

**(6) Dynan, Karen E., Maki, Dean M. "Does Stock Market Wealth matter for Consumption?" Board of Governors of the Federal Reserve System, Finance and Economics Discussion Papers 23, 2001.**

The paper compares the direct and indirect channels by which changes in household's wealth affects consumption. The direct channel reflects a quicker response where wealth changes directly cause changes in consumption through their effect on household's contemporaneous budget sets, while the indirect channel reflects a substantial lag to the wealth effect, and imply that these changes merely predict changes in consumption because they signal changes in future income, owing to uncertainty about the permanence of a given stock market movement.

The authors compare the direct and indirect effect by examining whether the consumption of stockholders is more highly correlated with excess returns on the stock market than the consumption of nonstockholders, which if confirmed suggests some role for the direct channel. They regress the change in consumption on contemporaneous and lags of change in stock price index controlling for taste shifters and some socioeconomic variables. They find that with only contemporaneous changes in stock prices, the estimated relationship between stock returns and the consumption growth of stockholders is positive, while it is negative and significant for non stock holders. Adding lagged changes in stock prices, they find that for stockholders the estimated response of consumption growth to contemporaneous stock returns is much larger when lags are included and the lags themselves have positive estimated effects on consumption growth, with much of the impact occurring in the first couple of years and diminishing after that. For nonstockholders, adding lagged wealth changes attenuates the estimated negative contemporaneous relationship as they are positive but statistically insignificant. These results imply that the aggregate relationship between consumption and stock market wealth is consistent with a direct view of wealth effects, and do not support an indirect channel.

Examining the magnitude of the marginal propensity to consume by regressing the change in consumption on capital gains, its lags and other control variables, they found that the marginal propensity to consume ranges from 5-15% in various measures of capital gains, which exceeds the range commonly estimated from aggregate data implying that the MPC of the wealthy who are left out of the sample because of the topcoding in the data is lower than the aggregate value.