The Liquid Hand-to-Mouth: Evidence from Personal Finance Management Software

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Abstract

We use a very accurate panel of all individual spending, income, balances, and credit limits from a financial aggregation app and document significant payday responses of spending to the arrival of both regular and irregular income. These payday responses are clean, robust, and homogeneous for all income and spending categories throughout the income distribution. Spending responses to income are typically explained by households’ capital structures: households that hold little or no liquid wealth have to consume hand-to-mouth. However, we find that few individuals hold little or no liquidity and also document that liquidity holdings are much larger than predicted by state-of-the-art models explaining spending responses with liquidity constraints due to illiquid savings. Given that present liquidity constraints do not bind, we analyze whether individuals hold cash cushions to cope with future liquidity constraints. To that end, we analyze cash holding responses to income payments inspired by the corporate finance literature. However, we find that individuals’ cash responses are consistent with standard models without illiquid savings and neither present nor future liquidity constraints being frequently binding. Because these models are inconsistent with payday responses, we feel that the evidence suggests the existence of households that spend heuristically and call those the “liquid hand-to-mouth.”

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