Office for National Statistics

Article

Financial resilience of households; the extent to which financial assets can cover an income shock

New experimental statistics show the extent to which different types of households have sufficient savings to cover an unexpected fall in their household employment income. Results from the sixth round of the Wealth and Assets Survey covering the period April 2016 to March 2018.

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1 . Main points

- These new experimental statistics show the extent to which different types of households have sufficient savings to cover an unexpected fall in their household employment income for a three-month period, an important component of household financial resilience.
- Nearly three-quarters (73%) of households in Great Britain whose household head is an employee had sufficient formal financial assets to cover a 25% fall in their household employment income for a period of three months, in April 2016 to March 2018; over half (54%) could cover a 75% fall for three months.
- On average, households with a self-employed head are more likely to have a savings buffer; more than three-quarters (76%) of self-employed households had enough financial assets to cover a 25% fall in their household employment income, and 61% could cover a 75% fall for three months.
- The differences in the savings buffers of employee and self-employed households are largest at the bottom of the income distribution; in the bottom income quintile, 69% of self-employed households had sufficient financial assets to deal with a 25% fall in their household employment income (for three months), compared with 60% of those with an employee as household head.
- By contrast, in the top income quintile, 90% of employee-led and 86% of self-employed households had enough savings to cover a 25% fall in their household employment income for three months.
- Older households are most likely to be able to have enough savings to cover a fall in their household employment income; 90% of self-employed households with a head aged between 55 years and State Pension age could cover a 25% fall for three months, compared with 57% of those aged under 35 years.

2 . Things you need to know about this release

The measures contained in this release are new Experimental Statistics for assessing the resilience of households to dealing with sudden falls in income or unavoidable rises in expenditure. They are designated as Experimental Statistics as they are still under development. These are initial outputs from our work in this area and we will continue to develop these and other broader measures. The methods and indicators are still subject to modification based on user feedback which we welcome, please see Data and Methodology section for the ways you can do this.

A related bulletin from the Wealth and Assets Survey (WAS), using more recent subjective measures of financial resilience to explore people's attitudes to financial security is available: Early indicator estimates from the Wealth and Assets Survey: attitudes towards financial security, April 2018 to September 2019.

3 . Introduction

Financial resilience has been defined as "the ability to cope financially when faced with a sudden fall in income or unavoidable rise in expenditure". The resilience taskforce, chaired by Baroness Drake, which reported in 2019, estimated that millions of working age people in Great Britain may experience an income shock each year, for example, through ill-health, job loss, relationship breakdown or caring responsibilities, and that the repercussions can be widespread and long-lasting.

The taskforce set out recommendations to better understand the extent and drivers of low financial resilience to better inform policy and highlighted the Wealth and Assets Survey (WAS) as a valuable data source for informative analysis, because of its collection of household wealth (assets and debts) and income data.

The current situation with the coronavirus (COVID-19) pandemic highlights why analysis in this area is so important. The data in this bulletin were collected pre-coronavirus (COVID-19) but provide insight into groups that may be more likely to experience difficulties during the current economic climate as well as those more common income shocks highlighted by the taskforce.

There are a number of ways in which households are protected against a fall in income, including state benefits, employer and insurance-based protections, access to affordable credit, and support from family and friends. However, one of the main defences is having a savings buffer in the form of relatively liquid assets, which can be used to support spending as necessary. These new Experimental Statistics therefore focus on the extent to which households have such a savings buffer in place to protect them against income shocks of different magnitudes.

As we continue to develop our Experimental Statistics on financial resilience, we will seek to include broader measures, drawing from both WAS and other sources as appropriate.

In order to assess the extent to which households are able to use savings to protect them from an income shock, we examine whether households have sufficient formal financial assets to cover a decrease in the household's total employment income (for all employed adults within the household), by 25%, 50% and 75% for a period of three months (see Data and methodology section). In choosing this measure we considered the following.

We are focusing on financial assets that are relatively accessible by households if needed urgently. We are not including households' property wealth and other forms of assets, which are relatively illiquid.

We are not accounting for the changes to cash benefits that may result from a fall in income. This indicator is not designed to directly simulate the impacts of a fall in income – it is instead intended to give an indication of the relative size of savings buffers held by different types of household.

We are implicitly focusing on the extent to which households are able to use savings if necessary to maintain their current living standards. In practice, some households may have scope to reduce certain forms of expenditure, though the evidence indicates this is often more difficult for short-term income shocks.

As the analysis assesses reductions in households' total employment income, this bulletin focuses on those households where the household head is employed, as those are the households for which a drop in employment income is most relevant. It is important to note that, although the analysis classifies households by the employment category of the household head if the household composition includes both employees and the self-employed, the household employment income will comprise a combination of both types of employment income.

For other households where the head is inactive, (for example, unemployed or retired), these households will also be affected by decreased employment income if other members within the households are in employment. However, the majority of households with an economically inactive household head have comparatively low levels of employment income and are therefore much less affected by employment income drops than households where the head is in employment.

Retired households are largely resilient to employment income shocks, as most are in receipt of pension income (private and/or state), have relatively high savings (compared with younger households) and lower expenditure. Retired households with private pensions are also relatively well-buffered from fluctuations in the financial market as the majority will have accessed an annuity making their pension income insensitive to shocks to the financial system; unlike working age households, whose private pension savings (if of defined contribution type) will be adversely affected by economic downturns.

4 . Dealing with income shocks

Each year, many households experience events that can lead to an income shock – a sudden unexpected fall in income – for example, illness, job loss, changing caring responsibilities or relationship breakdown. This analysis uses the Wealth and Assets Survey (WAS) to evaluate the extent to which households are protected from such an income shock by their financial assets (such as current accounts, savings and investments, trusts and bonds).

In practice, there are many other ways in which households might be protected, including support from government benefits, employers, and friends and family. Nonetheless, savings buffers form an integral part of households' overall financial resilience.

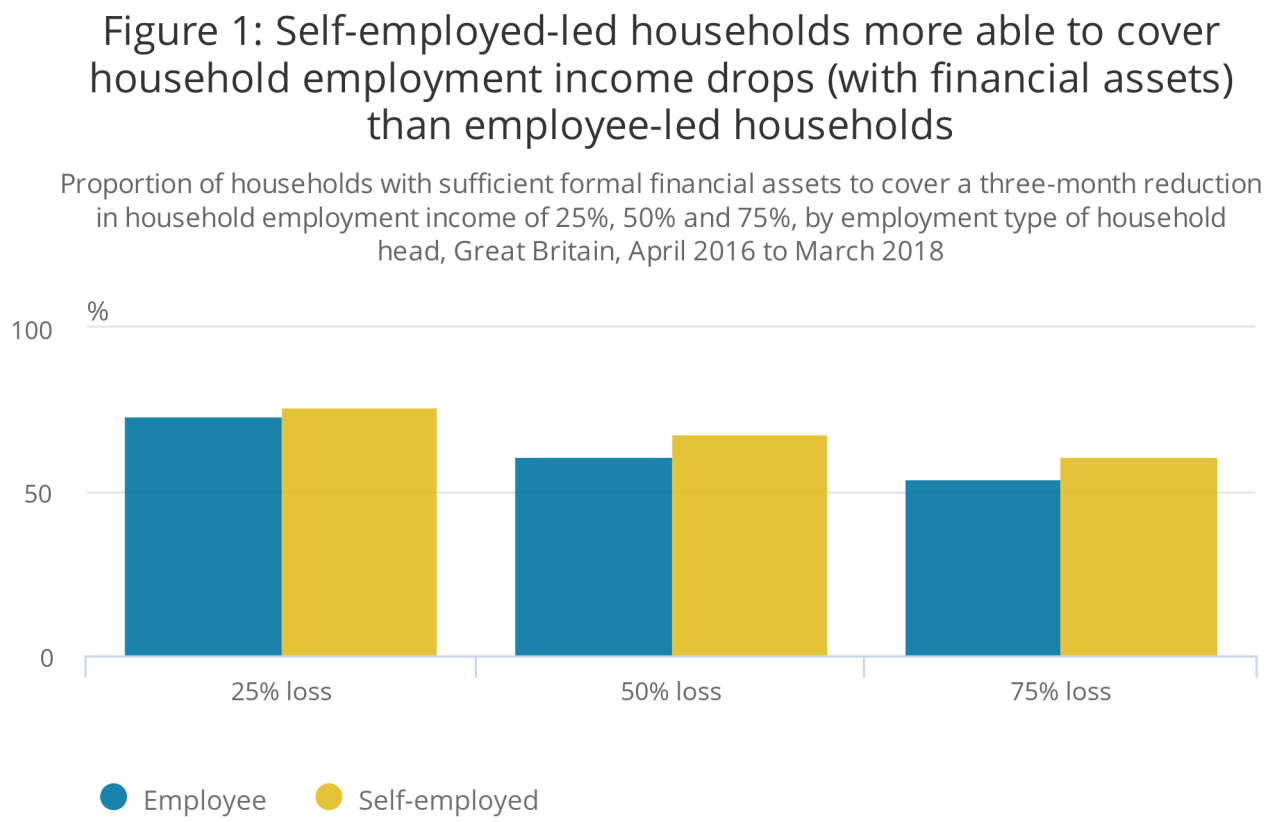
Looking at households where the head is an employee or self-employed (Figure 1), the proportion with financial assets to cover a three-month income shock reduces when the employment income drop gets larger. For example, for households where the head is an employee, 73% could cover a three-month drop in household employment income of 25%, and 54% could cover a 75% income drop.

On average, households where the head was self-employed were more resilient by this measure meaning they are, on average, more prepared than employees for income shocks, with 76% being able to cover a household employment income reduction of 25%, and 61% able to cover a 75% reduction. This is potentially a behavioural aspect of self-employment, where income streams are more volatile throughout the year and those in self-employment potentially have a greater need to maintain a savings buffer in order to maintain living standards during periods of lower income.

There is evidence that self-employed households do, on average, have higher formal financial wealth than employee households; the median value of household formal financial assets for self-employed-led households is £12,000, compared with £8,200 for employee-led households (WAS, April 2016 to March 2018).

Figure 1: Self-employed-led households more able to cover household employment income drops (with financial assets) than employee-led households

Proportion of households with sufficient formal financial assets to cover a three-month reduction in household employment income of 25%, 50% and 75%, by employment type of household head, Great Britain, April 2016 to March 2018



Source: Office for National Statistics – Wealth and Assets Survey

Notes:

1. Only where formal financial assets are greater than the loss of employment income are households deemed to have sufficient assets to cover reduction in employment income. Where formal financial assets are less than or equal to loss in employment income households are not deemed to have sufficient assets to cover reduction in employment income.

2. Formal financial assets are detailed within the Glossary.

3. Household head (HRP) is defined within the Glossary.

4. Employment income includes any income from all adults (not adults aged 16 to 18 years and in full time education) within the household from employee and self-employed work from main or other jobs.

5. Households where (prior to any employment income reductions) net regular household income (before housing costs) are less than or equal to zero have been excluded from this analysis.

6. The derivation of net income changed from July 2016 onwards. Before July 2016 'Total net regular household annual income' was used, from July 2016 onwards "Total net regular household annual income (before housing costs)" was used.

The regular net equivalised household income for households was split into five equal groups (quintiles) and ranked from lowest (quintile 1) to highest (quintile 5). For all three levels of household employment income reduction (25%, 50% and 75%), the proportion of employee and self-employed-led households with sufficient financial assets to cover the loss increases with income level (Figure 2).

For the lowest-income households (quintile 1), the proportion that had financial assets to cover fell as the amount of employment income lost was increased. For employees, 60% could cover a 25% drop, 49% a 50% drop and only 43% of households could cover a 75% drop in household employment income for three months using their financial assets.

Higher-income employee households (those in quintile 5) are more resilient according to this measure, being 1.5 times more likely to be able to cover a 25% drop and 1.7 times as likely to be able to cover a 75% drop than those in the lowest quintile. This reflects the capacity of higher-income households to build more financial assets than those in lower-income households.

Self-employed households with lower income are more resilient than their employee counterparts according to this measure. Following a 75% drop in household employment income, the self-employed in the lowest quintile are on average 1.3 times more likely to have financial assets to cover the drop in household employment income than their employee counterparts.

At the lowest household employment income drop level considered (25%) the resilience level of employees and the self-employed is similar from quintile 4 upwards, showing that both employee and self-employed households on middle to high income have sufficient financial assets to cover this relatively small percentage drop in household employment income.

However, once the household employment income is theoretically dropped by 75%, for all except the highest-income households (quintile 5), the self-employed are more likely to have financial assets to cover the drop than their employee counterparts. Despite this, many self-employed (and employee) households do not have sufficient savings buffers to cover a large employment income drop (75%) for three months, even those on relatively high incomes.

Considering income quintile 3, where median net equivalised household income would be around £29,000 a year, half of employee households and three-fifths of self-employed households would have sufficient financial means to cover the household employment income drop. This has serious implications as, for various reasons, households may likely find themselves in a situation where their household employment income does drop by this amount or more, or for time periods of longer than three months (for example, through ill-health or job loss).

Figure 2: Once household employment income falls by 50%, self-employed households (for all but the highest income households) are more likely than employee households to have financial assets to cover drop

Proportion of households with sufficient formal financial assets to cover a three-month reduction in household employment income of 25%, 50% and 75%, by employment type of household head and total household net equivalised income quintile, Great Britain

Notes:

1. Only where formal financial assets are greater than the loss of employment income are households deemed to have sufficient assets to cover reduction in employment income. Where formal financial assets are less than or equal to loss in employment income households are not deemed to have sufficient assets to cover reduction in employment income.

2. Formal financial assets are detailed within the Glossary.

3. Household head (HRP) is defined within the Glossary.

4. Employment income includes any income from all adults (not adults aged 16 to 18 years and in full time education) within the household from employee and self-employed work from main or other jobs.

5. Households where (prior to any employment income reductions) net regular household income (before housing costs) are less than or equal to zero have been excluded from this analysis.

6. The derivation of net income changed from July 2016 onwards. Before July 2016 'Total net regular household annual income' was used, from July 2016 onwards 'Total net regular household annual income (before housing costs)' was used.

7. Net equivalised income quintiles have been created by employment type of the household head.

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We now extend the analysis to look at the effect of age (of the household head) on the ability for households to lose differing proportions of their household employment income and replace it with their financial assets.

Figure 3 shows that both employee and self-employed-led households where the head is younger are less resilient by this measure than those with older household heads. This correlates with the fact that both household income and wealth generally increase with increasing age of the household head (until retirement, where levels drop again). Additionally, younger-aged household heads may have increased responsibilities (potentially related to childcare), that may have reduced or even prevented saving, compared with older-aged household heads where pressures of this kind are less or non-existent.

Looking at the most extreme income shock, a 75% drop in household employment income for three months, only 40% of employee-led households in the youngest age band (16 to 34 years), and 37% of self-employed, had sufficient funds to cover the employment income drop. Employee households where the head is aged 35 to 44 years were less likely than their self-employed counterparts to have funds to cover the drop (48% compared with 54% for self-employed households).

Older households (aged 55 years to State Pension age) were most likely (of working age groups) to be able to cover a large percentage (75%) employment income drop with their financial assets, with 70% of employee and 76% of self-employed households having sufficient funds.

Households where the head is over State Pension age were the least affected by a drop in household employment income (as expected as at least one member in the household is likely to be retired). In this age bracket, 85% of employees and 89% of self-employed households have sufficient assets to cover a 75% drop in household employment income.

Figure 3: Households headed by the youngest age band (16 to 34 years) were less likely to have sufficient financial funds to cover a drop in household employment income

Proportion of households with sufficient formal financial assets to cover a three-month drop in household employment income of 25%, 50%, 75%, by employment type and age of household head, Great Britain, April 2016 to March 2018

Notes:

1. Only where formal financial assets are greater than the loss of employment income are households deemed to have sufficient assets to cover reduction in employment income. Where formal financial assets are less than or equal to loss in employment income households are not deemed to have sufficient assets to cover reduction in employment income.
2. Formal financial assets are detailed within the Glossary.
3. Household head (HRP) is defined within the Glossary.
4. Employment income includes any income from all adults (not adults aged 16 to 18 years and in full time education) within the household from employee and self-employed work from main or other jobs.
5. Households where (prior to any employment income reductions) net regular household income (before housing costs) are less than or equal to zero have been excluded from this analysis.
6. The derivation of net income changed from July 2016 onwards. Before July 2016 'Total net regular household annual income' was used, from July 2016 onwards 'Total net regular household annual income (before housing costs)' was used.
7. SPA – State Pension Age at the time of interview.

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5 . Data and methodology

The Wealth and Assets Survey (WAS) launched in 2006 and is a biennial longitudinal survey conducted by the Office for National Statistics (ONS). This survey measures the well-being of households and individuals in Great Britain in terms of their assets, savings and debt, and planning for retirement. The survey also examines attitudes and attributes related to these. Classificatory variables (age, sex, employment status) are also collected.

Data used in this publication are from round 6 of the survey and were collected between April 2016 and March 2018. Approximately 18,000 households were sampled. Quality and methodology information on strengths, limitations, appropriate uses, and how the data were created is available in the Wealth and Assets Survey (WAS) QMI.

The estimates in this article are created by taking the total monthly employment income of all adults aged 16 years or over (excluding adults aged 16 to 18 years and in full-time education), within each relevant household (for example, households where the household head is self-employed for self-employed household estimates) and reducing the total household employment income by 25%, 50% and 75%.

Households' monthly employment income could encompass income from both employee and self-employed income (the total of which has been reduced), if the adults within the household earn income from both employee and self-employed work, however, analysis is presented by the employment type of the household head's main job. Each household's formal financial assets are then compared against this reduced employment income and where the assets exceed the value of three times the reduced household's monthly employment income (simulating three months of reduction), then the household is counted as having sufficient assets to cover the employment income drop.

Households where the total net regular household income (before housing costs) are less than or equal to zero have been excluded from this analysis. These statistics are experimental at present and we welcome feedback and comments at wealth.and.assets.survey@ons.gov.uk.

6 . Glossary

Equivalised income quintiles

Equivalisation is a standard methodology that adjusts measures to account for different demands on resources, by considering the household size and composition. Equivalised income quintiles divides equivalised net regular household income (before housing costs), sorted in ascending order, into five equal parts so that each part contains 20% of the distribution. The least 20% (of equivalised net regular household income) are in the first quintile and the highest 20% (of equivalised net regular household income) are in the fifth quintile.

Formal financial assets

Formal financial assets include: current accounts in credit, savings accounts, ISAs, National Savings, UK and overseas shares, insurance products, fixed-term bonds, employee shares, unit and investment trusts, UK and overseas bonds and gilts, and any other formal financial assets.

Household reference person

Household reference person (HRP) is the person that is the sole or joint householder or is responsible for household affairs. Where there are joint householders, the HRP is the person with the highest income. In cases where income is the same for a joint householder, the eldest person is assigned as the HRP.

Net regular household income (before housing costs)

Net regular household income (before housing costs) includes the sum of (net employment income (employee and self-employed)) benefits, net private pension income, net investment income, any other net regular income (including rental income, maintenance, alimony and separation payments, regular redundancy payments, royalties and educational grants), minus Council Tax (amount paid by households).