An Uneven Recovery in Household Wealth

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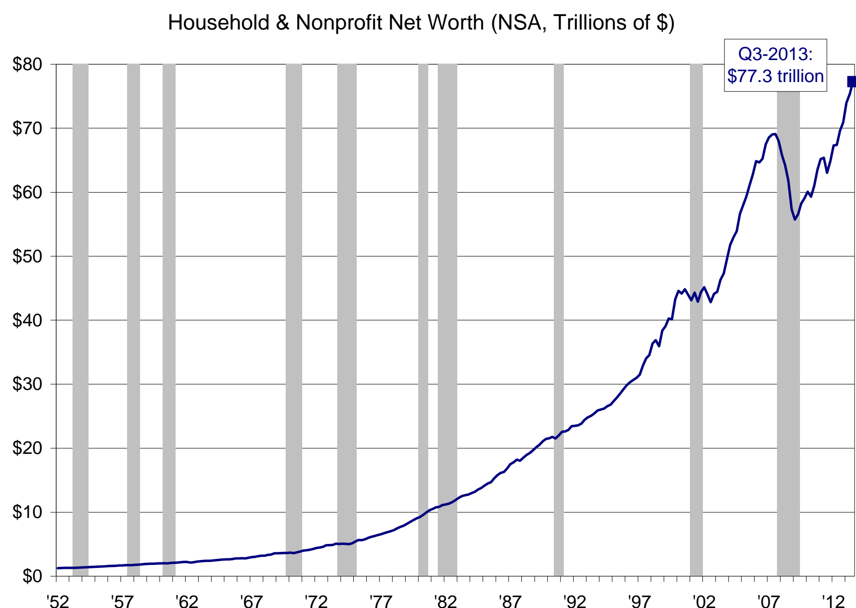
Introduction

Household net worth, or wealth, reached an all-time high in the third quarter of 2013 at more than $77 trillion, according to data published by the Federal Reserve.[1] After declining between the third quarter of 2007 and the first quarter of 2009 by a cumulative 19 percent – or more than $13 trillion on a nominal basis – household wealth took three and a half years to recover fully.

Some might expect the recovery in wealth to filter through into consumer spending via the traditional "wealth effect."[2] However, with a closer reading of the available data, this edition of *Housing Insights* finds that the true recovery in wealth is notably weaker than suggested by the Federal Reserve's headline figure for aggregate household net worth, and that an uneven rebound across asset classes likely implies a more limited boost to economic recovery from the wealth effect than in prior cycles.

Exhibit 1. Household Net Worth Rebounds, Rising to a Record High



Source: Federal Reserve Board

[1] In this piece, "household" refers to the Federal Reserve Board's category for Household & Nonprofit Organizations as used in its quarterly publication of the Financial Accounts of the United States (Z.1). The terms "wealth" and "net worth" are used interchangeably, and are defined as assets minus liabilities.
[2] The wealth effect refers to a change in consumer spending corresponding to a change in perceived wealth, for which the Federal Reserve Board's measure of Household & Nonprofit Organizations' net worth serves as a proxy.

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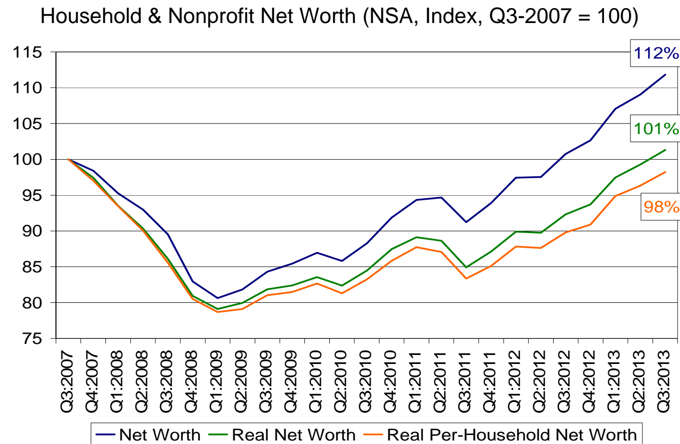
On Closer Inspection, the Wealth Rebound Appears Less Impressive

Nominal aggregate household wealth is now roughly 12 percent above its previous peak in the third quarter of 2007. However, after adjusting for inflation and the number of households, real net worth per household is still below the level reached nearly six years ago[3].

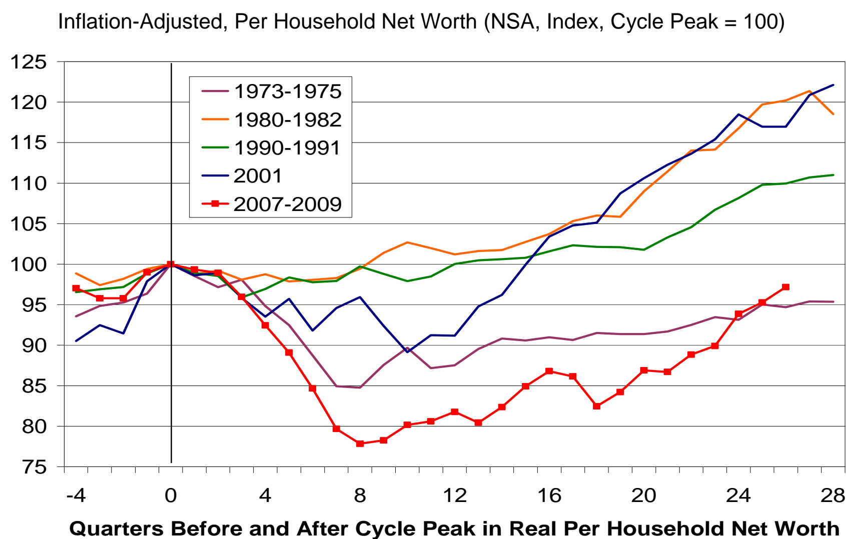
Exhibit 2. Real Wealth Per Household Remains Below 2007 Peak…



Source: Federal Reserve Board, Bureau of Economic Analysis, Census Bureau

This trend compares unfavorably to previous cycles in inflation-adjusted net worth per household since the 1970s. A full 26 quarters from the cycle peak, only the 1973-75 and the current cycle (which peaked in the first quarter of 2007) failed to recover the loss in real net worth per household. At the same point of the 1980-82, 1990-91, and 2001 cycles, net worth per household sat 20 percent, 10 percent, and 17 percent, respectively, above its cycle high. Furthermore, net household formations decelerated sharply during the "Great Recession" due in part to the depressed economy. Had net household formations continued at their pre-recession pace, the recovery in real wealth per household would be even weaker.

Exhibit 3. …And Its Recovery Lags Previous Net Worth Cycles



Source: Federal Reserve Board, Bureau of Economic Analysis, Census Bureau

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[3] We use the Bureau of Economic Analysis personal consumption expenditures chain price index to convert the nominal value of wealth to an inflation-adjusted value. To derive wealth per household, we use household counts from the Bureau of the Census Housing Vacancy Survey.

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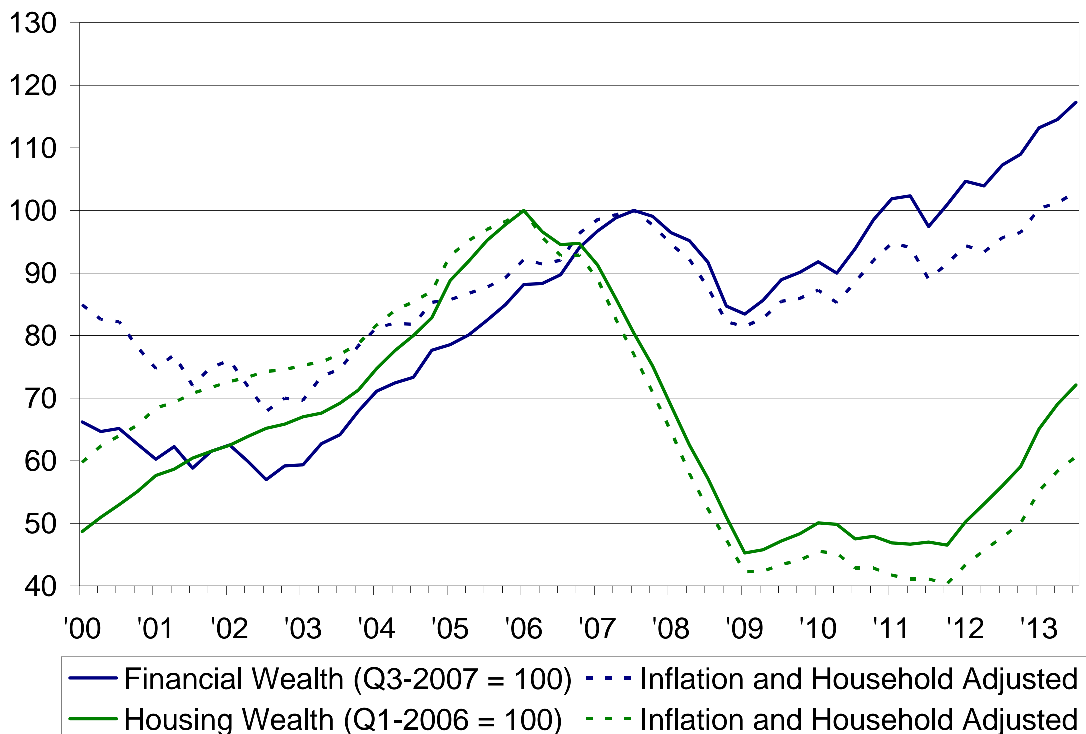
Recovery in Housing Wealth Lags Financial Wealth

The ongoing improvement in aggregate net worth masks uneven performance among asset classes. As it might be expected due to the severe housing downturn during the 2007-09 recession, households' housing wealth – defined as the total value of household residential real estate assets minus home mortgage debt outstanding – fell at a faster rate than total net worth. This contrasts with a relatively more modest decline and more rapid rebound in financial wealth, defined as the total value of household financial assets minus non-mortgage liabilities.[4] Housing wealth peaked in the first quarter of 2006 and fell a cumulative 55 percent over three years before reaching bottom.[5] Despite robust home price gains during the past year, housing wealth remains 28 percent below its prior peak. By contrast, financial wealth peaked later – in the third quarter of 2007 – and posted a 17 percent drop over a period of a year and a half before trending up and reaching an all-time high. However, as is the case with aggregate household wealth, when adjusting for inflation and the number of households, the recovery in housing wealth is even less inspiring. Real financial wealth per household surpassed its pre-recession peak in the second quarter of this year, while real housing wealth per household remained a stunning 39 percent below the cycle high. This is by far the worst performing recovery in inflation and household adjusted housing wealth since record keeping began in 1952.

Exhibit 4. Recovery in Housing Wealth Lags Financial Wealth



Source: Federal Reserve Board, Bureau of Economic Analysis, Census Bureau

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[4] Financial assets of the household and nonprofit sector include deposits (checkable, currency, savings, money market, etc.), equities, bonds, mutual funds, etc.

[5] This is in contrast to the CoreLogic national home price index (used for the calculation of the Federal Reserve's measure of household residential real estate assets), which did not fully trough until the first quarter of 2012. Household real estate *wealth* reached a cyclical bottom much earlier, in the first quarter of 2009, as a result of a persistent downward trend in home mortgage debt outstanding resulting from both mortgage pay-downs and write-offs.

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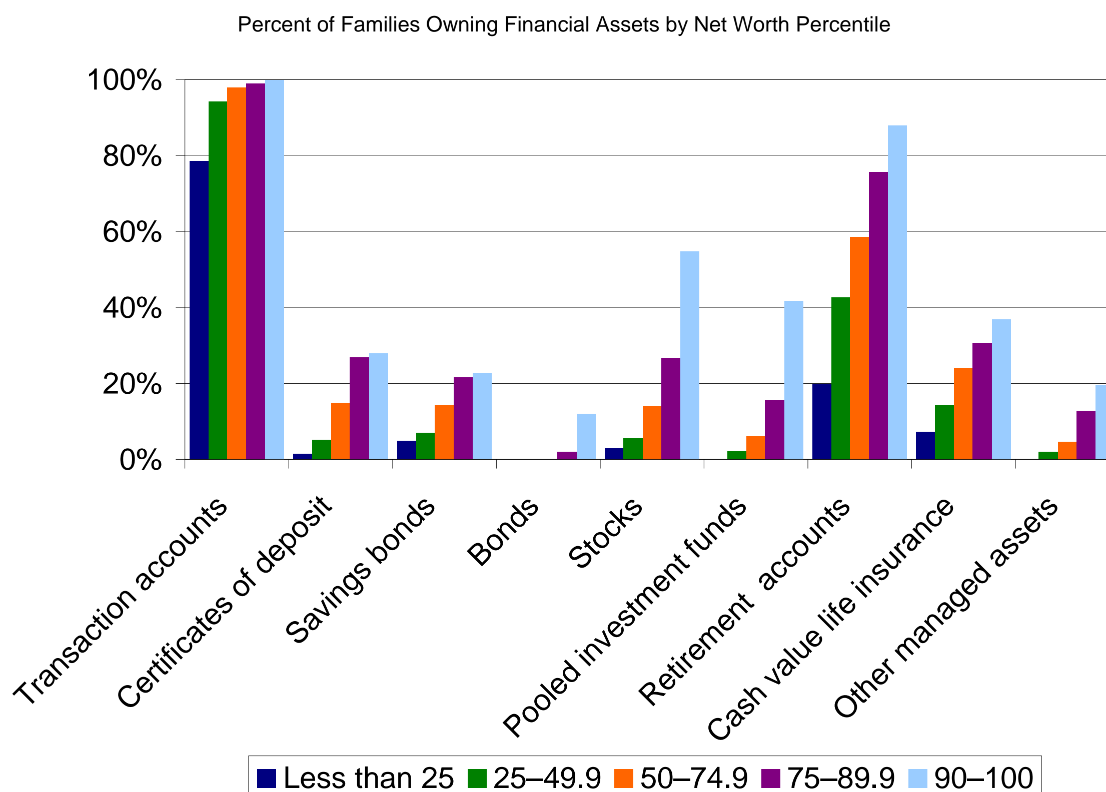
Sluggish Housing Rebound Limits the Broader Economic Impact of Recent Wealth Gains

The uneven recovery between housing and financial wealth has important implications for the distribution of wealth. Wealth is highly concentrated among the wealthiest households, and the composition of wealth varies significantly among households. Data from the 2010 Federal Reserve Survey of Consumer Finances (the most recent available) show that financial assets outside of traditional transaction accounts are not broadly held among households with below-median net worth.

Exhibit 5. Less Wealthy Households Unlikely to Own Financial Assets Outside of Traditional Transaction Accounts



Source: Federal Reserve Board Survey of Consumer Finances, 2010

The very low share of below-median net worth households directly holding stocks or pooled investment funds suggests that the majority of households have not participated in the stock bull market that began in 2009 to the same degree as higher wealth households. Of all the households that held financial assets, the median value of the financial assets in 2010 held by those in the lowest 25th percentile and the 25th to 49.9th percentile in net worth was just $1,100 and $7,800, respectively. By contrast, the median value for the top 10 percentile was nearly $900,000. The gap has likely widened substantially since then as the bull market has extended through this year.

While financial wealth, which has recovered relatively rapidly during the current cycle, is highly concentrated among wealthy households, housing wealth, which has lagged significantly in the current recovery, is much more broadly held among less wealthy households. Less than 3 percent of the lowest 25th percentile in net worth directly held stocks, but more than 20 percent of them owned a home. This suggests that less wealthy households, who have received little benefit from the rising stock market, have been disproportionately harmed by the sharp and prolonged downturn in the housing market and subsequent modest recovery.

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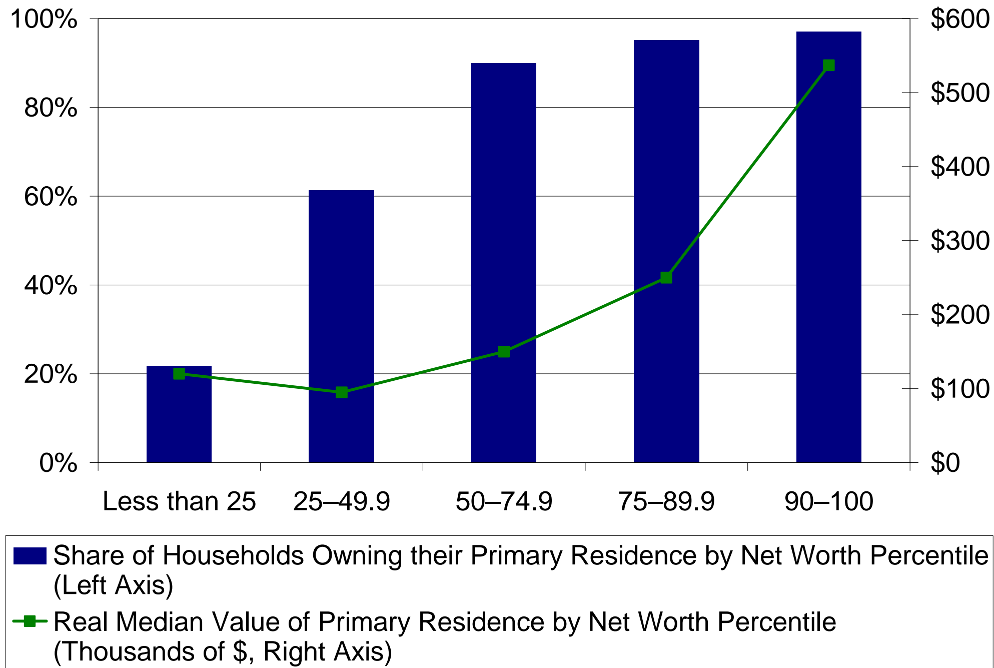
Exhibit 6. Ownership and Home Value Less Skewed by Net Worth than Financial Assets



Source: Federal Reserve Board Survey of Consumer Finances, 2010

Conclusion

This edition of *Housing Insights* demonstrates that household balance sheets still have not recovered fully from the "Great Recession" when adjusting for inflation and the number of households. Housing wealth declined more steeply and has recovered much more gradually than financial wealth. Financial assets are highly concentrated among very wealthy households, while housing is more broadly held among low- and moderate-wealth households. The vast difference in the pace of the recovery in financial and housing wealth is likely to have broad implications for the ongoing economic recovery. Traditional macroeconomic theory suggests that rising household net worth should help boost consumer spending growth, strengthening the economic expansion. However, the gradual recovery in housing wealth helps to explain the restrained pace of consumer spending in the current economic expansion, and will be crucial to the consumer outlook going forward.

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