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Why Financial Inclusion Matters: The Household Balance Sheet Perspective

Promising Pathways to
Wealth-Building Financial Services
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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 generation (Conley, 2009).
- Financial capital is one of the three strongest predictors of economic mobility (Butler, Beach and Winfee, 2008).
- Small amounts of wealth at the right moments can have a "transformative" effect on the life course (Shapiro, 2004).
- 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 event (McKernan, Ratcliffe, and Vinopal, 2009).
- Liquid and non-liquid assets are positively associated with later college completion, while unsecured debt is negatively associated with college completion (Zhan and Sherraden, 2009).
- 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 life (Shanks *et al*., 2009; Elliott and Beverly 2010).
- Among adults in the bottom income quartile from 1984–1989, 34% left the bottom by 2003-2005 if their initial savings were low, compared with 55% who left the bottom if their initial savings were high. Also, 71% of children born to high-saving, low-income parents move up from the bottom income quartile over a generation, compared to only 50% of children of low-saving, low-income parents (Cooper and Luengo-Prado, 2009).

Why Household Balance Sheets?

Strong balance sheets contribute to economic growth

- During the three decades preceding the financial crisis, consumer spending contributed nearly 71% of the nation's economic growth (Emmons, 2012).
- Weak household balance sheets suppress consumer spending, which leads to higher unemployment, which further suppresses consumer spending, and so on (Emmons, 2011).
- 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 weakness (Mian and Sufi, 2011).
- This is the first recession in U.S. history where deleveraging really matters (Bullard, 2012).
- It is the combination of declining housing prices *and* over-indebtedness that explains the severity of the contraction (International Monetary Fund, 2012).
- 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 effects (Dynan, 2012).
- 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 consumption (Case, Quigley, and Shiller, 2011).

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% of U.S. households are unbanked or under-banked (FDIC, 2012).
- ***Had low levels of savings.*** In 2005, net household savings reached its lowest level since the 1930s (Federal Reserve, Bureau of Economic Analysis).
- ***Incurred high levels and risky types of consumer and mortgage debts.*** By 2007, the ratio of household debt to GDP reached its highest level since the 1950s; more household debt was accumulated between 2001-2007 than in the previous 45 years (Federal Reserve, Bureau of Economic Analysis; Sufi and Mian, 2010).
- ***Did not diversify their assets sufficiently beyond housing.*** By 2005, we reached the greatest concentration of wealth in housing since at least 1952 (Federal Reserve).

Plus, misguided faith in ever-rising asset values…

Helped drive the financial crisis and ensuing economic downturn.

Household Balance Sheets Now: Savings

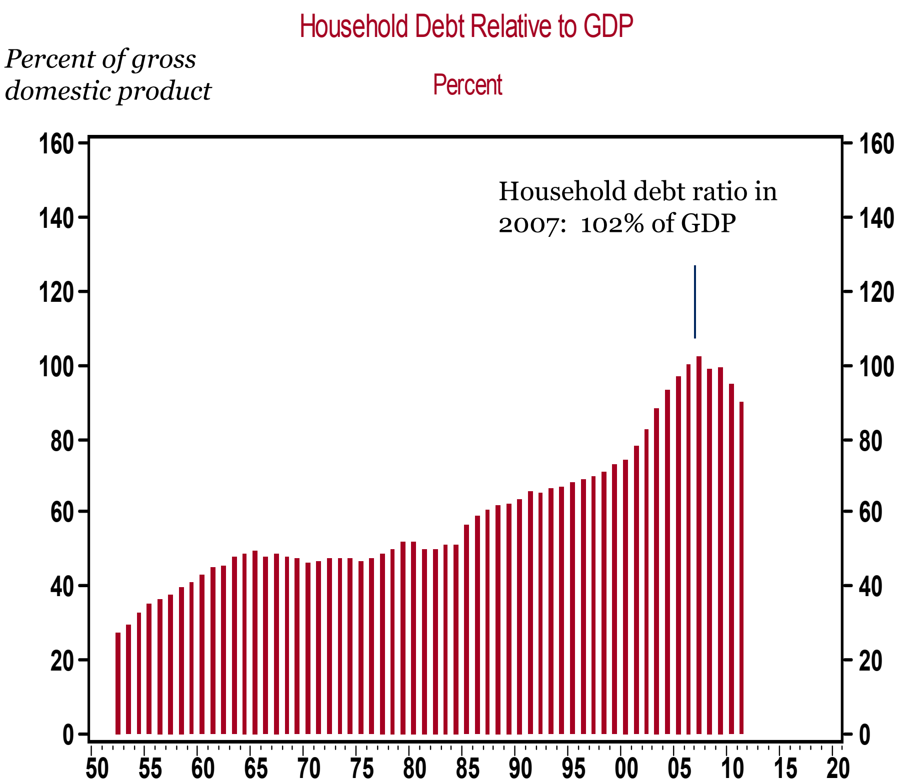
Roughly half of all Americans lack sufficient savings or report feeling "financial fragile":

- The number of families reporting having at least $3,000 in liquid savings has declined from nearly 53% in 2007 to around 48% in 2010—despite the fact that households reported in 2010 that liquid savings, instead of retirement savings, is now their top savings priority (Federal Reserve Survey of Consumer Finances, 2012).

- 43% of Americans households do not sufficient liquid assets to subsist at the poverty level for three months in the absence of income (CFED, 2012). If considering household net worth, the asset poverty rate falls to 27%—still substantially higher than the 2011 official income poverty rate of 15% (CFED, 2012; Census Bureau, 2012).

- Nearly half of all Americans consider themselves financially fragile, meaning that they would "probably" (22.2%) or "certainly" (27.9%) be unable to come up with $2,000 in 30 days from *any* source to cope with a financial emergency (Lusardi, Schneider, and Tufano, 2011).

Household Balance Sheets Now: Debt



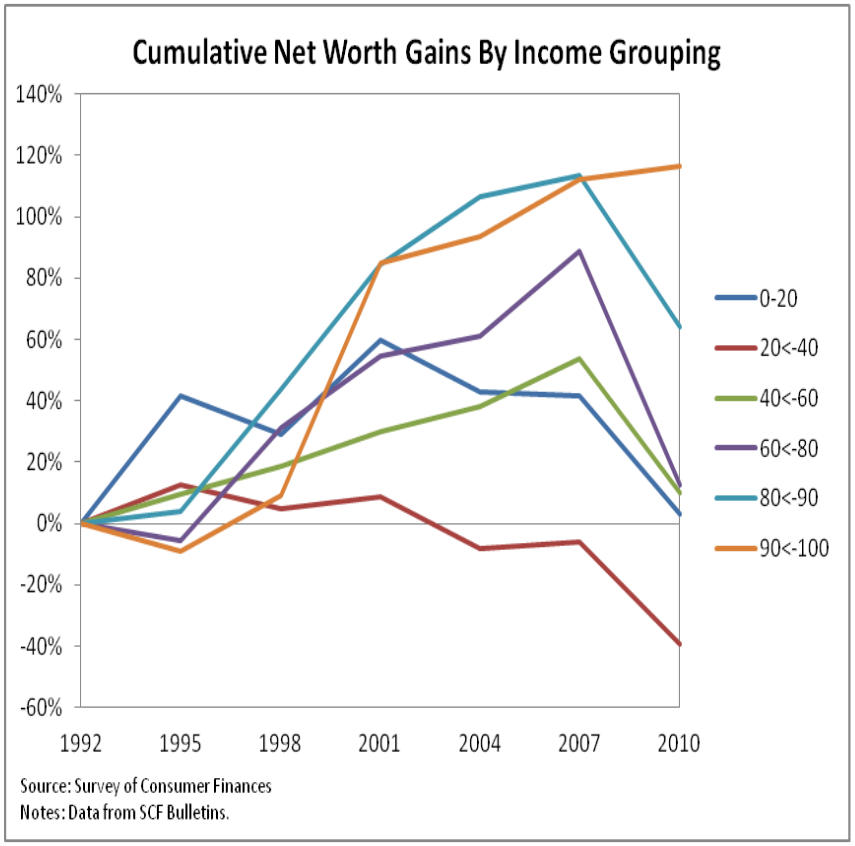
Sources: Federal Reserve, Bureau of Economic Analysis / Haver Analytics

- By 2007, the ratio of household debt to GDP reached its highest level since the 1950s (Federal Reserve, 2012; Haver Analytics, 2012).

- More household debt was accumulated between 2001-2007 than in the previous 45 years (Sufi and Mian, 2010).

- Roughly three-quarters of total household debt is mortgage debt, and approximately 22% of homeowners nationwide have negative equity (Federal Reserve, 2011; Core Logic, 2011).

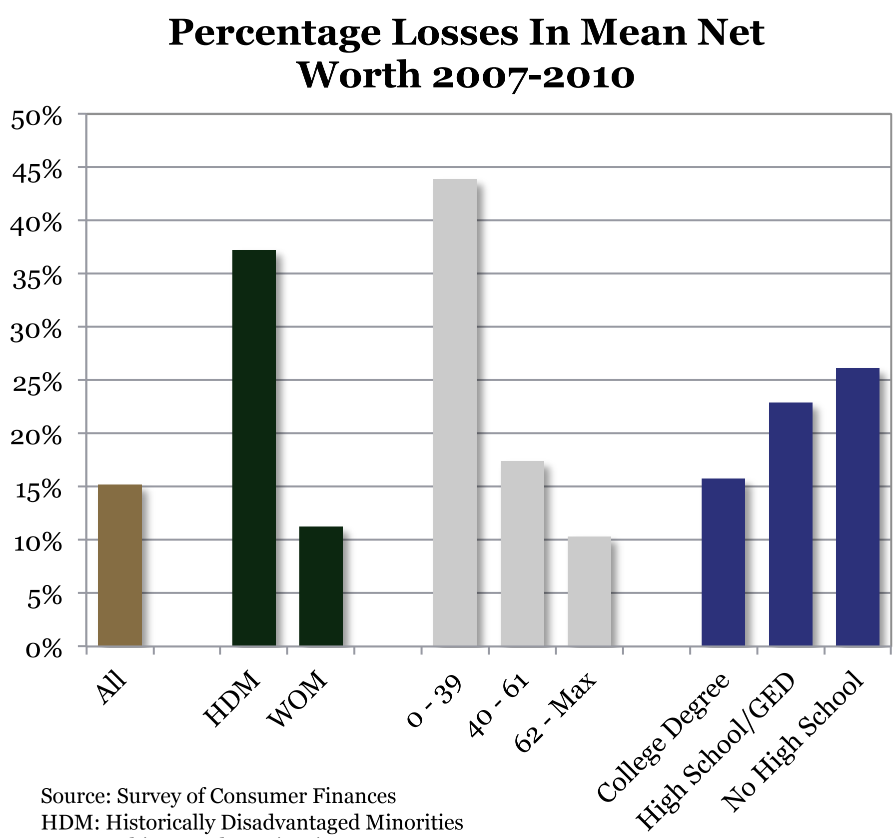
Household Balance Sheets Now: Net Worth by Income



- Between 2007-2010, the typical (median) family lost 39% ($49,539) of its net worth.
- Except for the top 10%, every income group lost wealth since 2007.
- Overall, the bottom 80% of households has lost two decades worth of wealth.
- Those in the 20-40% income quintile—the "working poor"—had had 40% 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 Education

(Emmons and Noeth, 2012)



Source: Survey of Consumer Finances
HDM: Historically Disadvantaged Minorities
WOM: White or Other Minority

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

- Young families
  - Under 40: -43.9%
  - Age 40-61: -17.4%
- Historically disadvantaged families
  - African-American and Hispanic (HDM): -37.2%
  - Whites, Asians and other minorities (WOM): -11.2%
- Less-educated families
  - < HS degree: -26.1%
  - High-school grads: -22.9%

Household Balance Sheets Now: The Racial Wealth Gap

Year	Overall Wealth Gap (Net Worth)	Wealth Gap w/o Home Equity (Net Financial Assets)
1984	$85,000	$30,000
2009	$236,000	$106,000

Source: Shapiro, 2012

- 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 any (Shapiro, 2012).
- A $1.00 increase in income results in $5.00 of wealth for whites, but only $0.70 for African-Americans (Shapiro, 2012).
- In 2009, median net worth was $113,149 for whites, $6,325 for Hispanics, and $5,677 for blacks (Pew Research Center, 2011).
- About a third of black (35%) and Hispanic (31%) households had zero or negative net worth in 2009, compared with 15% of white households (Pew Research Center, 2011).

Household Balance Sheets: Looking Ahead

Four balance sheet *failures* → Four balance sheet *challenges*

We will proactively research and help rebuild household balance sheets, in four ways:

1. As a conceptual framework, adding coherence and power to existing and future research and analysis.
2. As a barometer of the financial health of struggling families and communities, whose numbers now reach well into the middle class.
3. As a way to develop, not just protect, families.
4. 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

1. *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

2. *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

3. *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?*
   - 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 "Assets@21" Symposium; Federal Reserve System 2013 CD Research Conference; Speaker Series with Washington University in St. Louis

Why Financial Inclusion Matters

- Financial inclusion—accessing and using wealth-building financial services—is the *sine qua non* of a healthy balance sheet. If we don't get that right, then we can't get the rest of the balance sheet right.
- Imagine a baseball park: Only those at bat have a chance of running the bases and hitting financial home run. Unbanked and under-banked households are not even in the ballpark. We need to get more of these households in to the ballpark and a chance at bat.
- What are the routes, the gateways, the on-ramps in to the ballpark? Today we'll be looking at both bank *and* non-bank routes to financial inclusion. How far, for example, does mobile get us? Pre-paid cards? Simple account ownership? Savings strategies? Payment and credit products? What's the balance between "tech" and "touch"? What products and distribution channels will get more households in to the ballpark, and *keep* them in the ballpark?
- And we'll look at values, too: Should we be "agnostic" about these routes? Should our focus be on "quality" instead?
- What's best for consumers? What routes lead to a stronger balance sheet, upward mobility, and a growing economy?