Spending Less After (Seemingly) Bad News

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MIT MANAGEMENT SLOAN SCHOOL

Summary

Really nice paper and very clever idea!

Local unemployment hits a 12-months high → individuals reduce spending by 2% and cut credit card repayment by 3.5%

<u>Could capture two effects:</u>

12-month unemployment max = **bad economic conditions** + **salient news**

bad economic conditions: near 12-months unemployment maximums (within 0.2%)

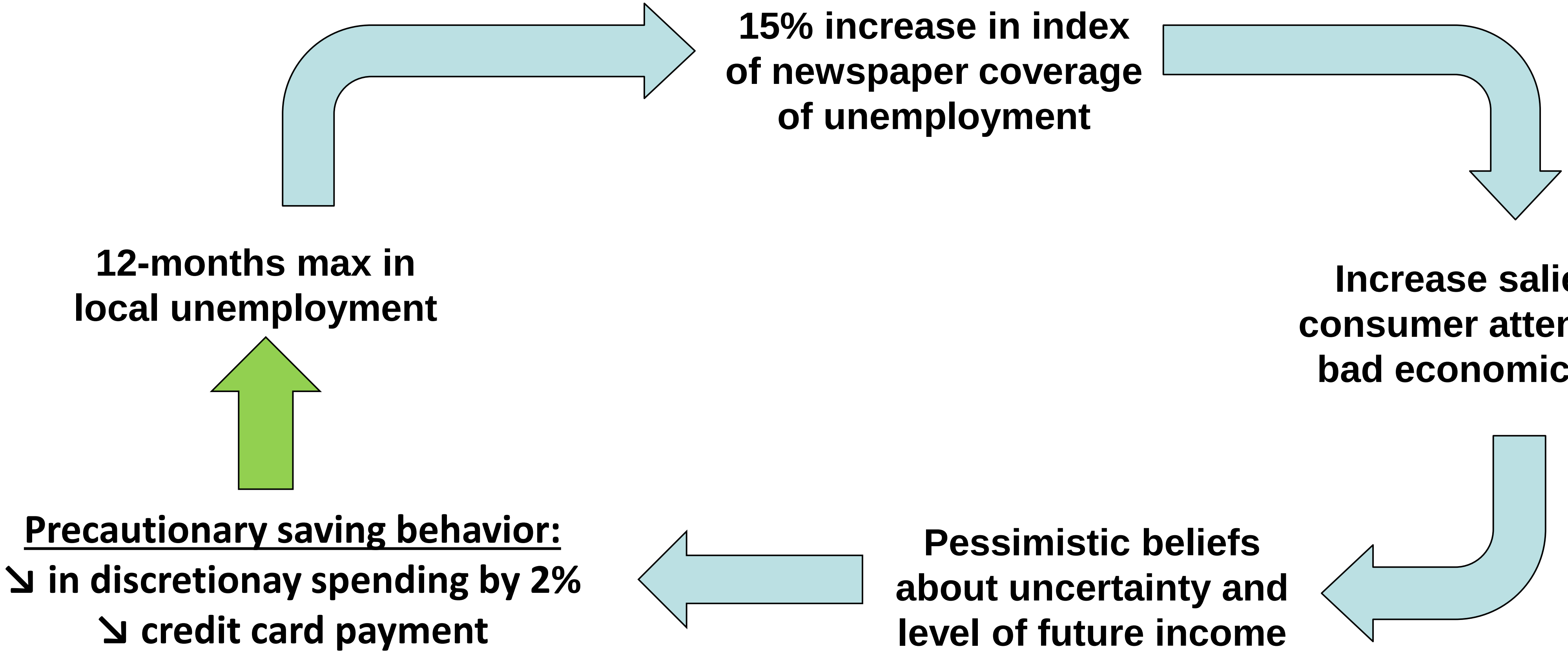
changes in unemployment rate

=> no significant effect on spending

salient news: false 12-months unemployment maximums (Chodorow-Reich et al, 2019)

=> 2% drop in spending

Mechanism


15% increase in index of newspaper coverage of unemployment
Increase salience/ consumer attention to bad economic news
Pessimistic beliefs about uncertainty and level of future income
Precautionary saving behavior:
↘ in discretionay spending by 2%
↘ credit card payment
12-months max in local unemployment

Big picture: rethinking intertemporal consumption behavior?

Permanent income hypothesis

$$u'_t = \beta R\, E_t(V_{t+1}) \quad => \; c_t = \delta \times PI$$

⇒ Prediction: MPC out of transitory income shocks should be small!

⇒ **Challenge:** in the data MPC out of transitory shocks ~0.3

Resolution: binding liquidity constraints

$$u'_t > \beta R\, E_t(V_{t+1}) \quad => \; c_t = w_t$$

Why aren't households saving their way out of the constraint?

- High-return illiquid assets: housing/retirement accounts (Kaplan Violante, 2014)

- Behavioral biases: present bias (Laibson et al, 2007), temptation (Kovacs and Moran, 2021)

Big picture: rethinking intertemporal consumption behavior?

Resolution: binding liquidity constraints?

$$u'_t > \beta R\, E_t(V_{t+1}) \quad => \; c_t = w_t$$

Challenge I: high MPC out of transitory shock among HH with high liquidity (Pagel Olafson, 2018)

Challenge II: Bad news about the future = positive shock to $E_t(V_{t+1})$

If liquidity constraint are binding => no spending response (hand-to-mouth)

- Baugh, Ben-David, Park, and Parker (2021): smooth tax payment (as if unconstrainted) but spend tax refunds as if constrained.
- Consistent with the results of this paper!

Need models to accommodate high MPC out of current income shocks + high sensitivity to expected future negative income!

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↗ newspaper mentions

↗ salience/attention to bad news

Pessimistic beliefs

(Seemingly) bad new

Announcement of 12-months maximum in local unemployment

Spending less:

↘ discretionary spending by 2%

↘ credit card repayment by 3.6%

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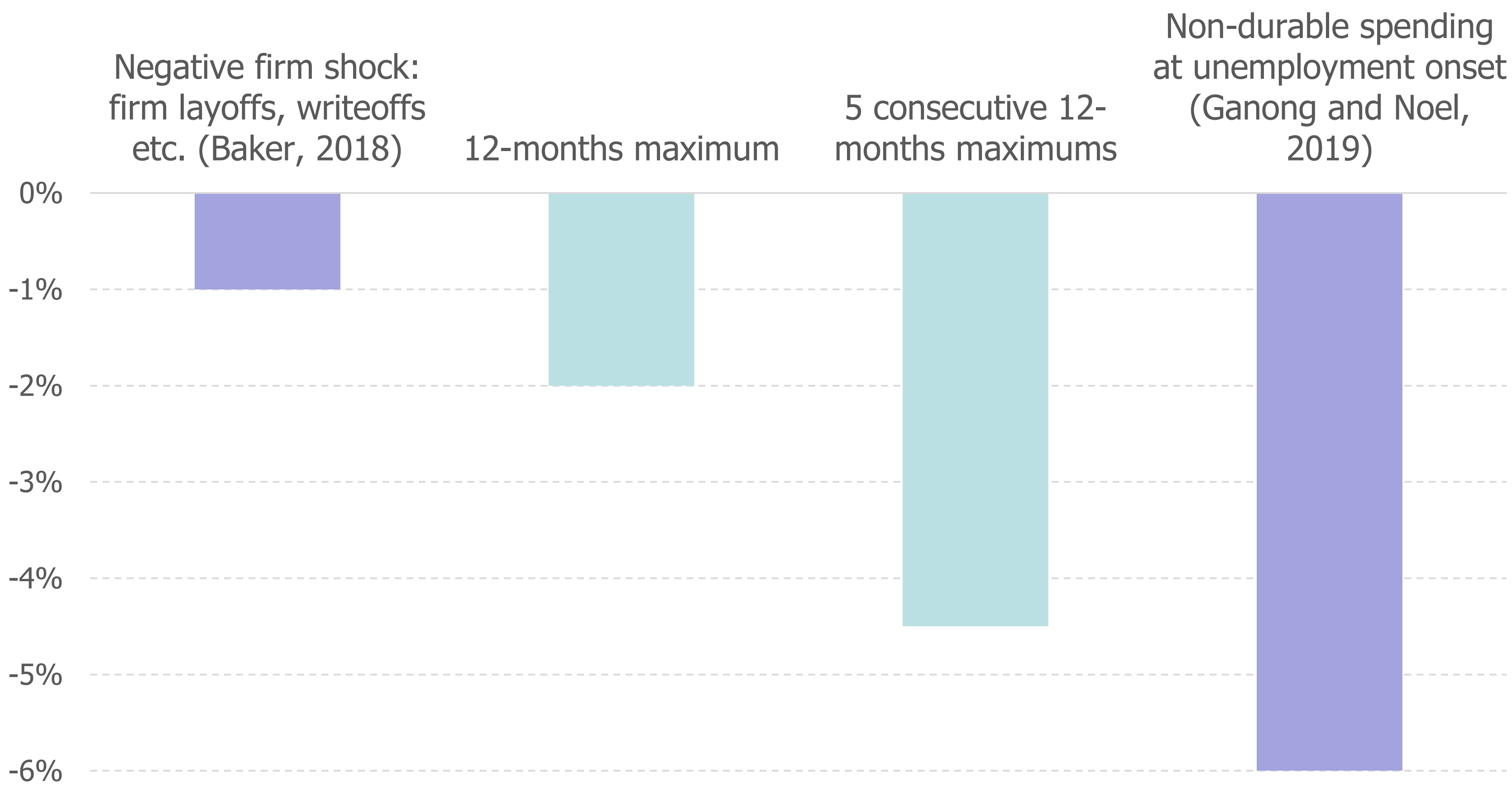
Comment I: The magnitudes are very large!



Comment II: Heterogeneity is puzzling!

Paradox: low income and low education individuals are most responsive to salient news.

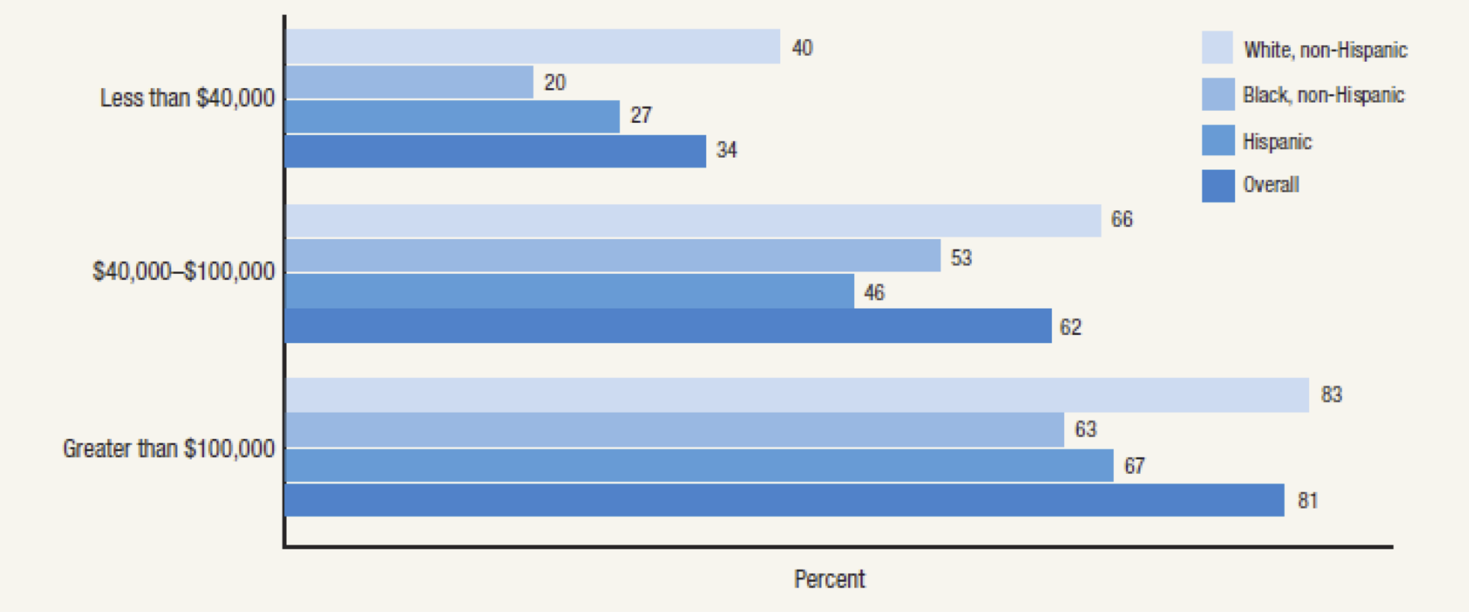
- Least likely to read news about unemployment (+ learning needs to be fast in this setting)
- Don't have precautionary saving (hand-to-mouth):

In theory, more liquidity constrained

= High MPC of current income

+ Low response to news about future

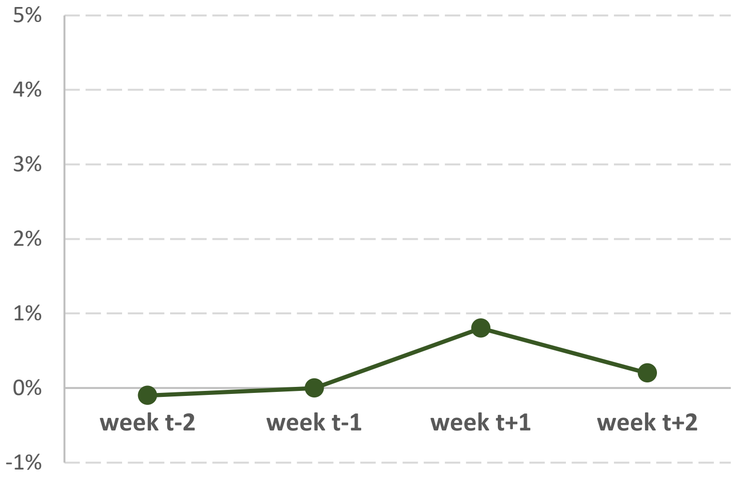
Figure 12. Respondents who would completely pay an emergency expense that costs $400 using cash or a credit card that they pay off at the end of the month (by family income, race, and ethnicity)



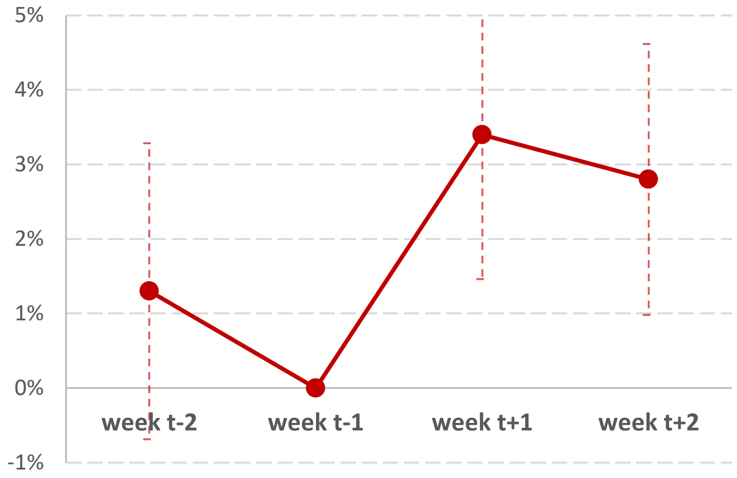
Source: Report on the Economic Well-Being of U.S. Households in 2015
http://www.federalreserve.gov/2015-report-economic-well-being-us-households-201605.pdf

Comment III: Parallel Trend Assumption?

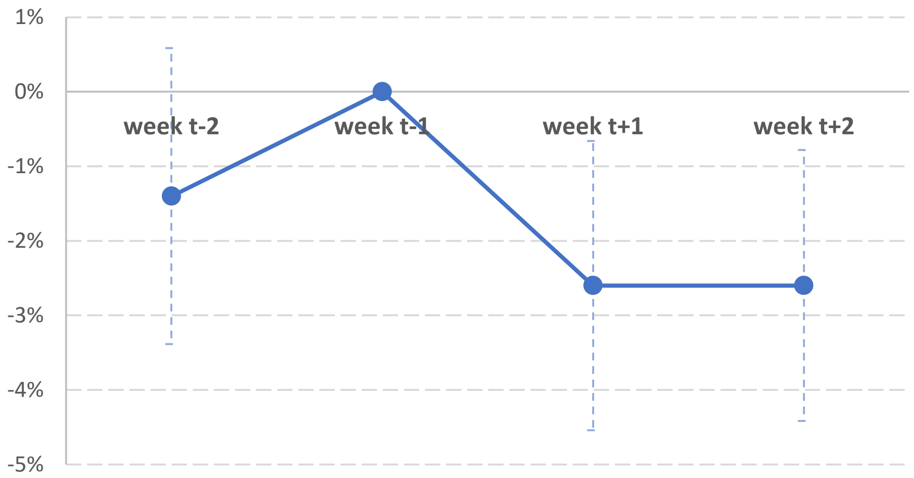
Treatment group (12 months max)



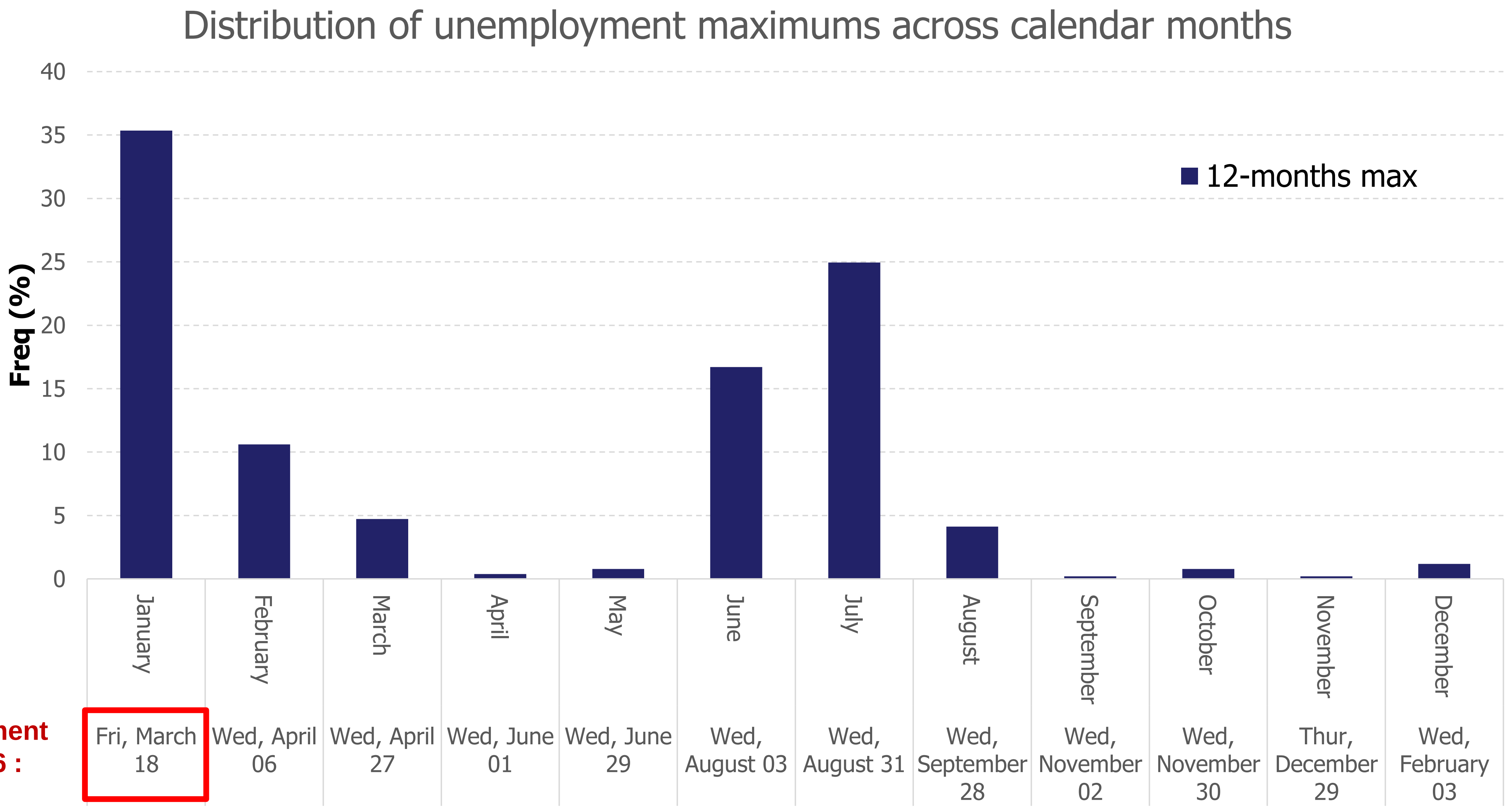
Control group (not 12 months max)



Treatment effect



Calendar month of 12-month unemployment max



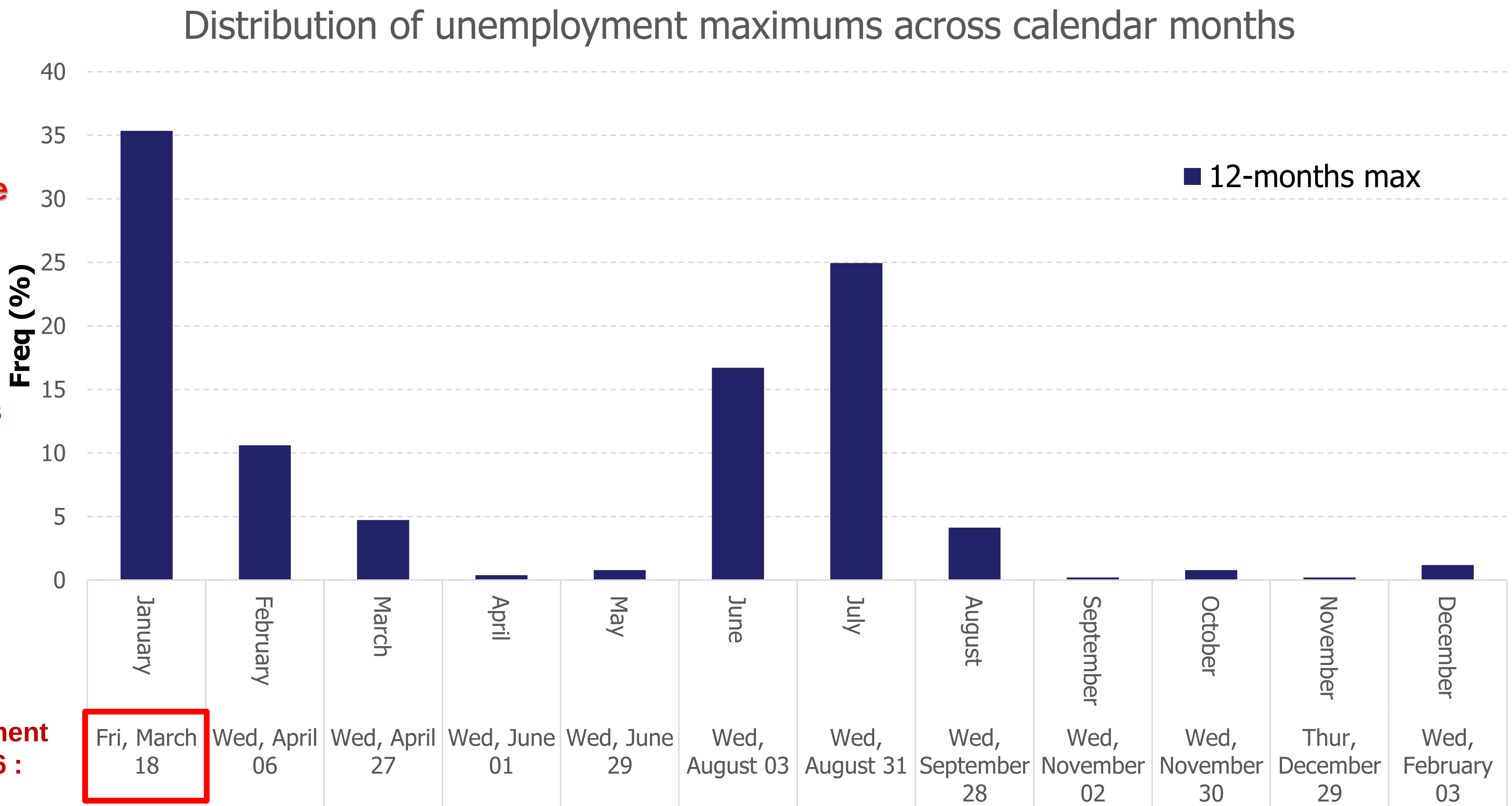
Announcement date in 2016 :

Calendar month of 12-month unemployment max

January report announced in the middle of the month

VS

Typically announcements toward end of month !



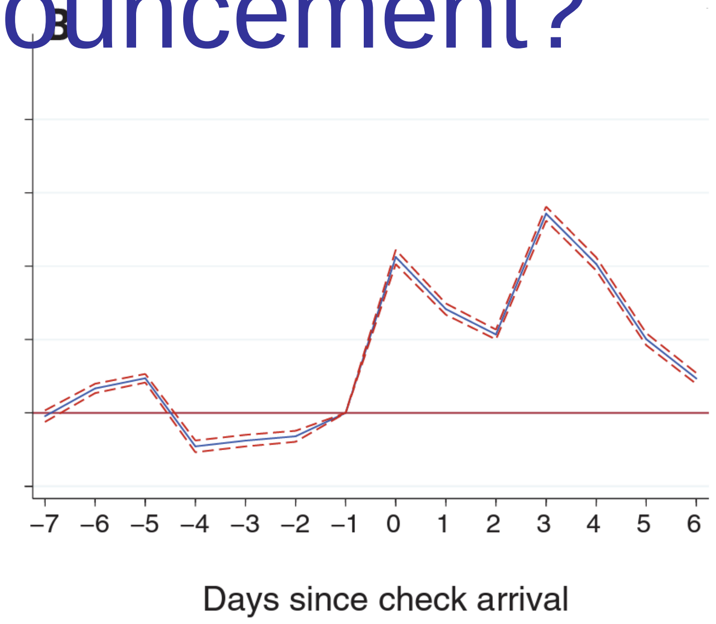
Announcement date in 2016 :

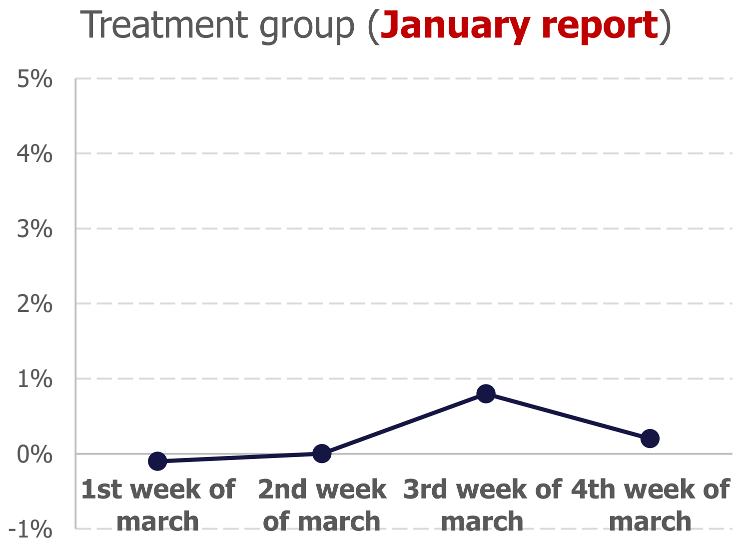
Mid-month vs end of month announcement?

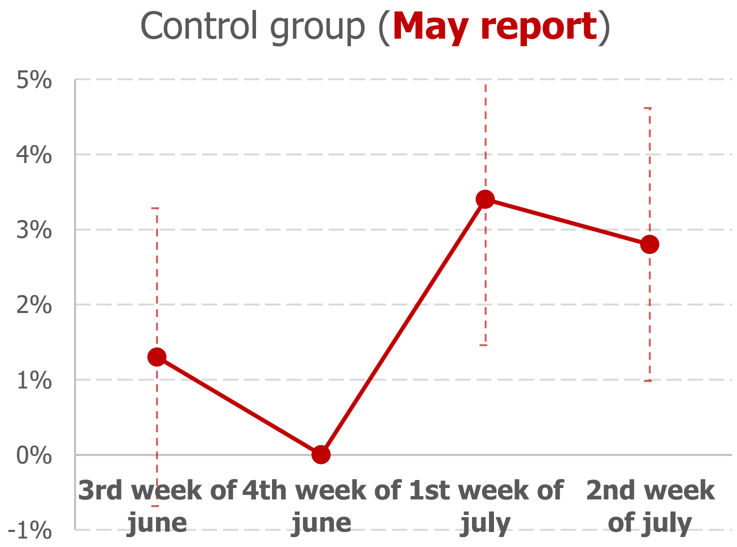
- **Non-recurring spending increase right after regular income (typically in the beginning of the month)** **Gelman et al 2014**

- **12-month max more likely to be in January which is a mid-month announcement**

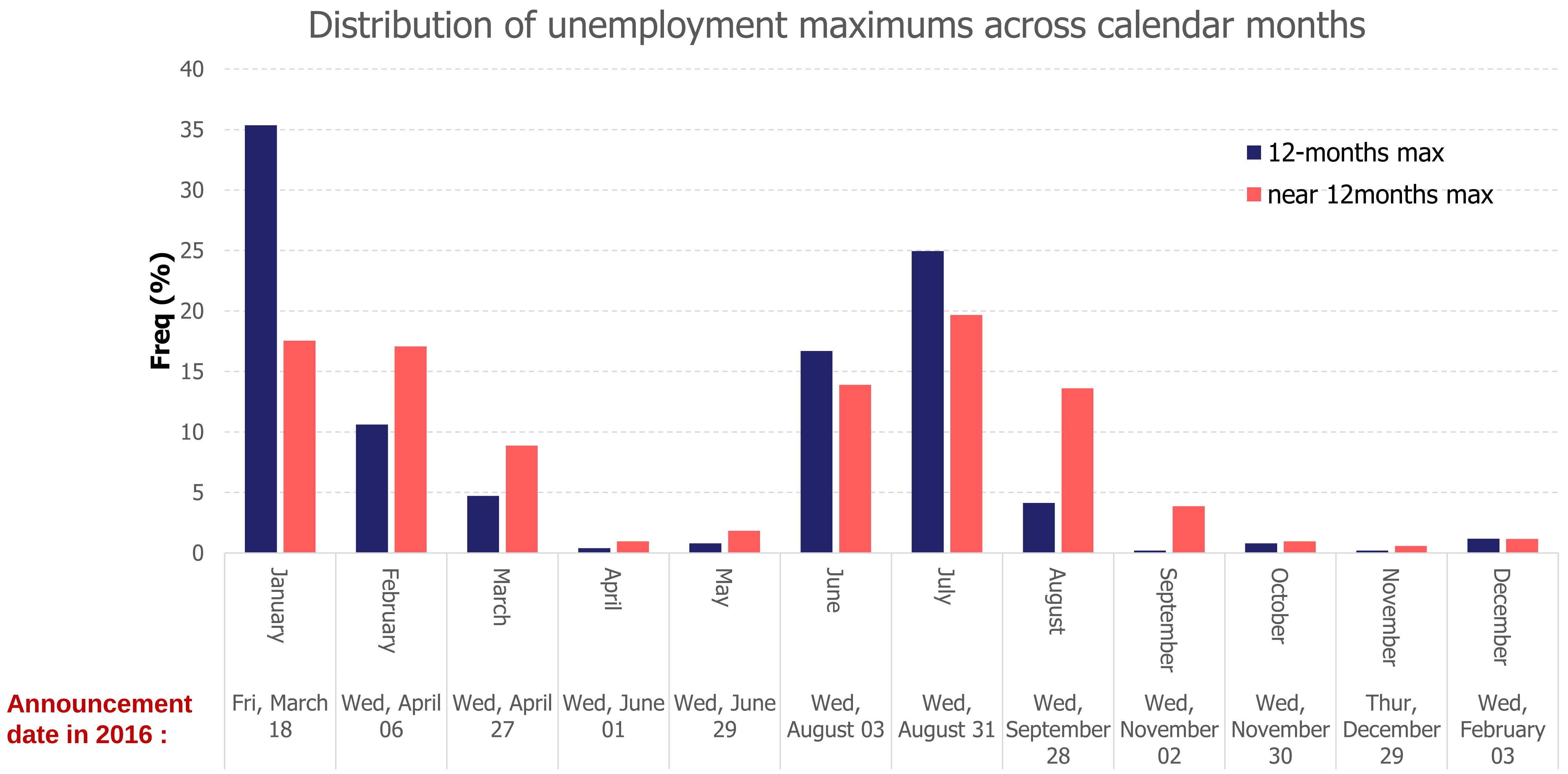
=> Month FE not enough: <u>need calendar week FE!</u>







Near-12-months max help but not enough!



Comment III: What to do?

Pre-trends are a concern in this setting:

- Plot event study over a longer horizon (to assess plausibility of parallel trend assumption)
- Calendar week fixed effects
- Other dimensions of selection (e.g. across geography) could drive pre-trends.
    - <u>Covariate * t : </u>parallel trends may be more plausible conditional on covariates (caveat: can introduce bias if treatment effects are heterogeneous).
    - Other more robust approaches (review in Roth, Sant'Anna, Bilinski and Poe, 2022)

<u>**Good news:**</u> these are fixable issues. A lot of robustness/placebo exercises in the paper: the qualitative result probably hold but magnitudes may be different

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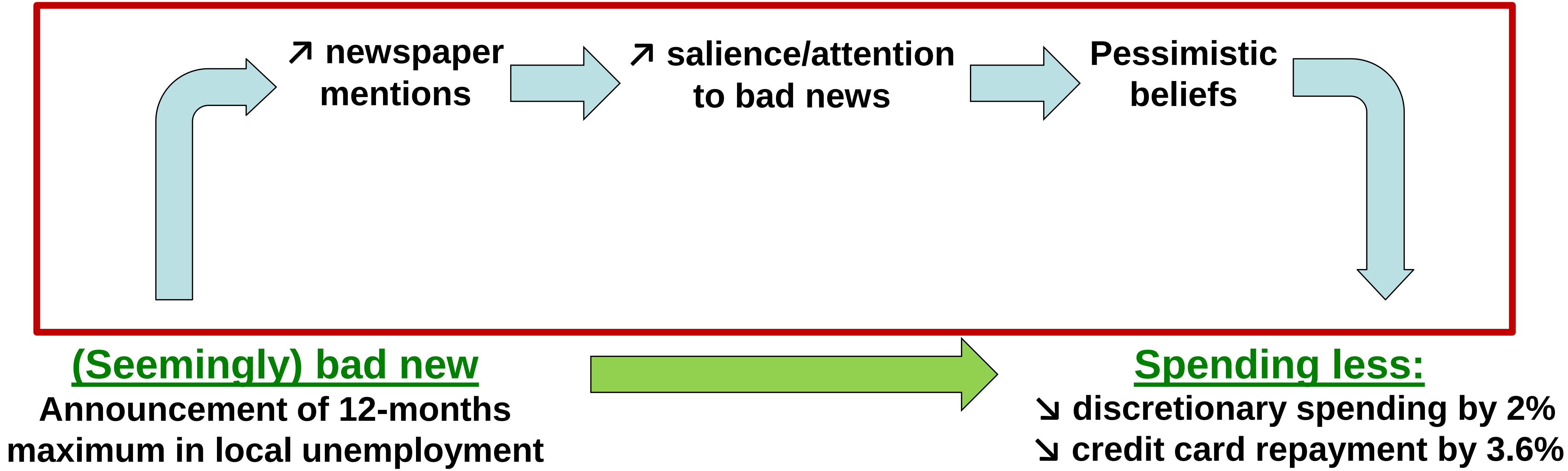

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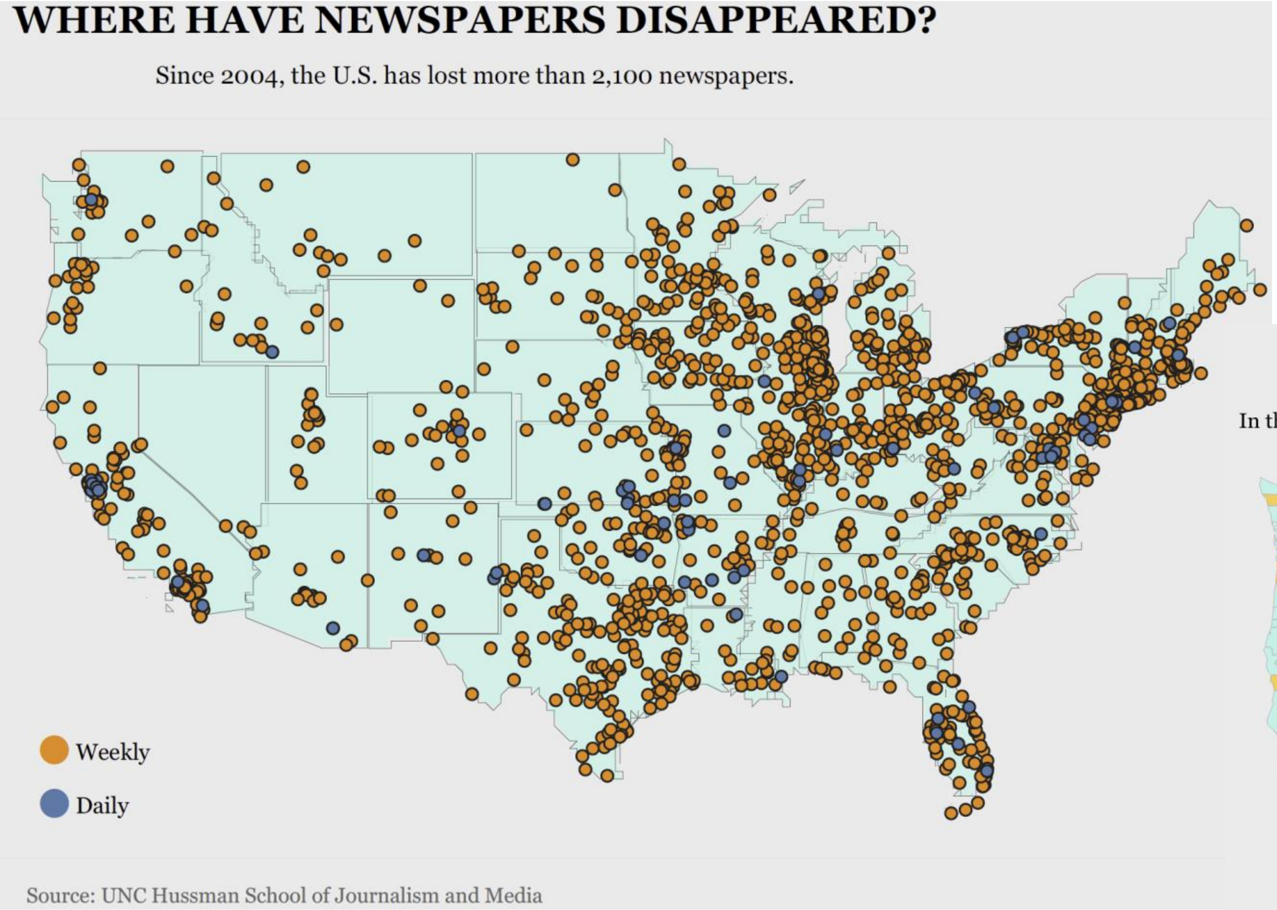
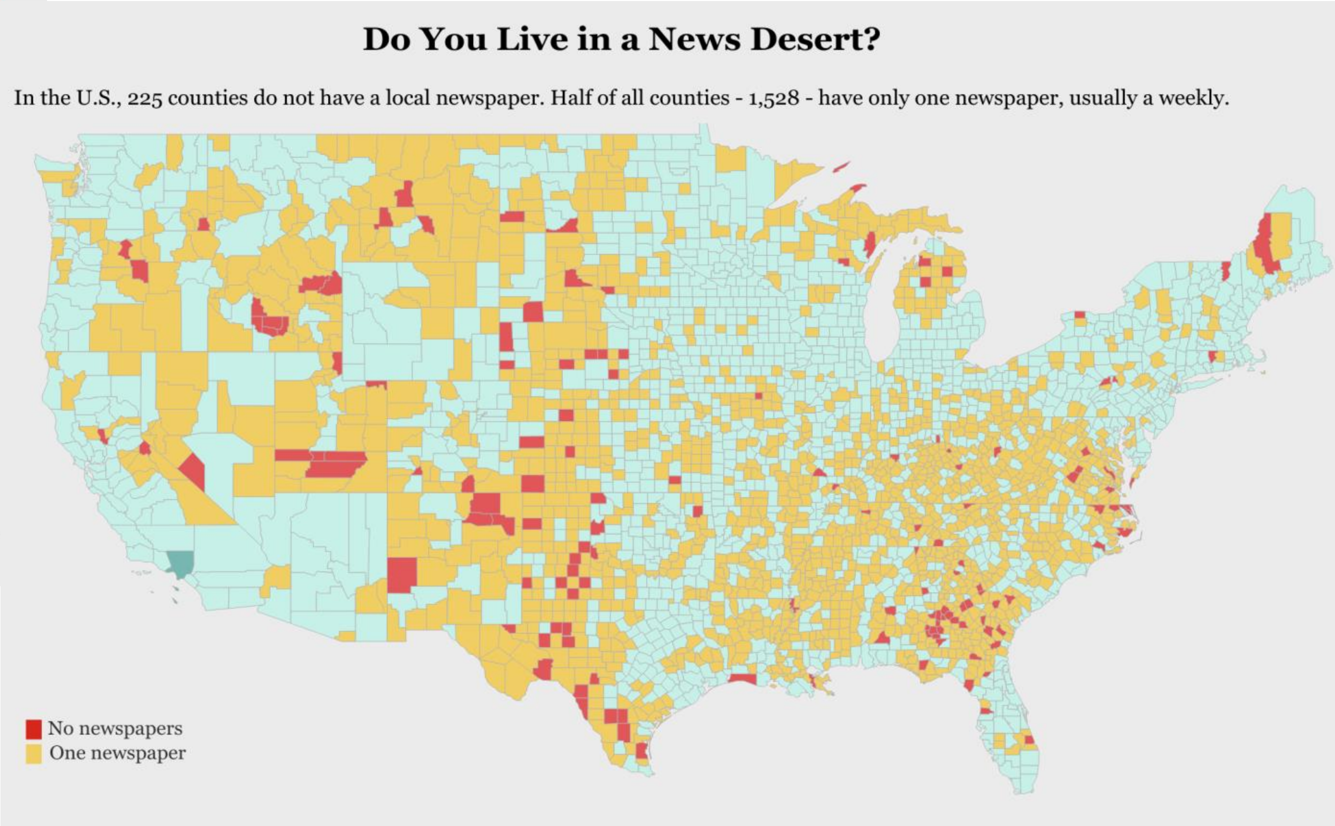
Supply of News about Unemployment



Suggestion:

use variation across space and over time in local newspaper presence?



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Attention to News

Mechanism requires that individuals pay attention to news about unemployment

Suggestion: **use proxies for inattention to test this channel**

Examples from the literature:

- Predictable political and sport events

  (Durante and Zhuravskaya, 2018; Couttenier and Hatte, 2016)

- Calendar day. People more distracted on Fridays?

  (DellaVigna and Pollet, 2009)

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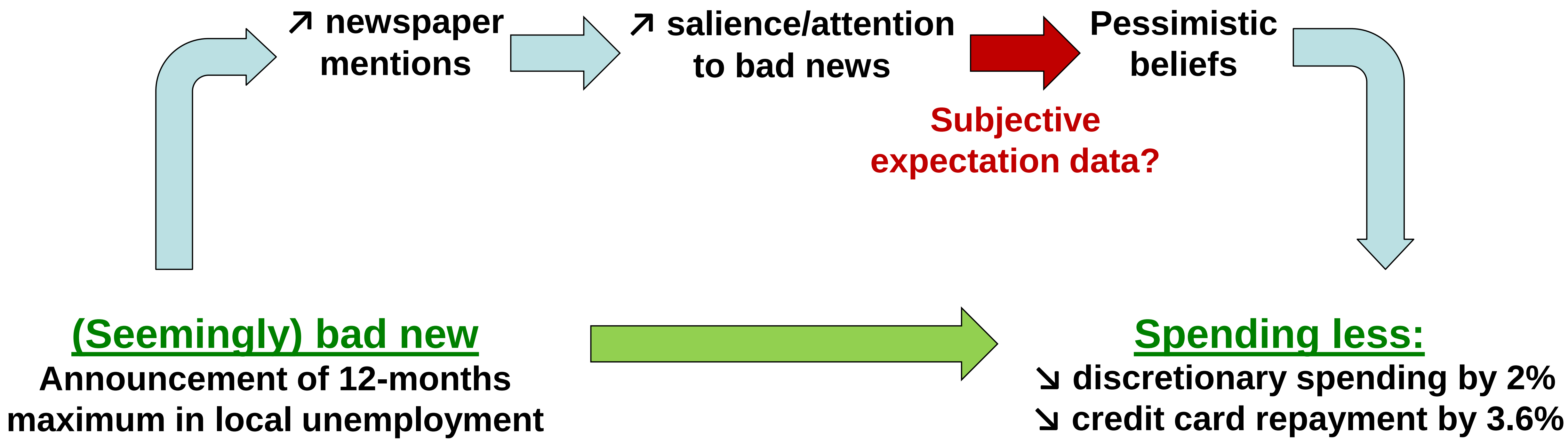

Conclusion

- Great paper: clever empirical approach to study effect of salient news on spending

- Current measurement challenges can be addressed w/ data available to authors

- Open up an exciting agenda of research about sentiment in household finance: a lot more to be done!