Household income expectations and their impact on consumer and financial behavior

Evguenia Bessonova (Bank of Russia, HSE), Nadezhda Ivanova (Bank of Russia, RANEPA), Alexandra Moskaleva (Bank of Russia, MSU)

Annotation

Changes in income expectations is an important factor in the intertemporal consumer problem. There are practically no studies examining the features of households' income expectations in the Russian economy and there are just a few studies (Semenova, 2011; Bessonova et al, 2024) taking into account the effects of these expectations on saving behavior of the Russian households.

In the literature on households' behavior in other economies, there are several papers, analyzing income expectations and their influence on households' consumer and financial decisions. Cocco et al. (2022) examine the features of households' income expectations in the UK and their impact on households' financial behavior. Rozsypal and Schlafmann (2023) study the systematic errors of households' forecasts in the US. Fermand et al. (2024) estimate the degree of uncertainty in the households' expectations in the US and the effects of this uncertainty on households' financial behavior.

In our study we use the results of the five waves All-Russian Survey of Consumer Finance (from 2013 to 2022), organized by the Ministry of Finance and Bank of Russia. The survey database provides an opportunity to analyze the feature of households' income expectations depending on social and demographic characteristics of households' heads and their influence on households' consumer and financial behavior in Russia.

Among demographic factors, affecting the features of households' income expectations, we pay special attention to ageing of the Russian society and consider possible differences in financial and consumer behavior of working- and non-working age respondents.

As the source of information on households' income expectations we use the answers of households' heads (the members of the households with the largest income) to the question "In your opinion, how will the financial position of your household change in the next year?" Answers to this question are compared to the subjective estimates of changes in the households' financial position in the previous year reported by households' heads and to the actual changes in households' income, which we calculate from the survey's database.

In the first part of our study, we draw several conclusions from the descriptive statistics of Russian households' income expectations depending on various social and demographic characteristics of households. On average, the income expectations turn out to be more positive than the subsequent subjective estimates of changes in the household' financial position in the previous year. In addition, income expectations became more pessimistic on average from 2013 to 2022. The fact that the Russian economy experienced three crisis episodes over such period of time can explains these two observations.

Younger respondents are more likely to anticipate the improvement of their future financial positions than the middle-age respondents, while older respondents are less likely to expect

worsening of their financial positions. All, but the highest-income decile, show approximately the same share of households expecting improvements in their financial positions (21-23%). This is a distinctive feature of the Russian households participating in the survey: Cocco et al. (2022) report an increase in optimistic expectations with increase in income of British households. At the same time, according to the subjective estimates, the Russian pourer households are more likely to experience worsening of their financial position, while the richer households are more likely to experience improvement of their financial positions.

With increase in the size of the location, there is an increase in the share of respondents anticipating to be better off in the next year, but at the same time, there is an increase in the share of respondents reporting to be worse off in the previous year.

Comparing the subjective estimates of changes in the financial positions reported by the heads of households with the actual changes in households' income, we conclude that on average respondents take into changes in their real incomes (so, they are free from so-called "money illusion") and evaluate correctly changes in their well-being.

In the second part of our study, we apply the panel regressions with individual- and time- fixed effects to examine how heads of households extrapolate from the previous positive and negative experiences forming their income expectations. As the dependent and main explanatory variables, we use the binary variables constructed on the basis of respondents' income expectations and their subjective estimates of previous changes in households' income. We also use a bunch of social and demographic factors as control and additional explanatory variables. All regressions are estimated on three samples – all households' heads, working-age households' heads and non-working age households' heads.

From the regression results we conclude that on average the Russian heads of households extrapolate from their previous experiences forming their income expectations. Working-age respondents are less likely to extrapolate from the past, but they are more likely to extrapolate from previous improvements in households' income, while non-working households' heads are more likely to extrapolate from the past deterioration of their financial positions.

Working-age respondents in richer households are less likely to anticipate positive changes in their well-being than respondents in the poorer households. At the same time, with increase in households' income, respondents tend to extrapolate less from the past. Richer respondents extrapolate less from the past positive changes in income, while all income groups extrapolate equally from the past negative changes.

With increase in the size of location, respondents are less likely to extrapolate from the past experience. Female head of households tend to extrapolate less than male ones. In addition, compared to males, for female head of households the impact of past positive changes are less important for future income expectations than impact of past negative changes in households' financial positions. The level of education and age turn out not to affect the degree of extrapolation from the past, but with increase in age the past negative shocks become more important for expectations of future income changes.

In the third part of out study we apply the panel regression analysis to investigate the influence of income expectations on saving patterns of the Russian households. According to our findings, working-age respondents who expect to be worse off are more likely to have any savings. Expectations of being better off do not systematically affect the probability of having savings. The subjective estimates of being better off (worse off) in the past increase (decrease) the likelihood of having savings, especially of having longer-term savings.

The future extensions of our study include the analysis of households' consumer behavior depending on their income expectations and examination of expectation "errors" and their impact on consumption, saving and borrowing patterns.

References

Bessonova E., Denisova I., Ivanova N. и Moskaleva A. (2024) Demography and Savings: Evidence from a Russian Household Survey. Bank of Russia Working Papers № 135 / October 2024

Semenova M. (2011) Save or borrow – what determines Russian households' financial strategies? BOFIT Discussion Paper No. 28/2011.

Cocco, J F., Gomes, F. and P. Lopes (2022) Evidence on expectations of household finances. CEPR Discussion Paper No. 17447.

Rozsypal F. and K. Schlafmann (2023) Overpersistence Bias in Individual Income Expectations and its Aggregate Implications. *American Economic Journal*: Macroeconomics vol. 15, no. 4, October 2023 (pp. 331–71)

Fermand E., Kuhnen C. M., Li G. and I. Ben-David (2024) Extrapolative Uncertainty and Household Economic Behavior. *Management Science* Vol. 70, No. 8