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Which Families Are Most Vulnerable to an Income Shock such as COVID-19?

KEY TAKEAWAYS

- Households lacking at least two months' income in "safe" or liquid assets, and those with high debt-to-income ratios, face the greatest risk of serious delinquency.
- Families with "convertible" wealth such as home equity are less likely to fall seriously behind on a debt obligation.
- Race and ethnicity matter in predicting serious delinquency, but the relationship is complicated.

Lowell R. Ricketts , Ray Boshara

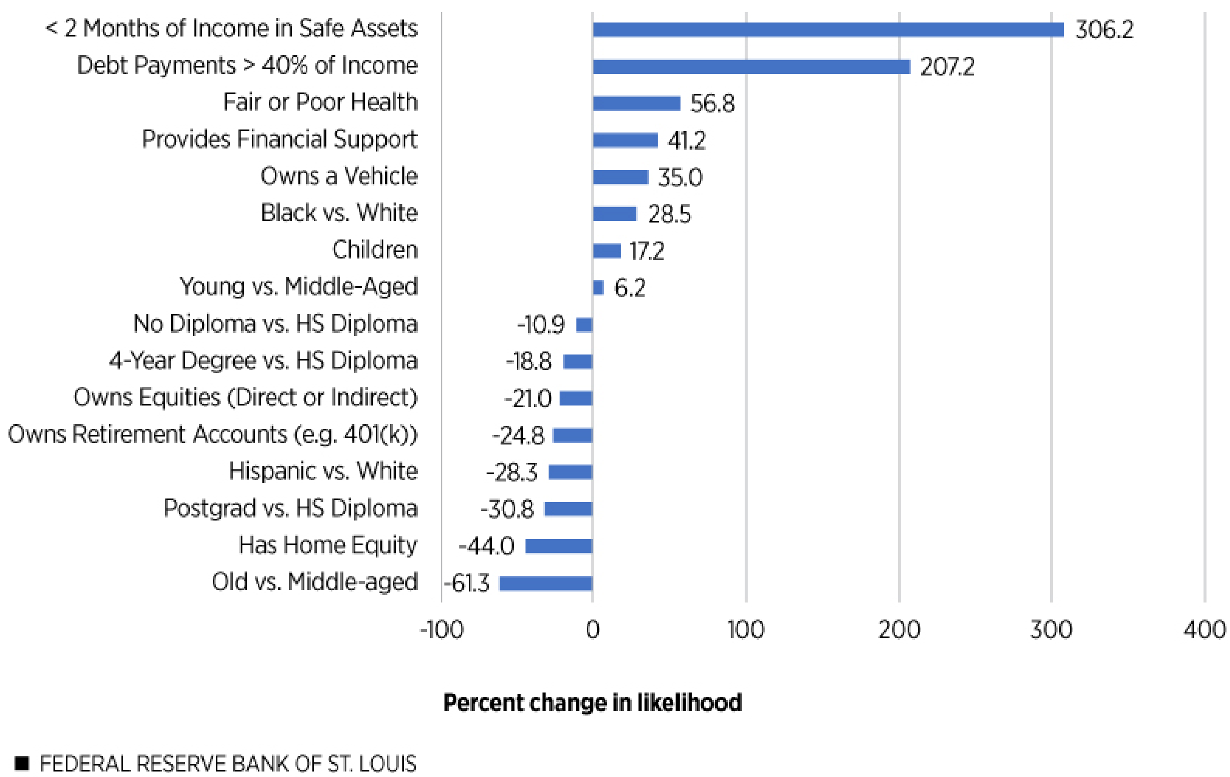
In late March, Congress authorized over $2 trillion to provide, among other emergency measures, direct cash payments to U.S. households adversely impacted by the COVID-19 pandemic. These cash infusions will help blunt the sudden and stunning loss of income felt by millions; however, those with little or no savings and wealth to fall back on are more likely to suffer even with the support.

In the past few years, our colleagues at the Board of Governors have generated national attention by reporting a finding from 2013 to 2018 annual surveys: Roughly 40% to 50% of Americans would meet a $400 unanticipated expense by borrowing or selling something. This signaled a disconcerting lack of emergency savings or liquidity for millions in the U.S.

We examined a barometer of potentially deeper financial fragility: reports of serious delinquency, which means a family was at least two months behind on a current loan obligation.[1] Our hope is that, by our profiling these families, policymakers can better target subsequent economic interventions to families in greatest need of building up their economic resilience.[2]

Who Is More Likely To Fall Behind?

Liquid Assets and Debt Burden Have Biggest Effect on Likelihood of Serious Delinquency



SOURCES: Federal Reserve Board's Survey of Consumer Finances and Center for Household Financial Stability calculations.
NOTES: The bar chart shows the percent change in the likelihood of serious delinquency. Each bar compares two groups. For example, in the sixth bar from top, we see that, on average, black families were 28.5% more likely to be seriously delinquent than white families, after controlling for the other variables shown here.[3]

Setting aside more complicated demographic factors for the moment, here's what the bar graph shows about the families more likely than others to experience serious delinquency, holding all other factors constant.

They don't have enough "safe" assets. By far, the most important predictor of serious delinquency is whether a family has at least two months' worth of income in the form of "safe" or liquid assets, such as cash and checking and savings accounts. If they don't, they are about 300% more likely to be seriously delinquent than those who have at least that buffer (or more).

They have too much debt relative to their income. The next most important factor associated with serious delinquency is whether a family's debt obligations exceed 40% of their income. If the family's debts are over that threshold, they are about 200% more likely than those who aren't as leveraged to be seriously delinquent.

They lack good health. Families reporting "fair" or "poor" health were nearly 60% more likely than those reporting "good" or "excellent" health to report a serious delinquency. This highlights how health problems (such as COVID-19) can lead to financial instability.

They are supporting family or friends. Families providing financial support to relatives or friends were 41% more likely to fall at least two months behind. In addition, each child in the family increased the likelihood of a serious delinquency by 17%.

They own vehicles. Those who own vehicles are 35% more likely than those who don't to report serious delinquency; it's possible that a vehicle loan itself is a source of delinquency.

Who Is Less Likely To Fall Behind?

Now let's look at some factors associated with families being less likely than others to report a serious delinquency, again holding all other factors constant.

They have other sources of wealth. Notably, families that have home equity, retirement accounts and equities (such as stocks) are 44%, 25%, and 21% less likely, respectively, to report a serious delinquency than families without those assets. We speculate that these generally appreciating assets serve as "buffers": They can be converted to more liquid assets, if necessary.

They have attained higher levels of education. In general, the more education families have attained, the less likely they are to experience serious delinquency. Compared to those with high school diplomas, those with a post-graduate degree were 31% less likely, and those with a four-year college degree were nearly 19% less likely, to report a serious delinquency.[4]

They are older. Older Americans (those aged 62 and above) are 61% less likely than middle-aged Americans to experience serious delinquency. Younger Americans had roughly the same rates of serious delinquency as those who are middle aged; this is consistent with previous work of ours suggesting that middle-aged and younger Americans typically have more financial obligations and less wealth than older Americans.

Do Race and Ethnicity Matter? Yes, though It's More Complicated

Finally—and, again, separate from all other factors—race and ethnicity matter, too, in predicting serious delinquency, though the associations are more complicated and may reflect longer-term structural barriers.

"Raw" (or unadjusted) data shows racial and ethnic gaps in delinquency are wide. Without considering any of the other factors that may impact delinquency rates, Hispanic families were 53% and black families were 117% more likely to have been seriously delinquent than white families.

After adjusting for the factors already discussed, Hispanics are less at risk of serious delinquency. Compared to whites, Hispanics are 28% less likely to experience a serious delinquency once we account for the factors above (safe assets, debt-to-income ratios, education, etc.) that otherwise place families at a greater or lesser risk of falling at least two months behind on a debt payment.

Blacks remain at a greater risk of serious delinquency. Blacks are still 29% more likely to report a serious delinquency than whites, even after accounting for the characteristics above that otherwise make families more or less likely to fall behind.

Why would blacks, but not Hispanics, be more likely to fall seriously behind on their debts?

While we cannot say for sure, it is likely other factors as well as "unobservable" characteristics may help explain the remaining risk of delinquency among black households. Those include characteristics related to race and ethnicity not captured by the survey, or impossible for the survey to capture—e.g., the legacy of slavery, historical discrimination and exclusionary asset policies such as "redlining."

As an earlier report by our Center concluded, "Survey evidence collected over about 25 years points toward structural factors related to demographic characteristics rather than individual risk preferences as the better explanation for varying delinquency risks."

As noted, a black family is about 29% more likely than a white family to experience serious delinquency, on average. This is despite the fact that we already ruled out the other factors that predict whether a family fell behind. That is, this specific racial difference unique to blacks remains even after accounting for racial gaps in debt-to-income ratios, wealth buffers, and the ownership of safe assets or vehicles, for example. This suggests the presence of embedded, structural and systemic factors identified in our Center's previous research.

How Can Economic Resilience Be Promoted?

We have examined reports of serious delinquency to predict which families may encounter significant financial hardship given the profound income shock caused by the COVID-19 pandemic. In doing so, we hope that we have helped policymakers, grant-makers, nonprofits and others target economic assistance to families who most need to develop or bolster their economic resilience.

Importantly, however, it should be observed that serious delinquency rates are chronically high for many of the families we described. Accordingly, potential COVID-19 responses should keep the longer-term outcomes for these families in mind, especially if an economic contraction is deep and the recovery slow.

We encourage policymakers and others to promote economic resilience not only through cash payments and other liquidity measures, but also by helping to build family wealth among less-educated, younger and black and Hispanic Americans—who, our Demographics of Wealth series and a recent Center blog post have demonstrated, consistently have lower levels of wealth.

Indeed, as we have demonstrated in this article, those who have longer-term assets such as home equity and retirement accounts, as well as more liquidity—in other words, those whose balance sheets are more diversified—were less likely to report a serious delinquency. And wealth-building measures will not only promote greater economic resilience, but greater rates of upward economic mobility as well.

Endnotes

1. Serious delinquency is defined as missing at least two consecutive scheduled payments within the year prior to the survey interview. From 1989 to 2016, the share of families reporting such a delinquency ranged from a low of 4.4% in 1992 to a high of 8.1% in 2010.
2. We used a model of serious delinquency and weighed different factors and characteristics of families, taking into account:
    - Demographics (race, ethnicity, age)
    - Family structure (marriage, number of children)
    - Financial support provided to friends and family
    - Safe and liquid asset holdings as a share of household income
    - Leverage—if monthly payments exceed 40% of monthly income
    - Family assets and finances (home equity, retirement accounts, vehicles, equities)
3. Effects related to survey year were also included in the model with year 2001 omitted. Of these years, 1992, 2010 and 2013 were statistically significant. Families surveyed in 1992 were 23% less likely to be seriously delinquent than those in 2001. In contrast, families surveyed in 2010 and 2013 were 45% and 27% more likely to be seriously delinquent, respectively, than those surveyed in 2001.
4. We found that those not completing high school were nearly 11% less likely to have a serious delinquency than those with high school degrees, but the result was not statistically significant, so we cannot say this difference is real.

ABOUT THE AUTHORS

Lowell R. Ricketts

Lowell R. Ricketts is the data scientist for the Institute for Economic Equity at the Federal Reserve Bank of St. Louis. His research has covered topics including the racial wealth divide, growth in consumer debt, and the uneven financial returns on college educations. Read more about Lowell’s research.

Ray Boshara

Ray Boshara is a senior adviser and assistant vice president of the Institute for Economic Equity at the Federal Reserve Bank of St. Louis. He is also a senior fellow in the Financial Security Program at the Aspen Institute. Read more about Ray's publications.