Rising Stocks, Home Values Are Restoring Wealth

U.S. Households Are Aided By Recovery, but Could Fall Victim to Sudden Declines

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WASHINGTON -- Recovering stock prices and steadily rising home values have almost restored the wealth of American families to levels last seen when the stock market peaked in 2000, new Federal Reserve data show.

The remarkable turnaround underscores a little-noticed factor in the economy's recovery, as well as a risk to it. The rebound in stocks that began last March plus continued gains in real estate have reversed the damage done to household wealth and spending when the stock-market bubble burst. That has helped fuel consumer spending despite anemic job growth in the past year. But by most measures, stocks and houses are richly valued today; a sharp drop in either could set back the economy.

The turnaround in the stock market has helped the recovery "big time," said Chris Varvares, president of Macroeconomic Advisers LLC, a St. Louis, Mo., forecasting firm. Indeed, he said it has probably contributed more to the recovery in the past year than the summertime tax cut.

Total household net worth rose to $42.1 trillion at the end of the third quarter from $41.5 trillion at the end of the second, the Federal Reserve reported Thursday. With stock prices up 12% in the fourth quarter and homes continuing to rise in value, albeit at a slowing rate, the total probably approached $43 trillion by the end of 2003. That isn't far from the record high of $43.6 trillion reached at the end of the first quarter of 2000. The figures aren't adjusted for inflation, and they include the holdings of nonprofit organizations.

From the cyclical low in September 2002, net worth has jumped $3.5 trillion, or 9%. Of that, 43% has come from the value of increased stock and mutual-fund holdings and 8% has come from increased home equity. The balance consists of bank deposits, pensions, insurance and other assets.

ON THE HOUSE

The value of households' real estate has risen steadily as stock portfolios fluctuate

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<th>$20 trillion</th>
<th>Real estate</th>
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<td>15</td>
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DOW JONES REPRINTS
In the third quarter, total wealth averaged $385,000 per U.S. family, but that significantly overstates the typical family's net worth. Wealth is heavily concentrated among the richest households. The new Fed data don't include any information on the distribution of wealth, although real-estate wealth is more evenly distributed than stock-market wealth.

Net worth consists of all household assets, such as stocks, mutual funds, pension savings, ownership of small businesses, minus liabilities such as mortgage and credit-card debt. The recession and weak recovery of 2001-2003 were due in part to households reeling in their spending in response to lost stock wealth. Mr. Varvares said the bear market in stocks probably cut household spending growth in half in 2002, to 2.7%.

Had the stock market stayed at its levels of last March, instead of rallying 47% from pre-Iraq War lows, consumer spending would have grown just 2.8% last year, he figures; instead, it was up an estimated 3.7%. The boost will continue this year, Mr. Varvares predicted: "The momentum in consumption from gains in the stock market to date is still significant."

Its recent gains have again put the stock market in richly valued territory by historical measures. And there are signs of frothiness, such as big gains in more speculative stocks, and low yields on risky bonds compared with safe Treasurys. That raises the risk that an unexpected shock such as another terrorist attack or a jump in long-term interest rates due to a plunging dollar could again send stocks reeling, hurting the economy.

Mr. Varvares estimated that if the stock market fell 20% this year, it would pull overall economic growth down to an inflation-adjusted 3.2% from his currently projected 4.5%.

In such a situation, the Federal Reserve would have less scope to cut its short-term interest-rate target, already at a 45-year low of 1%, than it did in 2000 when it was 6.5%. President Bush and Congress would also have less scope to stimulate the economy through spending increases or tax cuts because of the size of the budget deficit.

A potentially bigger problem would be a sharp fall in home prices. About 68% of U.S. families owned their home in 2001, the latest year for which Fed data are available. Just 52% own stocks, although that's up from 37% in 1992. In 2001, the typical family's home was valued at $122,000, the Fed said, four times the typical family's stock-market wealth of $34,000.

Low mortgage rates and a growing population have kept housing prices rising in the past few years, and that helped cushion consumer spending from the 46% loss of U.S. stock capitalization - - about $9 trillion, according to Fed data -- from March 2000 to September 2002. In recent years, many families have borrowed against their homes' increased value by taking out bigger mortgages or home-equity loans.

Indeed, total household debt grew at a 10.1% annual rate in the third quarter, the Fed said, down slightly from the 11.9% growth in the second quarter. With mortgage debt growing faster than home values, owners' equity dropped to 54.3% of home values in the third quarter, a new low, from 54.8%.
Ed Leamer, an economist at the University of California at Los Angeles, said home prices have risen far faster than rents, indicating that home prices are overvalued. "At some time, we have to correct the unreasonable valuations of the country's real-estate stock," Mr. Leamer said. That could hurt far more than correcting the stock-market bubble, he warned.

But Fed Chairman Alan Greenspan has said there is no housing bubble. And stock strategists are also generally sanguine on the market's outlook. Furthermore, the Fed has made it clear it will keep interest rates low until the economy is growing briskly and the risk of deflation has been banished. Low rates should continue to support housing and stock prices.

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