# The Determinants of Propensity to Consume out of Wealth: Who Will Spend More when Wealth Increases?

As a result of a rise in the value of one's home or stock portfolio a person might feel richer and thus increase his spending. For decades research efforts have been focused on empirically measuring the effect of wealth on consumption, yet little, if any, research has been devoted to the factors that affect households' decisions to spend more as the things they own increase in value. More specifically, it is of interest to determine which households are more likely to increase their spending in times of a wealth shock.

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The estimates of by how much an increase in wealth would affect consumption, namely propensity to consume out of wealth, vary across models. For example, Laurence Meyer and Associates (1994) estimated that the long-run impact of $1 increase in equity values increases consumption by 2 cents, while the same increase in non-stock market wealth raises consumption by 1.4 cents. Yet it is of interest for policy makers to be able to incorporate in economic analysis not only the magnitude of such wealth effect, but also to factor which households are more likely to increase their consumption as a result of increase in wealth. Starr-McCluer (2002) divided stockholders on the basis of self-reported increase in consumption as a result of the stock market increase in the 1990's and compared the two groups in terms of socio-demographic characteristics and expectations about job stability and the stock market. The current paper investigates households' demographic characteristics, financial situation, attitudes, and expectation about the future as predictors of propensity to consume out of wealth.

## Data and Findings

Data from the 2001 Survey of Consumer Finance were used to conduct the analysis. We used logistic regression to examine demographic and financial characteristics, attitudes, and expectations as predictors of self-reported increase in consumption out of an increase in wealth. The sample consisted of all 4,442 observations included in the CFS 2001 dataset. A weight variable was applied to the sample to compute the descriptive statistics so that the estimates are representative of the U.S. population.

Most of the demographic characteristics: age, household size and race were significant with p-values of less than 0.01. The results indicated that younger, non-white households with more family members are more likely to increase their spending as the things they own appreciate in value. Among the financial characteristics, income, stock holding of more than $100,000, and business ownership were statistically significant. Business owners and households with stock holdings of above $100,000 are more likely to increase consumption. Attitudes towards risk and credit, short-term spending horizon and optimism about the U.S. economy were also positively related to spending out of wealth.

## Discussion and Implications

The study identified demographic and psychographic characteristics as a potential segmentation tool in predicting which households are more likely to increase consumption out of an increase in wealth. The results indicate that age, household size, race, income, stock ownership and business ownership affect the probability that a household will increase spending out of increase in wealth. Such findings highlight the importance of taking in consideration how different households react to asset fluctuations as an important part in macroeconomic analysis.

We also found that minority households with positive attitude towards credit and short-term time orientation are likely to spend more in times of a wealth shock. Financial counselors and planners need to raise awareness about the benefits of financial discipline and regular savings among these consumers.

Finally, further research is needed to specifically investigate how wealthy households with income above $100,000, stock owners and business owners are likely to respond to an increase in the value of their assets. Our results are in line with the findings of other recent studies that indicate that the spending behavior of wealthy households might not be very well described by the standard version of the life-cycle hypothesis (Dynan, Skinner, and Zeldes, 1997).

## References

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