Abstract:

According to basic consumption theory, household responses to fiscal stimulus policy depend on household credit or liquidity constraints. We operationalize credit constraints as the price of liquidity defined as the interest wedge between borrowing and lending and test this hypothesis using a large, unanticipated stimulus reform, which in 2009 transformed illiquid pension wealth of Danish households into liquid wealth. Our analysis combines survey information, where respondents are asked about their spending response to the policy, with third-party reported administrative records of individual loans/deposits, allowing us to calculate individual and household specific marginal interest rates. We find a strongly significant relationship between household consumption responses and the price of liquidity. A one percentage point increase in the observed marginal interest rate is associated with around half a percentage point increase in the marginal propensity to consume. We also find evidence indicating that the observed differences in interest rates and consumption responses are governed by long term differences across households in preferences and income growth.

Co-authors: Claus Thustrup Kreiner and Søren Leth-Petersen.