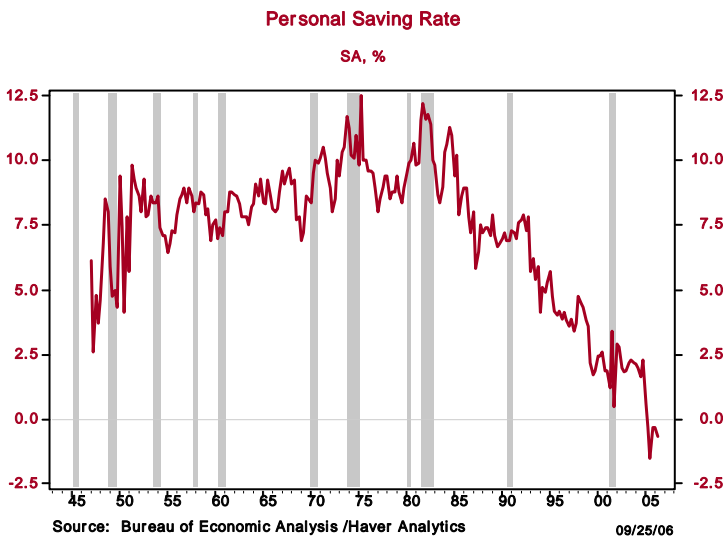




Household Wealth and the US Savings Rate

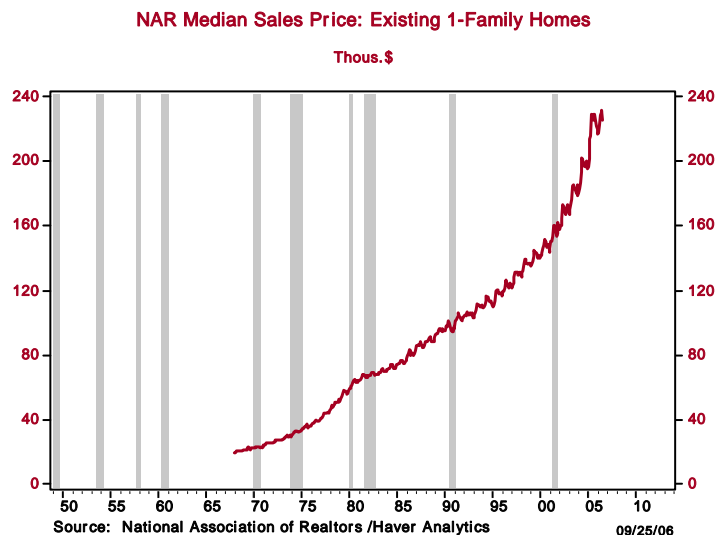
There's so much negative press about the fact that Americans don't know how to save. The official US savings rate reported by the Bureau of Economic Analysis is currently at zero. Pretty dismal, right? Ask anyone from the baby boomer generation, and they'll tell you their parents taught them how to save and invest for a down payment on their first house or for college. Ask these same people what Generation X and Generation Y are doing, and they'll tell you they're buying the biggest possible houses they can with little or no money down. Of course, consumers aren't stupid — they base their decisions on what they see happening around them. What they see is that housing prices go up, at least most of the time. So, the logic goes, why not buy the biggest house in a good neighborhood where the prices are likely to rise? This is not faulty reasoning. But economists don't seem to understand that the average family's behavior is greatly influenced by the value of its house and real estate holdings.

The chart at left shows that the personal savings rate in the United States has been falling since 1980, coinciding with the great bull market in US equities and the soaring value of real estate. The two go hand in hand. Behavioral economics, a relatively new branch, acknowledges this link between shifting market realities and human behavior (we think it's about time).



Note that while the savings rate has been falling, the value of existing homes has been rising. In fact, the median price of existing homes has tripled since 1980 (see chart below). In effect, the home has become a sort of piggy bank, and all the new mortgage products available have allowed consumers to withdraw some of the money out of this piggy bank in the form of home equity. Economists call this Mortgage Equity Withdrawal; think of it as a flow or stream of money out of the home. Economists believe that this flow of money is drying up and taking the entire housing market along with it.

But there are several problems with this argument: First, many consumers do not withdraw the equity from their homes. They actually live within their means, spending only out of savings or interest or investment income. They wouldn't dream of taking money out of their homes. Second, economists assume, based on home equity data outstanding, that the majority of people are spending the equity in their homes to make

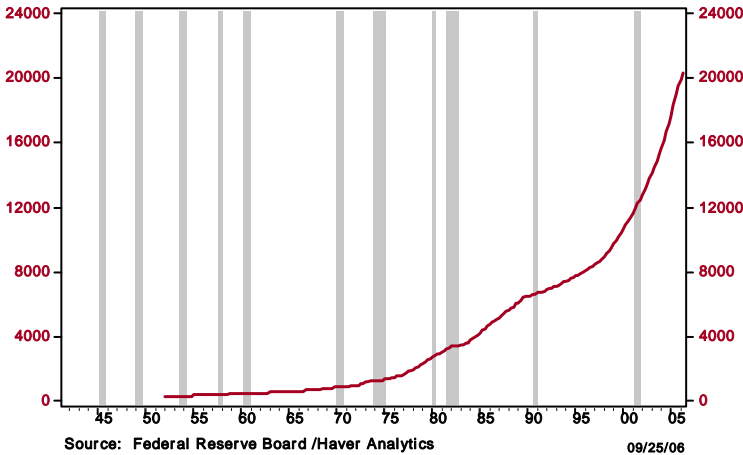


ends meet, to maintain a certain lifestyle, or to pay for healthcare or their children's college expenses. In reality, many middle-income consumers do this, but the question is really how many are doing it and does their aggregate activity have a bearing on total consumer spending? We don't think so. In fact, we think it would be nearly impossible for them to spend the entire equity value of their homes as long as they are still working and saving in a 401(k) or other deferred savings plan.

We like to focus on the outright value of all real estate holdings by US households. This is considered the stock of household wealth in the country. The chart at left displays the value of all US households' real estate wealth — in other words, the value of their primary residences. Note how rapidly the value climbed between 1980 and 2005. Real estate wealth rose from \$4 trillion in 1980 to \$20 trillion in 2005. But for some reason, economists ignore this phenomenal increase. They pretend it doesn't exist and doesn't impact consumer behavior, yet it strongly influences how people choose to allocate their money. In 2001, for example, consumer spending during a recession did not decline for the first time in post-World War II history. This is remarkable.

Look how much real estate wealth has risen since 2000. It went from \$12 trillion to \$20 trillion — an increase of \$8 trillion in just five years. Economists assume that this increase has no bearing on consumer behavior. We don't think this can possibly be true, and the weekly spending data prove it.

Households: Assets: Total Owner-occupied Real Estate
Bil. \$



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