(33) Edison, Hali, Sløk, Torsten. "Wealth Effects and the New Economy." IMF Working Paper 01/77, 2001.

The paper investigates whether there is a different impact from changes in new and old economy stock valuations on private consumption in several OECD countries, in light of the different behavior of the technology (TMT) and nontechnology (nonTMT) segments of the stock market. There are also two reasons to expect a difference between the effect from changes in new and old economy stocks on consumption: first, TMT stock valuations are much more volatile than nonTMT stock valuations which implies a greater risk involved in investing in them and consequently households might have a smaller propensity to consume out of new economy wealth increases. Second, the use of stock options as part of compensation has been more widespread in the TMT sectors worldwide which means that more households have been dependent on developments in valuations of new economy stocks, and thus changes in stock prices should have a bigger impact on consumption.

Estimating a vector autoregression models for each country for retail sales as a proxy for consumption, TMT stock market capitalization, nonTMT stock market capitalization as proxies for developments in wealth and industrial production as proxy for income, using a data from 1990-2000 for seven OECD countries. The impulse response functions show that for the United States, a shock to TMT valuations has an instantly positive effect on retail sales, whereas the effect of a shock to nonTMT stocks has a steadily rising effect on retail sales over time. For Canada and the UK the effect is significantly positive and relatively large for both types of stocks, whereas in Continental Europe the effect is much more muted.

For nonTMT, in Canada, UK, and the US, a 10% increase in nonTMT stock market capitalizations after two years leads to an increase in retail sales of around 1.4%. This is significantly higher than the o.4% increase in continental Europe. For TMT, a 10% increase in TMT market capitalization in North America and the UK has a 0.5% impact on consumption after two years compared to a 0.4% impact in Continental Europe and Japan.

To compare the impact of a one dollar increase in wealth on aggregate consumption in these seven countries, considering the different sizes of stock markets, the results suggest that for the US, a one dollar increase in TMT market capitalization leads, after two years to a 1.7 cents increase in aggregate consumption, and for nonTMT the impact is an increase of 5.1 cents, which suggest that consumers have indeed viewed changes in TMT stock valuations as a more temporary shock to wealth. For Canada both impacts are identical around 7.3 cents and not significantly different from the average estimate for North America and the UK. For the UK, the estimates are 2.9 cents for TMT, and 3.4 cents for nonTMT. For France, Germany and the Netherlands the cents per dollar effects are universally higher in the TMT sector compared with the non TMT sector. For the TMT, the average impact is an increase in consumption of 4 cents,

while for the nonTMT, the effect is around 1 cent per one dollar increase in capitalization.

The authors undertake robustness tests, where they considered the inclusion of house prices to the VAR system, the results imply that the TMT and nonTMT elasticity are relatively similar to the previous estimates, the house price effect differs across country groupings, where a positive shock to house prices in general has a negative effect in Canada, Japan, UK and the US, whereas the increase in house prices leads to an increase in consumption in continental Europe. They also considered the substitution of stock prices for stock market capitalization as a measure of wealth, and they find that none of the estimates are significantly different. Then they considered the substitution of aggregate stock prices for the TMT and nonTMT variables, and find the results confirm that Canada, the UK, and the US have a larger wealth effect than the other countries in the sample.