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Research Insights

How to reduce household financial stress during COVID-19?

More targeted income support policies are needed to help households manage increasing levels of financial stress driven by COVID-19.

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Financial stress during the COVID-19 crisis

Australians are experiencing a greater degree of financial stress during the COVID-19 crisis. The Melbourne Institute: Applied Economic & Social Research Taking the Pulse of the Nation survey suggests that around 30 per cent of Australians are experiencing moderate to high levels of financial stress (defined by their ability to pay for essential goods and services such as their rent, mortgage or bills). As a point of comparison, about 23 per cent of respondents to an alternative pre COVID-19 survey reported difficulty in paying for necessary living expenses (Comerton et al., 2018). Although the two surveys are not directly comparable, the estimates suggest an increase in the propensity of financial stress in the vicinity of 30 per cent.

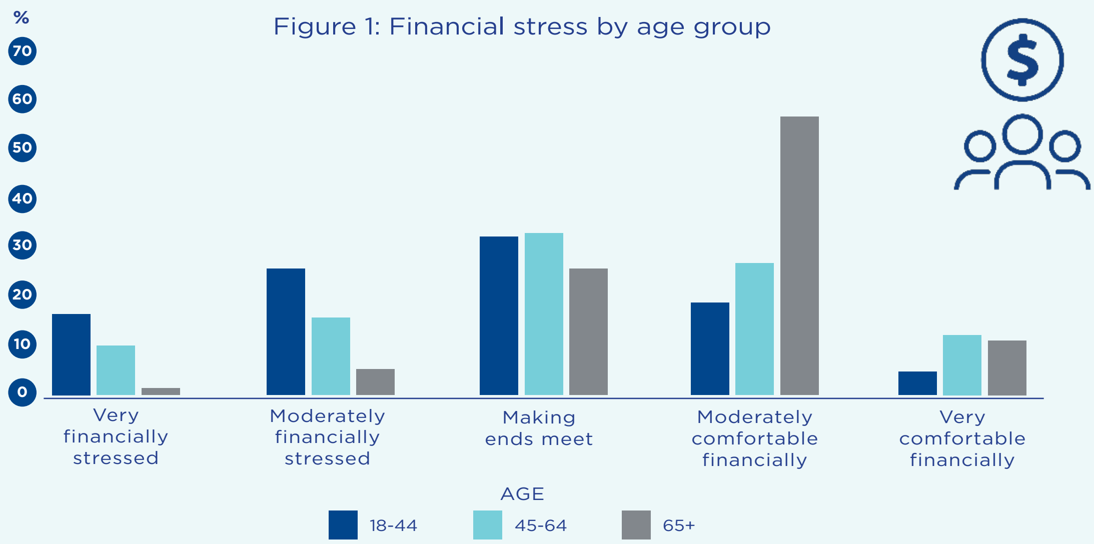
The Taking the Pulse of the Nation survey indicates that approximately 40 per cent of respondents up to the age of 44 are experiencing moderate to high levels of financial stress, compared to only 25 per cent of respondents in the 45-64 age group and less than 10 per cent of respondents in the 65+ age group (Figure 1). The presence of disproportionate financial stress in younger households is likely to curb growth in discretionary spending and limit the ability of such households to save for the future – potentially placing an additional burden on the welfare and social security system going forward.

Understanding the extent to which households are financially stressed and liquidity constrained is important for evaluating the impact of automatic stabilisers, social insurance and income-support policies. The extent to which households differ in their experience of financial stress depends, however, on a range of factors. This includes the household's capacity to smooth its spending, idiosyncratic shocks that it experiences, its spending habits and marginal propensity to consume and its position on the consumption lifecycle. Given these complexities, evidence-based findings on financial stress are important for determining appropriate income support and social welfare policies in this period of sharply declining economic conditions.

Evidence on financial stress and the appropriateness of income support policies

In evaluating the need for appropriate income-support schemes, it is necessary to understand the income and spending requirements of Australian households. There is little evidence on the association between such requirements and the experience of household financial stress. Recent research by Lim and Tsiaplias (2019) is useful in this respect as it examines the income and spending requirements of households using a methodology that relies on actual incidences of household-specific financial stress. The model recognises that households have different capacities to absorb income and expenditure shocks or shifts through reducing consumption or engaging in consumption substitution (for example, substituting towards cheaper goods and services). These capacities are important as they impact on the propagation of economic shocks, and the effectiveness of fiscal and monetary policy and social insurance mechanisms, with households on the cusp of financial stress likely to have a higher marginal propensity to consume and limited capacity to save. The research highlights three key issues that inform the types of income support policies that can help households in the current climate.

Figure 1: Financial stress by age group



Results are based on 3,600 respondents surveyed over the period 6-23 April 2020

Key Insights

1 The typical household can handle a 30 per cent income decline

The typical household has a real buffer between their household income and income requirement of about 30 per cent. Falls beyond 30 per cent are likely to place the typical household in financial stress. The JobKeeper package is sensible, in this respect, with the level of support being approximately 80 per cent of median income.

2 There is a significant lifecycle component to income and spending needs

There is a clear lifecycle component to spending needs, with requirements commencing a relatively steep decline from about 50 years of age, particularly as child dependency on parental income typically ceases. This pattern is consistent with the survey evidence which suggests that younger and middle-aged households are currently experiencing higher levels of financial stress.

3 30 per cent debt to income threshold doesn't apply to all households

The ubiquitous 30 per cent debt to income threshold used to identify financial stress only holds for certain types of households (for example, older households without dependents). Importantly, the threshold tends to under-estimate the needs of couples with young children. For some household groups (for example, single mothers with children), the threshold holds almost no explanatory power for either spending requirements or financial stress.

Targeted support for different households

To date, the Federal Government has announced a range of significant measures aimed at supporting the economy during this crisis. These include the JobKeeper scheme which provides wage subsidies of up to $1,500 per employee and a raft of measures that are tied to small and medium sized enterprises continuing to retain staff and thereby reducing the burden on the welfare system. The latter measures include additional payments tied directly to the quantum of salary and wage levels, instant asset write-offs, guarantees for bank loans and eviction protection. The level of support underpinning the JobKeeper package is sufficiently high such as to reduce the typical household's likelihood of experiencing financial stress to less than 50 per cent.

Direct support to households includes a temporary fortnightly Coronavirus supplement of $550 (primarily to JobSeeker recipients), and two stimulus payments of $750 (payable from March and July) for welfare recipients not entitled to the Coronavirus supplement (primarily pensioners). A key issue here, however, is that policies that are subject to the assumption that households have a common level of subsistence (or 'needs') are likely to under-compensate households with younger children and single parent households (Lim and Tsiaplias, 2015). In the current climate, it is also important that income support measures focus on the presence of households with young children and on disadvantaged groups, such as casuals and single mothers, who are likely to experience levels of financial stress that are not reflected in standard financial stress indicators (particularly when such individuals are unable to access the support provided by the JobKeeper scheme).

Effective fiscal stimulus during the COVID-19 crisis requires consideration of both financial stress and household income requirements. Notwithstanding the additional debt burden, targeted support for households is important in order to alleviate the significant household financial stress experienced during this economic downturn.

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Further Information

About the survey:

These results have been drawn from *Taking the Pulse of the Nation* - Melbourne Institute's survey of the impact of COVID-19. The aim of the weekly survey is to track changes in the economic and social wellbeing of Australians living through the effects of the coronavirus pandemic whilst adapting to various changes in Federal and State government policies.

The survey contains responses from 1200 persons, aged 18 years and over. The sample is stratified by gender, age and location to be representative of the Australian population.

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