

People predict budgets better on annual basis

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Everyone knows they should have a budget. But there's precious little research on how to go about it and what works best.

A new study in the *Journal of Consumer Research* found that people who made annual budgets were more accurate than those who made monthly ones. They also found that peoples' perception of their budget-making abilities affected the accuracy of the budgets.

During the study, researchers asked participants of various income levels to estimate their budgets for the next year and the next month. They also asked them how difficult budgeting was and told them a variety of stories about the challenges of budget preparation.

Authors Gülden Ülküman (University of Southern California), Manoj Thomas (Cornell University), and Vicki G. Morwitz (New York University) found that, contrary to popular advice, people were more accurate when constructing an annual rather than a monthly budget, even when they were logging their expenses weekly.

The researchers believe the annual budgets were more accurate because they were actually more difficult to construct, whereas people tended to be over-confident when preparing monthly budgets. The accuracy of the annual budgets improved when people were told the difficulty they experienced would result in more accurate budgets.

"Consumers' default tendency is to underestimate their budgets, for both next month and next year frames," write the authors. "However budgets

for the next year are closer to recorded expenses because consumers feel less confident when estimating these budgets, and therefore, adjust them upward."

The authors propose that the best way to prepare a budget is to make an annual budget and divide by 12. They also recommend removing distractions when budgeting, since programmed distractions tended to reduce the accuracy of the research subjects' budgets.

Source: University of Chicago

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