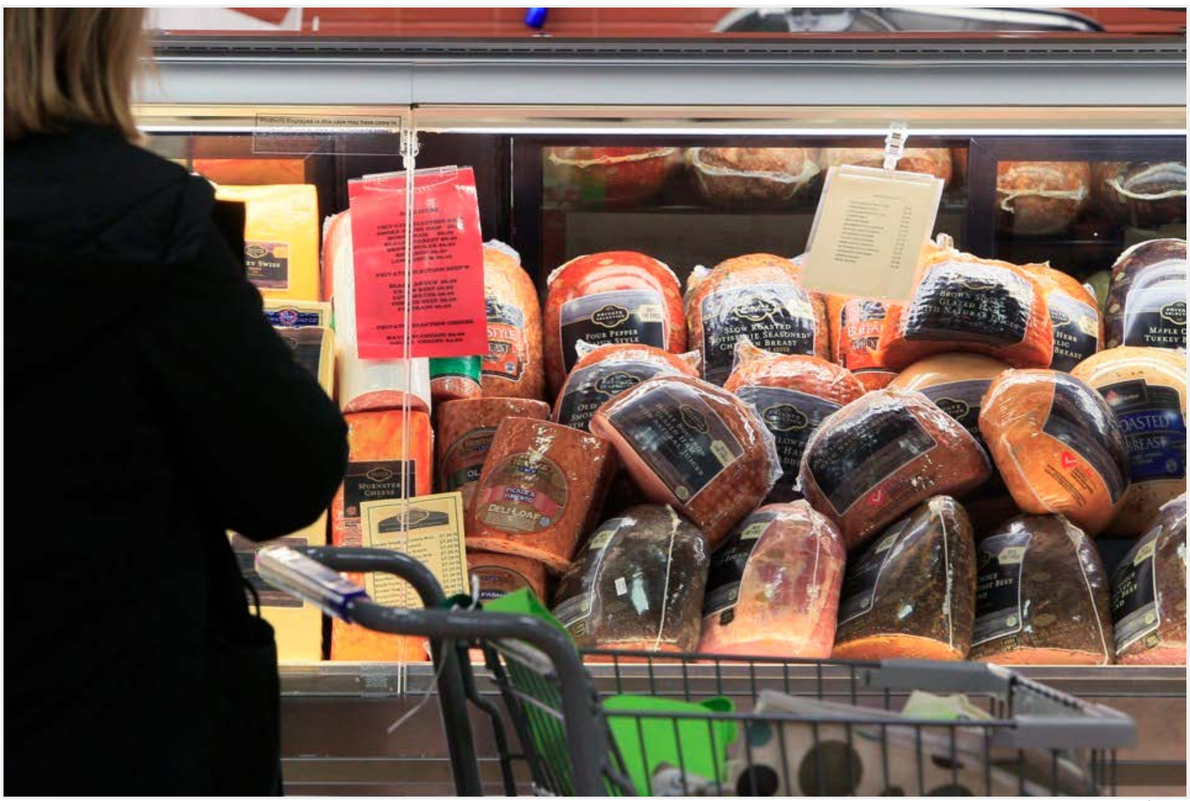
The Atlantic

When Home Values Suffer, Household Spending Does Too

In a nation where consumption makes up a significant share of the GDP, that's not good for the economy.



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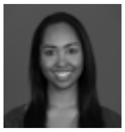
Perhaps unsurprisingly, there are correlations between how much Americans' homes are worth, their overall wealth, and how they spend their money, and these links go a long way in explaining why a crisis in the housing market can so quickly spiral out of control. A sudden dip in home values can leave homeowners feeling poorer and more economically fragile, causing them to reduce their spending in many different ways. When that happens en masse in a country where consumer spending represents nearly 70 percent of GDP, it can be catastrophic for the national economy.

But as straightforward as this dynamic may sound, economists have yet to fully nail down how exactly a fall in home values affects household spending. In order to explore that, the economists Greg Kaplan, Kurt Mitman, and Giovanni L. Violante looked closely at spending on nondurable goods—things that are consumed immediately or within three years or less, such as food and clothing—during and after the housing-market collapse. In a recent paper, they say that they found that the 30 percent decline in housing values that occurred during the Great Recession can be associated with a 6.1 percent decline in spending and a 3.1 percent decline in consumption during the 2007 to 2011 period. They also find that the decline in overall expenditures is partially the result of the fact that some stores reduced their prices in response to decreased demand during that time.

Kaplan, Mitman, and Violante aren't the first to put numbers on this, but their research is an expansion on and a confirmation of previous work, such as a 2013 paper that found that geographic areas that were hit the hardest by the crisis saw the largest fluctuations in spending. More than that, households that had low incomes or were deeply in debt were likely to cut their spending more severely than others as housing prices declined.

Perhaps the fact that Americans are shunning homeownership at an increasing rate, then will make for a more stable economy? Not quite. As rental prices continue to rise around the country, more people are stuck spending a significant share of their income on housing. That too squeezes spending—including on essentials like food and clothing—especially for low-income households.

ABOUT THE AUTHOR



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