

Why Should Central Banks Care About Financial Literacy?

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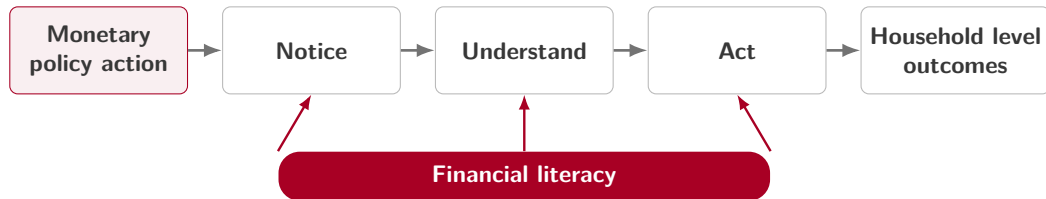
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Monetary policy does not transmit mechanically



Our question: is financial literacy a policy-relevant source of household heterogeneity in monetary transmission?

What we do

- ▶ **Document how financial literacy is associated with household behaviour along key channels of monetary-policy transmission**

Interest-rate, credit and balance-sheet, asset-price, and expectations channels

- ▶ **Use microdata from the ECB Consumer Expectations Survey to link financial literacy to attention, beliefs and financial choices**

Big Three financial literacy measure combined with high-frequency and topical survey modules across 11 euro-area countries

- ▶ **Assess whether financial literacy is also associated with household financial resilience**

Debt costs and burden, repayment risk, precautionary buffers and financial fragility

Related literature

► Financial literacy and household finance

Financial literacy predicts portfolio choice, retirement planning, wealth accumulation and financial fragility.

Lusardi and Mitchell (2014, 2023); van Rooij, Lusardi and Alessie (2011); Lusardi, Michaud and Mitchell (2017); Klapper and Lusardi (2020)

► Household heterogeneity in monetary-policy transmission

Transmission depends on household balance sheets, refinancing margins, portfolio exposure and consumption responses.

Kaplan, Moll and Violante (2018); Auclert (2019); Di Maggio, Kermani and Palmer (2020); Eichenbaum et al. (2022); Melcangi and Sterk (2025)

► Central-bank communication and household expectations

Households differ in attention to macroeconomic news, beliefs about policy, and ability to decode central-bank communication.

Coibion et al. (2022); Andre et al. (2022); Blinder et al. (2024); Ehrmann, Georgarakos and Kenny (2025); Dräger and Nghiem (2025)

Consumer Expectations Survey (CES)

- ▶ **Monthly internet panel** covering the 11 largest euro-area countries
Pilot started in January 2020 in DE, FR, ES, IT, BE and NL (~10,000 households); expanded in January 2022 to AT, EL, FI, IE and PT (~19,000 consumers)
- ▶ **Unique combination of financial literacy with household expectations and behaviour**
Perceptions and expectations; consumption; saving and investment; borrowing and household finances
- ▶ **Mixed-frequency modular survey design**
Monthly core questionnaire, quarterly and annual topical modules, and special-purpose ad hoc surveys
- ▶ **For a description:** ECB Consumer Expectations Survey Evaluation Report (ECB OP, 2021) and Georgarakos and Kenny (JME, 2022)

The “Big Three”: a parsimonious measure of basic financial knowledge

Interest

Compounding

Understand how savings grow when interest accumulates over time.

Inflation

Real values

Distinguish nominal returns from purchasing power after inflation.

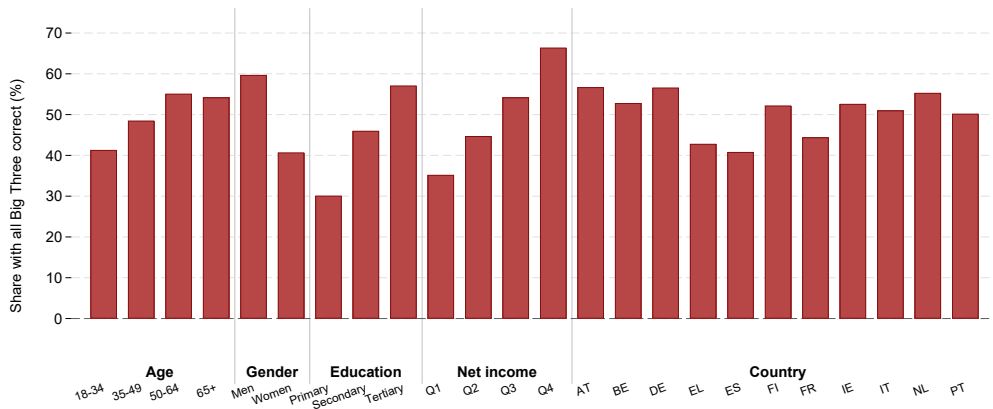
Risk

Diversification

Understand why a diversified portfolio is generally less risky than a single stock.

High financial literacy = all three questions answered correctly

Financial literacy is far from universal in the euro area

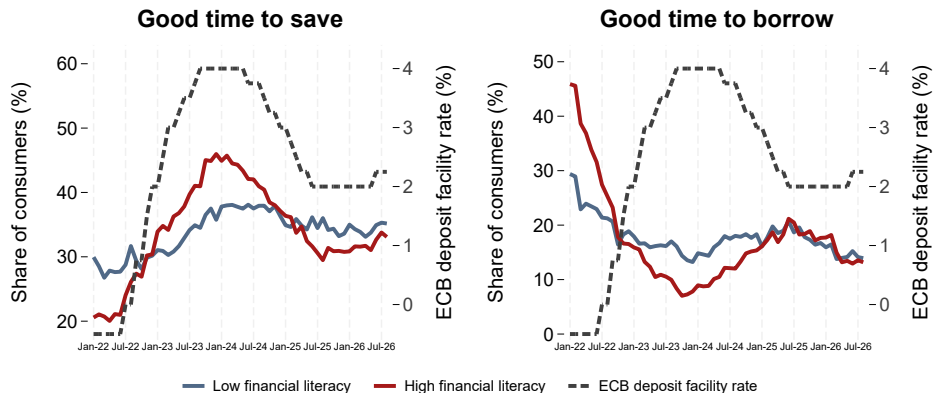


Roughly one in two consumers answers all three Big Three questions correctly, with substantial heterogeneity across demographic and socioeconomic groups.

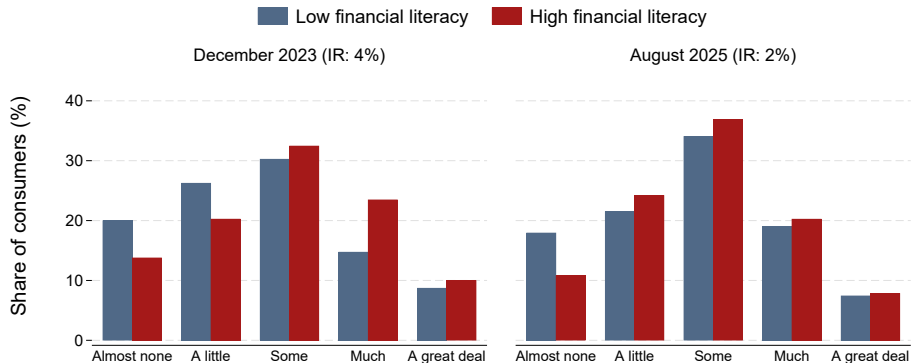
Financial literacy and the interest-rate channel

Interest-rate channel

Assessments of saving and borrowing track the policy-rate cycle more closely among financially literate households.



Financially literate households report paying more attention to interest rates.



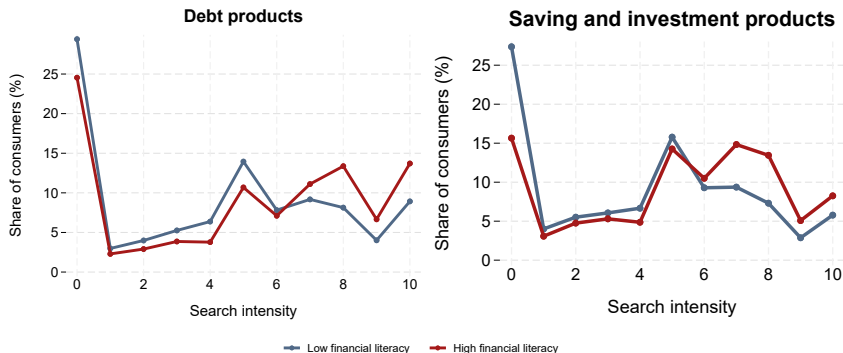
Financial literacy appears to strengthen the household interest-rate channel by improving attention to rates and interpretation of saving and borrowing incentives.

- ▶ Financially literate households are more likely to track interest-rate developments
- ▶ Their assessments of whether it is a good time to save or borrow move more clearly with the policy-rate cycle
- ▶ Lower attention or weaker understanding can dampen and delay pass-through from policy rates to household behaviour

Financial literacy and search for financial products

Credit channel

Financially literate households report more intensive search when choosing debt, saving and investment products.

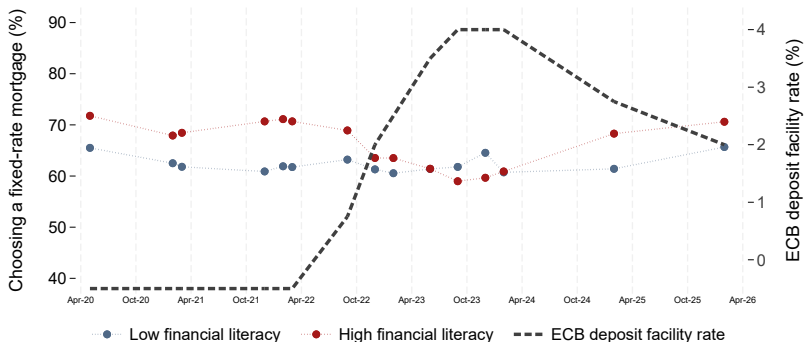


Source: ECB Consumer Expectations Survey, November waves 2022–2025; population-weighted estimates. Search intensity is measured on a 0–10 scale, where 0 denotes no search and 10 denotes a great deal of search.

Financial literacy and mortgage choice

Credit channel

Mortgage choices vary more with the interest-rate environment among financially literate consumers.



Source: ECB Consumer Expectations Survey and ECB Data Portal; CES-6 (largest six EA economies) balanced sample.

Debt costs and debt burden

Credit channel

	Mortgage interest rate		Debt-service-to-income ratio (housing)		Loan-to-value ratio (housing)	
	(1)	(2)	(3)	(4)	(5)	(6)
Big-3 (correct)	-0.54*** (0.026)	-0.35*** (0.027)	-0.06*** (0.003)	-0.01*** (0.003)	-0.05*** (0.005)	-0.03*** (0.005)
Country and wave FE	Yes	Yes	Yes	Yes	Yes	Yes
Demographic controls	–	Yes	–	Yes	–	Yes
Housing characteristics	–	Yes	–	Yes	–	Yes
Observations	28,307	27,906	24,618	24,233	21,066	20,796

Notes: OLS estimates. All specifications include country and survey-wave fixed effects. Even-numbered specifications additionally include demographic and housing controls.

Standard errors clustered at the individual level in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$. Source: ECB Consumer Expectations Survey; authors' calculations.

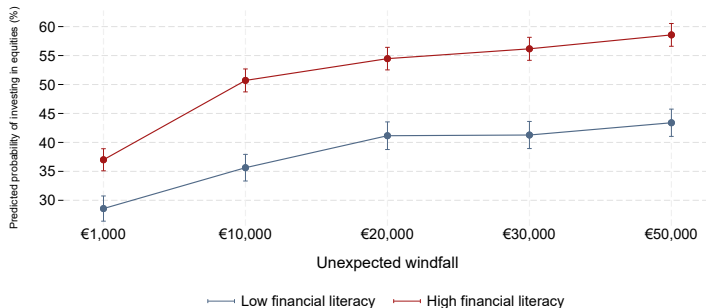
Financial literacy is associated with more active financial search, mortgage choices that vary with the rate environment, and more favourable debt positions.

- ▶ Search and contract choice are margins through which households translate conditions set by monetary policy into actual borrowing outcomes
- ▶ Financially literate households appear more responsive to the interest-rate environment when choosing mortgage contracts
- ▶ Lower mortgage rates, lower debt-service burdens and lower leverage imply different exposure to monetary policy tightening across households

Financial literacy and stock market participation

Asset-price channel

Financially literate households are substantially more likely to invest part of an unexpected windfall in equities.

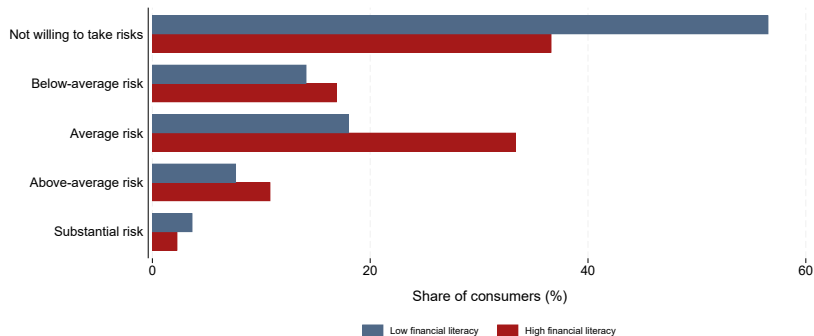


Consistent with the broader literature linking financial literacy to stock-market participation (van Rooij, Lusardi and Alessie, 2011, JFE).

Financial literacy and willingness to take financial risk

Asset-price channel

Financially literate households are less likely to avoid financial risk altogether and more likely to accept moderate levels of risk.



Source: ECB Consumer Expectations Survey, pooled November waves 2022–2025; population-weighted estimates.

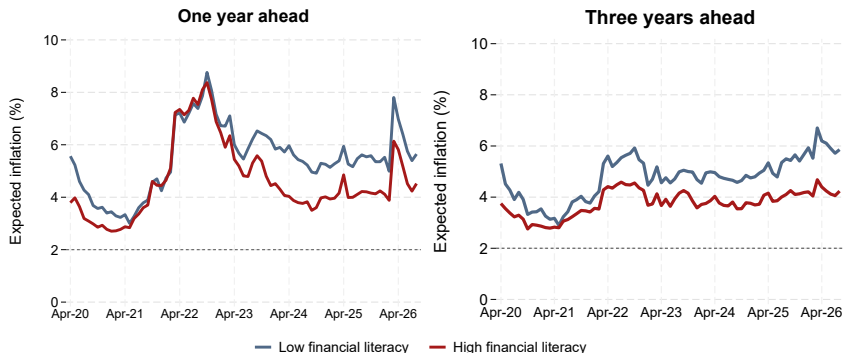
Financial literacy shapes exposure to the asset-price channel by affecting risk-taking and participation in equity markets.

- ▶ Households that avoid financial risk altogether are less exposed to changes in asset prices.
- ▶ Financially literate households are more likely to hold or choose equity exposure, including after a hypothetical windfall.
- ▶ Monetary-policy effects through discount rates, risk premia and portfolio valuations therefore reach households unevenly.

Financial literacy and inflation expectations

Expectations channel

Medium-term inflation expectations are closer to the ECB's price-stability objective among financially literate households.



Source: ECB Consumer Expectations Survey; population-weighted estimates.

Financial literacy and the expectations channel

Expectations channel

Financial literacy is associated with stronger information acquisition, greater central-bank credibility and trust, and better anchored medium-term expectations.

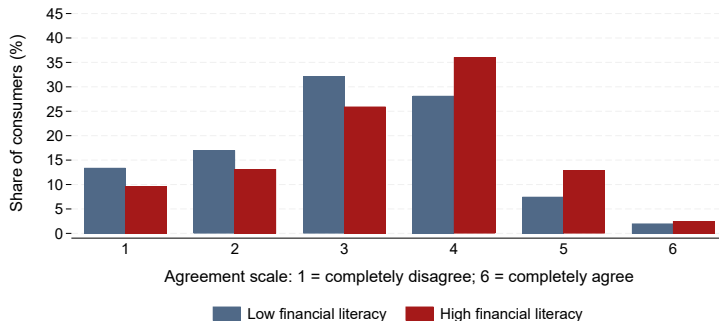
	ECB communication		Medium-term expectations		
	ECB news awareness (1)	ECB credibility (2)	High trust in ECB (3)	3y expectations in 1.5–2.5% (4)	Short- to medium-term pass-through (5)
Big-3 (correct)	0.03*** (0.003)	3.52*** (0.186)	0.03*** (0.003)	0.07*** (0.002)	
Big-3 × exp. inflation 1y					-0.04*** (0.008)
Observations	849,480	791,690	983,476	1,246,236	1,246,235

Notes: OLS estimates. Columns (1)–(3) use the controlled specifications from the ECB awareness, credibility and trust regressions. Column (4) reports the controlled specification for whether 3-year-ahead inflation expectations lie within 1.5–2.5%. Column (5) reports the interaction of high financial literacy with 1-year-ahead inflation expectations in the pass-through specification. Standard errors clustered at the individual level in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$. Source: ECB Consumer Expectations Survey; authors' calculations.

Understanding why the central bank raises rates

Expectations channel

Financially literate respondents are more likely to understand the rationale for monetary-policy tightening.



Respondents evaluate the statement: **“The ECB policy decisions to raise interest rates ensure overall price stability.”**

Financial literacy complements central-bank communication by improving policy comprehension, information acquisition and expectations anchoring.

- ▶ Rate hikes are observable, but their price-stability rationale is not automatically understood.
- ▶ Financially literate households are more likely to report ECB news awareness, trust and price-stability credibility.
- ▶ Their medium-term inflation expectations are closer to target and less sensitive to short-term inflation beliefs.

Financial literacy is associated with greater household resilience to unexpected expenses.

	Financially fragile (1)
Mean dep. var.	0.28
Big-3 (correct)	-0.11*** (0.003)
Observations	1,173,146

- ▶ Financial fragility captures whether a household could meet an **unexpected payment equal to one month of household income**
- ▶ Household resilience matters for the propagation of income, interest-rate and macro-financial shocks

Notes: Linear probability model. The dependent variable equals one if the respondent reports insufficient financial resources to make an unexpected payment equal to one month of household income. The specification includes demographic controls and country and survey-wave fixed effects. Standard errors clustered at the individual level in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$. Source: ECB Consumer Expectations Survey, April 2020–December 2025; authors' calculations.

Financial literacy and household repayment risk

Financial stability

	Expected late payments			
	Rent (1)	Mortgage (2)	Other loans (3)	Utility bills (4)
Mean dependent variable	0.09	0.07	0.08	0.09
Big-3 (correct)	-0.05*** (0.003)	-0.05*** (0.002)	-0.03*** (0.003)	-0.04*** (0.002)
Observations	213,408	204,267	211,734	371,441

Notes: Linear probability models. Dependent variable: expecting payment difficulty (next three months). All specifications include demographic controls and country and survey-wave fixed effects. Standard errors clustered at the individual level in parentheses. Source: ECB Consumer Expectations Survey, April 2020–December 2025; authors' calculations. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

Financial literacy is associated with household resilience, which affects how shocks propagate through consumption, debt repayment and the financial system.

- ▶ More resilient households can better absorb unexpected expenses and income shocks
- ▶ Lower expected payment difficulties reduce the risk that tightening or adverse shocks translate into broad repayment stress
- ▶ Household financial literacy is therefore relevant for both monetary transmission and macro-financial stability monitoring

What can central banks do?

Measure	Communicate	Educate
Treat financial literacy as a dimension of household heterogeneity in policy analysis.	Layer communication for audiences with different levels of financial knowledge.	Support continuous financial education.
Monitor pass-through, refinancing, expectations and resilience by literacy.	Explain monetary policy decisions and how they affect people.	This improves households' capacity to interpret and act upon monetary policy decisions.

Communication and financial literacy are complements, not substitutes.

Why should central banks care about financial literacy?

1. Monetary transmission depends on more than balance sheets

Households also differ in their ability to understand and act on financial information.

2. These differences appear across multiple channels of monetary policy transmission

Interest rates ■ Credit ■ Assets ■ Expectations ■ Financial resilience

3. Financial literacy belongs in the central-bank policy analysis

Not as a substitute for monetary or macroprudential policy, but as an analytical dimension.

A common monetary policy reaches households with very different capacities to understand and act on it.