

Homeowners do not increase consumption despite their property rising in value, research shows

May 15 2013

Although the value of our property might rise, we do not on that account increase our consumption. This is the conclusion by economists from University of Copenhagen and University of Oxford in new research which is contrary to the widely believed assumption amongst economists that if there occurs a rise in house prices then a natural rise in consumption will follow. The results of the study is published in the scientific journal *The Economic Journal*.

"We argue that leading economists should not wholly be focussed on monitoring the housing market. Economists are closely watching the developments on the housing market with the [expectation](#) that house prices and household consumption tend to move in tandem, but this is not necessarily the case," says Professor of Economics at University of Copenhagen, Søren Leth-Petersen.

Søren Leth-Petersen has, alongside Professor Martin Browning from University of Oxford and Associate Professor Mette Gørtz from University of Copenhagen, tested this widespread assumption of 'wealth effect' and concluded that the theory has no significant effect.

Homeowners do not increase their consumption

Søren Leth-Petersen explains that when economists use the theory of 'wealth effect' the presumption is that older homeowners will adjust their

consumption the most when house prices change whilst younger homeowners will adjust their consumption the least. However, according to this research, most homeowners do not feel richer in line with the rise of housing wealth.

"Our research shows that homeowners aged 45 and over, do not increase their consumption significantly when the value of their property goes up, and this goes against the theory of 'wealth effect'. Thus, we are able to reject the theory as the connecting link between rising house prices and increased consumption," explains Søren Leth-Petersen.

He believes that the reluctance by the homeowners stems from the fact that, for some people, houses or properties do not solely represent a financial value or asset, as for example registered securities or a car.

"Our house is our home and we all need a place to live. That is why homeowners in reality act different than the theory stipulates," says Søren Leth-Petersen.

In turn, Leth-Petersen suggests that it depends on the prospects of higher earnings which prompt homeowners to increase their consumption. Higher earnings also prompt investments into more expensive property and this creates rises to house prices on the [housing market](#).

Scientifically important time period

The strength of the research lies in access to detailed individual data whereas economic theories usually have been developed based on calculations of averages on entire populations. This research has accessed household-level panel data which has then been grouped and studied.

The researchers have analysed Danish tax administration data and

combined information about income, wealth and savings as well as home ownership, age, education and family composition from 90,000 households and almost 400,000 observations for the period 1987-1996.

According to Søren Leth-Petersen, this period is particularly interesting because homeowners underwent a cycle in which house prices declined from 1987 to 1992 and then increased from 1993 to 1996. The period is also interesting because it was not possible for homeowners to use their house as security for consumption loans before 1992. This enabled the researchers to establish how households took out consumption loans based on their housing equity when such loans were introduced.

The research shows that homeowners aged 45 and over did not react significantly to the rise in house prices. However, the younger [homeowners](#), who are typically short of finances, took the opportunity to take out additional consumption loans when given the chance.

An international discourse

In an international light, Denmark is a small country with large amounts of data which through decades has been gathered systematically. This makes Denmark well-suited for economic research, but this particular research, according to Søren Leth-Petersen, should be an international theoretical discussion regarding 'wealth effect'. Also British studies suggest similar findings to the results of that of his and his colleagues' recent research.

The results of the study 'Housing Wealth and [Consumption](#): A Micro Panel Study' is published in print 15 May in the acclaimed scientific journal '*The Economic Journal*'.

More information: [onlinelibrary.wiley.com/doi/10 ... /eoj.12017/abstract](https://onlinelibrary.wiley.com/doi/10.1111/eoj.12017/abstract)

Provided by University of Copenhagen

Citation: Homeowners do not increase consumption despite their property rising in value, research shows (2013, May 15) retrieved 26 April 2024 from <https://phys.org/news/2013-05-homeowners-consumption-property.html>

This document is subject to copyright. Apart from any fair dealing for the purpose of private study or research, no part may be reproduced without the written permission. The content is provided for information purposes only.