Household Indebtedness And Its Implications For Financial

The Great American Recession resulted in the loss of eight million jobs between 2007 and 2009. More than four million homes were lost to foreclosures. Is it a coincidence that the United States witnessed a dramatic rise in household debt in the years before the recession—that the total amount of debt for American households doubled between 2000 and 2007 to $14 trillion? Definitely not. Armed with clear and powerful evidence, Atif Mian and Amir Sufi reveal in House of Debt how the Great Recession and Great Depression, as well as the current economic malaise in Europe, were caused by a large run-up in household debt followed by a significantly large drop in household spending. Though the banking crisis captured the public's attention, Mian and Sufi argue strongly with actual data that current policy is too heavily biased toward protecting banks and creditors. Increasing the flow of credit, they show, is disastrously counterproductive when the fundamental problem is too much debt. As their research shows, excessive household debt leads to foreclosures, causing individuals to spend less and save more. Less spending means less demand for goods, followed by declines in production and huge job losses. How do we end such a cycle? With a direct attack on debt, say Mian and Sufi. More aggressive debt forgiveness after the crash helps, but as they illustrate, we can be rid of painful bubble-and-bust episodes only if the financial system moves away from its reliance on inflexible debt contracts. As an example, they propose new mortgage contracts that are built on the principle of risk-sharing, a concept that would have prevented the housing bubble from emerging in the first place. Thoroughly grounded in compelling economic evidence, House of Debt offers convincing answers to some of the most important questions facing the modern economy today: Why do severe recessions happen? Could we have prevented the Great Recession and its consequences? And what actions are needed to prevent such crises going forward?

The "debt-overhang hypothesis" -- that households cut back more on their spending in a crisis when they have higher levels of outstanding mortgage debt (Dynan, 2012) -- seems to be taken for granted by macroprudential authorities in several countries in their policy decisions, as well as by the international organizations that evaluate and comment on countries' macroprudential policy. Results are presented for UK microdata that reject the debt-overhang hypothesis. The results instead support the "spending-normalization hypothesis" of Andersen, Duus, and Jensen (2016a), what can also be called the "debt-financed overspending" hypothesis -- that the correlation between high pre-crisis household indebtedness and subsequent spending falls during the crisis reflects high debt-financed spending pre-crisis and a return to normal spending during the crisis. As discussed in Svensson (2019, 2020), this is consistent with the correlation reflecting debt-financed overspending through what Muellbauer (2012) calls the "housing-collateral household-demand" and Mian and Sufi (2018) the "debt-driven household demand" channel. The correlation is thus spurious and an example of omitted-variable bias. A simple model shows that consumption and debt changes are directly and strongly positively correlated, whereas consumption and debt levels are quite weakly negatively correlated. Importantly, and in contrast, examples show that there is no systematic relation between consumption cuts and levels of or changes in LTV ratios. The lack of a robust relation between consumption cuts and levels of or changes in LTV ratios implies that tests of these hypotheses should generally not be done by regressions of consumption cuts on levels of or changes in LTV ratios.

Debt amortization requirements have been suggested as a way to reduce household indebtedness. However, a closer look reveals that amortization requirements may create incentives for both borrowers and lenders to borrow and lend more rather than less. Suppose that a household plans to finance a given housing purchase through a preferred future mortgage path. If that mortgage path violates a new amortization requirement, the household can still achieve its preferred mortgage path, net after savings, by initially borrowing more, investing the excess borrowing in a savings account, and fulfilling the amortization requirement by withdrawals from the savings account over time. This is obvious, if the savings interest rate equals the mortgage rate, because then the excess borrowing is costless. But even if the savings interest rate is less than the debt interest rate, so that the excess borrowing is costly, there remains a strong incentive to initially borrow more than without an amortization requirement. Furthermore, under these circumstances, it is profitable and quite riskless for banks to let borrowers borrow more and invest the excess borrowing in a savings account in the bank, giving lenders an incentive to lend more, not less, than without amortization requirements. Thus, amortization requirements as a way of reducing household indebtedness may be counterproductive.

We live in a culture of credit. As wages have stagnated, we've seen a dramatic surge in private borrowing across the western world; increasing numbers of households are sucked into a hopeless vortex of spiralling debt, fuelled by exploitative lending. In this book Johnna Montgomerie argues that the situation is chronically dysfunctional, both individually and collectively. She shows that abolishing household debts can put an end to austerity and to the unsustainable forward march of debt-dependent growth. She combines astute economic analysis with the elements of an accessible guide to practical policy solutions such as extending unconventional monetary policy to the household sector, providing pragmatic and affordable refinancing options, and writing off the most pernicious elements of household debt. This framework, she contends, can help us to make our economy fairer and to tackle both the housing crisis and accelerating inequality.

The crisis threatens the welfare of about 160 million people in the Europe and Central Asia (ECA) region who are poor or are just above the poverty line. Using pre-crisis household data along with aggregate macroeconomic outturns to simulate the impact of the crisis on households transmitted via credit market shocks, price shocks, and income shocks this report finds that adverse effects are widespread and that poor and non-poor households alike are vulnerable. By 2010, for the region as a whole, some 11 million more people will likely be in poverty and over 23 million more people will find themselves just above the poverty line because of the crisis. The aggregate results mask the heterogeneity of impact within countries, including the concentration of the poverty impact in selected economic sectors. Meanwhile, stress tests on household indebtedness in selected countries suggest that ongoing macroeconomic shocks will expand the pool of households unable to service their debt, many of them from among the ranks of relatively richer households. In fact, already there are rising household loan delinquency rates. Finally, there is evidence that the food and fuel crisis is not over and a new round of price increases, via currency adjustments, will have substantial effects on net consumers. Lessons from last year s food crisis suggest that the poor are the worst hit, as many of the poor in Albania, Kyrgyz Republic, and Tajikistan, for example, are net food consumers, with limited access to agricultural assets and inputs. The resilience of households to macroeconomic shocks ultimately depends upon the economy's institutional readiness, the flexibility of the economic policy regime, and the ability of the population to adjust. However, compared with previous crises, the scope for households to engage in their traditional coping strategies may be more limited. Fiscal policy responses in the short-term are also constrained by rapidly falling revenues. Governments in ECA have to make difficult choices over what spending items to protect and what items to cut, social protection programs to reform and scale-up, and new interventions to mitigate the impact of the crisis.

The trajectories of increasing household debt are studied in the contexts of the US and the UK, Germany, the Netherlands, Finland and Norway. Household Debt and Economic Crises examines remedies to prevent and alleviate the over-indebtedness epidemic, creating a conceptual framework with which to analyse the causes and consequences of debt. Hiilamo argues that social policies are needed to tackle the current borrowing crisis that endangers and prevents the full participation in society of individuals with excessive debts.

Excessive household debt has allowed for economic growth, but this model has become increasingly unstable. Spooner examines bankruptcy law as a potential solution.

We study how unemployment affects the over-indebtedness of households using the new European Household Finance and Consumption Survey (HFCS). First, we assess the role of different labor market statuses (i.e. employed, unemployed, disabled, retired, etc.) and other household characteristics (i.e. demographics, housing status, household wealth and income, etc.) to determine the likelihood of over-indebtedness. We explore these relationships both at the Euro area level and through country-specific regressions. This approach captures countryspecific institutional effects concerning all the different factors which can explain household indebtedness in its most severe form. We also examine the role that each country's legal and economic institutions play in explaining these differences. The results of the regressions across all countries show that the odds of being over-indebted are much higher in households where the reference person is unemployed. These odds ratios remain fairly stable across different over-indebtedness indicators and specifications. Interestingly, we find similar results for secured debt only. Turning to country specific results, the role of unemployment varies widely across countries. In Spain, France or Portugal, for example, the odds ratio for the unemployed group is just below 2, whereas in Austria, Belgium, or Italy the odds ratio is higher than 4. Secondly, we situate the analysis in a macro-micro frame to identify households and countries that are especially vulnerable to adverse macroeconomic shocks in the labor market. For the Euro area, we find that the percentage of households plagued by over-indebtedness increased by more than 10%, suggesting that another unemployment shock could have a major impact on the financial solvency of Euro area households. Finally, the impact of this shock on single-headed households is much higher than on coupleheaded ones.

As in other advanced economies, there has been a significant run-up of household debt in Sweden during the last two decades accompanied by rising housing prices, prompting concerns about sustainability and the implications for financial stability. The rise in household debt and the banking system’s increased exposure to mortgage debt resulted with the changes in the macroeconomic environment. The note explores implications for financial stability of household indebtedness as well as Sweden's specific institutional features to ensure resilience of the financial system.

Nonfinancial private sector debt increased significantly in advanced economies prior to the global financial crisis and, with a few exceptions, deleveraging has been limited. Furthermore, in some countries households and corporations have continued to accumulate debt. Drawing on the literature, the paper aims to provide a quantitative assessment of the gaps between actual and sustainable levels of debt and to identify the key factors that drive excessive borrowing. Results suggest that variables that are typically found important in studies focusing on borrowing decisions, are also relevant for explaining the debt sustainability gaps.

This thesis consists of three essays attempting to determine the key determinants of spending-saving behaviour and financial stability of Canadian households from both micro and macro economics. In the first chapter, we try to isolate and evaluate the socio-economic character- istics of households who accumulate debt by spending more than what they earn in a given year. In particular, with a focus on the right tail of spending distribution -households who tend to spend a larger fraction of their income- we use multivariate regression type analysis to isolate socio-economic factors that contribute to debt accumulation and lead to insolvency. We aim to highlight the micro level factors that have contributed to the increase in the proportion of spender households in the population. Specifically, what are the marginal effects of age, income level, education, and family structure on the probability of a given households spends more than its income? Related to this question, we also consider the effect of budget allocation decisions on the probability of spending more than income and accumulating debt. We find that budget share of specific items in household consumption basket, has important information about the spending-saving behaviour of a household. Our analysis provides valuable information about what goods and services are the main outlays of expenditure for households in severe debt. The second chapter is about evaluating the relationship between household's saving rate and its long-run income from a more technical perspective. This chapter is an attempt to address the possible endogeneity issue present in this relationship. In addition to the conventional and widely exercised methodology, three alternative approaches are considered, and in a Monte Carlo experiment, the performance of four approaches is tested in three different environments. Results of our analysis show that the conventional methodology outperforms only when there is a simple linear type of endogeneity in the model. However, when more complicated types of endogeneity are present, it fails to predict saving rate unbiasedly. In the end, using FAMEX and SHS datasets from Canada, we re-evaluate the question with all different methods. Our empirical analysis suggests that more affluent households do save a larger fraction of their income, and the results are consistent across different years not sensitive to different instruments. Finally, the third chapter looks at the household financial stability from a macroeconomic perspective. Using aggregate data, at the provincial level, on households insolvency rate, we try to point out important aggregate key factors in determining financial instability of households. In a series of panel regression analysis, we explore the effect of aggregate variables such as GPD, unemployment rate, housing prices, interest rate, and household debt level, on the insolvency rate of households. Moreover, in a panel vector autoregressive estimation, we attempt to investigate the interactive effects and consequences of insolvency rate and gross domestic product, while controlling for other related aggregate variables. The key finding is that higher levels of household debt are associated with higher insolvency rate, and insolvency rate has a negative impact on GDP.

Household financial fragility has received considerable attention following the global financial crisis, but substantial gaps remain in the analytical underpinnings of household financial vulnerability assessment, as well as in data availability. This paper aims at integrating the contributions in the literature in a coherent fashion. The study proposes also analytical and estimation extensions aimed at improving the quality of estimates and allowing the assessment of household financial vulnerability in presence of data limitations. The result of this effort is a comprehensive framework, that has wide applicability to both advanced and developing economies. For illustrative purposes the paper includes a detailed application to one developing country (Namibia).

This book explores the complex interactions between debt and austerity, analysing the social, economic, and legal implications of governments’ responses to the 2008 financial crisis.

This paper discusses the evolution of the household debt in Australia and finds that while higher-income and higher-wealth households tend to have higher debt, lower-income households may become more vulnerable to rising debt service over time. Then, the paper analyzes the impact of a monetary policy shock on households’ current consumption and durable expenditures depending on the level of household debt. The results corroborate other work that households’ response to monetary policy shocks depends on their debt and income levels. In particular, households with higher debt tend to reduce their current consumption and durable expenditures more than other households in response to a contractionary monetary policy shocks. However, households with low debt may not respond to monetary policy shocks, as they hold more interest-earning assets.

This dissertation consists of three chapters in exploring the current account imbalances in the European countries. The first chapter investigates the effect of household indebtedness on the Twin Deficits phenomenon in European countries. Annual data from 1981 to 2012 for 28 European countries are used. Panel regression with fixed effects and General Method of Moments (GMM) approaches are adopted to examine the standard determinants of the current account imbalances and the effect of household indebtedness on the Twin Deficits hypothesis. Empirical findings indicate the existence of positive co-movement between the fiscal balance and current account balance, thus indicating the presence of the Twin Deficits phenomenon in the European region. Meanwhile, there is a negative association between gross household debt and the current account balance. This inverse relationship implies consistent behavior with the Twin Deficits between fiscal balance and current account balance, where increase in the gross household debt contribute to the growth of the current account deficit. Thus, the household debt may marginally exacerbate the Twin Deficits phenomenon. These results can be observed particularly in the countries with low fiscal deficits, public debt and household debt.

This technical note assesses the vulnerabilities of household and corporate sector balance sheets and quantifies the potential impacts from macroeconomic shocks using sensitivity and contingent claims analyses. The note analyzes the risks to the Spanish financial stability arising from household indebtedness. The analysis expands the use of microlevel data to assess household vulnerabilities, distinguishing between indebted and nonindebted households as well as accounting for the allocation of debt, debt service burden, and households' income and assets.

We confirm the negative relationship between household debt and future GDP growth documented in Mian, Sufi, and Verner (2017) for a wider set of countries over the period 1950–2016. Three mutually reinforcing mechanisms help explain this relationship. First, debt overhang impairs household consumption when negative shocks hit. Second, increases in household debt heighten the probability of future banking crises, which significantly disrupts financial intermediation. Third, crash risk may be systematically neglected due to investors' overoptimistic expectations associated with household debt booms. In addition, several institutional factors such as flexible exchange rates, higher financial development and inclusion are found to mitigate this impact. Finally, the tradeoff between financial inclusion and stability nuances downside risks to growth.

The October 2017 Global Financial Stability Report finds that the global financial system continues to strengthen in response to extraordinary policy support, regulatory enhancements, and the cyclical upturn in growth. It also includes a chapter that examines the short- and medium-term implications for economic growth and financial stability of the past decades' rise in household debt. It documents large differences in household debt-to-GDP ratios across countries but a common increasing trajectory that was moderated but not reversed by the global financial crisis. Another chapter develops a new macroeconomic measure of financial stability by linking financial conditions to the probability distribution of future GDP growth and applies it to a set of 20 major advanced and emerging market economies. The chapter shows that changes in financial conditions shift the whole distribution of future GDP growth.

Household Indebtedness and Its Implications for Financial StabilitySwedenFinancial Sector Assessment Program Update: Technical Note on Household Indebtedness: Implications for Financial StabilityInternational Monetary Fund

The Impact of Public Policy on Consumer Credit presents a collection of research papers and discussions commissioned to commemorate the silver anniversary of Georgetown University's Credit Research Center in 1999. Nine topics serve as focal points for the volume, with the general theme `What do we know, what do we need to know?' about the functioning of consumer credit markets at the beginning of the 21 century. Because the growth of household debt and the consequences of household debt burden have dominated discussion in both the media and policy arenas for decades, `Credit Growth and the Burden of Debt' is the theme for the first group of three papers. The papers address the cultural evolution of consumer credit in the U.S., the rise in consumer indebtedness and the alarming surge in personal bankruptcies. A second grouping of three papers takes a distinctly policy-oriented tack and examines questions regarding consumer access to credit (mortgage markets and evidence of discrimination), consumer protection through mandatory disclosure of information (Truth-in-Lending regulations), and the general state of financial literacy among the population of young consumers entering credit markets for the first time. The final three papers in this volume examine how technological innovations in risk management (through statistical risk scoring models), marketing (through use of personal information for targeted marketing) and finance (through securitization of consumer loans) have impacted the availability of credit products and sparked new public policy questions.

High household indebtedness could constrain future consumption growth and increase financial stability risks. This paper uses household survey data to analyze both macroeconomic and finanical stability risks from the rapidly rising household debt in China. We find that rising household indebtedness could boost consumption in the short term, while reducing it in the medium-to-long term. By stress testing households' debt repayment capacity, we find that low-income households are most vulnerable to adverse income shocks which could lead to signficant defaults. Containing these risks would call for a strengthening of systemic risk assessment and macroprudential policies of the household sector. Other policies include improving the credit registry system and establishing a well-functioning personal insolvency framework.

The "debt-overhang hypothesis" -- that households cut back more on their spending in a crisis when they have higher levels of outstanding mortgage debt (Dynan, 2012) -- seems to be taken for granted by macroprudential authorities in several countries in their policy decisions, as well as by the international organizations that evaluate and comment on countries' macroprudential policy. New results for Australian microdata are presented that reject the debt-overhang hypothesis. The results instead support the "spending-normalization hypothesis" of Andersen, Duus, and Jensen (2016), what can also be called the "debt-financed overspending" hypothesis - that the correlation between high pre-crisis household indebtedness and subsequent spending cuts during the crisis reflects high debt-financed spending pre-crisis and a return to normal spending during the crisis. As discussed in Svensson (2019, 2020), this is consistent with the above correlation reflecting debt-financed overspending through what Muellbauer (2012) calls the "housing-collateral household demand" channel and Mian and Sufii (2018) the "debt-driven household demand" channel.

Has monetary policy in advanced economies been less effective since the global financial crisis because of deteriorating household balance sheets? This paper examines the question using household data from the United States. It compares the responsiveness of household consumption to monetary policy shocks in the pre- and post-crisis periods, relating changes in monetary transmission to changes in household indebtedness and liquidity. The results show that the responsiveness of household consumption has diminished since the crisis. However, household balance sheets are not the culprit. Households with higher debt levels and lower shares of liquid assets are the most responsive to monetary policy, and the share of these households in the population grew. Other factors, such as economic uncertainty, appear to have played a bigger role in the decline of households' responsiveness to monetary policy.

Wiedemann reveals how the rise of financial markets as private alternatives to welfare states transforms social rights and responsibilities.

Household borrowing has grown considerably in many countries over the past two decades, both in absolute terms and relative to household incomes. Much of the increase can be viewed as a rational response by households to the effects of easing liquidity constraints on households, and lower inflation and borrowing rates. Regardless of whether the increase in debt is sustainable, it has important macroeconomic implications. The household sector will be more sensitive to shocks to interest rates and household incomes, and consumption spending will be more sensitive to changes in expectations of future income. The increased sensitivity will depend crucially on the distribution of debt across the household sector.

"Household debt levels relative to GDP have risen rapidly in many countries over the past decade. The authors investigate the macroeconomic impact of such increases by employing a novel estimation technique proposed by Chudik et al (2016), which tackles the problem of endogeneity present in traditional regressions. Using data on 54 economies over 1990?2015, they show that household debt boosts consumption and GDP growth in the short run, mostly within one year. By contrast, a 1 percentage point increase in the household debt-to-GDP ratio tends to lower growth in the long run by 0.1 percentage point. Their results suggest that the negative long-run effects on consumption tend to intensify as the household debt-to-GDP ratio exceeds 60%. For GDP growth, that intensification seems to occur when the ratio exceeds 80%. Finally, they find that the degree of legal protection of creditors is able to account for the cross-country variation in the long-run impact."--Abstract.

Sweden is experiencing double-digit housing price gains alongside rising household debt. A common interpretation is that mortgage lending boosted by expansionary monetary policy is driving up house prices. But theory suggests the value of housing collateral is also important for household's capacity to borrow. This paper examines the interactions between housing prices and household debt using a three-equation model, finding that household borrowing impacts housing prices in the short-run, but the price of housing is the main driver of the secular trend in household debt over the long-run. Both housing prices and household debt are estimated to be moderately above their long-run equilibrium levels, but the adjustment toward equilibrium is not found to be rapid. Whereas low interest rates have contributed to the recent surge in housing prices, growth in incomes and financial assets play a larger role. Policy experiments suggest that a gradual phasing out of mortgage interest deductibility is likely to have a manageable effect on housing prices and household debt.

To identify and quantify downside risks to housing markets, we apply the house price-at-risk methodology to a sample of 37 cities across the United States and Canada using quarterly data from 1983 to 2018. This paper finds that downside risks to housing markets in the United States have seemingly fallen over the past decade, while having increased in Canada. Supply-side drivers, valuation, household debt, and financial conditions jointly play a key role in forecasting house price risks. In addition, capital flows are found to be significantly associated with future downside risks to major housing markets, but the net effect depends on the type of flows and varies across cities and forecast horizons. Using micro-level data, we identify households vulnerable to potential housing shocks and assess the riskiness of household debt.

The global economy has seen substantial changes since the era of market liberalization in the 1980's that have formed the basis of the so-called Washington Consensus. An important result of more market-oriented policies has been the rapid rise in household indebtedness and of financialization of economies around the globe. Relying on a socialist rhetoric that is deeply rooted in classic Marxist theoretical considerations, where the asset holding bourgeoisie captures governments and exploits the working class, most commentators' claims are falling short of explaining why an exploited working class would support such a political-economic system in the first place. In order to explain this paradoxical situation, I develop a theoretical framework building on recent findings within the literature on household financial decision making. I find that OECD countries with a higher level of household debt also show changes in household preferences as well as a change in aggregate labor market behavior. From a policy perspective, these findings indicate that changes in enhanced financial access (i.e. financialization) and subsequently rising household indebtedness may shift social dynamics such that they affect political institutions.

Handbook of U.S. Consumer Economics presents a deep understanding on key, current topics and a primer on the landscape of contemporary research on the U.S. consumer. This volume reveals new insights into household decision-making on consumption and saving, borrowing and investing, portfolio allocation, demand of professional advice, and retirement choices. Nearly 70% of U.S. gross domestic product is devoted to consumption, making an understanding of the consumer a first order issue in macroeconomics. After all, understanding how households played an important role in the boom and bust cycle that led to the financial crisis and recent great recession is a key metric. Introduces household finance by examining consumption and borrowing choices Tackles macro-problems by observing new, original micro-data Looks into the future of consumer spending by using data, not questionnaires