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# Study: Housing Wealth Impacts Spending More Than Stocks

(November 30, 2004) -- Housing wealth has a more immediate impact on consumer spending than stock wealth and has sustained the U.S. economy since the beginning of this decade, shows a new study produced by the Joint Center for Housing Studies of Harvard University and Macroeconomic Advisers, LCC, and commissioned by the NATIONAL ASSOCIATION OF REALTORS®.

David Lereah, NAR's chief economist, says the study shows a large difference between the impact of housing wealth and stock wealth on consumer spending, particularly during the last economic downturn.

"Aggressive cuts in short term interest rates at the beginning of the decade forestalled economic problems and led to record home sales and home equity borrowing," Lereah said. "Without the stimulus, housing's contribution to consumer spending would have been about half as great, the recession much worse and the recovery less robust."

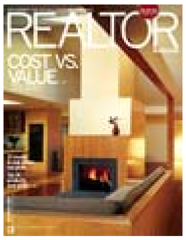
A major finding in the study is that over time, consumers spend about five-and-a-half cents out of every dollar increase in both housing wealth and stock wealth. However, spending from housing wealth only takes about a year to reach 80 percent of its long-run effect, compared with nearly five years for stock wealth to have the same effect – likely because near-term gains in stock wealth could prove to be unsustainable.

"In other words, housing produces a quicker lift to the economy while home-price growth provides lasting benefits," Lereah said. "Homeowners are more confident of gains in housing wealth, so they spend more readily and quickly when they occur."

"Housing Wealth Effects," sponsored by NAR's National Center for Real Estate Research, reviewed a number of existing studies and developed new models to compare wealth effects. The study shows that expansionary monetary policy can provide a rapid and substantial lift to consumer spending under the right circumstances. While some investors pulled out of the stock market when values began to fall in 2000, a near 45-year low in interest rates allowed housing to help the economy through a soft spot.

Regarding speculation about the prospects of a housing price bubble, Lereah says that debt service costs are largely ignored and not well-understood.

"In simple terms, over the last year monthly mortgage payments to buy a

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median-priced home would have taken about 18 percent of the typical family's income," he says. "In the early 1980s these costs exceeded 30 percent of family income, so we now have a fair amount of headroom. The fundamentals of a growing population, tight supply of homes available for sale and rising construction costs will support home prices moving forward."

Home price changes are far less volatile than stock values, but individual returns depend on market conditions in local areas. Between 1983 and 2003, the average deviation in annual value from national price trends in the top 100 metropolitan areas was only 4.7 percent. By contrast, stock values can rise and fall rapidly—even over the course of a single day.

During the period of 2001 to 2003, housing contributed more than one-quarter to consumer spending in each of those years. About half of that boost was attributable to gains in housing wealth through equity withdrawals and realized capital gains, confirming that housing propped up the economy.

In the fourth quarter of 2003, home equity accounted for 19 percent of household wealth, slightly higher than the combination of stocks and mutual funds. However, homeownership is more widespread than ownership of stock and contributes more to the balance sheet of the typical household. Home equity exceeded the value of stock owned directly by households by $2.6 trillion.

Other findings include:

- About 6 in 10 homeowners have more home equity than stock wealth.

- Total housing consumption, operations, related goods and investment came to about 23.1 percent of Gross Domestic Product in 2003. Over the last 50 years, housing has hovered between one-fifth and one-quarter of GDP.

- Housing wealth accounts for 36 percent of the nation's tangible assets. The U.S. Federal Reserve Board estimated the value of housing stock at $15.2 trillion in the fourth quarter of 2003.

- Late last year, the homeownership rate was 68 percent, but only 52 percent of households held stock—either directly or indirectly.

- In 2001, the Federal Reserve Board's Survey of Consumer Finances showed that the top 1 percent of stockholders controlled 33.5 percent of stock, while the top 1 percent of homeowners controlled 13 percent of home equity.

Lereah says homeownership has a larger effect than stocks on the typical household's finances. "The broader distribution of homeownership means that changes in stock wealth affect a much smaller share of households and mostly affects those with larger disposable incomes," he says.

In addition, homeowners accumulate significantly more wealth than renters. Analysis shows a renter in 1984 would have accumulated $42,000 in net wealth by 1999. However, a typical owner household in 1984 would have accumulated $167,000 in the same timeframe.

"Most of the differences between renter wealth and ownership wealth reflect the contribution that a leveraged investment in a home provides through appreciation in value, which has been exceptionally strong over the last three years," Lereah says. "Homeownership is unique in that it provides shelter in addition to being an investment that yields a financial return as values rise."

Housing is an attractive investment because it directly builds wealth through both home price appreciation and forced savings in the form of mortgage payments that reduce principal. "It is also appealing because it allows owners to tap into that wealth at favorable interest rates to finance other forms of investment and consumption," Lereah says.

Owners have the option of taking out a home equity loan or line of credit, or taking cash out while refinancing. In addition, when buying another property, they can keep some of the equity from their existing home and use only a portion as a downpayment on another.

The findings in this study suggest that expansion of monetary policy—a lowering of interest rates—at the onset of weakness after an economic expansion can give the economy a significant lift. Conversely, a tightening could slow home sales and reduce equity borrowing, which could quickly act as a drag on consumer spending and slow the economy.

"Accommodative monetary policy through lower interest rates during periods of economic weakness can make the difference between a steep recession and a soft landing," Lereah says.

—NAR

**Editor's Note:** For more information on housing statistics and market trends, visit NAR's Research Division.

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