

Abstract for Christian Bayer's talk, "Unequal Lives — Heterogeneity in income risk and household portfolios

Idiosyncratic income risk is the largest economic risk faced by households. We document large and persistent heterogeneity in this risk with a negative correlation between risk and income levels. We develop a Markov-switching state-space model for earnings risk that provides us with estimates of the time-varying risk type of a worker. Combining these estimates with wealth data, we show that low-risk workers accumulate more wealth, in less liquid and higher-return assets. A life-cycle model explains the empirical patterns of risk, wealth accumulation, and portfolios based on persistent risk types and incomplete, frictional asset markets with systematic return and liquidity differences.