Non-technical summary for 'Job Loss, Subjective Expectations and Household Spending'

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The risk of losing your job is a key uncertainty that workers face, particularly during recessions. Elevated levels of job insecurity have been a feature of the economic downturn associated with the COVID-19 pandemic. The extent to which job insecurity persists and affects household spending is important to determining the sustainability of the post-pandemic economic recovery.

It is well established that job loss is associated with reductions in earning and spending. But there are many things we do not know about the links between workers' perceptions of their job prospects, actual job outcomes and spending.

This paper examines 3 related questions: First, can people predict whether they will lose their current job or, if unemployed, find another job quickly? Second, when people do become unemployed, how much do they reduce their spending? Third, if people worry that they might become unemployed, do they save more 'for a rainy day'?

What do we learn?

We find that workers have some ability to predict job loss a year ahead, even when taking into account many of their personal characteristics. Most workers persistently overestimate their job loss risk, but some persistently underestimate it. And workers typically overestimate the probability of job loss by more during economic downturns. However, while workers are overly pessimistic about losing their jobs, the unemployed are too optimistic about finding a job.

We find that household spending falls significantly at the onset of unemployment. The typical household reduces total spending by 9 per cent in the year of unemployment, and they reduce their spending by similar amounts regardless of whether or not the job loss is expected. Even essential spending falls at unemployment, with weekly grocery spending falling by 7 per cent. These consumption losses also extend to the period after unemployment, and are smaller but still exist even when accounting for income losses. In contrast, there is limited evidence that concerns about future job loss affect spending for workers that do not actually lose their jobs.

Overall, household spending is excessively sensitive to predictable changes in income. This is inconsistent with standard textbook models of household spending, but consistent with empirical research from other advanced economies.

What does it mean for policymakers?

It is well established that unemployment is associated with significant hardship. Our research is relevant to the measurement of the individual welfare costs associated with unemployment because we quantify how much and for how long household spending falls in response to unemployment.

Because spending drops only when people lose their jobs, our findings highlight how labour market and macroeconomic policies that minimise the number of people who become unemployed (and the length of time they are unemployed) can support spending in the economy. Any policies that boost the cash on hand of workers, at least temporarily, also help to minimise the effect of unemployment on spending. The fact that some of the consumption losses associated with unemployment are due to income losses points to an important role for unemployment benefits in supporting households through periods of unemployment. Our findings do not speak directly to the issue, but income support policies that increase the income replacement rate during periods of widespread financial stress, such as recessions, may also help to minimise overall consumption losses.