

(16) Green, Richard K. "Stock Prices and House Prices in California: New Evidence of a Wealth Effect." *Regional Science and Urban Economics*, 2002, 32: 775-783.

The author address the question of whether the value of the stock market has implications for consumption in light of several conclusions in the literature that it is unlikely that changes in stock market values will have much impact on consumption. This is tackled by focusing on one particular market: the Northern California housing market, especially San Fransisco and Santa Clara County areas, and argues that this market is a prime candidate for a large wealth effect.

The paper argues that for changes in equity values to have a measurable impact on consumption: first, stock holdings must be wide spread, which is a condition that is satisfied in this area as households have high incomes and therefore more likely to hold relatively large amounts of stocks, in addition to the evidence that workers in the region are likely to be paid in stocks than are workers in other parts of the country and thus their current income as well as wealth could be influenced by changes in stock prices. Second, changes in stock prices must be unanticipated, and the valuations of many companies in North California were unexpectedly high. Finally, as housing is both a consumption and an investment good, high income households with unanticipated gains in share prices are expected to increase the amount of housing that they own.

To examine whether the last condition holds, the author uses tests of Granger causality to study whether stock values Granger cause house prices in Northern California markets, especially Santa Clara County and San Fransisco, and compare them to areas in Southern California, such as Los Angeles County, and Orange County, in which the wealth effect is not expected to be significant. The author argues that while a finding of Granger causality does not prove the existence of a wealth effect, it is empirically consistent with such an effect. The results can not reject the null hypothesis that the stock prices do not Granger cause Orange county and Los Angeles County, while confirm that they Granger cause house prices both in San Fransisco and Santa Clara county.

The author finally tests the size of the effect, and the results show that, in San Jose, a one time increase in the value of the stock price index of 1% will lead to an increase in house prices of 0.88% after 1 year, While in San Fransisco, it produces a 0.22% increase in house prices after 1 year, and concluded that the stock price index is not only a significant predictor of house prices but is an important predictor as well.