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Consumer Morsel

Who is living paycheck to paycheck?

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Key talking points

- People spending most, or all, of their regular income may be especially vulnerable to higher prices and any drops in their income.
- We've looked at the official government data as well as Bank of America anonymized and aggregated data to get a better sense of who might be living 'paycheck to paycheck'.
- Averages always mask a lot of diversity. We do find a proportion of people appear to be living paycheck to paycheck. But it does not seem as high as some media headlines suggesting over 50% of people are in this position.
- Households' discretionary spending is over 60% of their total spending across income groups. They also have elevated levels of deposit balances, as well as further borrowing capacity. As such living 'paycheck to paycheck' will not necessarily imply people do not have strategies to deal with higher inflation or economic weakness.

People just covering their regular spending will be vulnerable to higher prices

A recent media news headline stating that well over half of Americans are living 'paycheck to paycheck' caught our attention and we decided to look at what data we could find to try and test this observation.

First, of course, we really need to define what living 'paycheck to paycheck' means. To our mind it contains the suggestion that someone is regularly spending most or all of their income on everyday expenses.

Why is this important? Well, with higher inflation, higher interest rates and an uncertain economic outlook, those living paycheck to paycheck may be especially vulnerable to suddenly finding they are not able to cover their expenses. This could happen either because the cost of the basket of goods and services they are buying rises in price (inflation) to a point where it exceeds what they can afford, or because they have a drop in income which again throws their delicate balance between expenditure and income out of line.

If individuals living paycheck to paycheck have to plug the gap between their expenditures and income they may be able to call upon built-up savings. But if people don't have much savings they may have to cut back spending. At the level of the macro economy, if a significant portion of consumers cut back on their spending this could make an economic slowdown worse.

When we look through the data we do find a proportion of people likely living 'paycheck to paycheck'. But we do not find it to be as high as some media stories suggest. We will continue to develop our research in this area.

Who is living paycheck to paycheck?

Trying to identify who exactly is living paycheck to paycheck is complex. Perhaps the first place to start is to see how income and consumer spending differ across the income distribution. Exhibit 1 shows the amount of dollars spent annually on goods and services for households in different 20% buckets ('quintiles') of the income distribution. The data is drawn from the Bureau of Labor Statistics' Consumer Expenditure Survey.

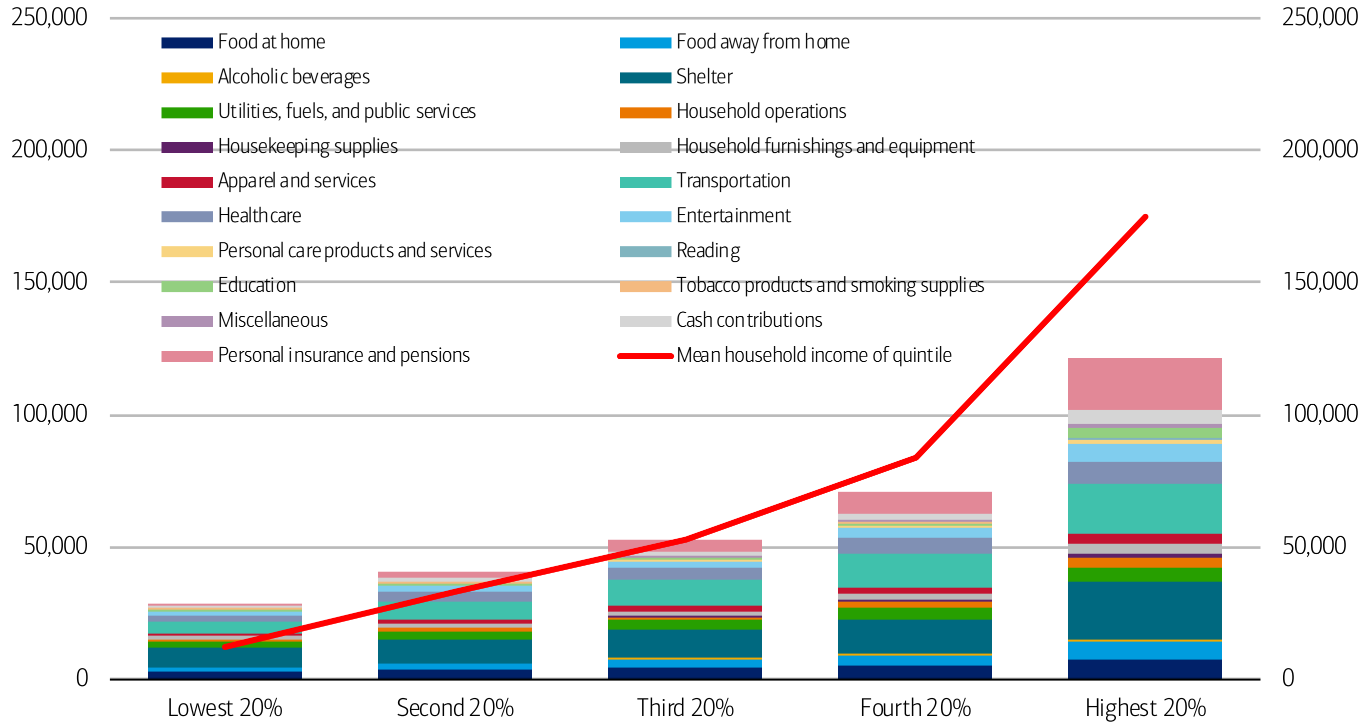
The most recent figures are only for 2020. But 2020 was an anomaly year for the American consumer due to the pandemic which created some large swings in consumer spending habits. So to avoid this in Exhibit 1 we use the data for 2019.

Comparing the level of total consumer spending in each of the quintiles to the average level of household after-tax income in that specific quintile (the red line in the exhibit), it is clear that generally speaking as incomes rise an increasing proportion of households cover all of their expenditures on goods and services and have money left over. Conversely at the lower end of the income distribution household expenditure appears to be greater than their after-tax income, while around the middle of the distribution there appears something of a balance between spending and income.

Not everyone at the lower end of the income distribution will be lower paid workers. For example students and retirees may have low incomes but relatively high spending. But the overall message from this survey data would appear to be that those living 'paycheck to paycheck' tend on average to be located at the bottom of the income distribution rather than the top.

Exhibit 1: Consumer expenditure by income quintile ($, 2019)

As incomes rise more of total household consumer expenditure is covered by after tax income. Conversely those on lower incomes do not all cover their total spending.



Source: Bureau of Labor Statistics

Using recent Bank of America data shows averages mask diversity

While economists are often happy to talk about 'the average', in the real world no two households are the same.

There will be households that do not conform to generic expectations. For example they may spend all their income despite being on a large salary. Some may have committed themselves to a large mortgage which necessitates large monthly payments, or they have a large family who they were seeing through college.

Alternatively, it is possible someone on a relatively modest income could actually maintain equally modest spending levels. They could for example be retired, or been living alone with no mortgage to pay.

In order to dig a little deeper into the paycheck-to-paycheck question we have looked at aggregated and anonymized Bank of America customer data. We look at customers with deposit accounts in the quarter ended March 31, 2022 (Q1), as the most recent quarter available at the time of writing.

Within this sample we look at inflows and outflows into these accounts over this quarter. Both inflows and outflows are defined broadly – any payments out of the account is an outflow, while any payment into the account is an inflow. So, for example, inflows would include income from employment (for example, if paid by ACH (Automated Clearing House) or check), but could also include any other income, transfers from other accounts and any other payments into the deposit account (for example, peer to peer). Outflows, on the other hand, are also very broadly defined. They will include payments for goods and services, repayments of credit card bills, and any other outward transaction from the deposit account.

We acknowledge some limitations with our current approach. Some people may earn a significant proportion of their annual income through, for example, annual bonuses or other irregular payments. They may therefore aim to balance their outgoings with their income over a longer time-frame than just one quarter. Equally, some expenditure will not be regular: people may buy a car or pay for an annual vacation in a particular quarter, which could increase their outflows temporarily.

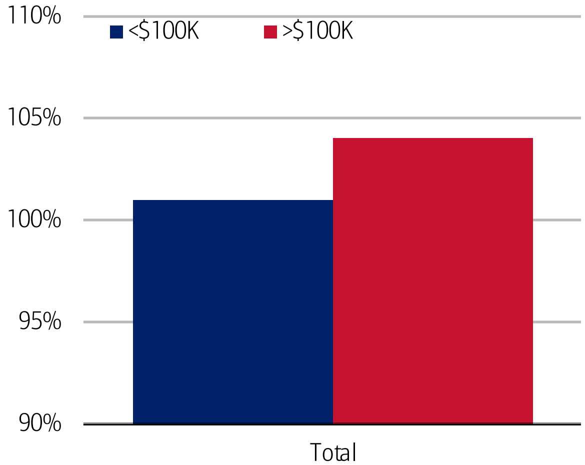
Another limitation in terms of making inferences from Bank of America data to the wider US population is that the customer base may not be necessarily representative of the wider population.

We look to continue to enhance this work going forward, by widening the time-frame under analysis and also by looking at a more granular level into the inflows and outflows.

With these caveats set out, the following shows our initial findings. Our goal here is to look at the aggregated inflows and outflows into accounts to see the extent to which these are in balance. We then consider the proportion of accounts where inflows fall significantly short of outflows.

Exhibit 2: Q1 2022 Inflows as a percentage of outflows in Bank of America aggregated and anonymized customer deposit data by household income

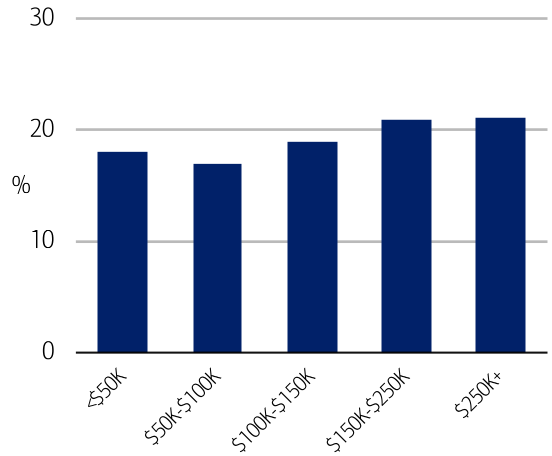
By and large outflows and inflows are very closely aligned over the quarter



Source: Bank of America internal data

Exhibit 3: Q1 2022 Percentage of customers where inflows are less than 85% of outflows, by customer income groups

As incomes rise there appears to be more of a tendency for inflows to fall short of outflows



Source: Bank of America internal data

Exhibit 2 illustrates inflows as a percentage of outflows across the data, split into two broad levels of annual household income, above and below $100K.

If the ratio was exactly at 100% this would imply outflows from accounts would exactly match inflows, while a ratio in excess of 100% implies that these customers have some inflows in excess of their outflows. What we find is that average inflows into customer accounts are almost exactly aligned with outflows for customer accounts for average incomes less than $100k. For those with income over $100k average inflows exceed outflows by 4%.

For any one account we likely wouldn't expect their inflows to exactly match outflows exactly at any point in time. People's income can be 'lumpy' for example, with annual bonuses paid. Equally, people may make lumpy spending decisions – for example annual renewals of subscriptions, or one-off spending such as vacations. So we would not view any accounts where the ratio of inflows to outflows falls below 100% as necessarily signaling they are financially stretched – bonus payments, taxes paid and received, and other irregular payments may all contribute to ratios below 100% during any finite period of time.

So to dig deeper we focus on those accounts that reflect a significant short-fall of inflows relative to outflows. Here we define this short-fall threshold as being where inflows fall below 85% of their outflows.

What we find, shown in, Exhibit 3 is interesting: in each income group the percentage of accounts where inflows fall well short of outflows does not vary that much by income. And, in fact, the percentage actually appears to be higher for higher income groups than for lower income groups.

Just over 20% of clients with incomes above $250K per year have a 15% or greater short-fall in inflows compared to outflows in 2022 Q1. For customers with incomes in the $50K-$100K range, which will covers US household median income, there is around 17% of the sample where inflows are 15% or more below outflows.

How can it be that higher income groups have a higher share of customers where inflows fall short of outflows?

One important source of variation on the spending/outflows side may be mortgage payments. The internal data suggests that the average client with income less than $100K has average mortgage payments that are only around half that of the average clients with income above $100K. And, again, there will be lots of diversity within these averages.

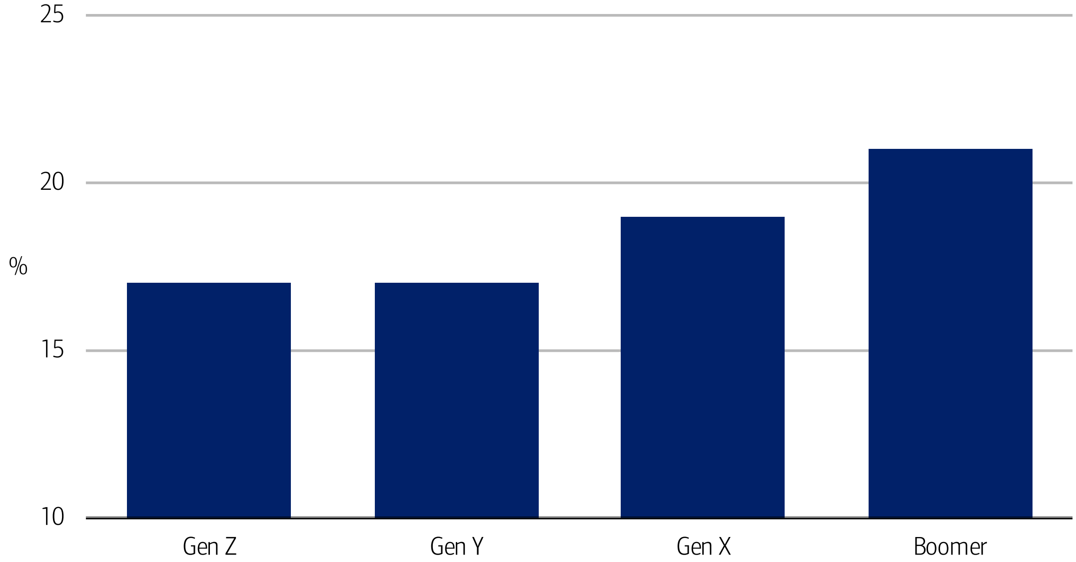
Another source of outflow variation could be payments to brokerage or other investment accounts. These tend to rise sharply with income, meaning that some higher income groups will register high outflows to this source – though importantly they are likely to have scope to reduce those outflows if they needed to.

On the inflows side higher paid jobs may have a higher proportion of irregular income such as bonuses, which will not be covered by our Q1 2022 sample if paid in other quarters of the year.

We should also not ignore the very important demographic component to all of this. Those earning more will tend, as a rule, to be older. As a result they may have more commitments on the spending side, with families and children for example. They may have levels of accumulated savings and other financial assets on which to draw. It appears, as illustrated by Exhibit 4, that there is a higher proportion of clients where inflows are well below outflows in older age groups.

Exhibit 4: 1Q 2022 percentage of customers where inflows are less than 85% of outflows, by customer age (%)

A higher percentage of older age groups appear to have inflows that are less than outflows by a significant margin



Source: Bank of America internal data

How worried should we be?

The upshot of this ongoing analysis is that, unsurprisingly, we find there is a lot going on beneath the surface of consumers' spending and income. Those on lower incomes are likely to be most challenged by rising inflation and economic uncertainty. But as we dig into the data we find there are small but significant groups living 'paycheck to paycheck' even at higher income levels, and indeed across the age distribution – though by no means as many as some of the concerning press headlines have suggested.

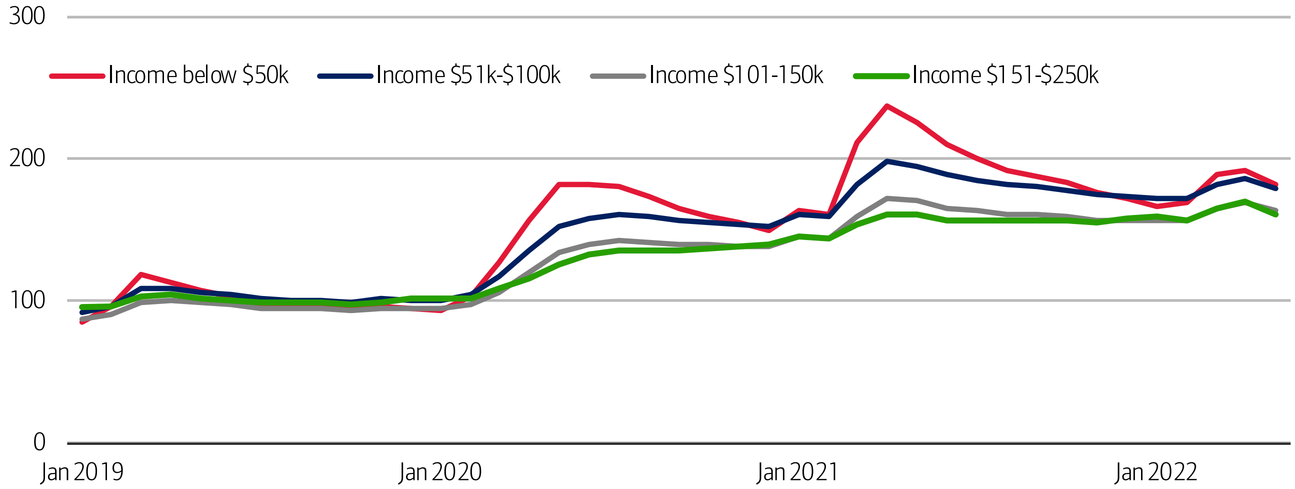
How worried should we be that some people appear to be living paycheck to paycheck?

We would caution that the term 'paycheck to paycheck' can sometimes be confused with the idea that people are only just covering their basic essentials, such as food and gasoline. When we look at aggregated and anonymized credit and debit card spending data we see that the share of spending that is discretionary is above 60% across income groups. This tends to imply that while some people may be living paycheck to paycheck they may still have scope to reduce their discretionary spending if they need to.

And we think one other piece of good news, covered in our recent Consumer Checkpoint, is that savings and checking balances appear elevated for many people relative to before the pandemic. This hopefully means that even households under a lot of pressure in terms of rising monthly spending have some savings buffers to draw upon. Additionally some households are likely to have further borrowing capacity if required – with average lower credit utilization rates than pre-pandemic.

Exhibit 5: Median household savings and checking balances (rebased, 2019 average =100 for each group) for a fixed group of households (HH) between January 2019 and May 2022

Savings remain well above pre-pandemic levels



Source: Bank of America internal data (see methodology for more detail)

So overall we would tend to view some of the media headlines around the paycheck to paycheck with some caution. There is a proportion of the population who likely fit this description, but it does not appear to be as high as suggested in media stories. And even those who may be experiencing living paycheck to paycheck may have some strategies they could deploy in response to higher inflation and more challenging economic times.

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Sources

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Methodology

Selected Bank of America ("BAC") transaction data is used to inform the macroeconomic views expressed in this report and should be considered in the context of other economic indicators and publicly available information. In certain instances, the data may provide directional and/or predictive value. The data used is not comprehensive; it is based on aggregated and anonymized selections of Bank of America data and may reflect a degree of selection bias and limitations on the data available.

The data on inflows and outflows into direct deposit accounts data is based on BAC internal data, it is derived by anonymizing and aggregating data from Bank of America consumer deposit accounts in the US at a highly aggregated level.

The household consumer deposit data based on Bank of America internal data is derived by anonymizing and aggregating data from Bank of America consumer deposit accounts in the US and analyzing that data at a highly aggregated level. Monthly data used in Exhibit 5 includes those households that had a Bank of America consumer deposit account (checking and/or savings account) for all 41 months from January 2019 through May 2022.

Additional information about the methodology used to aggregate the data is available upon request.

Disclosures