DOES SHORT-TERM EMERGENCY SAVINGS TRANSLATE INTO LONGER-TERM FINANCIAL WELLNESS?

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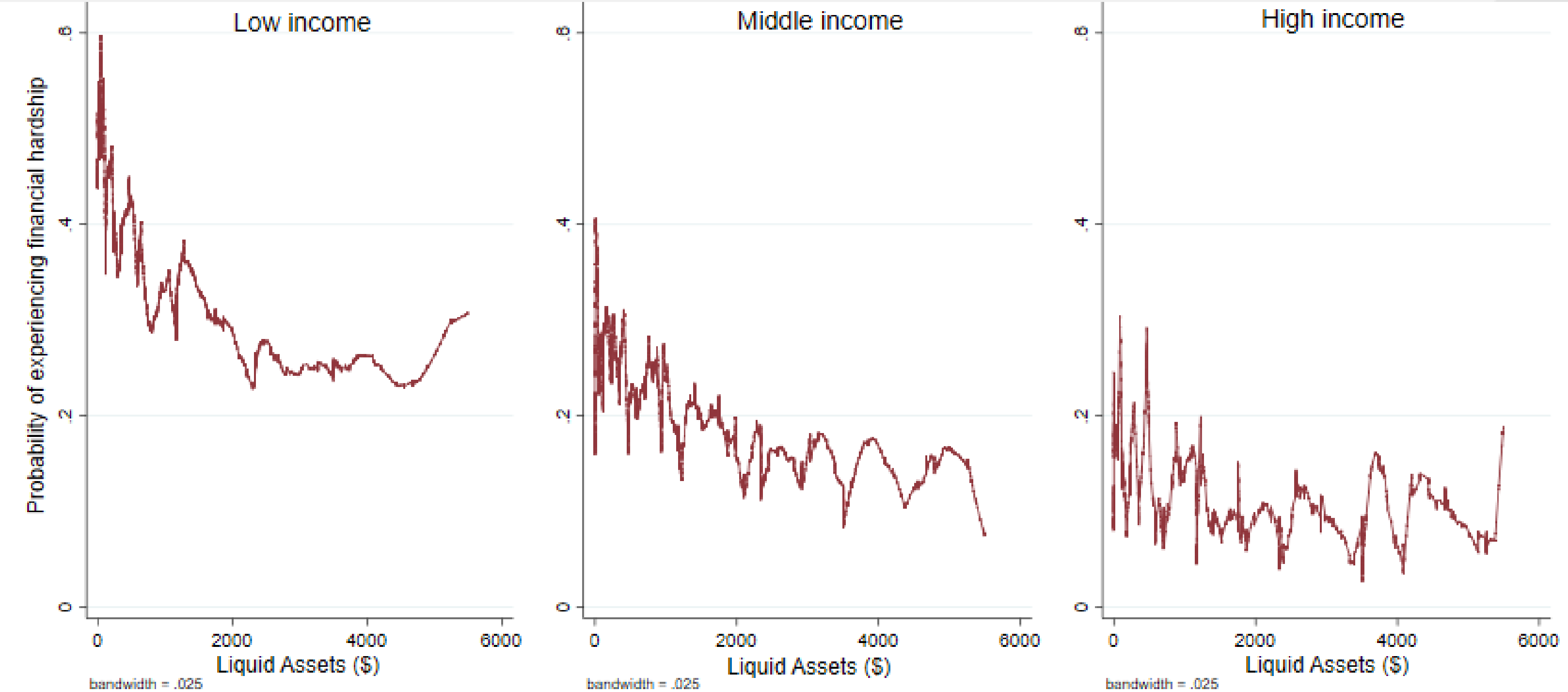
WHAT EXACTLY IS AN "EMERGENCY SAVINGS BUFFER"?

- Suze Orman recommends that households have at least 8 months of living expenses (based on the duration of unemployment spells)
- Investopedia.com pushes households to save $14,327 (about a quarter of the average annual expenditure per household)
- Yet, a Fed study shows that almost half of U.S. households could not easily handle an emergency expense of just $400 in 2016

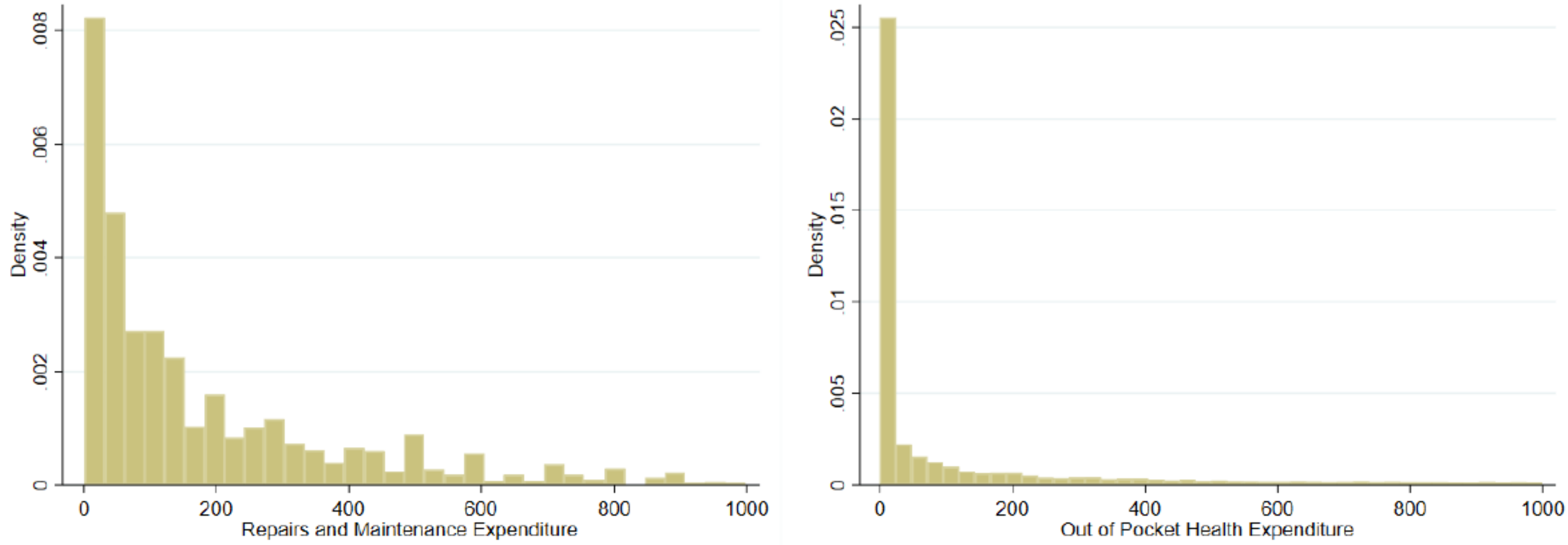
SMOOTHED SCATTERPLOT — HARDSHIP VS. LIQUID ASSETS BY INCOME LEVEL



2008 Surveys of Income and Program Participation (sampling over 2009-2011)

WHY IS THE SAVINGS-HARDSHIP RELATIONSHIP CONVEX?

Because the expense shock distribution is convex

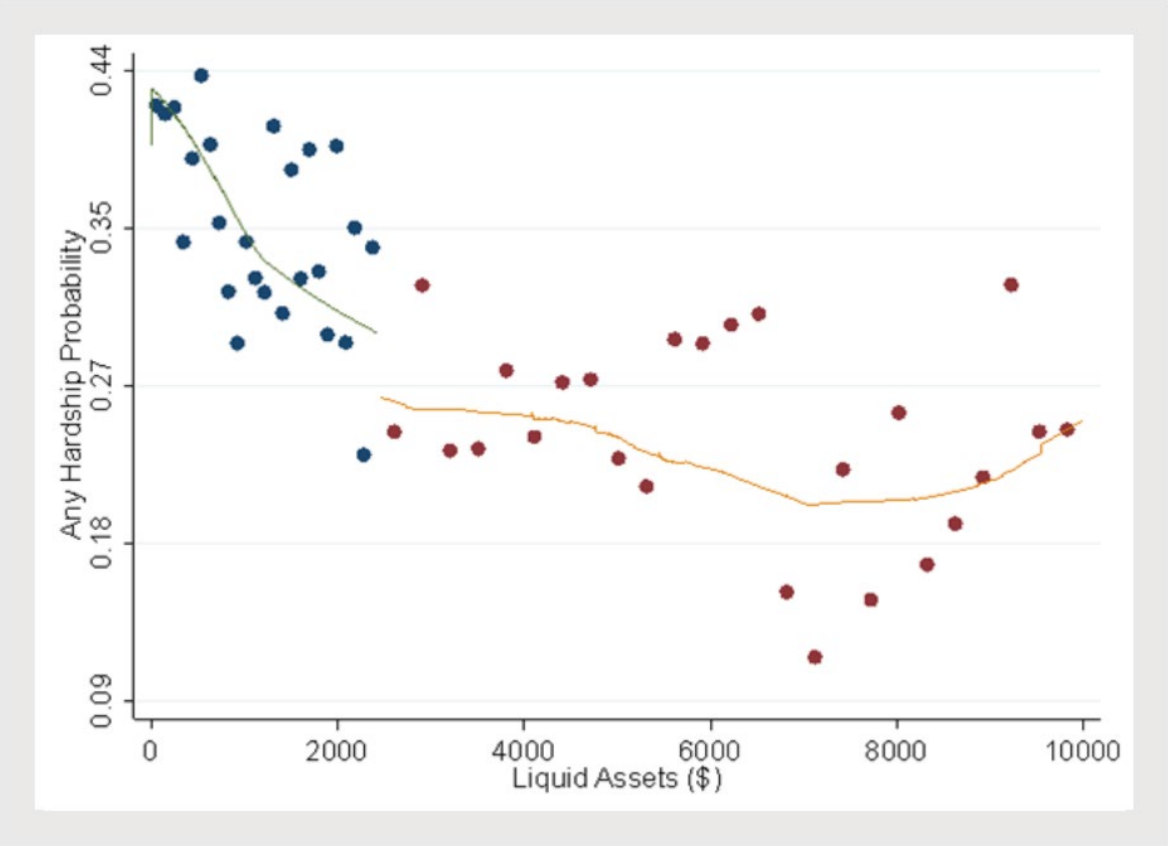


(a) Repairs and maintenance expenditure

(b) Out-of-pocket health expenditure

ESTABLISHING A "SUBSTANTIAL EMERGENCY SAVINGS BUFFER" AS AMOUNTS GREATER THAN $2,452

The Mean Probability of Experiencing Any Form of Near-Term Financial Hardship with Bins of Initial Liquid Savings



EMPIRICAL STRATEGY

Does Short-Term Emergency Savings Translate into Longer-Term Financial Wellness?

Data

- Use the 2014 SIPP as an "out-of-sample test" of whether low-income households with at least that buffer ($2,452) incur less financial distress 3 years later
- Track households once per year for 4 years, from **2013 (Wave 1) to 2016 (Wave 4)**

EMPIRICAL STRATEGY

Outcome variable: The "Hardship Index"

- A continuous measure of hardship, constructed from a principal components analysis on 6 measures of food, bill, housing, and medical insecurity. Weights:

Hardship	Weights
$Food_1$	0.51
$Food_2$	0.50
$Food_3$	0.45
Utilities	0.32
Housing	0.38
Health	0.21

- Cut the index into terciles in each wave
  - e.g., $HighHardship_4 = 1$: indicates that household is in the highest tercile of the hardship index as of Wave 4 (2016)

EMPIRICAL STRATEGY

Regression equation:

$$(1)\ HighHardship_4 = \alpha + \beta_1 I(LiqAssets_1 > 2452) + \pi Log(1 + LiqAssets_1) + Controls + \epsilon$$

Controls:

- The financial hardship index as of Wave 1
- Log-transformations of a household's balance sheet characteristics as of Wave 1
- Log-changes (between Wave 1 and Wave 4) of household income and total debt
- Changes in access to social programs, marital status, and household size

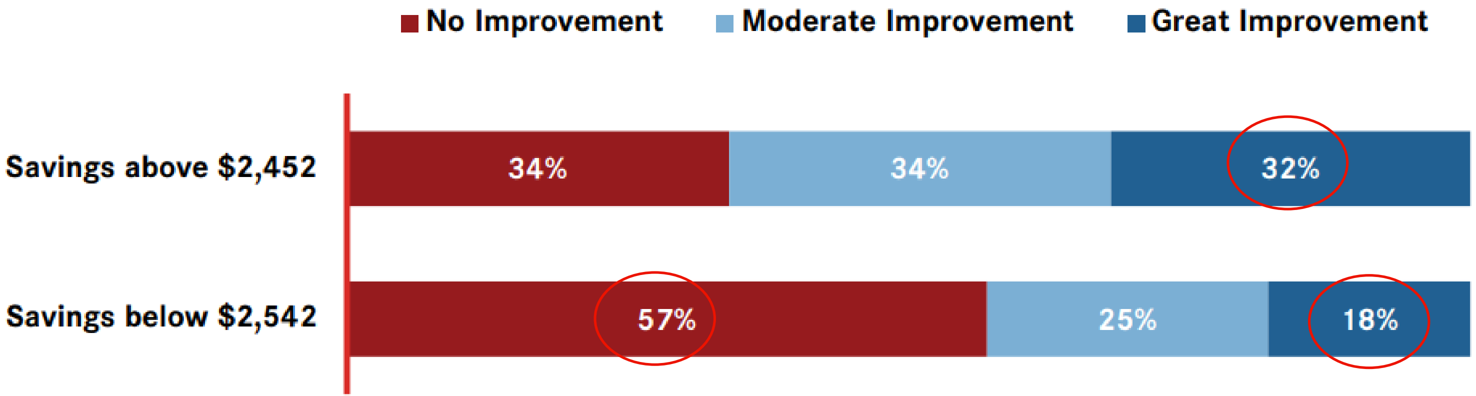
RESULTS

Regression equation	(1)
Dependent variable	$HighHardship_4$
β	−0.095 (0.02)
Sample	All
Savings measured at	Wave 1
N	4,590

- When a household has a buffer of >$2,452 as of Wave 1, its probability of being in the high-hardship tercile as of Wave 4 (3 years later) falls by 9.5%pt.

RESULTS

Change in Financial Well-Being between 2013 and 2016 of Low-Income Households above and below the $2,452 Savings Threshold



% = Probability of Transitioning from the High-Hardship Tier to High-Hardship (No Improvement), Mid-Hardship (Moderate Improvement), or Low-Hardship (Great Improvement) Tiers, between 2013 and 2016

CONCLUSIONS

- Emergency savings is predictive over a longer-term (at least 3 years down the road)
- Having liquid assets of at least $2,452 is linked to a 9.5%pt decline in the probability of being in the highest tercile of financial hardship, 3 years later
- Achieving a substantial liquidity buffer at some point (even if drawn down during some periods) is correlated with a better financial well-being, relative to peers, over time

CAVEATS

- Correlation is not causation
  - Still, the act of building a savings buffer is a choice
- Finally, our data is all pre-pandemic
  - And the tools households use to manage shocks may be forever changed

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