Comments on

Lifecycle Impacts of the Financial and Economic Crisis on Household Optimal Consumption, Portfolio Choice and Labor Supply

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Central Question

• How would an economic and financial crisis affect household behavior?
  – Financial/economic crisis = at least a 30 percent decline in stock market in
    the first year and below average GDP growth for four years
      (“contractionary state”)
  – Household behavior = Short- and long-term effects on consumption, labor
    supply, retirement age (public annuity level), and wealth allocation among
    stocks, bonds, and private deferred and immediate annuities

• Special analysis of households facing a “triple whammy”
  – a financial/economic crisis at the beginning of the analysis
  – unemployed in at least two of the first four years of the analysis
  – have “below first quartile” (below “25th percentile”?) cumulative stock
    returns through age 62
Basic Results

• For households age 20, the combination of an economic and financial crisis has very little impact on behavior.

• For households age 55, there is a small but noticeable drop in consumption.
Figure 1: Short-term Effects of Financial/Economic Crises on Young Cohort (Age 20)
## Results for Households Facing a Triple Whammy

<table>
<thead>
<tr>
<th>Age of beginning of analysis</th>
<th>55</th>
<th>20</th>
<th>20</th>
</tr>
</thead>
<tbody>
<tr>
<td>Time period</td>
<td>Short term</td>
<td>Short term</td>
<td>Long term</td>
</tr>
<tr>
<td>Consumption</td>
<td>Falls 10%</td>
<td>Falls by 10-15%</td>
<td>Falls by 2%</td>
</tr>
<tr>
<td>Work Hours</td>
<td>Rise 6-22%</td>
<td>Fall by 8-9%</td>
<td>Rise</td>
</tr>
<tr>
<td>Retirement Date</td>
<td>Later by 1 year</td>
<td>___</td>
<td>Later</td>
</tr>
<tr>
<td>Equity Exposure</td>
<td>Falls, then rises</td>
<td>Falls</td>
<td>Rises</td>
</tr>
</tbody>
</table>
Figure 3: Long-term Effects of Financial/Economic Crises on Young Cohort (Age 20)
Model Specification

- Two states of the economy – expansions and contractions

- The unemployment rate is assumed to be lower in expansions than contractions.

- Equity returns are assumed to have higher mean and lower variance in expansions relative to contractions.

- Permanent wage shock has mean zero in both states and has lower variance in expansion.

- Transitory wage shock is the same in both states.
Base Case Model Results

- Work hours peak at age 25-26 (Figure 1)
- A lot of saving by 20 year olds (Figure 1)
- Net saving withdrawals begin by age 50 (Figure 3).
- What is the age pattern of private annuity purchases in the model?
Building results up from simpler models

• Hard to pinpoint the channels through which policies are having effects in the model

• Could run the same shocks to wealth or labor demand/unemployment in a simpler life cycle model first and then build up to the full specification

• Conjecture: the results would largely be the same in a model without two states of the world (i.e., without the stochastic structure of asset and labor market returns being contingent on the state of the world).