How will the pandemic affect Gen Y financial planning?

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In late April 2020, the Daniels College of Business at the University of Denver brought 2008-09 graduates back (virtually) to the college to speak to students nearing graduation. The theme was "Tales from the trenches… getting a job during the Great Recession."

Two months prior, such an event would have been unthinkable. Unemployment was at historic lows, and the stock market had gone up strongly over the last decade.

Prolonged periods of prosperity can dull the urgency to gain financial literacy, which is the backbone of good financial planning. Ironically, tough times tend to highlight the areas where financial literacy is weakest. Recent TIAA Institute surveys show that risk and insurance are among the weakest areas of financial literacy. These topics call for careful consideration of negative outcomes, which presents both quantitative and behavioral challenges, including the tendency to overweigh recent observations. Thus, younger Gen Y households may have had less reason to learn how to best prepare for hard financial times.

An episode like the COVID-19 pandemic reveals how negative shocks interact with household financial outcomes. In my TIAA Institute paper, *Advising the Financially Vulnerable New Gen Y Household*, I highlight the sensitivity between the earned income ("top line") and surplus/deficit ("bottom line") for a representative new Gen Y household. Sensitivity tends to be quite high, with a 10-times multiple from percentage changes in the top line to the bottom line. This is due to fixed costs, both in terms of "sticky" lifestyle expenditures as well as debt that requires fixed payments. A negative shock to earned income on the top line, such as that occurring from COVID-19, is thus amplified strongly to the bottom line.

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In the short run, the COVID-19 pandemic is likely to drive more gig-type employment, which will elevate earned income volatility. The rational response to top line volatility is a reduction in fixed expenses. The sharing economy helps move fixed expenses from ownership of assets like homes and automobiles to more of a variable expense posture, potentially stemming bottom-line losses.

How does financial literacy and experience with shocks matter? Consider that some Gen Y households, like our recent virtual visitors to the Daniels College, were managing new households during the 2008-09 crash. If they have since built safety nets from durable earned income sources and/or liquid assets on their balance sheet, they are much better prepared for the current shock. Moreover, a shock like COVID-19 offers opportunities, such as the ability to buy large-ticket items like homes and automobiles at favorable prices and low interest rates.

Employers can certainly help with preparation for financial shocks. A 2020 TIAA Institute paper, *Millennials and money: The state of their financial management and how workplaces can help them*, outlines timely advice to employers about how best to help their Gen Y employees increase their financial knowledge and, likewise, improve their well-being and financial security.

Too late for planning vis-à-vis COVID-19 for Gen Y? Perhaps. But the truly valuable lesson for Gen Y is the incentive to gain financial literacy, and with it the discipline of financial planning that will serve them well during future shocks.

Read more:

Millennial financial literacy and fin-tech use: Who knows what in the digital era

Millennials and money: The state of their financial management and how workplaces can help them

Advising the financially vulnerable new Gen Y household

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