(12) Macklem, R. Tiff. "Wealth, Disposable Income and Consumption: Some Evidence for Canada." Bank of Canada, 1994.

The author develops a measure of aggregate private sector wealth in Canada, which includes financial, physical and human wealth, and examines its ability to explain time series behavior of aggregate consumption of nondurables and services over both the long and short horizons. The long run analysis examines the relationship between consumption, wealth and disposable income using static linear regressions, and serves as a precursor for the estimation of error correction consumption equations designed to explain the short run dynamics of consumption around its long run trend.

Three basic long run relationships are considered: a long run Keynesian consumption function, and a model that includes both disposable income and wealth, and a version where wealth is disaggregated into its components: human and nonhuman. The results reveal that both disposable income and wealth are significant determinants of trend movements in consumption at any reasonable level of significance, and almost all the explanatory power of wealth is coming from the human wealth component, as the coefficient on nonhuman wealth is small. The author attribute this to the fact that as equity is considered an important component of nonhuman wealth, consumers may view much of the volatility in equity prices as short run in nature and that a majority of people do not hold equity. Estimating a long run equation that includes an alternative measure of nonhuman wealth that does not include equity reveal that once we restrict attention to assets such as housing which has less variable returns and are more widely held, fluctuations in both human and nonhuman wealth have important effects on consumption.

For the short run analysis, two error correction models are considered: one that specifies a relationship between consumption, disposable income and total wealth, and a second that enters human wealth and nonhuman wealth excluding equity separately. In the second model, the author finds that the impact of this substitution is relatively minor.

This lead to the conclusion that fluctuations in equity prices have no significant impact on aggregate consumption. Therefore, a measure of nonhuman wealth that includes equity is found to have little explanatory power in either the long or the short run, while a measure that excludes equity is a significant long run determinant of consumption.