It's raining; perhaps you should spend your rainy-day fund

It is common advice. Build an emergency fund equal to between three and six months of take-home pay in case of unexpected expenses. Often also known as "rainy-day funds" because money is set aside for unfavourable conditions, they are the bedrock of personal financial planning

Spending your rainy day-fund

For many, unfavourable conditions have arrived. It's raining. Work and income have dried up. Many people face not only a Covid-19 crisis but a liquidity crisis. The liquidity crisis can be reduced by taking money from the rainy-day fund. That's what it is there for.

But there are four problems with this.

First, nobody can be sure how long this crisis will last. We don't know the rainy-day fund needs to last.

Second, there is a presumption that many people have rainy-day funds. Survey evidence suggests few people have a sizeable emergency savings buffer.

Third, there is a presumption that a key motive for why people save is as a precaution against income shocks. Hence the technical term "precautionary savings". But studies of why people save are ambivalent about whether many save due to uncertainty about future income, this may not motivate many savers. If so, those who have savings may not be willing to reduce them in the current circumstances.

Fourth, a noticeable percentage of those who have savings will be reluctant to reduce them because they are more emotionally wired to save rather than to spend. These people will find it difficult to reduce savings.

No umbrella

Suggesting people spend their rainy-day fund makes little sense if many do not have money put aside for emergencies. Many cannot shelter from the rain, or can only do so for a short time.

Surveys consistently show that personal and household finances in many countries are fragile. Our own ING International Surveys have consistently shown for many years that around three in ten people across Europe have no savings at all. Of those who do, only about four in ten have three months or more of take-home pay available, meeting the generally accepted rule-of-thumb for good financial management.

About half across Europe, the US and Australia say they run out of money at the end of each pay period occasionally or most of the time. Even small unexpected expenses can cause trouble. The US Federal Reserve reports that four in ten could not cover a $400 emergency expense using cash or its equivalent (i.e. a credit card that would be paid off in full in the next payment period).

Why people save

A further twist on this concern is that studies of saving behaviour prevaricate on whether people save as a precaution against income volatility, at least in a strong form. A 2015 paper based on survey data from a representative sample of Dutch households found "strong precautionary motive in the saving behaviour of the households in our sample." However, a 2017 survey of the literature on precautionary saving found "most of the reviewed works find evidence of precautionary motive for saving, there is not a consensus on the magnitude of the precautionary saving and some works conclude that this motive is nearly irrelevant."

Nevertheless, there appears to be agreement that there can be a variety of responses in the way households react to income shocks, such as being experience now. A 2019 paper based on survey data from Dutch households found significant differences in reactions to hypothetical income shocks. Those with liquidity constraints (i.e. limited access to credit or savings) cut spending more. But even those not constrained cut back.

If rainy-day funds are typically small and also, income uncertainty or variability may not be the main reason people save, suggesting that people dip into those savings may make little sense to them.

Unpredictable forecasts

Usually, rainy-day funds are set up to meet emergencies that have a known cost. For example, the cost of an urgent car repair is likely to be known with some accuracy so can be accommodated by a given rainy-day fund. The current situation is less predictable. The rain may last for some time.

Given this, the best way to use rainy-day funds is unknown. But that is not an excuse to avoid making a plan. Figure out your and your household's spending priorities. Any plan under current circumstances is likely to be inexact. However, as John Maynard Keynes said: "It's better to be roughly right than precisely wrong."

You may as well make this plan now. Do not put it off. Procrastination has been shown to lead to financial problems. To offset the temptation to procrastinate, research suggests enlisting others to do the task with you can help. It's a form of commitment device.

Tightwads and spendthrifts

Even if people have saved for uncertain events, they may find spending those savings emotionally difficult. It may be that those who save tend to be cautious. Some may even find spending difficult, to the point that they spend less than they would ideally like to spend. They are emotionally conflicted by spending. Such people can be called "tightwads". On the other hand, there are those who spend more than they would like. These people can be called "spendthrifts".

A 2007 paper studying spending attitudes among around 13,000 people in the USA found that most (60 per cent) people are not conflicted by their spending behaviour. They are neither tightwads nor spendthrifts. However, 24 percent recorded as tightwads and 15 per cent as spendthrifts. Tightwads outnumber spendthrifts by a ratio of 3:2. There were differences in the extent of 'tightwadism' across the different samples in the study, but the lowest percentage was 19%. Reluctance to spend appears to be a noticeable occurrence.

The paper did not trace these groups to saving behaviour. Nevertheless, there is evidence that about one-in-five people are reluctant to spend. If so, spending their rainy-day fund will be difficult.

Waiting out the rain

How people will react to the current situation is as unpredictable as the outcome of what we're going through. We should not assume people will run down their savings. They may simply wait to spend again once the rain is over.

Author

Alissa Lefebre
Economist
alissa.lefebre@ing.com

Deepali Bhargava
Regional Head of Research, Asia-Pacific
Deepali.Bhargava@ing.com

Ruben Dewitte
Economist
+32495364780
ruben.dewitte@ing.com

Kinga Havasi
Economic research trainee
kinga.havasi@ing.com

Marten van Garderen
Consumer Economist, Netherlands
marten.van.garderen@ing.com

David Havrlant
Chief Economist, Czech Republic
420 770 321 486
david.havrlant@ing.com

Sander Burgers
Senior Economist, Dutch Housing
sander.burgers@ing.com

Lynn Song
Chief Economist, Greater China
lynn.song@asia.ing.com

Michiel Tukker
Senior European Rates Strategist
michiel.tukker@ing.com

Michal Rubaszek
Senior Economist, Poland
michal.rubaszek@ing.pl

This is a test author

Stefan Posea
Economist, Romania
tiberiu-stefan.posea@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Jesse Norcross
Senior Sector Strategist, Real Estate
jesse.norcross@ing.com

Teise Stellema
Research Assistant, Energy Transition
teise.stellema@ing.com

Diederik Stadig
Sector Economist, TMT & Healthcare
diederik.stadig@ing.com

Diogo Gouveia
Sector Economist
diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Ewa Manthey
Commodities Strategist
ewa.manthey@ing.com

ING Analysts

James Wilson
EM Sovereign Strategist
James.wilson@ing.com

Sophie Smith
Digital Editor
sophie.smith@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Adam Antoniak
Senior Economist, Poland
adam.antoniak@ing.pl

Min Joo Kang
Senior Economist, South Korea and Japan
min.joo.kang@asia.ing.com

Coco Zhang
ESG Research
coco.zhang@ing.com

Jan Frederik Slijkerman
Senior Sector Strategist, TMT
jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure
Katinka.Jongkind@ing.com

Marina Le Blanc
Sector Strategist, Financials
Marina.Le.Blanc@ing.com

Samuel Abettan
Junior Economist
samuel.abettan@ing.com

Franziska Biehl
Economist, Germany
Franziska.Marie.Biehl@ing.de

Rebecca Byrne
Senior Editor and Supervisory Analyst
rebecca.byrne@ing.com

Mirjam Bani
Sector Economist, Commercial Real Estate & Public Sector (Netherlands)
mirjam.bani@ing.com

Timothy Rahill
Credit Strategist
timothy.rahill@ing.com

Leszek Kasek
Senior Economist, Poland
leszek.kasek@ing.pl

Oleksiy Soroka, CFA
Senior High Yield Credit Strategist
oleksiy.soroka@ing.com

Antoine Bouvet
Head of European Rates Strategy
antoine.bouvet@ing.com

Jeroen van den Broek
Global Head of Sector Research
jeroen.van.den.broek@ing.com

Edse Dantuma
Senior Sector Economist, Industry and Healthcare
edse.dantuma@ing.com

Francesco Pesole

FX Strategist
francesco.pesole@ing.com

Rico Luman
Senior Sector Economist, Transport and Logistics
Rico.Luman@ing.com

Jurjen Witteveen
Sector Economist
jurjen.witteveen@ing.com

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com

Egor Fedorov
Senior Credit Analyst
egor.fedorov@ing.com

Sebastian Franke
Consumer Economist
sebastian.franke@ing.de

Gerben Hieminga
Senior Sector Economist, Energy
gerben.hieminga@ing.com

Nadège Tillier
Head of Corporates Sector Strategy
nadege.tillier@ing.com

Charlotte de Montpellier
Senior Economist, France and Switzerland
charlotte.de.montpellier@ing.com

Laura Straeter
Behavioural Scientist
+31(0)611172684
laura.Straeter@ing.com

Valentin Tataru
Chief Economist, Romania
valentin.tataru@ing.com

James Smith
Developed Markets Economist, UK
james.smith@ing.com

Suvi Platerink Kosonen
Senior Sector Strategist, Financials
suvi.platerink-kosonen@ing.com

Thijs Geijer
Senior Sector Economist, Food & Agri
thijs.geijer@ing.com

Maurice van Sante
Senior Economist Construction & Team Lead Sectors
maurice.van.sante@ing.com

Marcel Klok
Senior Economist, Netherlands
marcel.klok@ing.com

Piotr Poplawski
Senior Economist, Poland
piotr.poplawski@ing.pl

Paolo Pizzoli
Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

Marieke Blom
Chief Economist and Global Head of Research
marieke.blom@ing.com

Raoul Leering
Senior Macro Economist
raoul.leering@ing.com

Maarten Leen
Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller
Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Germany, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com

Sophie Freeman
Writer, Group Research
+44 20 7767 6209
Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com

James Knightley
Chief International Economist, US
james.knightley@ing.com

Tim Condon
Asia Chief Economist

+65 6232-6020

Martin van Vliet
Senior Interest Rate Strategist
+31 20 563 8801
martin.van.vliet@ing.com

Robert Carnell
Regional Head of Research, Asia-Pacific
robert.carnell@asia.ing.com

Karol Pogorzelski
Senior Economist, Poland
Karol.Pogorzelski@ing.pl

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

Viraj Patel
Foreign Exchange Strategist
+44 20 7767 6405
viraj.patel@ing.com

Owen Thomas
Global Head of Editorial Content
+44 (0) 207 767 5331
owen.thomas@ing.com

Bert Colijn
Chief Economist, Netherlands
bert.colijn@ing.com

Peter Vanden Houte
Chief Economist, Belgium, Luxembourg, Eurozone
peter.vandenhoute@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Gustavo Rangel
Chief Economist, LATAM
+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo
Economist, Digital Finance
+44 20 7767 5306
carlo.cocuzzo@ing.com