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The Financial Crisis and Household Balance Sheets: A New Research Effort Under Way at the St. Louis Fed

The Great Recession set in motion numerous adverse repercussions, with damage to household balance sheets being especially pronounced. As reported by Bill Emmons and Bryan Noeth in this issue of *The Regional Economist*, household wealth declined nearly $17 trillion in inflation-adjusted terms, or 26 percent, from mid-2007 to early 2009, with only about two-fifths of that loss recovered by early 2012. Emmons and Noeth found that wealth losses hit older, wealthier Americans (who had the most to lose) the hardest in terms of absolute dollars, but affected younger, less-educated and minority households the most in terms of percentage.

Not surprisingly, the adjustments required by the damage to household balance sheets are ongoing and are likely to take years to complete. In fact, this is the first U.S. recession in which household "deleveraging"—the slow, painful process of families paying down their debts and rebuilding their savings—has played a key role. Steep declines in housing prices, along with historically high levels of household debt before the crash, made this recession particularly severe. The International Monetary Fund recently reported that "housing busts preceded by larger run-ups in gross household debt are associated with significantly larger contractions in economic activity."[1] The unprecedented debt overhang leaves the Federal Reserve with a seemingly paradoxical policy, at least with respect to many households: Monetary policy has kept interest rates low to encourage borrowing in the context of an economy with too much borrowing.

As Fed policymakers continue to work through this paradox, a clear challenge remains to define mechanisms whereby Americans, especially low- and moderate-income Americans, can rebuild their balance sheets, which will help both struggling families and the stagnant economy move forward. Too many Americans were unbanked or underbanked, too many did not save enough, too many ran up their debts or accumulated risky debt, and too many did not diversify their assets beyond housing. How can we turn each of these balance sheet failures around? How can we help families consider their *entire* balance sheet?

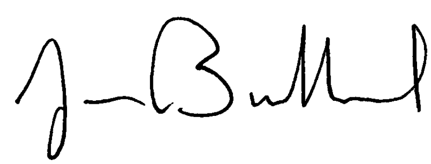
To help meet these challenges, I am pleased to report that the St. Louis Fed has begun a research initiative on the topic of household financial stability. This new initiative will focus on three key questions:

1. What is the state of household balance sheets in this country—what can we say, quantitatively, about the health of household balance sheets in aggregate but, especially, by age, race, education level, income and other demographic factors?
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?
3. What can we do to improve household balance sheets—what are the implications of our research for public policy, community practice, financial institutions and households?

Many in the Federal Reserve System have been studying family balance sheets for years. What we hope to offer is a broad conceptual framework, a common table where those throughout the System and beyond learn and work together. We also plan to publish research offering new perspectives on balance sheets and why they matter. In addition, we are constructing a balance sheet data clearinghouse, modeled on the St. Louis Fed's FRED® (Federal Reserve Economic Data) database; creating a balance sheet index to gauge the health of American balance sheets; and organizing research symposia, practitioner forums, a speaker series and other activities to understand and improve family balance sheets.

Ray Boshara, who joined the St. Louis Fed last year as a senior adviser, will lead the initiative. Ray brings more than 20 years of national experience to this effort; he has advised leading policymakers worldwide on this issue, and, most recently, he was invited to testify last October before the U.S. Senate Banking Committee on rebuilding household balance sheets.[2] We have a high-quality team that will contribute to the project. However, the success of this initiative requires the efforts of many more researchers. As such, our team will work with colleagues throughout the Federal Reserve System and beyond to increase substantially our understanding of household balance sheets.

As we continue to recover from the economic crisis, and as the Federal Reserve approaches its centennial commemoration in 2013, we are challenged to innovate and to think about new ways to help American families and the U.S. economy thrive. We are excited about the contribution that our new household financial stability research initiative can make to this important challenge. Ω



ENDNOTES

1. See International Monetary Fund. *World Economic Outlook: Growth Resuming, Dangers Remain,* April 2012, p. 91.
2. For Boshara's full testimony, see http://www.stlouisfed.org/publications/br/articles/?id=2213