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US Daily Economic Notes

The housing "wealth effect" may be substantial in 2013

Thursday	Release	Forecast	Previous	Consensus
8:30 am	Initial jobless claims (01/19):	355k	335k	358k
10:00 am	Leading indicators (Dec):	+0.5%	-0.2%	+0.4%

Source: Deutsche Bank, Bloomberg Finance LP

Commentary for Thursday: One of the most significant indirect effects from the housing recovery is the "wealth effect" on consumers due to the recovery in home prices. The wealth effect is multi-faceted: It is partly due to the psychological lift resulting from higher home values, i.e. the perception of a stronger household balance sheet position actually supports spending. More directly, price appreciation enables households to refinance debt, thereby reducing interest expenses, as well as tap into home equity via lines of credit or cash-out refinancing. Even small moves in home prices can have large effects on consumption, because housing comprises such a significant share of household assets. In fact, housing is typically the single largest asset for most households. **According to the Fed's Flow of Funds report, household real estate assets total approximately $17.2 trillion**. As a result, a small change in home values can have a massive effect on aggregate household assets. According to the Case-Shiller home price index, prices increased by 3.7% over year-earlier levels through Q3 2012. The latest FHFA home price index was up 5.6% as of November, and December median existing home prices rose 11.5%. In the Flow of Funds report, the value of household real estate holdings increased by 5.6% over the four quarters ending in Q3 2012, which amounts to a substantial dollar change of $912B. Based on previous analysis, **we are projecting home price appreciation of 5-10% in 2013, which translates into a further increase in household assets, i.e. wealth creation, ranging between $860 billion and $1720 billion**. To be sure, the wealth effect on consumer spending could be substantial.

The prevailing estimates of the wealth effect on consumption from home price appreciation is generally believed to be around 0.05 to 0.10. In other words, a one dollar increase in home values lifts consumer spending by five to ten cents. Thus, for an asset class valued at $17.2 trillion, relatively small changes can result in sizeable wealth effects. For example, in the 5-10% price appreciation scenario highlighted above—which lifts housing wealth by $860 billion to $1720 billion—**the wealth effect on consumer spending should range between $43 billion (0.05 x $860B) and $172 billion (0.10 x $1720B)**. This is substantial considering that real consumer spending increased by $178 billion over the past four quarters, and we are currently projecting an increase of $155 billion for 2013 (Q4/Q4).

Our current forecast for residential investment through yearend 2013 (12.5% Q4/Q4) results in an increase of $48B. Interestingly, this is roughly on par with the low end of our range of potential wealth effects. However, as we have recently highlighted, our present forecast for residential investment may be too conservative. Our modeling suggests that a more substantial increase—in the range of 25% to 37%—is possible. The more aggressive scenario of 37% (which is consistent with housing starts near 1355k) would lift residential investment by $142 billion. Note that this is actually shy of the upper end of the wealth-effect spectrum. The important consideration is that the wealth effects on consumer spending from relatively modest home price appreciation (of 5-10%) rival the direct contribution from a substantial acceleration in homebuilding. In other words, **while residential investment could contribute between 0.4% and 1.0% to GDP this year, wealth effects could easily match the contribution**. Thus, through its direct and indirect effects, the housing sector alone could potentially contribute as much as 2% to real GDP growth this year. *–CR*

Policy Speeches

There are no monetary policy speeches scheduled for Thursday.

Year End Targets

Real GDP growth: +2.3% Q4/Q4
Core CPI: +2.6% Q4/Q4
Unemployment rate: 7.3%
Fed Funds: 0.15%
10 Yr Treasury: 3.00%

Fed Policy

We expect the Fed to continue mortgage and treasury purchases through at least mid-2013.

Tsy Auction & Announcements

		Size	Prev.
11:00 am	2-y note (ann.)	$35B	$35B
11:00 am	5-y note (ann.)	$35B	$35B
11:00 am	7-y note (ann.)	$29B	$29B
1:00 pm	10-y Tips (auc.)	$15B	$13B

Appendix 1

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