Comments on ‘The role of debt in UK household spending decisions’

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Outline

- Initial overview of household balance sheets and consumption patterns.
- The paper focuses on debt and consumption because they are not normally part of PI/LCH models.
- Aggregate data limits analysis, micro data is more informative than aggregated data.
- This paper uses survey evidence as well as micro-data to answer econometric questions.

It does a good job in three respects:

1. Review of theory (briefly)
2. There is an objective assessment of household balance sheets over last 25 years.
3. There is a discussion of some empirical micro-econometric models

Outline

Nevertheless, I thought it could advance further than it did in several other ways…

- I will briefly touch on theoretical issues and lessons from the aggregate data.
- Then consider how useful the microdata really are to address these issues.
- Finally, I will make four suggestions for new ways to get more from the data.

Theory

1. The theory discussion is closely connected to PI/LCH with representative consumers.
   - What about models where consumers differ over more than just age and income profiles?

     Heterogeneous behaviour of households is a major justification for use of microdata rather than aggregated data.
   - Iacoviello models – patient and impatient households – lending and borrowing, debt and asset accumulation are endogenised.
   - Ambiguity about what type of consumption – housing, durables, non-durables. There are multiple crossing of these boundaries in theory and empirical sections.

Aggregate Data

2. The aggregated data reveals some important relationships that could carry over to the empirics:

- There is a sharp distinction between behaviour of home owners and renters.

All the information in empirical part is based on secured debt, only the home owners; this is linked only to non-durable consumption.

It would have been nice to see more of the hard evidence on relationships between these groups.

Aggregate Data

- Assets held by old, debt by the young: always the case, but more so now.
- Connection through time between asset values, debt & consumption, but also with accumulation of new debts and assets.

Cross section information rather than panels inhibits the exploration of decisions by same households through time.

Has there been a change in behaviour by the same households or has recent households behaviour differed from the past?

Debt Adjustment

- The relationship between consumption and debt is complex.
- The paper focuses on a structural question: what is the impact of high/moderate/low debt levels on consumption?
- High debt is the result of high accumulation of debt.
- Has there been a recognition that debt accumulation and the debt level or gearing were out of line with ‘normal’.
- Are adjustments to debt-consumption relationships influenced by re-adjustment back to the ‘new normal’? i.e. deleveraging by households as well as by financial institutions under new (and persistent) economic conditions.

Identification

3. Issues of debt are connected with households' ability to borrow, and therefore demand and supply of credit.

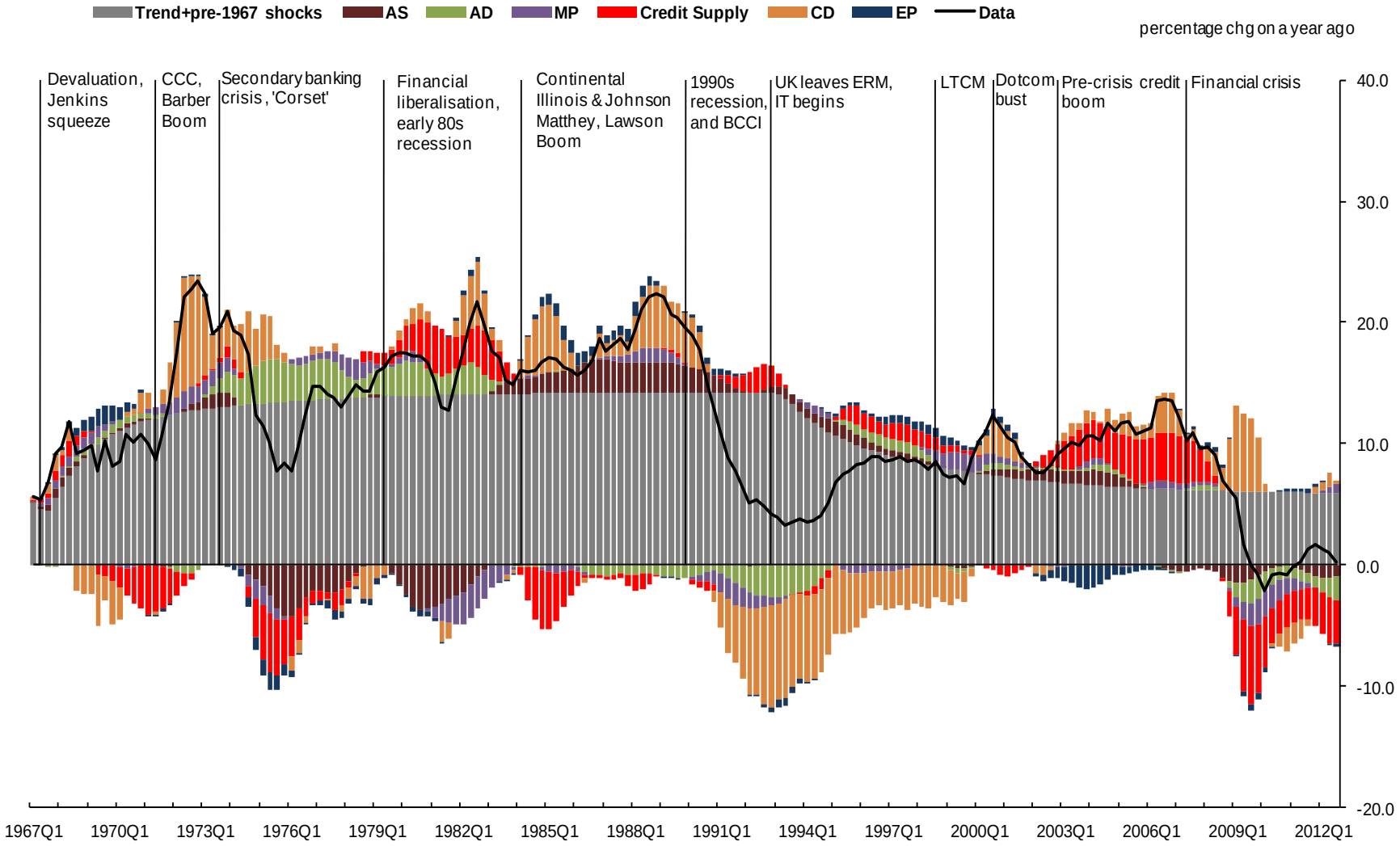
- Central issue is the question of identification. How to separate changes in the consumption-debt relationship due to demand and supply effects?
- Some suggestions:

1. Use shocks that can be identified with MP, AD, AS
2. Use information from the BoE Credit Conditions Survey to separate shocks to credit supply
3. Use information from changes to financial regulations
4. Identify where there have been changes to income expectations

Shocks to MP, AD, AS

- **Has weak lending and activity in the United Kingdom been driven by credit supply shocks?** *Alina Barnett and Ryland Thomas*
- Fully working structural VAR analysis to identify separate monetary policy, AD and AS shocks.
- In addition they separate credit demand and supply shocks.
- Credit supply shocks can account for much of the weakness in bank lending, therefore also household debt, and possibly consumption.

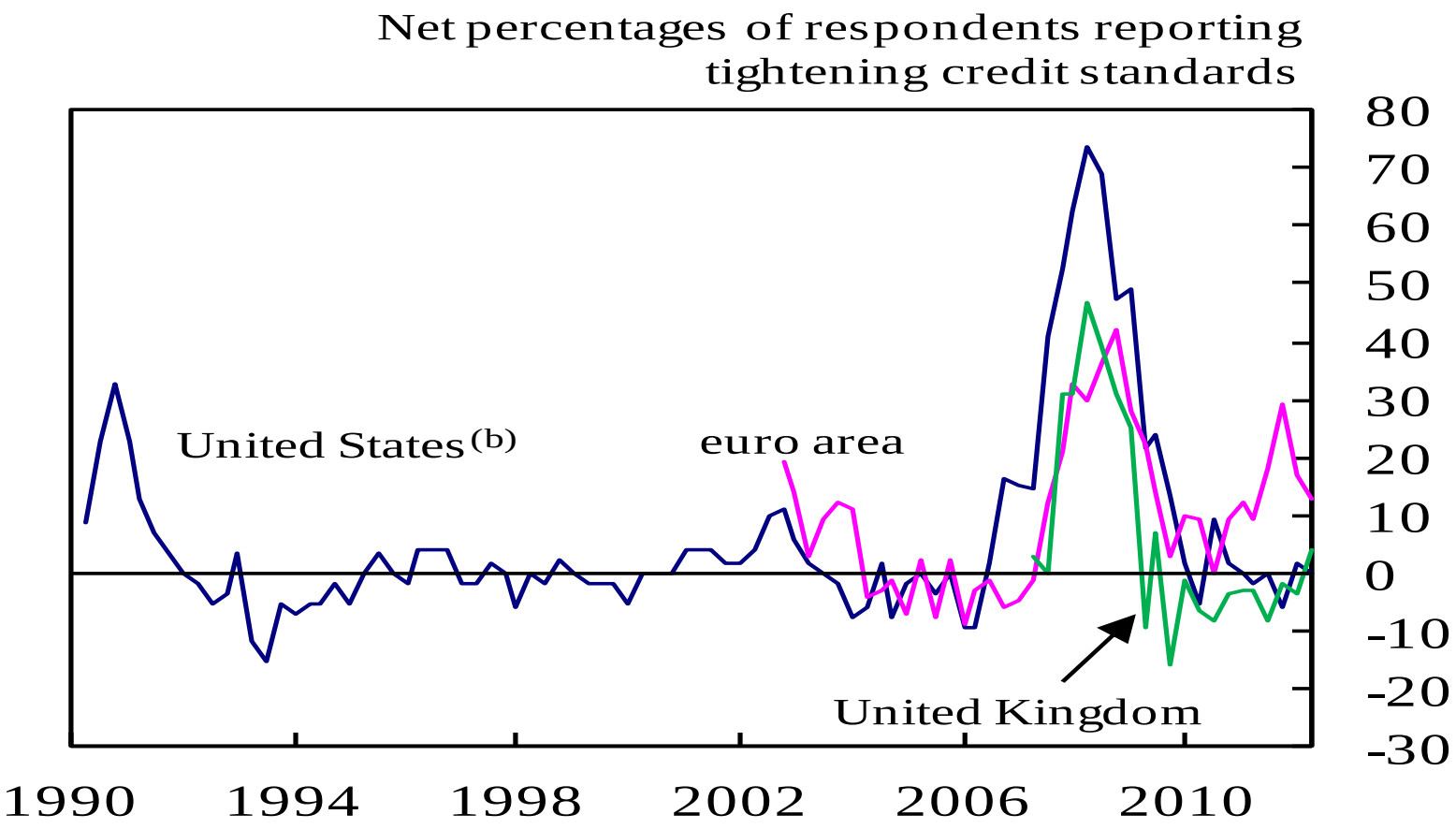
Different shocks and bank lending growth in the UK



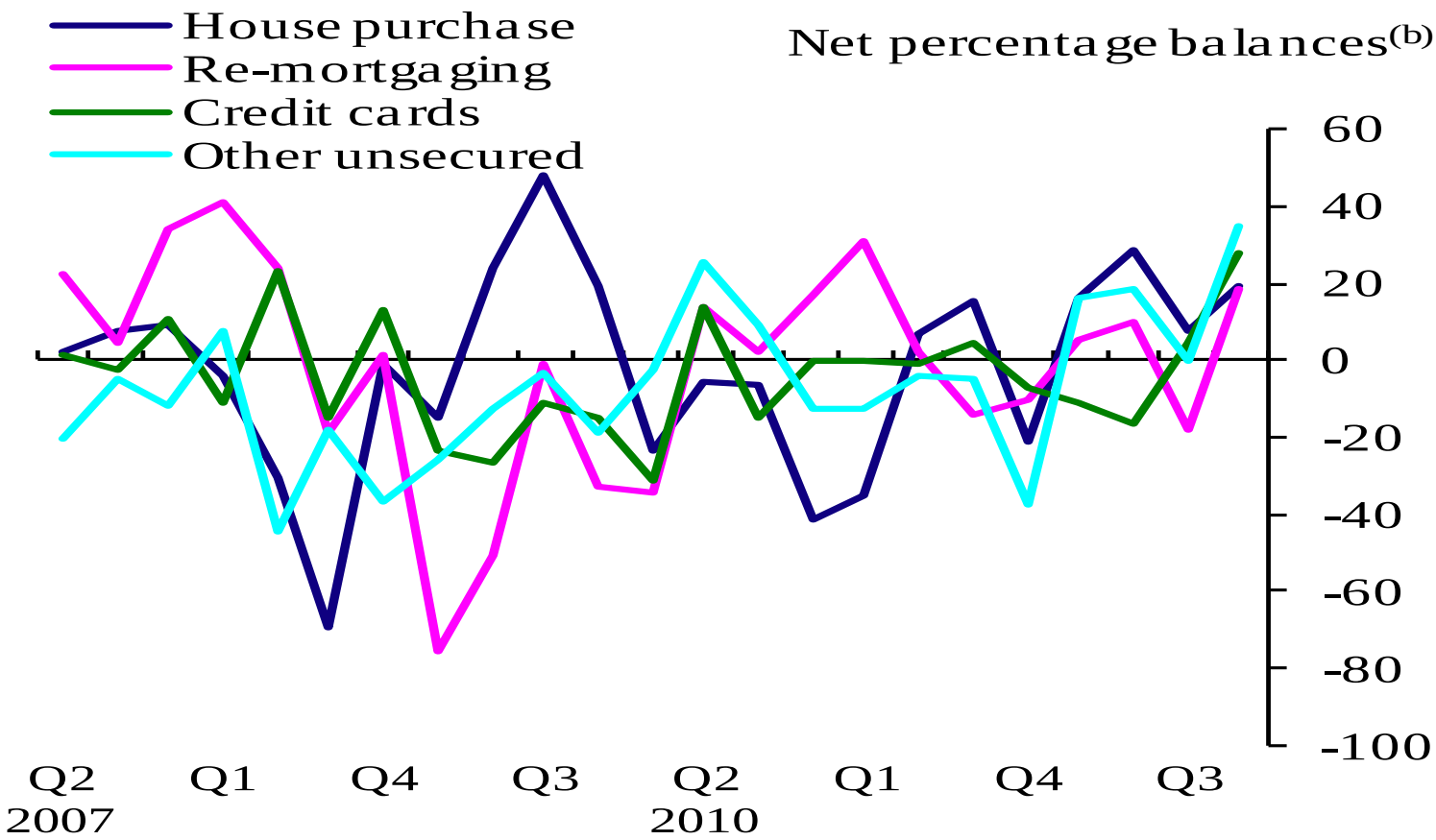
BoE Credit Conditions Survey

- Data from the CCS provide reasons for changes in supply and demand.
- Drawback that it was only introduced in 2007, but lending patterns are similar to longer surveys in other countries (e.g. Loan-Officers Survey, United States).
- It is possible to gauge demand and supply effects for UK households.
- The underlying causes are reflected in net percentage balance answers to questions about loan spreads, fees, and the capacity of banks to supply credit, including reduced appetite for risk, changing market share objectives and tighter funding conditions.

Similarity with US and EA



Demand for credit by UK households



Changes to financial regulations

- **The Impact of Capital Requirements on Bank Lending** *Jon Bridges*
- This paper provides evidence on the variation in individual bank capital requirements by the FSA 1990-2011 for 40 banking groups.
- This could capture the supply side effects of changes in lending (debt accumulation) as regulatory changes were introduced.
- Findings: Capital requirements bind; and these changes affect credit supply, therefore debt accumulation and possibly consumption if credit financed. The growth rate of household secured and unsecured lending falls, clearer for the former, less so for the latter.

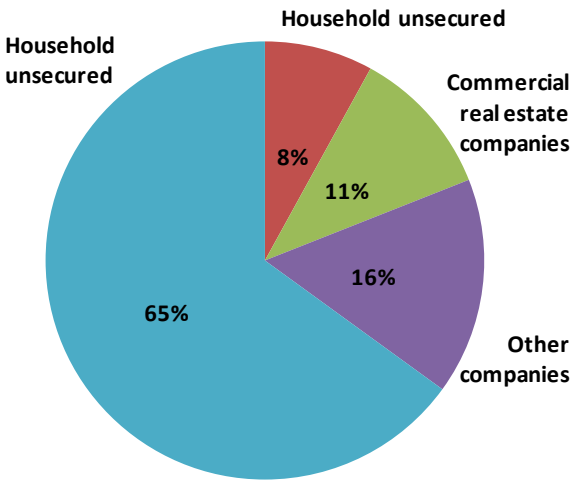
Bridges' Contribution

1) Estimate directly on instrument of policy

- Confidential, time-varying, bank specific "trigger ratios"

2) Accurate lending data:

- Sectoral lending data
- 'True flows' of lending



3) Captures the <u>direct</u> effects of a change in capital requirements on lending, but also the <u>indirect</u> effects via adjusting capital and capital buffers.

Income expectations

- Can income expectations be calculated solely from the level of debt taken on by the household? This is an argument advanced in the paper.
- While it is a *possible* explanation for higher debt and consumption levels, it would be nice to have some confirmation from good proxies e.g. surveys.
- Can a robust link be made between income shocks and debt levels at the household level? Otherwise could you report net percentage balances as an indicator of generally falling expectations about future income?

Conclusions

This paper provides a good review of the literature on debt and consumption. Household level data can help answer some issues that aggregate data cannot answer, especially when tied to surveys.

But there are many issues of identification to address that could make the paper more informative still about the underlying causes.

Also a sharpening of the focus on the relationships between different types of consumption, and debt, would deliver clearer answers on the role of debt on household spending decisions.