The evolution of households' balance sheets during the first few years of the economic recovery

- The Survey of Household Finances, albeit with some delay, provides us with valuable information for assessing the health of households' finances.
- Between 2014 and 2017, household income increased, although it still stood below pre-crisis levels, and the debt to income ratio decreased to levels close to those of 2005-2008.
- The economic recovery between 2014 and 2017 did not lead to an increase in inequality, while it did enable a reduction in households' financial vulnerability.

How has the income, wealth and debt of Spanish households evolved in recent years? We can answer this question thanks to the recent publication of the 2017 Survey of Household Finances (2017 SHF). This survey, which the Bank of Spain publishes every three years, is an invaluable source of information for understanding the state of households' balance sheets. Furthermore, it allows us to analyse lower-income households in greater depth.

Aggregate household income in recent years

Before we begin analysing the numbers, let us review the economic context of the country in 2017. The Spanish economy experienced a period of strong economic recovery between 2014 and 2017. During this period, the economy grew at rates of around 3% and generated some 450,000 jobs per year. In addition, a series of temporary factors, such as the compression of interest rates, lower oil prices and a rebound in the growth of the country's main trading partners gave further impetus to the advance of economic activity and bolstered the climate of confidence.

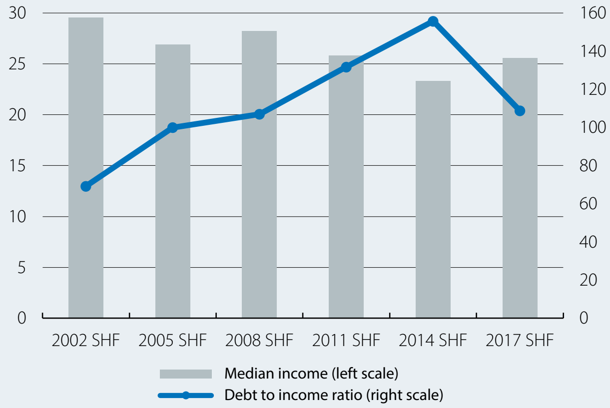
With this background, and as can be seen in the first chart, the SHF shows us that the median total gross income of households in 2017 began to recover from the historic lows registered in 2014.[1] There was also a sharp drop in the ratio of household debt to median gross income, which went from 156% in 2014 to 109% in 2017. Households' median net wealth, on the other hand, fell by around 6% to 115,000 euros, mainly due to a reduction in the percentage of homeowner households.[2] The ratio of debt payments to household income, meanwhile, fell by 2.8 pps, reaching 15.8%, the lowest value since the SHF of 2005.

Thus, we can see how the recovery in the labour market fuelled the growth of household income. We can also see that, between 2014 and 2017, households embarked on a major deleveraging process. This, together with the compression of interest rates mentioned above, allowed the debt burden (measured as the percentage of gross income that is allocated to cover debt payments) to decrease.

1. Total gross income includes both wage and non-wage income, before taxes and social security contributions.
2. The percentage of households that own their primary home went from 80.4% in 2014 to 75.9% in 2017.

Household income and debt

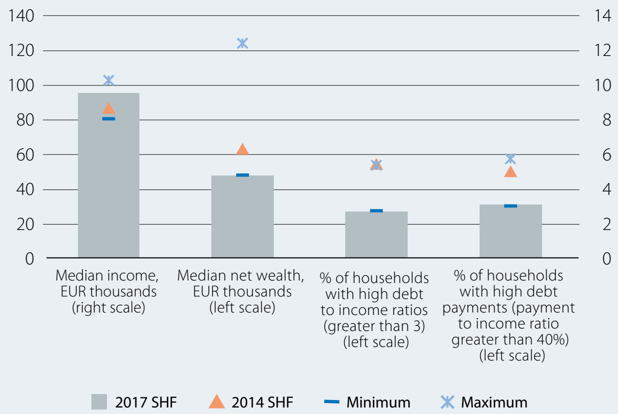
(EUR thousands, 2017 base)



Source: *CaixaBank Research, based on data from the 2017 Survey of Household Finances (Bank of Spain).*

Household income, wealth and debt in the bottom 20th income percentile

(EUR thousands and percentages)



Source: *CaixaBank Research, based on data from the 2017 Survey of Household Finances (Bank of Spain).*

Income, wealth and debt: fragile groups...

One major benefit of the data provided by the SHF is that they allow us to break down the balance sheet of households according to income level. In this way, we can take a closer look at how the economic recovery was transmitted among lower-income households. In the second chart we show the breakdown of the changes in income, wealth and measures of the debt burden among households in the lowest 20th percentile in terms of income.[3] For each variable, the chart shows the value according to the SHF of 2017 and that of 2014, as well as the minimum and maximum value taken among all the available SHFs (the first one was published in 2002).

In terms of income, the data for 2017 reflect a positive trend for lower-income households. The median gross income grew by 11.7% compared to 2014, although it remained below the maximum of the available historical series. In contrast, we see how the net wealth of this segment of households fell, reaching its lowest level. This decline in net wealth is not due to an increase in debt, since the value of the median debt of households in the segment in question fell from 25,500 euros in 2014 to 8,300 euros in 2017. Rather, it is due to a fall in the value of their assets. This decrease on the asset side of the equation could be related to the decline in the percentage of low-income households who are homeowners. This percentage went from 67.3% in 2014 to 60.6% in 2017. The data also show that the financial vulnerability of households with fewer resources has declined since 2014. In particular, the percentage of households with high levels of debt, which we define as those with debt to income ratios greater than 3, has fallen to half of the figure registered in 2014, going from around 54% to slightly over 27%. It should be noted that the figure for 2017 is the lowest level in the entire period for which data are available (since 2002). In addition, the percentage of households with very high debt burdens (where the household allocates over 40% of its income to covering debt payments) has also fallen significantly – from slightly more than 49% in 2014 to just under 31% in 2017.

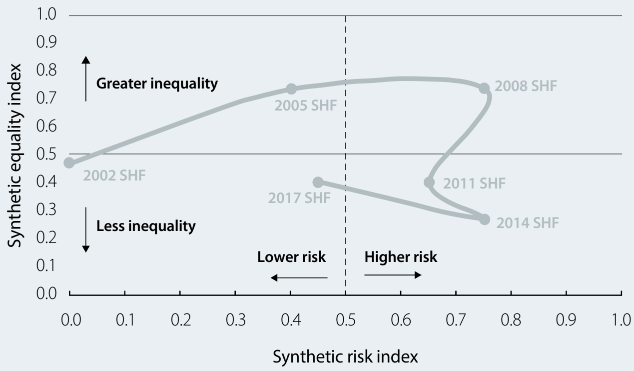
... and inequality

As the SHF provides disaggregated information on income, wealth, debt and financial burden for households with more and fewer resources, it informs us about changes in the level of inequality and vulnerability to which households are exposed. Given that monitoring a broad set of variables complicates the task of interpreting the data, in the third chart we show the trend in a synthetic inequality index and a synthetic vulnerability or financial risk index through the various waves of the SHF.[4]

3. i.e. The 20% of households with the lowest income.
4. The synthetic inequality index is calculated on the basis of the information from three underlying data series. These three indicators compare the gap between households in the 40th income percentile or below and those in the 60th income percentile or above in the following areas: (i) average income, (ii) average wealth and (iii) the Herfindahl index of asset portfolio concentration. The latter indicator measures the extent to which higher-income households have more diversified asset portfolios than lower-income households. Typically, low-income households have almost all their assets concentrated in their main home, while high-income households have other physical and financial assets besides their main home. The synthetic risk index is calculated on the basis of four underlying indicators: (i) the percentage of households with some form of debt, (ii) the median value of the debt for those households that have some form of debt, (iii) the percentage of households with debt to household income ratios greater than 3, and (iv) the percentage of households with debt payment to household income ratios greater than 40%.

Synthetic inequality and risk index

(Percentile)



***Note:** Both synthetic indicators are measured in percentiles. A value of 1 denotes the highest value observed for that indicator among all the waves of the SHF, while a value of 0 denotes the lowest value.*
***Source:** CaixaBank Research, based on data from the 2017 Survey of Household Finances (Bank of Spain).*

Starting from the first publication of the SHF in 2002, we can see how the data from the survey showed an increase in inequality and risk up until 2008. From then on, and with the onset of the recession, we see how the inequality indicator began to fall. This is because the recession affected all households, but the collapse in financial asset prices that accompanied it particularly affected households with more resources. The risk indicator, meanwhile, remained high due to the high volume of debt present on households' balance sheets. Nevertheless, by 2017 we can see that the economic recovery has enabled a reduction in the risk factor, thanks to the deleveraging process undertaken by households. This reduction has taken place without a significant increase in the degree of inequality in the economy, which in 2017 stands close to the median of all the periods considered.

The 2017 SHF and the economic situation in 2020

In conclusion, the data from the 2017 SHF show us that the first few years of the economic recovery led to improvements in household income, both for the median household and for households in lower income percentiles. Also, during the period between 2014 and 2017, Spanish households took advantage of the improvement in income to reduce their level of debt, which has led to a substantial reduction in their degree of financial vulnerability. It is important to note that a lower degree of financial vulnerability is key for preventing temporary and adverse shocks to the economy from having a lasting impact. In this regard, the 2017 SHF shows us that the economy has undertaken a major recovery process. Coupled with the significant correction of macroeconomic imbalances, this places it in a stronger position to handle and minimise the impact of episodes of turbulence like the COVID-19 pandemic, which we describe in further detail in the economic outlook section of this same *Monthly Report*.

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