

(10) Pichette, Lise, Tremblay, Dominique. "Are Wealth Effects Important for Canada?" Bank of Canada Working Paper 30, 2003.

The authors examine the link between consumption and disaggregate wealth in Canada, to confirm whether the higher wealth observed in the data played a role in maintaining consumer spending over the last decade.

Estimating the long run equations, in the specification with total wealth, they find a significant coefficient of 0.25, while when nonhuman wealth is disaggregated into stock market, housing and the remainder, all variables are highly significant determinants of consumption, while the stock market wealth coefficient (0.02) is much smaller compared with the one for housing (0.09).

They also highlight the limits of the error correction model used pervasively in the literature, and they suggest proceeding with their empirical analysis using vector error correction model to take into account the dynamic responses of all variables in the cointegrating vector. Estimating the VECM, they find that all the adjustment to the long run equilibrium is more likely to be done by human and stock market wealth, since their adjustment coefficients are economically large and highly significant. Examining the effects of permanent shocks, they find that the importance of a permanent shock to stock market wealth for consumption is not clear, while consumption's reaction to a permanent shock to housing wealth is relatively strong and significant. They also investigate the transitory component of each variable, and found that the adjustment coefficients associated with human and stock market wealth are both significant and economically large, which means that these two variables are mainly responsible for the restoration of the equilibrium following a shock, and thus expected to have a larger weight in the transitory innovation. They also find that the variability in consumption, disposable income and housing wealth is explainable by permanent shocks, while the variability in human and stock market wealth are attributable to permanent shocks.

Calculating the MPC, taking into account the transitory and permanent components of each type of wealth, they find that the MPC out of stock market wealth is weak with less than 0.5 cents per dollar increase in this type of wealth, and is attributed to the high concentration of holdings of equities to the wealthy who have lower MPC compared to the median. They also find a significant MPC of 5.7 cents per dollar increase in housing wealth. They attribute this discrepancy to the observations that the distribution of housing wealth is less concentrated than that of the stock market, households might consider shocks to the housing market less volatile than shocks to the financial markets, housing wealth is less liquid than stock market wealth, capital gains resulting from housing wealth are likely to have a higher MPC since gains from that type of wealth have a fiscal advantage relative to stock market gains.

They finally find that it takes time for consumption to completely adjust to the various shocks.

