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Household wealth in the euro area: The importance of intergenerational transfers, homeownership and house price dynamics

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ABSTRACT

Results from the Eurosystem Household Finance and Consumption Survey reveal substantial variation in household net wealth across euro area countries that await explanation. This paper focuses on three main factors: (i) homeownership, (ii) housing value appreciation and (iii) intergenerational transfers. We show that these three factors, in addition to the common household and demographic factors, are relevant for the net wealth accumulation process in all euro area countries, and that, using various decomposition techniques, differences in homeownership rates and house price dynamics are important for explaining wealth differences across euro area countries.

1. Introduction

Recent empirical evidence shows that household wealth varies substantially across developed countries (e.g. Davies et al., 2011; Christelis et al., 2013). Results from the Eurosystem Household Finance and Consumption Survey (HFCS) show for the first time that this holds true for the euro area (HFCN, 2013a). This dataset provides high quality household wealth micro data enabling consistent cross-country comparisons based on ex-ante harmonised household surveys for the euro area. For several smaller euro area countries, it is the first time that high quality household wealth micro data has become available. In the euro area,[1] median household net wealth ranges from €51,400 in Germany to €397,800 in Luxembourg (Fig. 1). The corresponding mean value for the euro area is €230,800, ranging from €79,700 (Slovakia) to €670,900 (Cyprus) and €710,100 (Luxembourg). Thus, the natural question to ask is: why are the observed net wealth differences between euro area countries so large and what are the factors driving these differences?

This paper provides an in-depth analysis of factors contributing to household wealth (differences) across euro area countries. Differences in household characteristics aside, it focuses on three major factors for the wealth accumulation process. First, this paper analyses the effects of differences in homeownership rates, which vary substantially between euro area countries (Slovakia: 90% and Germany: 44%). For most homeowners, the value of the household main residence (HMR), which results from initial price, accrued capital gains from increased property prices and depreciation or reinvestments, is regarded as the most valuable asset in the household wealth portfolio. The mean contribution of the HMR to total net wealth is almost 50% in the euro area. Importantly, homeowners are wealthier than their non-home owning counterparts.

Thus, household net wealth must somehow be linked to homeownership. In theory, this does not need to be. Let us assume that we have two identical countries with perfect markets, in which income streams of households are the same and certain. Households have the same preferences and want to smooth consumption over their life-cycle. The only difference is that by assumption in one country every household rents their HMR and in the other country every household owns their HMR. Let us further assume that returns are the same over all investment categories and the same as interest rates for paying off debt. The need to smooth

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[1] In the text, the term euro area refers to the 15 euro area countries included in the first wave of the HFCS and excludes Estonia, Ireland and other countries which joined at later stages.

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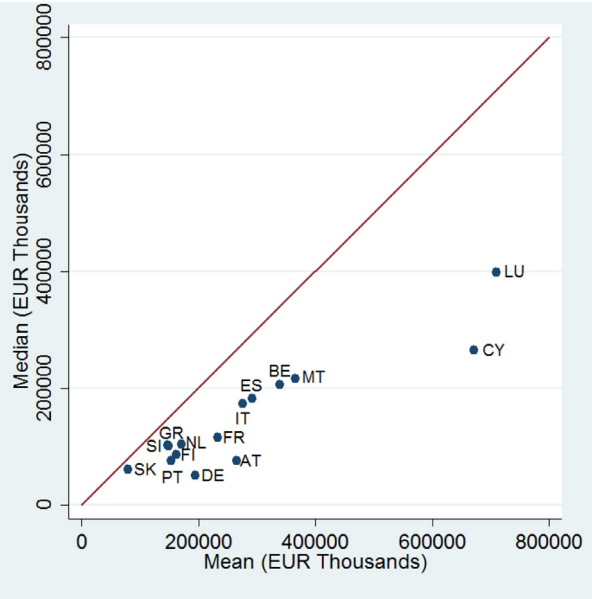

Fig. 1. Mean and median net wealth in the euro area by country. *Source:* own calculations based on the HFCS UDB (User Database) 1.0; data are multiply imputed and weighted.

consumption over the working and retirement phase and to save for leaving bequests determines net wealth for each household at any age. For each age cohort, this net wealth level is completely unaffected by whether or not the households owns or rents. Only the composition of net wealth differs. The amount invested in the HMR net of mortgages for owners is exactly offset by higher financial assets of tenants. In addition, at the time of HMR acquisition, households simply exchange financial assets for real assets (plus an eventual mortgage) whereas by construction total net wealth stays unaffected. It follows that the in reality observed higher net wealth of homeowners must be linked to behavioural or institutional factors or a combination of both. A higher share of homeowners does not per se imply higher net wealth. Institutional differences may affect the a priori irrelevance of owning / not owning in the above example, as they induce behavioural changes. For example, countries often promote homeownership with subsidies and tax deductible interest rate payments for mortgages etc..., which make homeownership a very attractive long-term investment relative to other financial investments, because it promises long-term capital gains (not least as land prices usually do not get cheaper). In some countries, homeownership is also commonly regarded as a means for old-age provision, in particular if public pension rights are on the low and/or uncertain side. In addition, households are likely to change their saving and consumption behaviour prior, during and after the HMR acquisition. They have every incentive to save regularly and larger amounts of their net disposable income, as the HMR acquisition acts as a long-term commitment device. Thus, it is important to analyse how homeownership contributes to the wealth accumulation process and how differences therein can explain the household wealth differences across countries.

Second, if homeownership matters, then the dynamics of house price developments over time matter for how wealthy households are and differences therein must contribute to explaining wealth differences across countries. This is because increased house prices represent an increase in equity in the HMR and thus a one-to-one increase in net household wealth. This holds true even if these capital gains are perfectly anticipated and as long as households do not consume the accrued capital gains immediately (which is contrary to the usual models of consumption smoothing). As we will show, the residential property price dynamics varied substantially over time and across euro area countries, and this largely explains the observed wealth differences across countries. For this purpose, we construct our own housing value appreciation (HVA) index using HFCS data, which is available for the same period and comparable across countries. The results are robust to varying ways of constructing the HVA index and to using indices based on publicly available macroeconomic time series.

For most households becoming a homeowner is related to incurring mortgage debt to pay off. In many countries, obtaining a mortgage is a major hurdle, since maximum loan-to-value ratios effectively limit mortgage accessibility for households in general and young households in particular; the latter have less time to save for necessary down-payments (e.g. Chiuri and Jappelli, 2003). This is where intergenerational transfers come in, the third focus of this paper. Intergenerational transfers represent an injection of resources increasing household wealth if not consumed immediately and are both important for the wealth accumulation process and national income (e.g. Wolff and Gittleman, 2011 for the U.S. and Piketty, 2011 for France). Our results show that intergenerational transfers (excluding inherited/gifted HMRs) contribute on average 11 percentage points to mean total net wealth. Combined with the HMR contribution of 49%, these two factors contribute 60% to mean total net wealth of households.

We proceed as follows: first, we explain the median level of total net wealth and show that intergenerational transfers, homeownership and house price dynamics are important factors for the wealth accumulation process. Second, we analyse how differences in these factors contribute to explaining existing net wealth differences across countries. For this purpose we make use of state of the art decomposition techniques. We show that net wealth differences in the euro area are to a large extent driven by cross-country differences in homeownership rates, house price dynamics and to a minor extent received intergenerational transfers. Across euro area countries, these factors explain on average 56% of the difference in total net household wealth at their respective median level relative to Germany. Similar results are found along the whole household net wealth distribution, although the relevance of the analysed factors in explaining household net wealth differences tend to be lower for the wealthier percentiles of the population.

We acknowledge that the paper is mainly descriptive and provides results from an accounting point of view. The issue of causality is not addressed. However, the presented results indicate that household behaviour plays an important role and suggest certain causal relationships to explain wealth levels and wealth difference between countries. Section 2 presents the database and introduces descriptive statistics. Section 3 presents the construction of HFCS based property price indices. Section 4 presents the estimation strategy, reports the results and summarises some additional robustness tests. Section 5 concludes.

2. Data, descriptive statistics and methodological issues

We use data from the Eurosystem HFCS. The dataset includes over 62,000 observations, which represent almost 140 million private households resident in the euro area (excluding Ireland and Estonia). For a brief summary of the most pertinent facts concerning the dataset see the Online Appendix A. For very detailed descriptive results and methodological details, see HFCN (2013a,b). Definitions of explanatory variables and detailed summary statistics are provided in the Online Appendix B.

Coefficients and standard errors presented in this paper are adjusted to account for the multiply imputed nature of the database following Rubin's (1987) rules. All results are weighted to take into