

(14) Bertaut, Carol C. "Equity Prices, Household Wealth, and Consumption Growth in Foreign Industrial Countries: Wealth Effects in the 1990s." International Finance Discussion Papers 724, Board of Governors of the Federal Reserve System, 2002.

The paper investigates whether the strength of the wealth effect varies across some industrial countries, and what factors may underlie this variation. As wealth data for most industrial countries are not available for a sufficiently long time series for estimation, the author adopts three different approaches to generate estimates of consumption responses to changes in wealth.

The first method use conventional estimates of the U.S. marginal propensity to consume out of wealth, in addition to data on equity from each country in the G7 and Australia, Sweden and the Netherlands to calculate implied percentage point consumption responses to 10% increase in stock prices. The drawback of this method is that it assumes the marginal propensity to consume out of wealth to be the same across countries. Therefore, the author uses a second method that relates consumption growth to changes in equity prices in an estimated reduced form equation. In both methods, the author finds that a 10% increase in equity prices would raise consumption in the long run in the countries understudy, with the largest responses in the U.S., U.K., and Canada where equities are an important form of household wealth, while among European countries, the responses are larger for Netherlands and Sweden compared to France, Germany or Italy.

The third method employed uses the aggregate household sector wealth data to estimate a long run relationship between consumption, income and wealth, using two stage error correction models, in which the measure of wealth in each is either total household sector wealth, financial wealth only, financial and nonfinancial wealth, or equity and nonequity wealth. The most significant result in the first stage long run equations is that in the U.S. and Canada, the coefficients on equity and on financial wealth are significant, while in the U.S. the coefficients on nonequity and nonfinancial wealth consisting primarily of housing are also significant. Also, for the U.K., where financial wealth can be distinguished from housing wealth, both forms of wealth enter significantly. Using this method, the author also concludes that a 10% increase in stock prices would imply an increase in consumption of 1.2-1.4% in the U.S., 0.8-0.9% for the U.K., 1.6-1.8% for Canada, 0.5% for Australia and Japan, and 0.3% in France. Furthermore, a 10% increase in housing prices imply an estimated increase in consumption of 0.7-1% in the U.S., 1-1.2% for the U.K., 1.1-1.3% for Canada, and 1.6% for Australia.

Estimating the second stage which relates changes in consumption to its own lags and lagged changes in the variables of interest, the author finds that the adjustment of current consumption to imbalances between the level of consumption, income, and wealth is slow, as it takes 2-4 years for a change in income or wealth to feed through to consumption.

The author concludes that wealth effects are found to be significant in several industrial countries, where in Canada and the U.K., the estimated consumption responses to a given change in equity prices are comparable to those for the U.S., while in continental Europe the results suggest more modest consumption responses reflecting the small shares that equities still occupy in aggregate household wealth. However, in some of the smaller European countries where equity financing is more common and equities are becoming more important in household wealth, such as Sweden and Netherlands, wealth effects appear to be important.