The Financial Position of Consumers*

The strength or weakness in the financial balance-sheet positions of the various sectors of the economy is generally assumed to play a significant role in the over-all course of economic activity, credit flows, and interest rates. Even though it is true that spending and financial transactions are most closely related to the flow of money income to each individual, business, and governmental unit in the economy, there is a strong presumption that balance-sheet considerations also exert a separate influence that should not be overlooked. A family or business with large stocks of financial assets and only small debts is likely to be more willing to spend out of current income, or to borrow against future income, than a similar family or business with only small financial assets and large outstanding debts. Consequently, when balance-sheet positions are strong on average, spending propensities are likely to be higher than when balance sheets are weak.

This article deals with the financial balance-sheet position of one sector of the economy—the consumer sector. The primary purpose of the article is to present in a systematic way the available data on financial assets and liabilities, with particular focus on the broad trends of the past twelve years. Since no attempt is made here to go beyond the financial items on the balance sheet, this article leaves aside consideration of consumer wealth held in the form of physical property—such as houses and durable and semidurable goods—which also are presumably important factors in consumer behavior.

The discussion that follows first presents the assets side of consumers' balance sheets—with reference to four particular types of financial assets—and then discusses the liabilities side. Two traditional methods of combining the effects of trends on both sides of the balance sheet into over-all measures of financial strength are also evaluated. The article closes with some tentative conclusions about the recent financial position of consumers relative to earlier years.

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PRECAUTIONARY NOTES

Before turning to the data, some notes of caution are in order. First, the balance-sheet data are taken from the flow-of-funds accounts compiled by the Board of Governors of the Federal Reserve System and, while they represent a major conceptual and statistical effort of many years, these data do have some limitations for the purpose of the present analysis. For example, the "household" sector, as defined in the flow-of-funds accounts, includes, besides consumers, private nonprofit institutions directly serving households. While it is possible partially to eliminate such institutions from the liabilities side of "consumers'" balance sheets, presently available data do not permit their exclusion from the assets side. Furthermore, except for corporate stocks, flow-of-funds data on assets and liabilities are measured at face value whereas market valuation would be preferable for this study. In addition to these definitional difficulties, there are uncertainties regarding measurement: it is quite likely that the flow-of-funds data on the household sector are the least reliable ones among all the major sectors covered, since no direct information is available on certain types of consumer assets. It should be stressed, however, that these data limitations are in all likelihood not so serious as to invalidate a broad analysis of general trends, especially if the time period examined is reasonably long and the over-all changes are fairly large.

A second note of caution relates to the fact that, in attempting to characterize the financial position of consumers, one should examine not only the total value of all assets and liabilities, as is done here, but also the distribution of these claims and obligations among consumers. Any balance-sheet strength derived from the ownership of corporate stocks and bonds, for example, cannot be attributed to consumers as a whole, for these instruments are not widely held. Consumer debt is also unevenly distributed, and any increase in its outstanding volume should be evaluated in terms of the effects on only a limited portion of the over-all consumer population.

A final cautionary note relates to the need to take some account of the effects on assets and liabilities that stem purely from the changing scale of economic activity over time. As the economy grows and the country's population increases, it is to be expected that total assets and liabilities of consumers will grow as well. In order, then, to make a meaningful comparison of balance-sheet positions at two separate points of time, it is necessary to "deflate" by some measure of the level of over-all economic activity. In this article, balance-sheet figures have been expressed as a ratio to the over-all total of personal outlays[1] as defined in the gross national income and product accounts. Any number of other deflators might have been used—the most obvious alternative being personal disposable income—but experiments with alternative measures revealed no significant differences from the results reported in this article.

TRENDS IN CONSUMER FINANCIAL ASSETS

During most of 1952-64—the time period of this analysis—the various categories of consumer financial assets have shown highly diverse trends. Because of this it is worthwhile to distinguish four main categories of assets: namely, liquid assets, bonds and mortgages, life insurance and pension fund claims, and corporate stocks.[2] Each of these types of assets tends to reflect, and be affected by, a different set of economic forces.

Consumers' "liquid" assets are usually defined as including holdings of demand deposits and currency, savings deposits and other depositary accounts, United States savings bonds (which are redeemable on demand), and short-term Government securities. The over-all size of such holdings at any one point in time is often used as "the one" measure of an individual's or all individuals' balance-sheet strength. Comprising money and close money substitutes, these assets are a source of immediately available purchasing power and can provide a means of increasing consumption or long-term investment at the expense of short-term liquidity.

During the greater part of the 1952-64 period, the ratio of consumer liquid assets to consumer spending moved within a narrow range of 85-88 per cent. Since 1960, however, the ratio has edged upward, and by late 1964 stood at about 95 per cent (see Chart I). At the 1964 level of personal outlays, this increase of approximately 8 percentage points in the liquid assets-spending ratio represents more than $78 billion in additional liquid assets.

Among the various components of the liquid assets total, consumers' holdings of demand deposits and currency (i.e., of money, narrowly defined) rose in absolute amount over the past twelve years, but their growth rate was quite low compared with the increase in consumer spending. As a result, the assets-spending ratio for this particular component moved downward rather steadily over the period. Moreover, an even stronger downward trend is evident in the ratio of savings bonds to spending, for the stock of savings bonds held by consumers actually declined slightly over the period. Holdings of marketable, short-term Government securities grew at a more rapid rate than did holdings of money, but nevertheless only just enough to keep pace with the upward trend in spending. Consumers' savings deposits, on the other hand, grew quite rapidly over the early part of the period and their growth accelerated after 1960, with the pace of the advance substantially exceeding the rise in consumer spending throughout. In the 1950's, the surge in savings deposits roughly compensated for the sluggish growth in the other liquid assets components, and the over-all liquid assets-spending ratio remained stable. In more recent years, however, the sharper rise in savings deposits was sufficient to bring about an actual increase in the over-all liquid assets-spending ratio. Since savings deposits have been the only strong growth element in the liquid assets category, they have understandably attracted much attention in recent financial analysis.

The differences in growth rates between the various types of liquid assets, and the resulting changes that occurred in the composition of consumer liquid assets holdings, have to some extent been influenced by changes in the structure of interest rates since 1952. Because rates paid on savings deposits moved upward virtually throughout the period, both absolutely and relative to rates on other liquid assets, it became progressively more advantageous to hold savings deposits rather than savings bonds, and at the same time it became more costly—in terms of interest foregone—to hold cash and demand deposits. The growing yield advantage of savings deposits was, of course, widely and successfully advertised by savings institutions.

In contrast to the accelerated growth in liquid assets held by consumers during recent years, consumer holdings of bonds and mortgages—the second of the assets categories enumerated above—have shown a somewhat slower rate of growth since 1960 than in earlier years. The ratio of holdings of bonds and mortgages to total personal outlays rose from 14.9 per cent at the end of 1952 to 18.8

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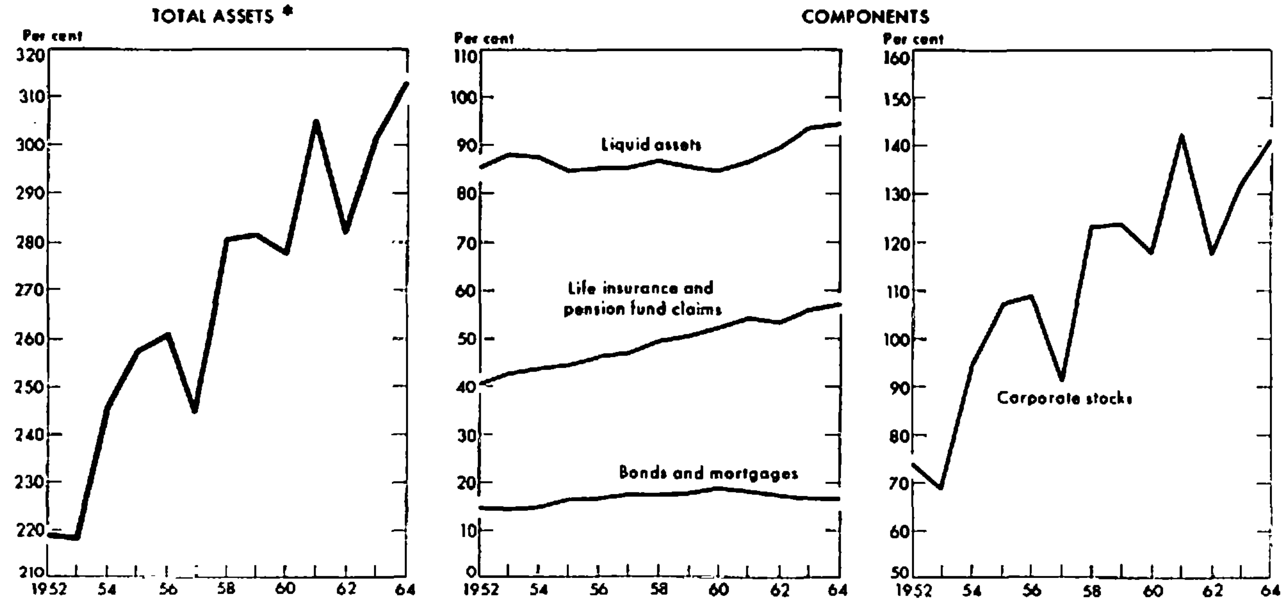
[1] Personal consumption expenditures plus consumers' interest payments.

[2] A few minor items on the assets side of the consumers' balance sheet—such as customers' credit balances at securities brokers and dealers—are included in the discussion of total assets but are not analyzed separately.

Chart I

CONSUMER FINANCIAL ASSETS EXPRESSED AS A PERCENTAGE OF PERSONAL OUTLAYS



* Includes customers' credit balances and other minor categories of financial assets not shown separately.

Source: Board of Governors of the Federal Reserve System.

per cent by the end of 1960, but the next four years witnessed a net downward movement in this ratio, to 16.6 per cent at the end of 1964 (see Chart I). Bonds and mortgages have accounted for a steadily declining share of total consumer assets over the past four years.

Once again, interest rate developments may account for at least part of this relative shift in the composition of consumer assets. The rise in interest rates on time and savings deposits undoubtedly led some individuals to hold in such accounts funds that might otherwise have entered the bond and mortgage markets directly. However, some part—possibly a substantial part—of total personal holdings of bonds and mortgages is administered institutionally (through trust funds) and hence is not subject to the direct discretion of individuals.

A third component of consumer financial assets singled out in this article is the paid-in value of claims against insurance and pension plans. This category has become one of the most important outlets for savings (see Chart I), and accounted for nearly one sixth of the estimated value of all financial assets held by consumers at the end of 1964. Moreover, in recent years the increases in such claims have absorbed 30 to 50 per cent of the annual net additions to total financial assets. Because these contractual claims are in most cases not readily convertible into cash at the option of the holder, they provide little immediate or short-term financial flexibility. On the other hand, insurance and pension claims do provide basic safeguards against future adversities and thus permit consumers to take more risks in investing their other financial assets.

The primary reasons underlying this rapid rise in consumer holdings of insurance and pension reserves are fairly clear. These two forms of accumulating financial assets have become widely used only during the years covered by this study.[3] While consumer incomes have steadily grown, the demand for these assets has grown even faster, demonstrating an increased preference for financial security. It is well-known, for example, that in

[3] A recent study of the effects of pension fund growth on savings patterns found that, when households come under a pension plan, they do not merely substitute pension contributions for other forms of saving but that "the net addition to aggregate personal saving apparently equals the full amount of employees' and employers' contributions". See Phillip Cagan, *The Effect of Pension Plans on Aggregate Saving: Evidence from a Sample Survey*, Occasional Paper 95 (National Bureau of Economic Research, 1965), page 82.

labor contract settlements of recent years great emphasis has been placed on employee pension arrangements.

The fourth and final component of consumer financial assets here reviewed—holdings of corporate stock—has been the greatest single source of increased consumer wealth since 1952. Corporate stocks, valued at market prices,[4] at the end of 1964 amounted to 141 per cent of consumer spending, compared with only 74 per cent at the end of 1952 (see Chart I). By far the greatest source of the increased value of corporate stock holdings has been the appreciation of market prices: in the past twelve years, consumers have spent a net total of only $3 billion for stocks, but stock values have been marked up an additional $414 billion.

The ratio of the total of all components of consumer financial assets[5] to personal outlays rose from 219 per cent in 1952 to 313 per cent in 1964, turning down only temporarily in three periods of stock market decline—in 1957, 1960, and 1962. This is a picture of considerably increased strength on the assets side of the consumers' balance sheets. The significance of this improvement in aggregate balance-sheet strength is open to some question, however. In spite of the increase in the proportion of consumer holdings of bonds, mortgages, and corporate stock over the past decade, none of these assets are as yet widely held. According to a recent survey, less than one family in five owns corporate stock and only one in fifty owns marketable bonds.[6] Also, in the case of corporate stock the vulnerability of market prices to large-scale fluctuations in either direction leaves open the question to what extent consumers can view market appreciation as a permanent source of increased financial strength.[7]

In view of these factors, trends in the financial position of the average consumer may possibly be more closely represented by movements in the two broadly distributed classes of assets—liquid assets and private life insurance and pension claims. But even when the analysis is restricted to these assets, the period since 1952 is still characterized by an improving financial assets position, though the trend is, of course, far less strong than when stocks, bonds, and mortgages are included.

TRENDS IN CONSUMER LIABILITIES

Any assessment of consumer financial positions must also take into account the liabilities side of the balance sheet. The two main types of individual indebtedness are consumer credit and home mortgage debt, both of which have grown sharply throughout the postwar period.[8]

At the end of 1952, the total amount of consumer credit outstanding equaled about 12 per cent of personal outlays. With more widespread use of this type of debt over recent years, the total had grown to fully 18 per cent of spending at the end of 1964 (see Chart II). Both instalment and noninstalment forms of consumer credit shared in this growth. During the past three years of high automobile sales, instalment loans for car purchases have grown especially rapidly.

The increase in outstanding mortgage debt of consumers, from 22.4 per cent of consumer spending in late 1952 to 45.1 per cent at the end of 1964 was even sharper than the growth of consumer credit (see Chart II). The major factor in this expansion has been the steady shift in living habits over the postwar years away from apartment rental and toward individual homeownership. In 1950, only about 55 per cent of all families owned their homes, but by 1960 almost 62 per cent were homeowners, and the proportion is probably even higher today. A second important factor in the growth of home mortgage debt—particularly in the past few years—is the liberalization of mortgage terms, which has allowed larger mortgage loans on homes of any given value as well as more frequent inclusion of major household appliances in mortgages.

Along with the growth in the outstanding amount of consumer credit and home mortgage debt, there has been

[4] As previously noted, all data published in the flow-of-funds accounts are recorded on a face value basis, except for corporate stocks which are valued at market prices.

[5] The four components discussed above, plus customers' credit balances and all other categories of financial assets.

[6] See Board of Governors of the Federal Reserve System, "Survey of Financial Characteristics of Consumers", *Federal Reserve Bulletin* (March 1964), pp. 285-93.

[7] As a first approximation in answering the question, it might be suggested that stock owners distinguish between a gradually increasing "basic" value of their holdings, as the economy and corporate earnings expand over the years, and more transitory fluctuations of the stock market around this basic trend. Only the former would be included as a permanent source of increased financial strength. Needless to say, it would not be easy to quantify and verify this suggestion.

[8] Three other categories of consumer indebtedness may be mentioned briefly. Consumers borrow relatively small amounts using nonresidential mortgage debt. They also borrow from insurance companies against life insurance policies and from securities brokers and dealers against holdings of marketable securities. It should be noted that these types of debt have also risen. They amounted to 3.6 per cent of personal outlays in 1952 and to 6.7 per cent at the end of 1964.

a rise in the ratio of monthly or annual repayments on such debt to after-tax personal income. This ratio, representing the proportion of current disposable income precommitted to contractual debt obligations and therefore presumably unavailable for other purposes, is often used as a rough gauge of the financial "burden" of consumer debt. With respect to instalment debt, repayments (including refinancings) grew from 10 per cent of total disposable personal income in 1952 to almost 14 per cent in 1964. Recent studies conducted by the University of Michigan's Survey Research Center indicate, however, that much of this growth in aggregate consumer borrowing can be accounted for by a rise in the proportion of households using instalment debt rather than by a rise in the average indebtedness of households that already had some debt outstanding. This may reflect a broader acceptance of consumer credit among various income groups as a means of financing major expenditures, and a widening in the types of purchases for which consumer credit is considered appropriate. Thus, according to these studies, the average indebtedness of debtor households is not at present appreciably higher relative to the current incomes of these households than it was a few years ago, compared with the incomes prevailing at that time.

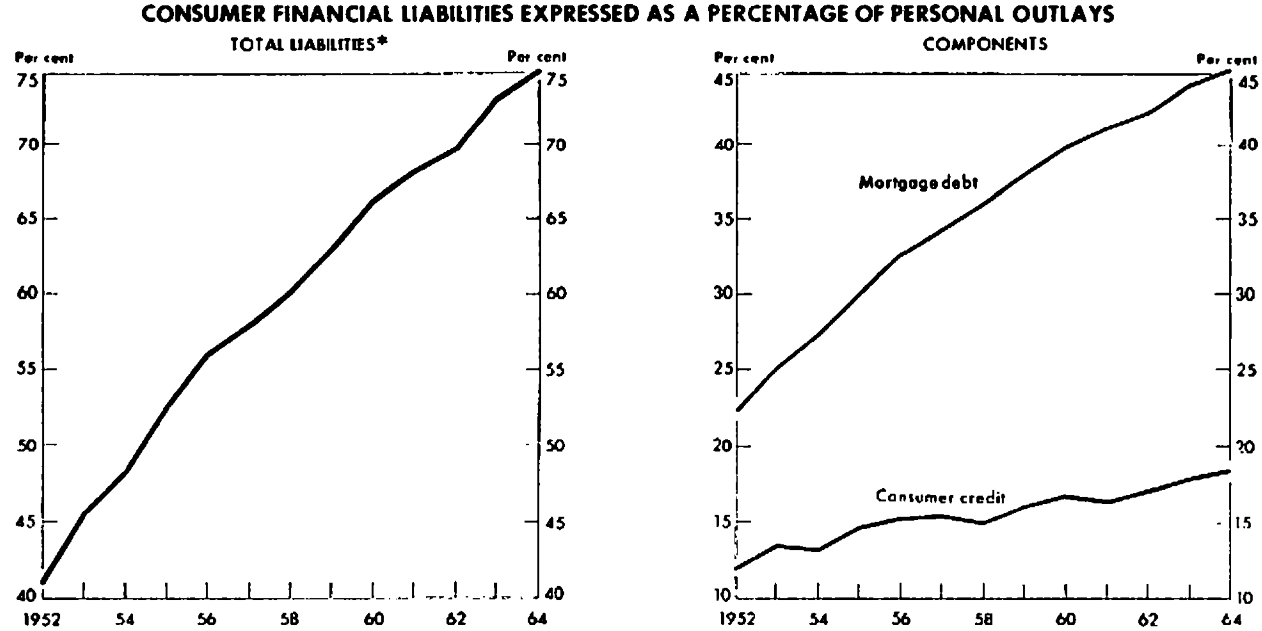
The volume of mortgage repayments undoubtedly has also risen sharply in relation to consumer incomes, perhaps partly because of an increased rate of repayments, but adequate information on the extent of the rise is not readily available. One factor tending to hold down the increase in the mortgage repayment-income ratio has been the gradual lengthening in maturities on mortgages, which of course reduces the size of the average monthly payment. Moreover, as families move from apartments to homes, to the extent that the increased mortgage payments are merely a substitute for what had previously been rental payments, a rise in the mortgage repayment-income ratio implies no increased financial burden on the individuals involved.

THE NET BALANCE-SHEET POSITION

It is apparent that the balance-sheet position of consumers has been subject to two opposing trends. On the one hand, consumer holdings of financial assets have grown, which might have contributed to the willingness as well as the ability to spend for current consumption. On the other hand, consumer debts have also risen, which implies an increase in the volume of contractual claims

Chart II

CONSUMER FINANCIAL LIABILITIES EXPRESSED AS A PERCENTAGE OF PERSONAL OUTLAYS

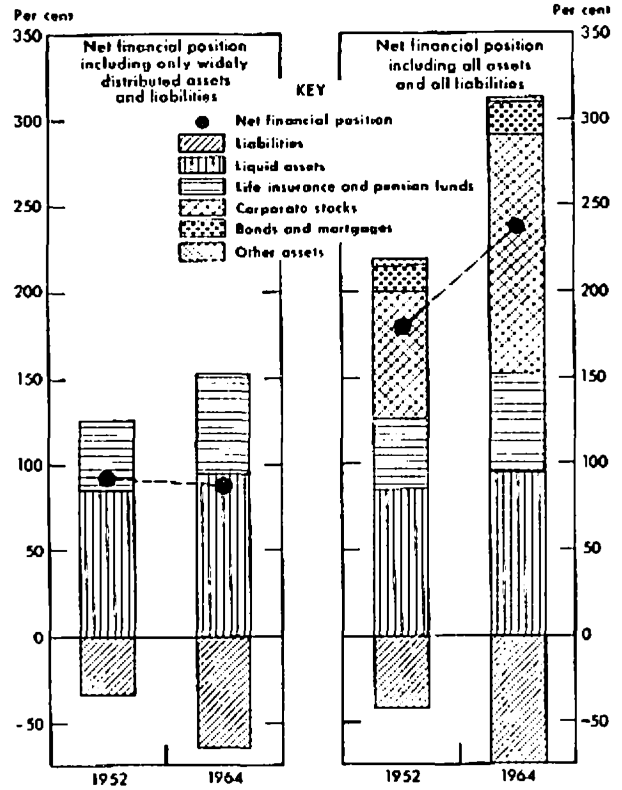


* Includes securities credit and other minor categories of liabilities not shown separately.

Source: Board of Governors of the Federal Reserve System.

Chart III

THE NET FINANCIAL POSITION OF CONSUMERS EXPRESSED AS A PERCENTAGE OF PERSONAL OUTLAYS



Source: Board of Governors of the Federal Reserve System.

against both assets and incomes and therefore perhaps leads to some restraint on spending. One simple way of netting these divergent trends is to subtract the liabilities from the assets, and thus to obtain a rough measure of the movement in consumers' financial net worth. This procedure, of course, ignores many difficulties, such as the changes in the character of both assets and liabilities as well as the distributional shifts of these claims among the consumer population. These are problems which cannot easily be solved, but they can perhaps be eased by presenting two measures of net worth. The first is simply the difference between total assets and total liabilities. The alternative measure is an attempt to focus on the net worth position of only the "typical" consumer and thus includes only those assets and liabilities which are probably common to a majority of the population (see Chart III).

Perhaps the most significant point about these two net worth measures is that they have not moved together over the past twelve years. The over-all net assets position of consumers—the total of all assets less all liabilities—increased markedly over this period (see the right-hand panel of Chart III). The ratio of net assets so defined to personal outlays amounted to 238 per cent by the end of 1964, compared with only 178 per cent at the end of 1952. The alternative net assets measure—liquid assets and life insurance and pension claims, less consumer credit and household mortgage debt—actually declined slightly over the period, from 92 per cent of consumer spending in 1952 to 88 per cent at the end of 1964 (see the left-hand panel of Chart III).

The question inevitably arises as to which of these two measures offers the truer picture of trends in the underlying strength of consumer balance sheets over the past twelve years. Unfortunately, the safest statement is that neither measure is wholly adequate. While it may not be proper to give full weight to bonds, mortgages, and stocks in computing net assets, it also is not proper to exclude them entirely, especially since corresponding liabilities of the owners of these securities have not been eliminated in the computation. In a sense, then, the two measures presented might be considered to be extremes, with the true measure lying somewhere in between. Limited as this conclusion is, it is useful. Given the fact that net worth, excluding the narrowly distributed assets, fell only very slightly relative to consumer spending over the period while the over-all measure rose substantially, a middle position would lead to the conclusion that the net balance-sheet position of consumers has at the very least held its own over the past twelve years, and in all likelihood has actually strengthened to a significant degree.

CONCLUDING REMARKS

The main value of the preceding analysis may well be that it suggests the difficulty of making firm statements about recent trends in the over-all balance-sheet condition of consumers. Nevertheless, it may also serve as a basis for comment on two issues in the area of consumer financial strength which have been widely discussed. One is the increase in consumer liquidity as represented by the rapid accumulation of savings deposits since 1960, and the other is the continued expansion in consumer debt.

As mentioned earlier, savings deposits provide consumers with the ability to increase spending on goods and services independently of current incomes or availability of consumer credit, and without the risk of capital losses. The unleashing of this potential source of purchasing power in a period of high-level economic activity could have inflationary consequences. However, the recent uptrend in savings deposits should be viewed in the context of the relative decline in other liquid assets and the simultaneous rise in debts. Total liquid assets have increased considerably less than either nonliquid assets or debts, and balance-sheet liquidity has actually declined relative to total assets and total liabilities. Moreover, there are some indications that consumers themselves do not view savings deposits merely as a temporary store of purchasing power. Despite the fact that the massive growth in savings deposits in recent years has been associated with considerable economizing on demand deposits, the turnover rate on savings accounts at mutual savings banks and on share accounts at savings and loan associations appears to have remained stable. This would imply that consumers have not usually considered savings deposits as substitutes for demand deposits as a means of accumulating funds intended for spending, even in the face of recent high rates of spending on items such as automobiles which have at times led to heavy drains on accumulated financial assets.

Nevertheless, it would be wrong to ignore completely the inflationary or speculative potential of the currently substantial liquid assets holdings of consumers. While the assets may not themselves spark inflation, they might be mobilized in reinforcing such a trend once it got under way for other reasons. In such a period, consumers would have a strong incentive to accelerate planned future expenditures on goods and services or to shift into assets such as common stocks or real estate at the expense of their liquidity holdings, especially since inflation reduces the real yield on fixed-income assets.

At the opposite pole, some observers have become increasingly worried by the mounting burden of debt incurred by families, and by the deflationary potential of these obligations. The sharp rise in these debts, it is said, may limit further borrowing capacity and therefore restrain future spending on consumption goods and homes. Moreover, if the current level of indebtedness is already pressing against the ability to meet scheduled repayments, an economic decline of even modest proportions could result in widespread defaults, thereby weakening the solvency of creditors and adding to the downward pressures on the economy generally. This is a one-sided view. The rise in aggregate indebtedness must be viewed against the fact of the widening use of consumer and mortgage credit as living patterns change. Furthermore, one may once more note that at least on an aggregate basis the net balance-sheet position of consumers has most likely improved over time despite the growth in debt. Thus, to whatever extent the assets shown on consumer balance sheets (and such provisions as insurance on borrowers' lives) serve as a protection against consumer defaults on loans, the ratio of protection of creditors seems to have been maintained or strengthened. Naturally, this observation does not answer the argument that in a massive deflation the value even of fixed-price assets and hence the protection of creditors might be impaired. The answer to this argument must be found in our national commitment to economic growth and in the constant quest for fiscal and monetary policies appropriate to that commitment.