Ladies and gentlemen,

Welcome to the European Central Bank Conference on Household Finance and Consumption. This conference follows an important milestone in a project that the Eurosystem took up more than six years ago, the Household Finance and Consumption Survey (HFCS). The results from the first wave of the survey were published last April, and the microdata were made available to researchers interested in their use. The conference programme is a testimony to the potential that the HFCS has to enhance our understanding of the economic behaviour of individual households.

Let me explain why the ECB decided to embark on this complex project. Now more than ever, after the recent financial crisis, it is clear that aggregate data do not always reveal the whole story. The same aggregate statistics can be the result of different underlying situations. In particular, micro-economic sub-structures may react differently when facing a shock or an economic policy intervention. Progress in economic theory and in empirical methods also highlights the usefulness of a more granular approach to macroeconomic outcomes.

To be more precise, there are two areas of great importance for the ECB in which the use of household-level data can prove very useful: monetary policy and financial stability.

Monetary policy interventions have distributional effects across the population depending on the composition of the assets and liabilities of households. One could argue that monetary policy is in essence distributional in the intertemporal dimension and the euro area crisis has uncovered distributional effects of monetary policy in the spatial dimension. Such effects are however unintended, or in other words, they are a means to an end, that is price stability. Central banks should steer away from distributional politics. But there can be a thin line between intended and unintended consequences, which makes it even more necessary to understand the cross-sectional effects of monetary policy interventions.

Let me give you a few examples. The proportion of total assets invested in interest-bearing products and the proportion of liabilities subject to adjustable rates may to a large extent determine the response of a household’s future income and net wealth to a change in interest rates. We would like to know how homeowners vs. renters, poor vs. rich, employed vs. unemployed, would feel the impact of specific monetary policy interventions, and to what extent and how this affects the transmission to the aggregate economy. Moreover, since we operate in a monetary union, it is also important to measure and analyse the effects across the different Member States, which is only possible if homogeneous information is available for all of them. In addition, the survey can be used to estimate how inflation affects portfolios of various households, along the lines of Doepke and Schneider (2006).1

We are also interested in the implications of household financial positions for financial stability. For this purpose, the matching of assets and liabilities has to be done at the individual level. When monitoring the evolution of financial vulnerability ratios such as the

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debt service to income ratio, the debt to income ratio or the debt to asset ratio, aggregate figures may mask underlying problematic situations, such as pockets of households with unsustainable financial burdens which could lead to defaults and bank losses in case of an adverse macroeconomic scenario. In this vein, the data can be used for conducting micro-simulations as a policy tool. This is already done in other central banks such as those of Finland\(^2\) or Sweden\(^3\), which incorporate these simulations as part of their regular monitoring of the economy. As another example, the reasons for the accumulation of debt can be studied as in Mian and Sufi (2009)\(^4\), who document that the expansion of mortgage credit in the US before the crisis occurred disproportionately in areas with declining relative income growth and led to a sharp increase in mortgage defaults later on.

Going beyond these two direct policy applications, the HFCS offers researchers an invaluable tool to deepen our understanding of a wide variety of topics in the field of household finance.

The first results of these efforts will already be presented in this conference. I would like to draw your attention to some of them. Household indebtedness has grown steadily in most developed countries in the last two decades, both in absolute terms and relative to household income\(^5\), but the research on the causes and consequences of this indebtedness is limited to a few countries, mainly the US and the UK. We are now in a position to study which factors determine the debt holdings of euro area households, how is this debt distributed among them, what type of debt do households make use of and what is the effect of these holdings on spending.

It is also important to study the portfolio of assets that households are holding. There is ample evidence that most households hold rather simple portfolios, composed basically of real estate and deposits.\(^6\) However, the development of financial markets and the creation of new financial instruments have facilitated the diversification of households’ portfolios. Stock holdings have increased, mainly through the commercialisation of mutual funds and retirement accounts, and this has allowed more households to benefit from the equity premium. On the other hand, and in light of the problematic financial situation faced by many households during the recent financial crisis, more research will be needed to see whether financial innovation could have negative effects on some households and to what extent households are able to understand the risks they are exposed to, e.g. once house prices start to decline substantially. This goes hand in hand with the concept of financial literacy, another area of research which has attracted substantial attention lately, and which may become even more relevant an issue given the increasing trend towards private households managing their own pension wealth in the future.\(^7\) As an example, one of the papers that will be presented in the conference studies the effects of exposure to financial training on the debt behaviour of young US consumers.

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Another advantage of survey data is the possibility of collecting information on households’ attitudes, beliefs and expectations. This allows researchers to establish a connection between behavioural traits and observed financial decisions. For example, in the HFCS, households are asked about the amount of risk they are willing to take on when making financial investments or whether over the next year they expect their income to go up more, less or about the same as prices. In the next couple of days we will listen to presentations on how gamblers manage their personal finances or how important are the presence of loss aversion and narrow framing, two of the most prominent aspects of prospect theory, for portfolio choice decisions.

The study of household finance has much to say on the causes and consequences for the economy of the current financial crisis. The 2007 crisis, which originated in the US, is labelled the “sub-prime crisis”, and it is rooted in the excessive accumulation of debt by households which did not have the appropriate buffers to repay their debt in case of a negative shock. As policy-makers we should be deeply interested in knowing where the risks are concentrated in the household sector, how much of a threat they pose to other agents in the economy, which kind of shocks households are more vulnerable to. And should we, as policy-makers, worry about a house price decline, a rise in unemployment or a stock market bust? How exposed is consumer demand to declines in prices of different assets? How will financial losses of individual households impact on public finances? Tomorrow morning we will hear about some of these topics and in particular about the effect of macroeconomic experiences on households’ risk-taking behaviour and portfolio choice, the effect of credit supply shocks on asset allocation and the consumers’ demand for cash in an after-crisis scenario of low interest rates.

The closing session of the conference will deal with the topic of cross-country wealth comparisons. Explaining household wealth differences across countries is not as easy as casual observers might think. There is a plethora of factors involved in the wealth accumulation process. Public comments on the first wave of the survey last April confirmed the usefulness of a careful analysis and explanation of cross-country wealth differences, as was done in the explanatory documents. The papers which will be presented here will analyse the role of income, home ownership and house price dynamics, household structure and intergenerational transfers in this process of wealth accumulation.

I hope the exchange of ideas that will take place in the next two days will help us to further our understanding of how households manage their finances in a complex and uncertain world, to draw useful policy lessons and prepare for the next waves of the survey. And I hope this conference will spur research in this exciting field, from which we all, researchers and policy-makers alike, have so much to learn.

Thank you very much for your attention.

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