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Is Housing Wealth an “ATM”? The Relationship Between Household Wealth, Home Equity Withdrawal, and Saving Rates

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Abstract

This paper examines the roles that increasing personal wealth and home equity withdrawal (HEW) have had in the decline in the personal saving rate in the United States. It does so by comparing the U.S. experience with that of Australia, Canada, and the United Kingdom. Mortgage market liberalization and innovation reduce household cash-flow and collateral constraints while making housing wealth more liquid as HEW becomes easier over time. Regression analysis indicates the expected negative relationship between U.S. saving and net worth, with a somewhat smaller coefficient than in previous empirical studies. Changes in HEW are found not to have a significant impact on U.S. saving in the short or long run. In that sense, housing wealth is not an “ATM.”

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Notes

1. Goldman Sachs (2006) is a typical example of analysis that posited a strong

link between HEW and U.S. consumption. Duca (2006) argued that the increasing reliance of U.S. households on HEW in the first part of the decade explains why the saving rate has fallen so far.

2. In an earlier version of this paper, we discussed whether the observed declines in saving rates in the four countries under consideration were mere statistical artifacts or real phenomena after adjusting for the effects of inflation, capital gains taxes, and imputed rents (Klyuev and Mills, 2006). Although we found that these adjustments had a significant impact on the level of the saving rate, they did not reverse the declining trend.

3. A possible adverse effect of securitization is to increase credit rationing for those borrowers whose characteristics do not meet the standardized criteria needed for eligibility into the pools of mortgages to be securitized.

4. See Frankel (2006) for a discussion of how the credit scores of mortgages backing nonagency MBS have declined markedly between 2000 and 2005.

5. Frankel (2006) shows how the share of prime mortgages backing U.S. nonagency MBS issuance fell from around 50 to 25 percent since 1995 as Alt-A (near-prime) and subprime lending grew. Subprime loans constituted 9 percent of U.S. securitized mortgage debt and financed 15 percent of home sales in 2005 (JPMorgan, 2006, p. 29).

6. Boone, Girouard, and Wanner (2001) find that financial deregulation and innovation raised the marginal propensity to consume in Canada, the United Kingdom, and the United States (Australia was not included in the sample). Borrowers may also seek to reduce interest costs by refinancing unsecured consumer credit through cheaper secured debt, especially if interest on mortgage debt is tax-advantaged relative to unsecured debt (as it has been in the United States since the Tax Reform Act of 1986).

7. This study examined the degree to which HEW as a proportion of disposable income was related to a constructed indicator of mortgage market completeness in eight European Union countries from 1990 to 2002.

8. In the United States, according to Freddie Mac data, as a proportion of the loan, average fees and points charged on a 30-year fixed rate mortgage fell from 2.5 percent in 1984 to 0.6 percent in 2005. Although the inclusion of zero-point loans in the sample in 1998 resulted in a fall in this data series of about 0.3–0.5 percent, there has nevertheless been a trend decline in this measure of mortgage transaction costs. Consequently, long-term interest rates need to fall significantly less than they did previously to make it worthwhile for the borrower to refinance in net present value terms (Bennett, Peach, and Peristiani, 2001).

9. Issuance of U.S. HEL and HELOC asset-backed securities rose from $61 billion in 1999 to $515 billion in 2005 (JPMorgan, 2006).

10. Such schemes generally take one of two forms. A home reversion plan entails a home owner selling all or part of his or her home for a lump sum with the right to remain in occupation. On sale, lenders receive their equity share of the proceeds. A lifetime mortgage involves the borrower remortgaging his or her house to take a cash lump sum or annuitized income stream. Interest accumulates and is settled on the sale of the property. In the United Kingdom, roughly £1¼ billion of home reversion mortgages and home income plans were sold each year during 2003–05 (United Kingdom Financial Services Authority, 2006).

11. This analysis uses comparable definitions across countries; hence it does not necessarily reproduce national accounts definitions.

12. In addition, the Dutch National Bank surveys households in the Netherlands annually to assess their use of HEW (van Els, van den End, and van Rooij,

2005). In 2003, respondents said that increases in secured debt were used predominantly for home improvement (70 percent), followed by saving and investment (10 percent), consumption (8 percent), and repayment of other debt (6 percent).

13. Stock variables are entered as averages of end-of-period and beginning-of-period values.

14. This coefficient is somewhat smaller than values reported in other studies (for example, Maki and Palumbo, 2001).

15. White's robust standard errors are employed to assess significance levels. Use of Newey-West or unadjusted standard errors does not alter the findings.

16. Some of the drop may reflect the effect of Hurricanes Katrina and Rita.

17. Because the saving rate is calculated for the personal sector, our main measure of HEW also covers that sector, which includes not only households (and nonprofit organizations) but also unincorporated businesses. Our alternative measure excludes the latter. Both measures are derived using the Federal Reserve's Flow of Funds Table 10: *Derivation of Measures of Personal Saving*. A different measure can be derived from Table 100: *Households and Nonprofit Organizations*, but it tracks the first very closely and yields identical regression results.

18. Housing net worth is the difference between the value of residential assets and loans secured by housing. Financial net worth is the difference between financial assets and unsecured debt.

19. The regression on quarterly data included a lagged dependent variable, because otherwise residuals exhibited mild autocorrelation. Coefficients on

HEW were not significant in a quarterly regression that omitted the lagged dependent variable.

20. One reason for that result is the high correlation between net housing wealth and HEW. Indeed, when the latter is excluded from the equation, the coefficient on the former becomes –0.016, but still remains insignificant. HEW remains insignificant in regressions in which net housing wealth is excluded and net financial wealth is used in place of net worth.

21. The coefficient for household net worth was not statistically significant in the U.K. regressions.

22. The HEW series illustrated here are gross rather than net.

23. The three measures of HEW shown in Figure 7 are our main measure, the alternative measure described in note 17, and that used in Greenspan and Kennedy (2005).

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Additional information

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Appendix

Financial Liberalization and Mortgage Product Innovation

Selected Measures of Financial Liberalization

Table A1

Table 3 Table a1

Recent Mortgage Product Innovations

Table B1

Table 4 Table a2

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