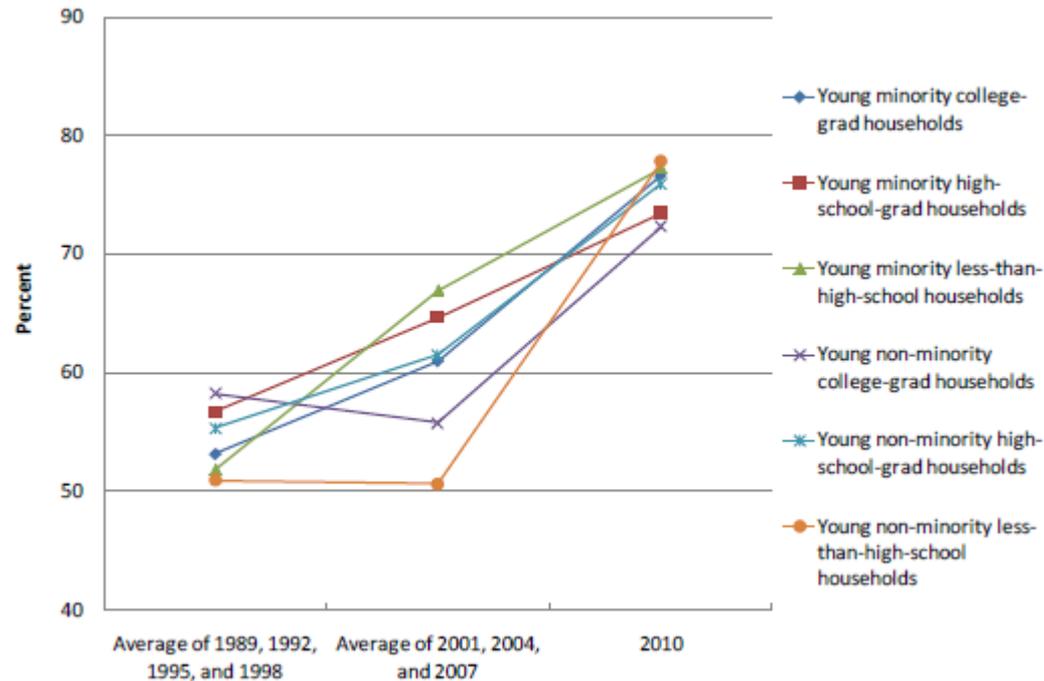


Young families had the most leverage before the crash and now have much more.

Source:

¹Survey of Consumer Finance

Average Mortgage LTV Ratios Among Young Families¹



Young families have high LTV ratios across race/ethnicity and education levels.

Source:

¹Survey of Consumer Finances (2012)

Older Families' Loss of Wealth¹

40 percent of older families' loss of wealth between 2007 and 2010 was due to housing.

Old families (62 and older)	CHANGES IN:	2007-10 change in dollars	2007-10 change in percent	Contribution to decline in net worth (%)
	Durable goods	418	1.60	-0.5
	Financial and business assets	(46,327)	(7.73)	49.9
	Residential real estate	(36,721)	(11.34)	39.6
	Total assets	(82,629)	(8.71)	89.1
	LESS CHANGES IN:			
	Non-mortgage debt	(579)	(6.88)	-0.6
	Mortgage debt	10,697	25.28	11.5
	Total liabilities	10,118	19.95	10.9
	EQUAL:			
	Change in net worth	(92,748)	(10.32)	100.0

Source:

¹Survey of Consumer Finances (2012)

Middle-Aged Families' Loss of Wealth¹

53 percent of middle-aged families' loss of wealth between 2007 and 2010 was due to housing.

Middle-aged families (40 to 61)	CHANGES IN:	2007-10 change in dollars	2007-10 change in percent	Contribution to decline in net worth (%)
	Durable goods	(1,467)	(5.22)	1.2
	Financial and business assets	(57,437)	(12.00)	47.1
	Residential real estate	(64,819)	(20.03)	53.2
	Total assets	(123,723)	(14.90)	101.5
	LESS CHANGES IN:			
	Non-mortgage debt	1,560	9.17	1.3
	Mortgage debt	(3,435)	(3.04)	-2.8
	Total liabilities	(1,875)	(1.44)	-1.5
	EQUAL:			
	Change in net worth	(121,847)	(17.40)	100.0

Source:

¹Survey of Consumer Finances (2012)

Young Families' Loss of Wealth¹

75 percent of young families' loss of wealth between 2007 and 2010 was due to housing.

Young families (under 40)	CHANGES IN:	2007-10 change in dollars	2007-10 change in percent	Contribution to decline in net worth (%)
	Durable goods	(3,074)	(16.62)	4.5
	Financial and business assets	(31,596)	(32.25)	46.4
	Residential real estate	(51,014)	(35.85)	74.9
	Total assets	(85,685)	(33.11)	125.9
	LESS CHANGES IN:			
	Non-mortgage debt	(570)	(2.98)	-0.8
	Mortgage debt	(17,044)	(20.18)	-25.0
	Total liabilities	(17,614)	(17.00)	-25.9
	EQUAL:			
	Change in net worth	(68,071)	(43.87)	100.0

Source:

¹Survey of Consumer Finances (2012)

Why Did Young Homeowners Lose So Much Wealth During the Crisis?

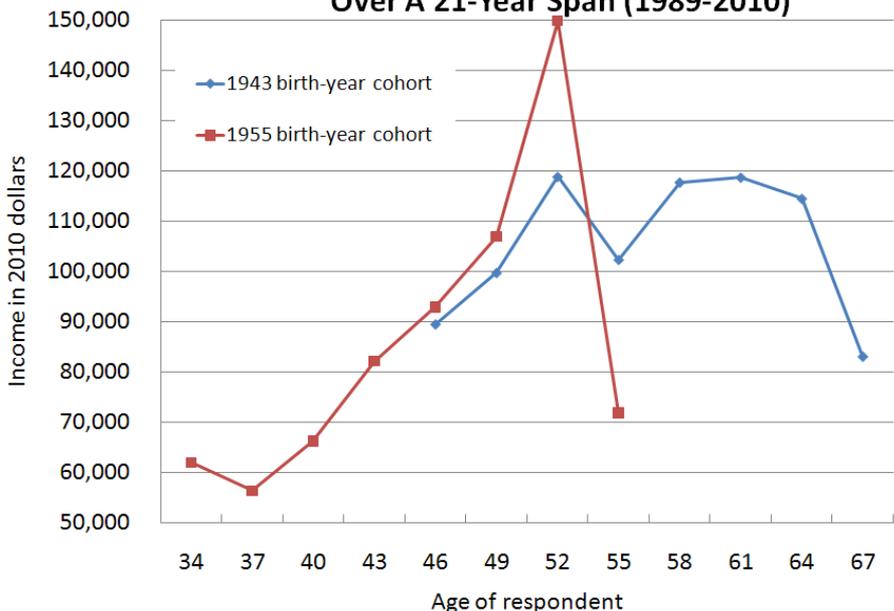
- Characteristics of young homeowners:
 - Highly concentrated in housing
 - Extreme leverage
- We find evidence that these characteristics of young homeowners were even more pronounced as the crisis hit, a consequence of the “bubble mentality” that infected the nation.

Any Good News?

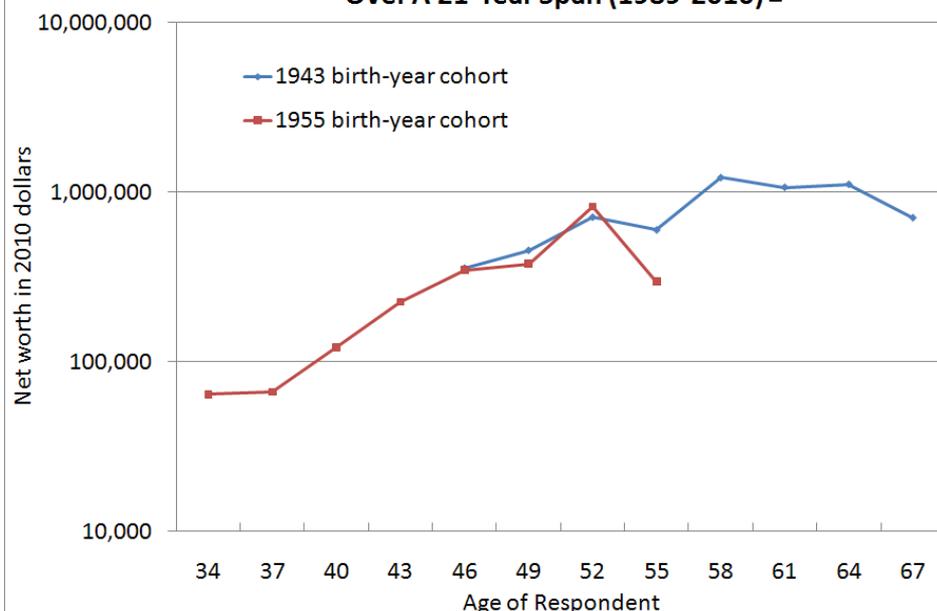
- Young families have a long time to recover.
- Young families that were not yet homeowners face lower house prices.
- Sad as it is, defaulting on an underwater mortgage actually improves the family's balance sheet as a "fresh start."
- We may learn from this experience:
 - There's no rush to become a homeowner.
 - Use less leverage.
 - Portfolio diversification matters for the young, too.

Another Hard-Hit Group: Baby Boomers Born in the Mid-1950s

Median Incomes For Two Birth-Year Cohorts Observed Over A 21-Year Span (1989-2010)¹



Median Net Worth For Two Birth-Year Cohorts Observed Over A 21-Year Span (1989-2010)²



Sources:

^{1,2}Survey of Consumer Finances (2012)

Overview of the Household Financial Stability Initiative

- Overview article by Jim Bullard from the *Regional Economist* :
 - “The Financial Crisis and Household Balance Sheets: A New Research Effort Underway at the St. Louis Fed”
<http://www.stlouisfed.org/publications/re/articles/?id=2257> .
- See also www.stlouisfed.org/hfs for more publications, past and upcoming events, and other information.

Household Stability Work in Progress

Look for these articles in 2013:

- “Why Did Young Families Lose So Much Wealth During the Crisis? The Role of Homeownership,” by William R. Emmons and Bryan J. Noeth, forthcoming in Federal Reserve Bank of St. Louis Review
- “Rebuilding Household Financial Stability,” by Ray Boshara and William Emmons, forthcoming in Federal Reserve Bank of St. Louis 2012 Annual Report
- Margaret Sherraden, William Emmons, Nancy Morrow-Howell, and Bryan Noeth, “Financial Vulnerability and Capability Across the Life Course,” 2012 working paper

Do you have questions?
E-mail us at:
communities@stls.frb.org

Wrap-up/Closing

Thank you to today's presenters and to all participants for joining this session.

Next steps:

- All session materials are available on our web site and in the next few days we will be posting an audio file of today's session
- Additional Federal Reserve System resources related to this topic can be found on our web site along with links to your local Federal Reserve Community Development office
- If you have topical suggestions for future sessions, or any questions about this program, please feel free to contact us at communities@stls.frb.org
- Information about future sessions will be posted on our website along with archived materials from past sessions: www.stlouisfed.org/connectingcommunities/