(27) Poterba, James M. "Stock Market Wealth and Consumption." Journal of Economic Perspectives, 2000, 14:99-118.

The paper overviews the literature on how stock market wealth affects consumption, in light of the rising stock market in the 1990s that was accompanied by rising consumer spending. Studying the composition, level and distribution of net worth during 1989-1999 reveals that the stock market accounts for one quarter of household net worth, owner occupied real estate and consumer durables are roughly equal in value to equity holdings, while other financial assets account for the remainder. While the real value of tangible assets increased by only 14%, and that of financial assets other than equities rose 38%, the real value of corporate equities surged 262% during this period. Wealth is also dispersed unevenly across households, where 1% of households with the greatest net worth hold roughly one third of the assets in the economy, while the real estate holdings are less concentrated than the holdings of corporate stocks. Also, less than half of all households own corporate stock, and even for those who do, stocks is typically not the largest asset in their portfolio.

Reviewing the evidence on the comovement in consumption and household net worth reveals that the estimate of the marginal propensity to consume out of wealth varies substantially across models, and depends on the particular measure of wealth that is included in the set of explanatory variables, on the measure of household consumption, on the data sample, and on the particular specification being estimated. There are also reasons that marginal propensity to consume out of wealth vary over time as there have been changes in the mix of wealth shocks which recently have been associated with equities which are held by fewer households whose MPC may be smaller, in addition to the growing importance of equity investments that are held in tax-favored retirement accounts where the MPCs out of gains from these accounts is smaller than that out of directly held assets as the former are often thought of as long tem assets, and finally the falling cost of leaving bequests might reduce MPCs.

The author analyzed the types of consumption that are associated with those in the top percentiles of the net worth distribution, where the data suggested two consequences of the concentrated nature of corporate stock ownership and the associated concentration of wealth gains in the 1990s: First, there has been an expansion in total outlays on some luxury items although the increase in such outlays is probably small by comparison to the increase in household stock market wealth. Second, there has been a sharp increase in the demand for some durable luxury goods that are in fixed supply resulting in significant price appreciation for such goods, which translated into higher user costs for these durables, and because the appropriate measure of consumption outlays for durables is their rental equivalent cost, durable good inflation translates into higher consumption for the households who own these goods.

While changes in consumption affect national saving through their impact on personal saving, a rising stock market can also affect national saving through its effect on government spending, as rising stock prices can boost tax receipts, and the resulting increase in government saving has probably offset to some degree the decline in personal saving triggered by the rising stock market.

The author argues that it is possible that changes in stock prices affect spending even by households that do not own stocks because they affect consumer confidence, or the uncertainty that consumers perceive about future economic conditions, thus raising spending even among households with little or no exposure to the stock market. Then if changes in the stock market can trigger changes in consumer confidence then it is possible for a stock price appreciation to have a broader impact.