

(5) Barata, José Martins, Pacheco, Luís Miguel. "Asset Prices and Monetary Policy: Wealth Effects on Consumption." Paper for the 20th Symposium on Banking and Monetary Economics, University of Birmingham, 2003.

The aim of this paper is to test a model explaining private consumption as a function of income, and financial and housing wealth using data from 5 European Union countries. The authors attempt to test the hypothesis that though the literature emphasized that wealth effects are less significant in continental Europe compared to the U.S. or the U.K. due to the more advanced financial deregulation degree, and the higher numbers for household stock ownership and stock markets capitalization in these two countries, the continuous process of financial deregulation could have facilitated the flow of wealth effects in Europe.

Due to econometric problems in the static specification, an error correction model is used to capture the dynamics of the relationship between consumption expenditure, disposable income, indices for share prices, equity prices, and residential prices, and other variables proxying for uncertainty in futures streams of revenues, and substitution effects on consumption. As predicted, the authors find that all error correction terms are negative and significant, and the stock price effect is only significant in the countries for which they do not have data about residential prices. In these countries, the implied elasticity of consumption with respect to real equities is around 2%, and when there is available data an implied elasticity of consumption with respect to real residential prices between 10-20%. These results did not support the hypothesis that financial liberalization and broadening of stock ownership has increased the potential impact of stock market fluctuations on consumption in Europe.

They finally concluded that as they found a strong and contemporaneous connection between residential prices growth and consumption growth, the housing market appears to be more important than the stock market as a factor influencing consumption. They however asserted that this conclusion is tentative till further analysis utilizing data from a larger number of European countries and using more refined econometric procedures.