Financial Distress and Macroeconomic Risks

(Mustre-del-Río, Sánchez, Mather, and Athreya, 2022)

Discussion by Fiona Greig
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The research question is superb.

Research question: How does financial distress matter for understanding the aggregate and cross-sectional consumption responses to macroeconomic shocks?

Why this matters.

1. Recessionary shocks are often **regressive** and increase inequality. *We need to think about recession response as a tool for mitigating both economic contraction and inequality.*

2. The most impacted workers are also those who experience the most **financial distress** in general. W*elfare losses in the face of macroeconomic shocks could be large without policy interventions.*

3. Each recession is unique and warrants a different **policy response.** *We need to learn how different fiscal and macroeconomic policies work and when to use which.*

The answer is…

Research question: How does financial distress matter for understanding the aggregate and cross-sectional consumption responses to macroeconomic shocks?

The answer is… complicated (2x3x3x2 = 36 possible answers)

Two definitions of financial distress…

1. 30 day delinquency on credit card
2. 80% of credit card borrowing limit exhausted

Three response outcomes tracked…

1. Aggregate consumption
2. Dispersion of the consumption response
3. Consumption-based poverty

Research question: How does **financial distress matter** for understanding the **aggregate and cross-sectional consumption responses** to **macroeconomic shocks**?

Three possible channels explored…

1. Direct: People who are credit constrained can't smooth their consumption during a downturn.
2. Indirect: Some people are persistently credit constrained, and therefore will be impacted more by macroeconomic shocks.
3. Correlational: Places with the greatest financial distress may experience the largest macroeconomic shocks.

Two types of macroeconomic shocks…

1. House price shock (Great Recession)
2. Labor income shock (COVID-19)

Four comments / questions

1. The **indirect channel** is really important! Empirical evidence from COVID corroborates this. What is being captured here? Some people are persistently *liquidity constrained or* persistently more *impatient?*

2. Countercyclical policy is designed to influence spending. Can you use the model to interrogate not just macroeconomic shocks but the **policy interventions** to mitigate them (e.g. unemployment insurance, stimulus, debt forbearance)?

3. Housing price shocks and income shocks are qualitatively very different. That makes them interesting. MPCs out of housing price shocks feel like a **"mushier" target** than MPCs out of income shocks. Are we at risk of false precision?

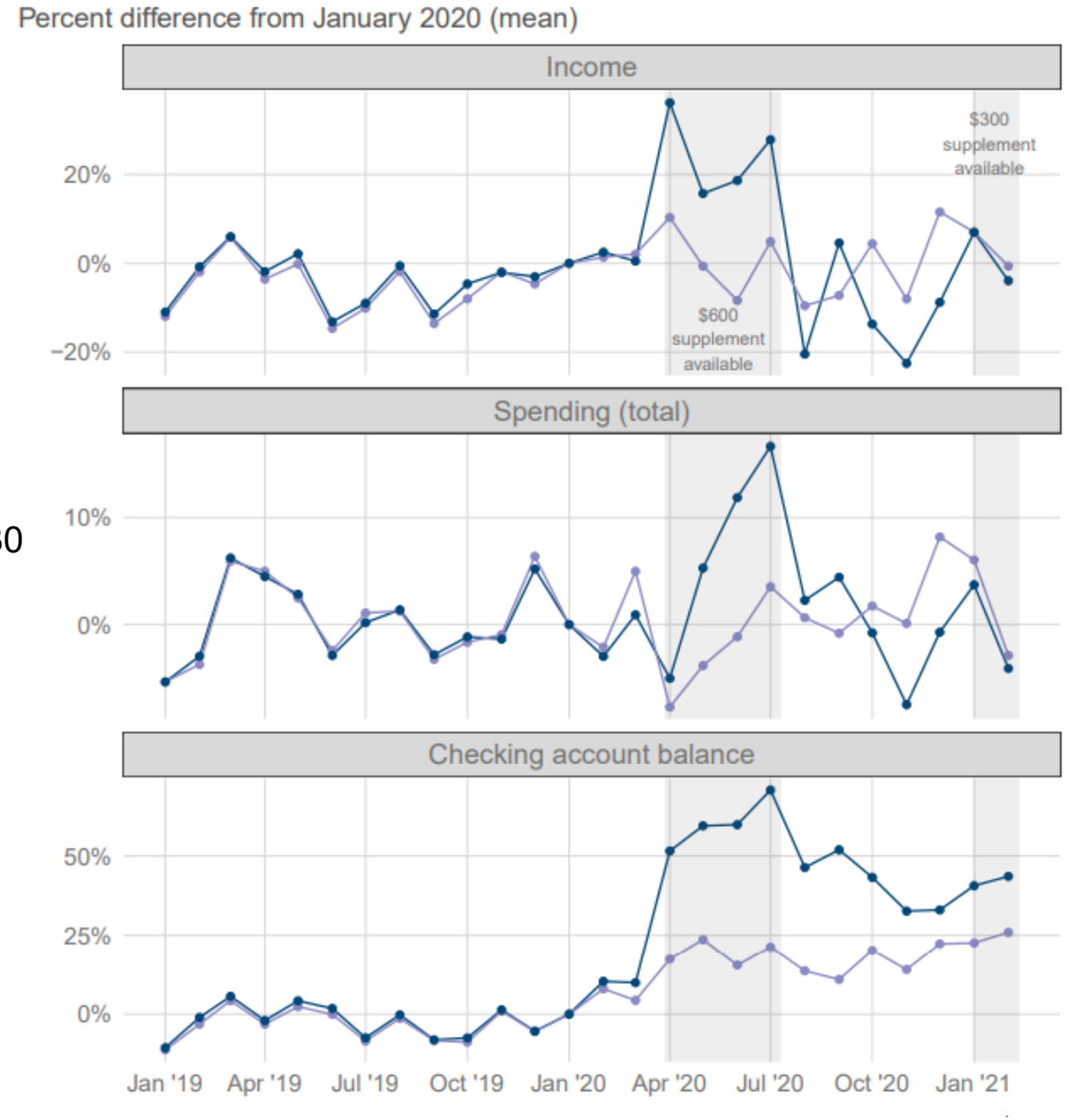
4. The **current environment** is again different – high inflation combined with big drop in stock prices. How might we use this model to understand distributional consequences of these (very different) price shocks?

UI benefits during COVID were so generous that they drove jobless workers out of a low-liquidity state. MPCs were still high.

Low liquidity state: MPC at start of UI benefits = 0.43.

High liquidity state: MPC when $600 supplements end = 0.30

Some form of *permanent* heterogeneity unrelated to liquidity (e.g. impatience) must be driving the high MPC.



Source: Ganong, Greig, Noel, Sullivan and Vavra. July 2022. Spending and Job Finding Impacts of Expanded Unemployment Benefits: Evidence from Administrative Micro Data.

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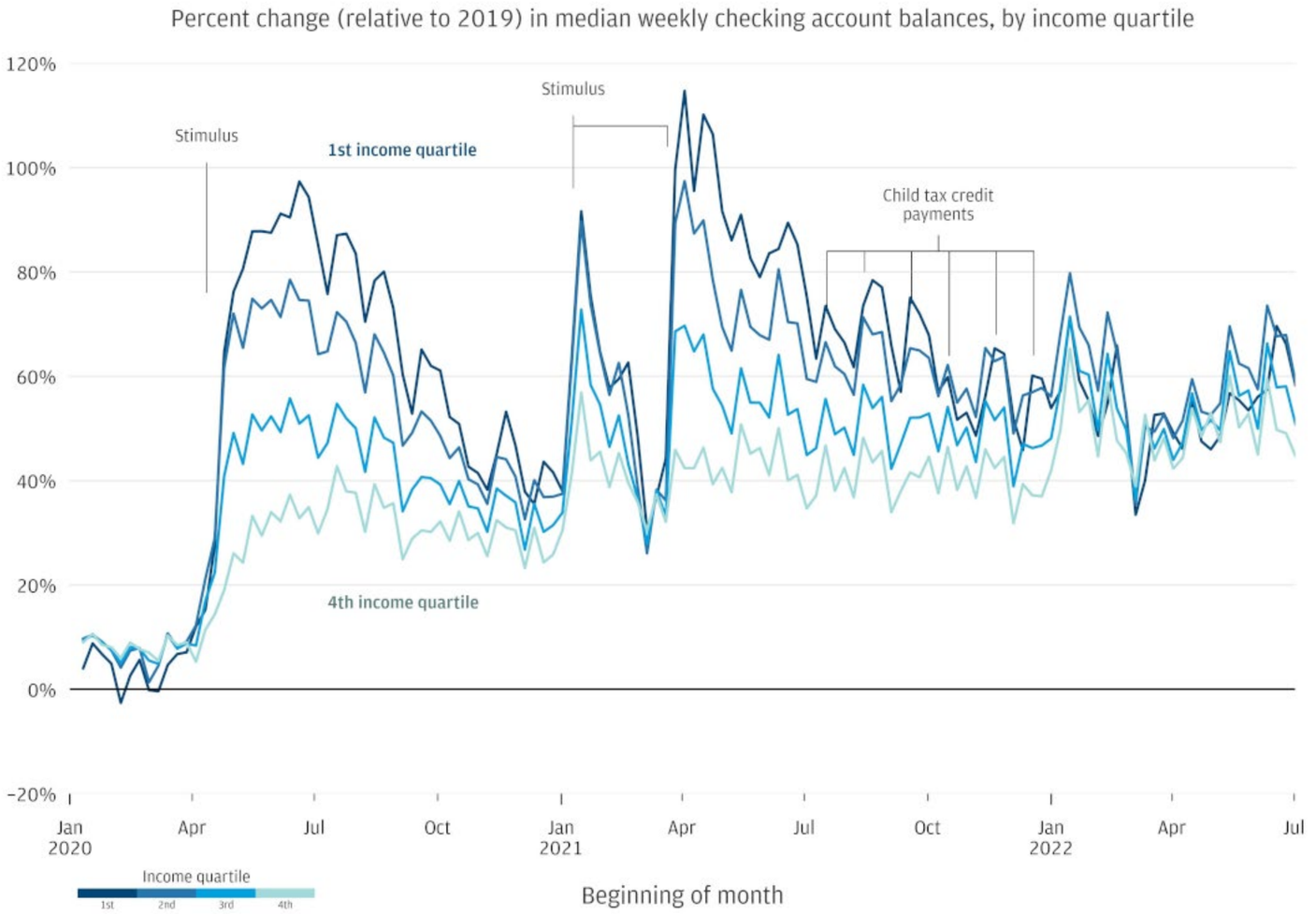
Large fiscal supports elevated cash balances (and spending) especially for lower income families. Can you model these?



Note: We assign households into income quartiles based on the relative rank of their annual incomes in 2019, 2020, and 2021.

Source: JPMorgan Chase Institute

Huge amounts of fiscal support

- 3 rounds of stimulus
- UI supplements
- Child tax credits
- Mortgage forbearance
- Student loan forbearance

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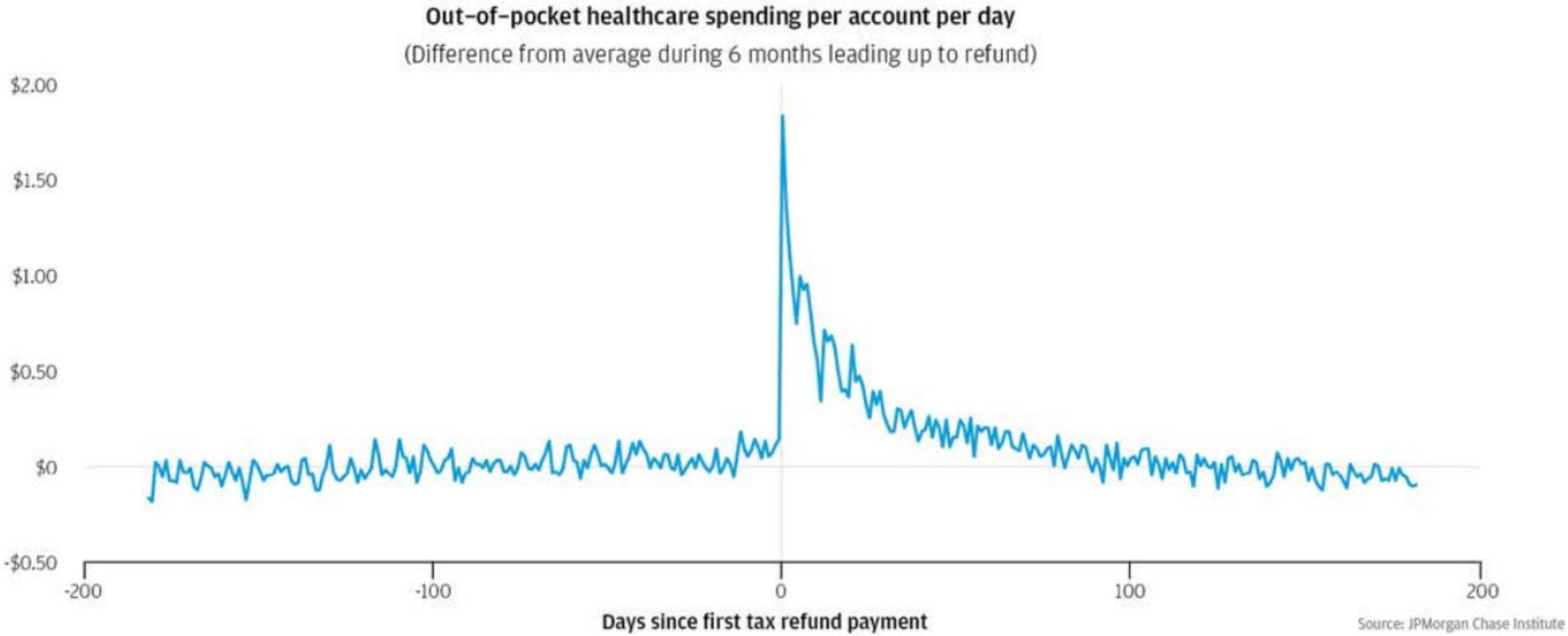
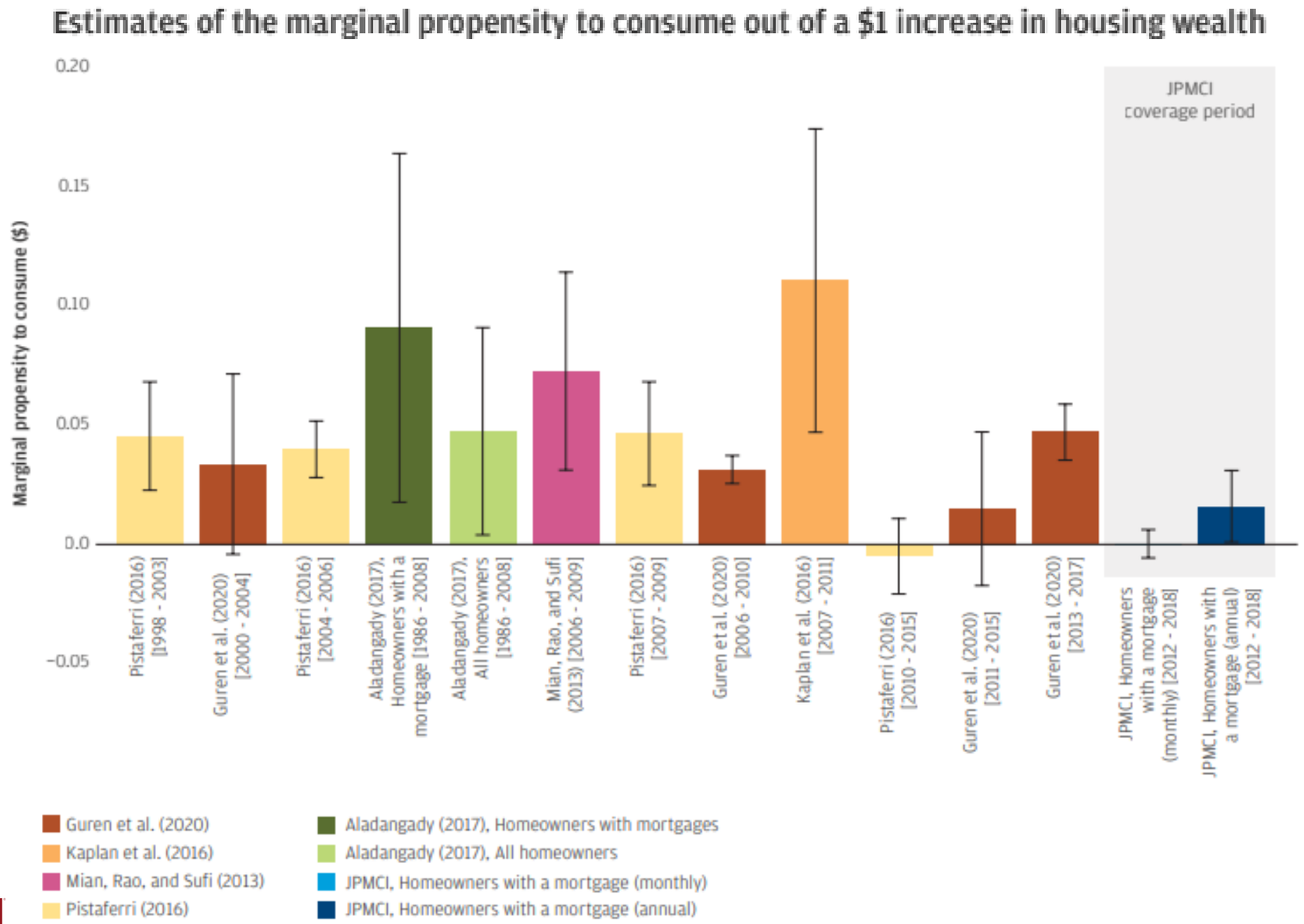
MPC out of (even transitory) income shocks are (always) big.

Figure 2: Out-of-pocket healthcare spending spikes when a tax refund payment is received



MPCs out of housing wealth are small – maybe even zero.



Source: Farrell, Diana, Fiona Greig, and Chen Zhao. 2020. "The Housing Wealth Effect in the Post-Great Recession Period: Evidence from Big Data." JPMorgan Chase Institute.

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Consumption response to income shocks and housing price shocks are qualitatively and quantitatively very different.

MPCs out of a **temporary income shock** are measured over a **1 year period.**

They are big and relatively **heterogeneous**.

Table 7: MPC Out of Income Shocks

		(lowest FD)				(highest FD)
	Aggregate	Q1	Q2	Q3	Q4	Q5
MPC	.308	0.239	0.287	0.317	0.331	0.385

MPCs out of a **permanent housing shock** are measured over a **3-year period.**

They are small and relatively **homogenous**.

Table 6: MPC Out of House-price Shocks

		(lowest FD)				(highest FD)
	Aggregate	Q1	Q2	Q3	Q4	Q5
All Households	0.070	0.071	0.071	0.069	0.071	0.072
Homeowners	0.087	0.081	0.081	0.088	0.091	0.095
Homeowners, Uncorrelated Shocks	0.089	0.083	0.085	0.092	0.095	0.099

Land your model somewhere here…

MPC out of income shock

MPC out of house price shock

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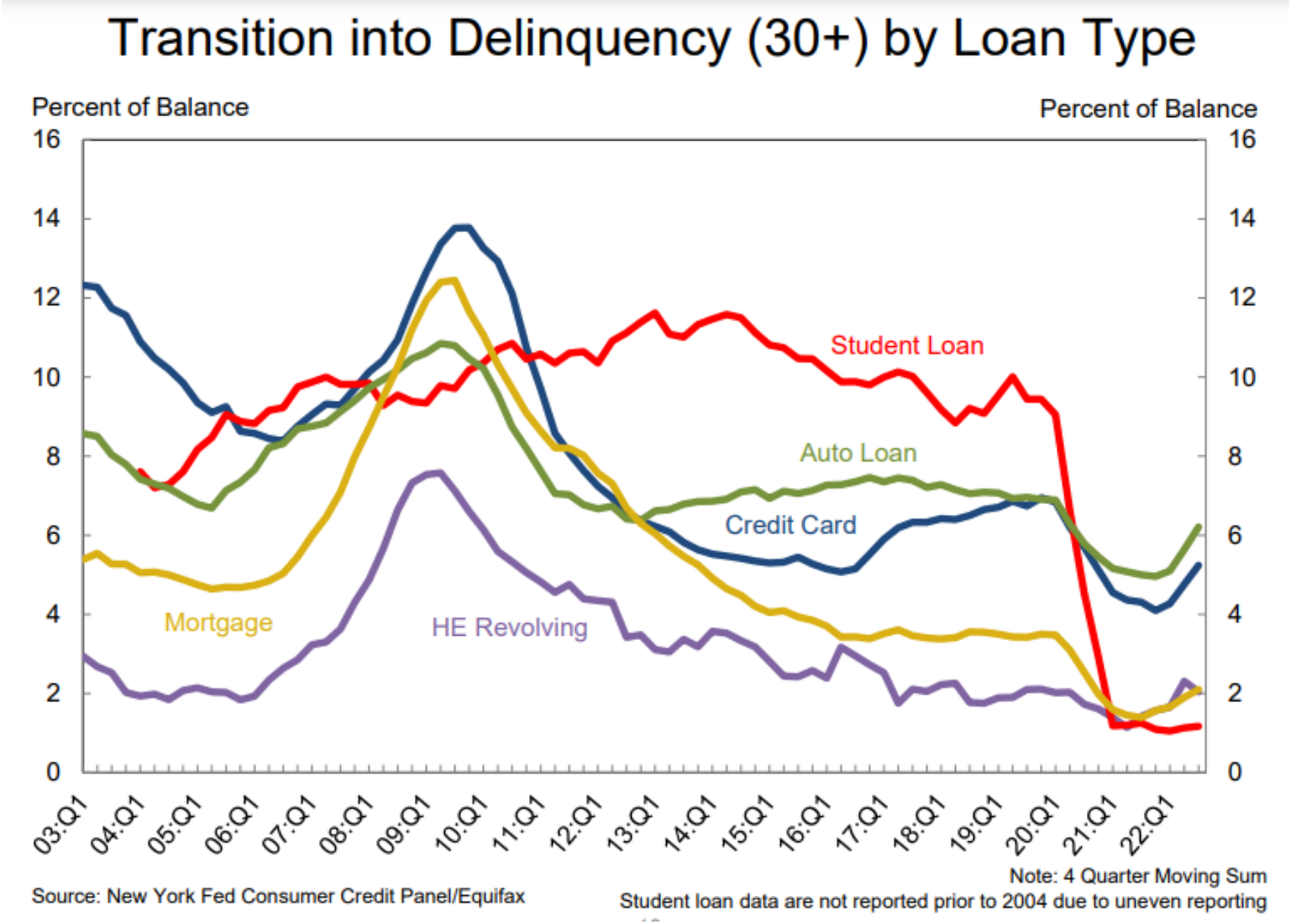
Credit card and auto loan delinquencies are ticking up



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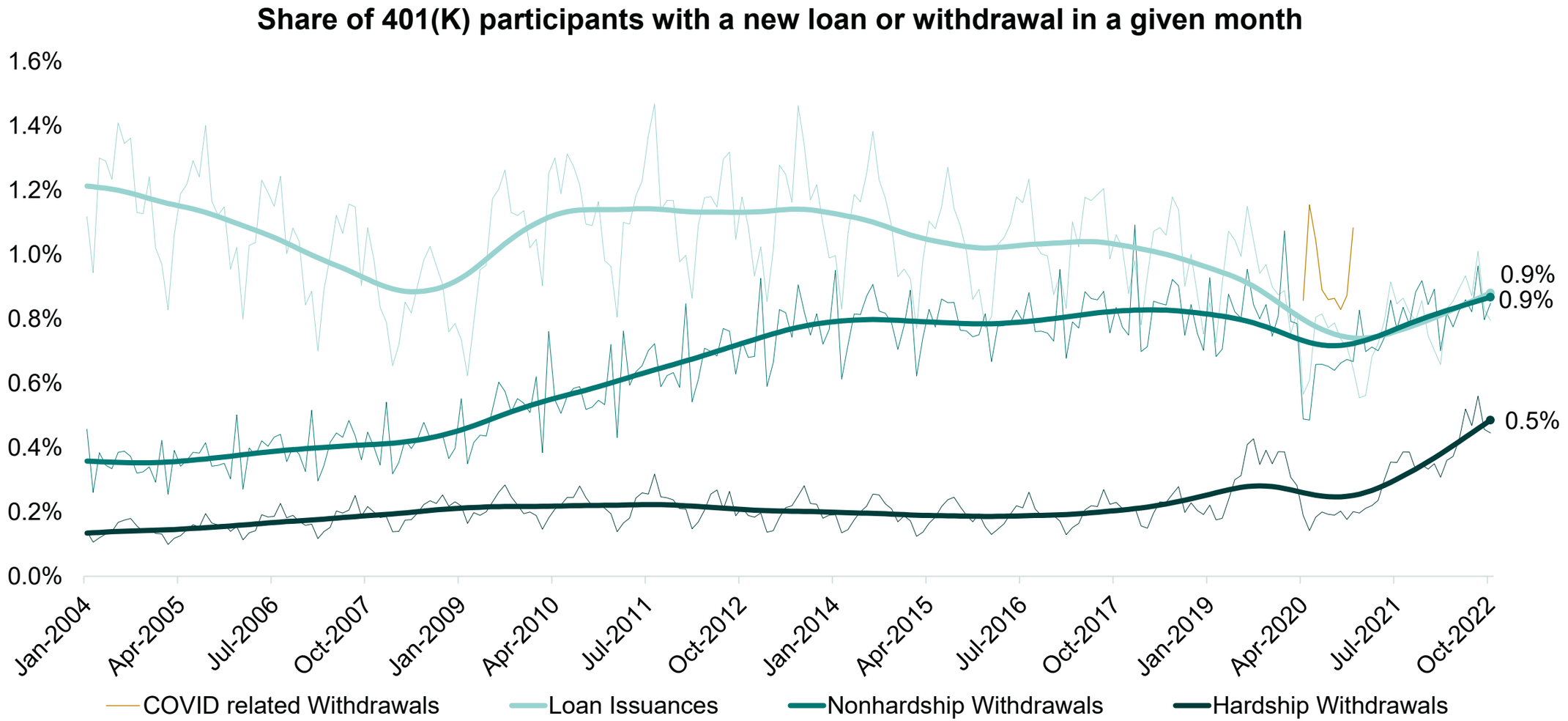
Retirement Plan loans and withdrawals are increasing in 2022



Notes: This chart reflects the share of workers participating in an employer sponsored defined contribution retirement plan who took out a new loan or withdrawal from their retirement account in any given month, as of October 2022. The sample is based on 5 million participants in 1700 employer-sponsored retirement plans. Thin lines reflect raw data. Thick lines seasonally adjust the data using a Hodrick-Prescott filter.

Thank you.