

Real Estate Versus Financial □
Wealth in Consumption

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Executive Summary

Real Estate Versus Financial Wealth in Consumption

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A surprising aspect of United States economic performance in the millennium is ongoing positive economic growth in the face of a collapsing stock market, record trade deficits, rising unemployment rates and declines in the number of people employed. A contributor to this paradoxical result could be the housing market. Rising house prices may be counterbalancing falling financial wealth and declining balances in pension accounts. Families could offset declines in spending from falling stock prices by increased spending from real estate wealth. Alternatively, homeowners refinance to access equity for consumption or investment in other assets, such as the stock market. Another possibility is that U.S. households are consuming at a greater rate from their housing than from their financial assets. A household may own a house worth \$100,000 with no mortgage debt, and \$100,000 in stocks, bonds and other financial assets. Even if both increased by 10% in value during one year, the amount of wealth-induced spending might differ.

This study examines the impact of changes in real estate and stock prices on consumer spending using quarterly data over the period from 1952 through 2001. Real estate equity includes holdings of principal residences, vacation homes and rental property. Financial equity includes liquid deposits as well as stocks, bonds and mutual funds. More than two-thirds of households own homes, as compared with only half owning stocks or bonds. Moreover, many stock-owning households have their funds only in a retirement account.

The results indicate housing has a substantial impact on economic activity. For each dollar increase in real estate wealth less mortgage debt, consumers spend 8 cents in that year. By comparison, a one dollar increase in financial assets from stock and bond markets increases spending by 2 cents in the current year. The impact of housing is four times as large.

The results are applied to two empirical observations: 1) the decline in the savings rate during the 1990s and 2) the robustness of the economy to the sharp drop in stock returns after 2000. About half the decline in the fraction of income that Americans save, from 6.5% in 1995 to 1% by 2001, is attributable to increases in real estate and financial wealth. Virtually all the decline in consumption occurring from the stock market decline of 2000-2001 is offset by rising consumption from real estate wealth. Real estate smoothes and stabilizes consumption when other assets are performing poorly.