The Relationship Between Budgeting and Indicators of Financial Well-Being

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A gap in our understanding of budgeting behaviours

Financial well-being: "the extent to which someone is able to meet all their current commitments and needs comfortably, and has the resilience to maintain this in the future."[1]

Budgeting is a research priority identified in Canada's National Research Plan 2016-2018. Budgets are universally recognized as an effective money management tool. However, in analyses conducted with cross-sectional data, the relationship between budgeting and financial well-being outcomes is not clear. Our research seeks to explain some of the inconsistencies in the findings by exploring the impact budgeting behaviours have on the achievement of financial well-being outcomes.

Key research question

What is the impact of always staying within a budget on a household's probability of achieving financial well-being outcomes?

Methodology

Analyses were conducted on data from the 2014 Canadian Financial Capability Survey. Almost half (48%) of Canadian adults under the age of 65 in our sample (n=3,448) had a household budget. Of those who have a budget, 31% always stay within it.

[1]Kempson, E., & Poppe, C. (2018). Understanding Financial Well-being and Capability: A Revised Model and Comprehensive Analysis. *Consumer Research Norway – SIFO, Oslo and Akershus University College of Applied Sciences, Professional Report no.3 – 2018*, 156 p

Our analysis regressed four dependent variables using two logit models:

Budgeting behaviour
1) Household always stays within budget
2) Household does not budget

Financial behaviour model
Household always stays within budget
Financial behaviours (e.g., financial confidence, financial knowledge, ability to pay bills)
Socio-economic and demographic factors (e.g., age, education, income)

Financial well-being outcome
1) Outstanding credit card balances
2) Absorb a $5,000 unexpected expenditure (UE) with savings

Simplified (base) model
Household always stays within budget
Socio-economic and demographic factors (e.g., age, education, income)

Financial behaviour model

What we found

Summarized findings of financial well-being analyses

Financial well-being outcomes	Outstanding credit card balances	Absorb $5,000 UE with savings
Budgeting behaviour		
Always stays within household budget	- Negative	–
Financial behaviours		
Confidence	+ Positive	- Negative
Knowledge	–	+ Positive
Regrets a previous financial decision	+ Positive	–
Seeks sources of investment information	+ Positive	–
Monitors financial topics	+ Positive	–
Monitors bank accounts daily	+ Positive	–
Difficulty Keeping Up with bills	+ Positive	- Negative
Ownership of a principal residence		
Owns outright	- Negative	+ Positive
Rents	- Negative	–

What we learned

1. Those who are either (1) financially confident or who (2) have struggled to keep up with their bills within the last 12 months are less likely to always stay within their household budgets.
2. Households that always stay within their budgets are less likely to have outstanding credit card balances.
3. Struggling to keep up with bill payments is the largest predictor that a household owes outstanding credit card balances and would not use savings to absorb a $5,000 unexpected expense.
4. People whose principal residence is owned outright are less likely to owe outstanding credit card balances and more likely to absorb a $5,000 unexpected expense with savings.

Key messages

1. Our preliminary analysis found evidence that people use budgets because they face financial constraints. These constraints in turn reduce their probability of achieving positive financial well-being outcomes. As a result, budgeting behaviours were negatively correlated to many financial well-being outcomes. In the future, budgeting research should be conducted using longitudinal data in order to determine causal effects.
2. Canadians who face financial constraint are at a higher risk of negative financial well-being outcomes. Those who are struggling to make ends meet can benefit from targeted messaging to:
   - Educate on best practices of budgeting;
   - Increase their knowledge of low interest credit alternatives; and
   - Build their savings buffer.
3. People who have a mortgage on their home are vulnerable to negative financial outcomes. Homeowners can benefit from targeted messaging aimed to empower them to budget towards paying more than their minimum monthly mortgage payment and to save for unexpected expenses.

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