

The Vulnerability of Household Finance and Its Effects: A Literature Review and Prospects

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How to cite this paper: Xie, B. Y., & Tao, j. H. (2025). The Vulnerability of Household Finance and Its Effects: A Literature Review and Prospects. *Open Journal of Business and Management*, 13, 894-903.
<https://doi.org/10.4236/ojbm.2025.132048>

Received: January 6, 2025

Accepted: March 4, 2025

Published: March 7, 2025

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Abstract

With the continuous deepening and profound adjustment of the macroeconomy and financial market, household financial fragility has become a hot topic. This paper reviews the related literature on household financial fragility and conducts an in-depth analysis of the factors and effects that influence household financial fragility. Based on this, it proposes effective strategies to enhance household financial resilience.

Keywords

Household Finance, Vulnerability, Financial Resilience, Asset Allocation, Financial Literacy

1. Introduction

The way to rule a country is to enrich the people. Finance is the core of the modern economy, and the family is the basic unit of the economy and society. In recent years, with the deepening development of financial markets, new ways to meet the financing needs of families have increased, and families have been able to participate more flexibly in financial market decision-making. However, this has also brought about a corresponding sharp rise in leverage. According to the Macro Leverage Report released by the National Financial Development Laboratory¹, China's annual resident household leverage ratio has continued to rise, up 1.3 percentage points in 2023, and the resident leverage ratio has stabilized in the 60% to 65% range for four consecutive years. While pulling consumption to promote eco-

¹National Institute for Finance and Development (NIFD): Fighting for "Nominal": Current Issues Critical to Nominal Economic Growth—Macro Leverage Ratio for FY2023, January 25, 2024, <http://www.nifd.cn/SeriesReport/Details/4132>.

economic growth, high leverage will also make households over-indebted (Ruan et al., 2020), excessive “financialization” of the source of household wealth (Xiang & Bao, 2023), and increased financial risks and other problems more prominent, and in the case of a higher debt leverage ratio, households are more vulnerable to economic fluctuations, thus leading households into a state of financial vulnerability.

Household financial fragility is manifested as the possibility of financial risk due to the inability of households to assume all their debts on time (Leika & Marchettini, 2017). The rising financial high leverage of households leads to the problem of financial fragility of households to be more prominent, so the study of factors affecting the financial fragility of households can not only guide the financial decision-making of households, promote the healthy development of the household financial market, and provide low-income and high-risk households with more financial services and support, but also provide a strong reference for the formulation of policies at the governmental level, to promote the national commonwealth Realization.

Household financial resilience develops based on vulnerability, which refers to the ability of households to withstand risks and restore their financial status by rationally allocating financial assets, effectively managing liabilities, and taking other measures in the face of external economic shocks (Barrett et al., 2014). In the current risk-prone era, households lacking resilience are more susceptible to unexpected factors and fall into the long-term poverty trap. In contrast, households with high developmental resilience are usually better able to cope with different emergencies, the study of how to effectively enhance the financial resilience of households is a topic worthy of in-depth exploration in the current situation, which can help to maintain the quality of life of residents’ households, enhance the well-being of households and the happiness of their members, and promote the stability of society at both the social This will help maintain the quality of life of households, enhance their well-being and the happiness of their members, and promote social and macro-finance stability.

Based on this, this paper in-depth analysis of financial literacy, debt leverage, risk appetite and macro-digital finance, the four factors affecting the financial vulnerability of households, respectively, from their respective roles in the financial vulnerability of the pathway to in-depth discussion, analysis and summary of the financial vulnerability of households into the situation of the micro-households and the macro-financial level of the impact of different effects, and then put forward to enhance the financial resilience of the family’s possible path, with a view to providing a useful basis for the analysis summarizes the different effects of households falling into financial vulnerability at the micro-household and macro-financial levels, and then proposes possible paths to enhance the financial resilience of families, with a view to providing a useful basis for decision-making by households and the relevant departments in avoiding financial risks and maintaining financial stability. The article structure is shown in the figure below (Figure 1).

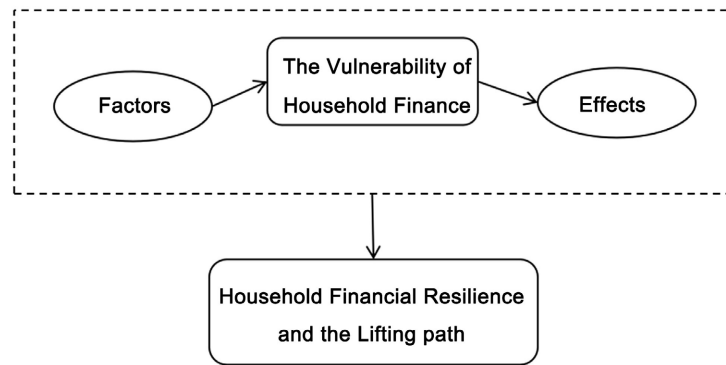


Figure 1. Theoretical framework diagram.

2. Analysis of Factors Affecting the Financial Vulnerability of Households

2.1. The Meaning of Household Finance and Its Vulnerability

Campbell, an American economist, first put forward the concept of “Household Finance” at the American Finance Association in 2006, which considers that household finance explores the importance of saving behavior, financial decision-making, and risk management of resident families (Campbell, 2006). From the micro level, household finance is related to each family’s financial decision-making and happiness index; from the macro level, household finance is related to macroeconomic stability, social welfare, fiscal policymaking, and financial market stability. Family finance has gradually received more and more attention from the academic community, which has contributed to the development and research in this area.

The concept of “vulnerability” was first proposed in the last century in the field of ecology (Niu, 1990; Xu et al., 2009), and has gradually been widely used in the fields of disaster science, economics, sociology, and so on (Anderson, 1995; Shang, 2000; Goodhart et al., 2006). Household financial vulnerability is the concept of vulnerability in the household wealth framework, which refers to the state of risk accumulation of households due to high indebtedness or irrational asset allocation, and covers the financial risk caused by the volatility of the price of household financial assets. As an important component of macro-finance risk, household financial risk is manifested in its impact on changes in economic structure through consumption on the one hand, and on macro-economic stability through financial behaviors such as indebtedness on the other. With the financial crisis in recent years, a series of adverse effects have spread in various fields, and people have begun to explore the root causes of the phenomenon of household loan defaults, thus gradually becoming involved in research on the issue of household financial vulnerability.

2.2. Analysis of Factors Affecting the Financial Vulnerability of Households

2.2.1. Financial Literacy

Financial literacy is a key factor influencing the financial vulnerability of house-

holds. Financial literacy is the ability to integrate financial knowledge and financial resources from the household perspective. The risk identification, coping, and buffering capacities of resident households are all affected by the level of household financial literacy, which in turn may lead to a significant divergence in household financial vulnerability (Klapper et al., 2013). Specifically, from the perspective of risk identification, the lack of financial literacy can lead to households' inability to make judgments when making key elements such as interest rate judgments, which increases the risk coefficient of loan defaults; and from the dimension of risk management, the lack of financial literacy is easy to induce households to make biased financial choices, which then constitutes an unfavorable impact on the financial vulnerability of households (Wu & Wu, 2018). Many scholars in China have also studied that higher levels of household financial literacy can attenuate the negative effects of high leverage on vulnerability by significantly improving the ability to identify risks (Li & Zhu, 2020; Liu et al., 2020; Zhang et al., 2020).

2.2.2. Debt Leverage

The biggest manifestation of household financial vulnerability, in reality, is the debt problem, and household financial vulnerability tends to show an overall increase with the rise of the leverage ratio (Hu, 2022). Against the background of rapid accumulation of household debt, especially the large amount of non-safe debt held by households, the impact of changes in debt leverage ratio on household financial vulnerability may appear through two paths. First, from the perspective of debt-servicing pressure, high household leverage magnifies the negative effects of income volatility and other risk events on households, which need to rely on new indebtedness in order to maintain current levels of consumption and to pay off existing debt, a process that will undoubtedly further exacerbate the negative impacts of risk on household welfare. Second, from the perspective of household liquidity, rising debt leverage increases the interest burden borne by households, which can lead to short-term liquidity difficulties for households and increase the potential for debt default, thus leading to financial fragility.

2.2.3. Household Risk Preferences

Differences in risk preferences across households also have implications for household financial vulnerability. Specifically, when households face financial difficulties, their subjective attitudes toward risk can be a way to help them escape from their difficulties, and risk aversion and risk preference, as two distinct psychological states, can have a significant impact on households' financial behaviors and coping strategies. Risk-averse individuals are more likely to be passive when faced with major emergencies, lack the ability and strategies to cope with risk, and are more likely to rely on external support. In contrast, households with a high degree of risk aversion show greater initiative and resilience and are more inclined to escape from the financial vulnerability of their households by proactively seek-

ing and seizing opportunities (Yu, 2024).

2.2.4. Digital Finance

In the current context of globalization, the rapid development of digital finance has not only provided effective solutions to the deficiencies existing in the traditional financial sector but also opened up more diverse and feasible channels for households to participate in economic activities (Guo et al., 2020). By reducing the transaction cost of financial services for residents, alleviating information asymmetry, and lowering the threshold of access to the financial sector for residents, digital finance improves the enthusiasm of households to participate in the financial market as well as their ability to deal with financial risks, and alleviates the financial vulnerability of households (Liu & Li, 2023; Ye & Luo, 2023; Wu, 2023; Lv et al., 2023). Chen & Wang, (2021) concluded from their study that digital finance may reduce household financial vulnerability by increasing household emergency savings and reducing over-indebtedness (Chen & Gong, 2021).

3. Effects of Household Financial Vulnerability

Household finance covers all dimensions of residents' lives, and household financial vulnerability consequently affects all aspects of micro-residents' household financial asset allocation, household consumption behavior, household risk management ability, and macro-financial stability.

3.1. Household Financial Asset Allocation

Households' financial vulnerability is characterized by a high-risk status, which can have an impact on the allocation of financial assets to households. In recent years, the macro environment has been turbulent, and the occurrence of various uncertain events has brought negative impacts on the financial status of residents' families, and the number of families in a state of financial vulnerability has risen sharply. Dai & Zhou, (2022) argue that, as a family-specific risk, family financial vulnerability affects the investment decisions of different families from the perspective of heterogeneity. The empirical study concludes that household financial vulnerability will inhibit household risky financial investment; at the same time, household financial vulnerability will also make households more risk-preferred, but risk preference is shown as a negative masking effect in this influence process. In the long run, household financial vulnerability has a sustained dampening effect on financial risky investment.

3.2. Household Consumption Behavior

Consumption is one of the most stable variables on the macro level and plays a role in promoting economic growth and optimizing and improving the standard of living. Generally speaking, depending on their income levels and the risks they face in consumption, consumers will adopt two strategies, namely, intertemporal consumption and risk diversification, to protect themselves against income vola-

tility, intertemporal consumption is to protect themselves against risks by investing in financial assets and their returns. Households can realize intertemporal consumption arrangements with the help of holding financial assets or adopting borrowing to achieve consumption smoothing. Household financial vulnerability covers factors such as debt leverage, liquidity constraints, etc., and has a highly sensitive impact on households' intertemporal consumption path choices and their ability to smooth consumption. By proposing the intertemporal consumption behavior hypothesis, Li Le (2023) argues that both persistent or temporary states of financial vulnerability have a significant impact on household consumption, and household financial vulnerability triggers changes in household intertemporal consumption behavior.

3.3. Capacity for Household Risk Management

Household financial vulnerability is influenced by different risk preferences on the one hand and the internal risk management capacity of households on the other. Vulnerability is usually characterized by excessive indebtedness or insufficient savings, which can leave households without sufficient funds to cope with external shocks, such as unemployment or illness, and reduce their resilience to financial risks. When households are in a state of financial vulnerability, objective conditions affect the ability of households to use risk management financial instruments, and family members may make irrational financial decisions due to financial pressures, which affects the diversity of financial portfolios, and reduces the risk diversification ability of households as well as their financial resilience (Dai & Zhou, 2022).

3.4. Macro-Financial Stability

Household financial vulnerability can be transmitted to the macro-financial system through the credit market. When a large number of households fall into financial distress due to vulnerability and are unable to repay their debts, the non-performing loan ratio of banks rises, which in turn may trigger a credit crisis, and this risk transmission mechanism is particularly obvious in the real estate market. Since the largest proportion of the scale of household indebtedness in China is housing debt, if a large number of households fall into financial difficulties at the same time, the volatility of the financial market increases and the stability of the entire financial system will be threatened, which may further trigger a systemic crisis, which may be manifested in extreme situations such as bank failures and the collapse of the financial market, which will have a huge impact on macroeconomic and financial stability.

4. Pathways to Greater Household Financial Resilience

Today's world is in a situation of great change not seen in a hundred years. The uncertainty has brought great challenges to the world, and the concept of resilience has gained wider attention. How families, as the most basic unit of society,

can show a strong ability to resist and adapt in the financial field when they are hit by shocks is the essence of family financial resilience, and also an issue worthy of academic attention (Sun & Xiang, 2024; Zou & Huo, 2023). Therefore, in order to enhance the ability of households to withstand and recover from shocks after facing various stresses or shocks, as well as to avoid getting into trouble, and to maintain macro-financial stability, it is imperative to effectively enhance household financial resilience. Financial resilience refers to the ability of a household to withstand external economic shocks by rationally allocating financial assets, effectively managing liabilities, and taking other measures to resist risks and restore its financial condition.

4.1. Optimizing the Debt Structure and Enhancing the Financial Literacy of the Population

At the micro level, it is first necessary to optimize the debt structure of households. Households should rationalize their debt structure and scale, avoid over-indebtedness and the creation of non-performing debts, and improve their risk management capacity to prevent themselves from falling into a state of financial vulnerability. Secondly, it is also necessary to improve the financial literacy of households. Residents with higher financial literacy can make optimal choices in financial decision-making, consumption behavior, and asset allocation, participate in diversified financial activities to reduce the likelihood of undesirable risks and promote the expression and realization of residents' formal credit needs, which will correspondingly increase the well-being of the family. In addition, the improvement of residents' digital competence (Tian et al., 2024), good accumulation and transfer of household assets (Phadera et al., 2019), etc., all play a positive role in improving resilience.

4.2. Strengthening Financial Regulation and Promoting Financial Approach Strategies

At the macro level, strengthening overall financial regulation is the primary initiative. The Government and regulators should strengthen the supervision of the financial market to prevent excessive volatility and risk transmission in the financial market, enhance financial stability at the macro level, and further supervise and improve the social security system to provide more risk protection for households. In addition, it is necessary to adhere to the financial level approach and strategy. Promoting the continued robust development of digital finance can effectively improve households' perception of risk, promote the accumulation of household assets and welfare, and enhance household resilience (Li & Lu, 2024). Financial inclusion, on the other hand, can help reduce poverty increase income, and combat risk to curb vulnerability, thus effectively improving household financial resilience (Chai & Qi, 2023).

5. Conclusions and Outlook of the Study

At a time when the State is vigorously promoting common prosperity, the family,

as an important component of our economy, needs to receive more attention. Family finance not only represents the lifestyle and economic level of each family but also becomes an important factor affecting the overall financial and social stability. The current academic research on family finance is gradually increasing, and the content of research on family finance is getting deeper and deeper, and the research perspectives are also enriched. Through combing the read literature, this paper focuses on household financial vulnerability as an indicator of the degree of household financial stability, summarizes its connotation, and finds that household financial vulnerability is affected to different degrees by variables such as financial literacy, debt leverage, digital finance, risk preference, etc., and analyzes that it also has a corresponding impact on micro household financial asset allocation, consumption behavior, and macro-financial stability.

However, the current academic research on family financial resilience involves less, and at the theoretical level, there is still a lack of definition of the indicator of family financial resilience in China, and the measurement and analysis of family financial resilience has not received extensive attention. At present, China's high-quality development is still in a critical period, and the problems of insufficient household financial resilience have gradually emerged, such as the high risk of default caused by the insolvency of some low-asset households, the high concentration of residents' household asset allocation in real estate, and the high leverage of financial assets. Therefore, an in-depth study of the influencing factors and role mechanisms of family financial resilience is of great practical significance for improving family financial decision-making, thus further promoting social harmony and financial stability, which still requires continuous research and innovation by scholars to provide a more solid theoretical foundation and practical guidance for the sound development of family finance.

Conflicts of Interest

The authors declare no conflicts of interest regarding the publication of this paper.

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