According to many observers in the business press, the recent surge in home equity withdrawal has fueled a substantial increase in consumer spending and left household balance sheets in a much-weakened state. In this view, the return of interest rates to higher levels and the consequent end of the refinancing boom will compel consumers to cut back their spending sharply.

A new article in *Current Issues in Economics and Finance* (vol. 9, no. 12, “After the Refinancing Boom: Will Consumers Scale Back Their Spending?”) presents a markedly different view. Contending that consumers have used the equity withdrawn from their homes to restructure their balance sheets and reduce debt service burdens, authors Margaret McConnell, Richard Peach, and Alex Al-Haschimi suggest that households will in fact be in a better position to spend going forward.

The authors base their conclusion on an analysis of household assets and liabilities from the late 1990s through mid-2003, the period when equity withdrawal was rising rapidly. The data indicate that during these years, households increased their acquisition of financial assets and reduced their reliance on nonmortgage liabilities—credit card debt and other forms of consumer credit. Households continued to purchase consumer goods, but they did so at about the same rate as in the past.

The authors infer from the data that households have not been using the withdrawn equity to step up their spending irresponsibly. Rather, households appear to be using low-cost, tax-advantaged mortgage debt to make many of the same purchases that they would otherwise have financed by drawing down their financial...
Publications and Papers

The Research and Market Analysis Group produces a wide range of publications:

- **EPR Executive Summaries** — online versions of selected *Economic Policy Review* articles, in abridged form.
- **Current Issues in Economics and Finance** — concise studies of topical economic and financial issues.
- **Second District Highlights** — a regional supplement to *Current Issues*.
- **Staff Reports** — technical papers intended for publication in leading economic and finance journals, available only online.
- **Publications and Other Research** — an annual catalogue of the Group’s research output.

Call for Papers on Corporate Governance

On September 30 and October 1, 2004, the Federal Reserve Bank of New York will host the conference Governance of Not-for-Profit Organizations. The conference is being cosponsored with Princeton University’s Bendheim Center for Finance and the *Journal of Accounting and Economics*.

Interested authors can submit papers relating to all aspects of the governance of not-for-profit firms by July 15, 2004, to hamid.mehran@ny.frb.org.

Detailed information can be found at www.newyorkfed.org/research/conference/2004/governance_call_papers.html.

assets or increasing their credit card debt. “The picture that emerges,” the authors note, “is one of financial prudence rather than profligacy.”

Additional support for this position, the authors contend, comes from tracking a comprehensive measure of the household debt service burden. Despite the rapid increase in mortgage debt in recent years, debt service payments are claiming a smaller share of household after-tax income.

The authors conclude that, with debt service falling and household net worth rising at about the same rate as before the surge in home equity withdrawal, there is little reason to expect a slowdown in consumer spending. In fact, consumers may now be better able to spend than in the past.
New Titles in the Staff Reports Series

The following new Staff Reports are available at www.newyorkfed.org/research/staff_reports.

Macroeconomics and Growth

No. 174, October 2003
What Explains the Stock Market’s Reaction to Federal Reserve Policy?
Ben S. Bernanke and Kenneth N. Kuttner
This paper analyzes the impact of changes in the federal funds rate target on equity prices, with the aim of both estimating the size of the typical reaction and understanding the reasons for the reaction. On average, a typical unanticipated 25-basis-point rate cut is associated with a roughly 1 percent increase in broad stock market indexes. The response varies across industries in a pattern consistent with the capital asset pricing model. Policy’s impact on expected future stock returns accounts for the largest share of the stock price response, while the direct effect of the real risk-free interest rate is small.

Microeconomics

No. 173, October 2003
Inflation Inequality in the United States
Bart Hobijn and David Lagakos
Inflation is often assumed to affect everyone the same way. However, differences in spending patterns across households and differences in price increases across goods and services lead to unequal levels of inflation. This paper measures the degree of inflation inequality across U.S. households from 1987 to 2001. Its results suggest that inflation experiences vary significantly, with most of the differences traceable to changes in the relative prices of education, health care, and gasoline. Cost-of-living increases are found to be generally higher for the elderly, largely because of their health care expenditures, and the cost of living for poor households is most sensitive to fluctuations in gasoline prices. The study also finds that households experiencing high inflation in one year do not generally do so in the next year.

Banking and Finance

No. 175, October 2003
Cross-Country Differences in Monetary Policy Execution and Money Market Rates’ Volatility
Leonardo Bartolini and Alessandro Prati
The volatility patterns of overnight interest rates differ across industrial countries in ways that existing models, designed to replicate the features of the U.S. federal funds market, cannot explain. The authors present an equilibrium model of the overnight interbank market that matches these different patterns by incorporating differences in policy execution by the world’s main central banks, including differences in central banks’ management of marginal lending and deposit facilities in response to shocks. Their model is consistent with central banks’ observed practice of rationing access to marginal facilities when the objective of stabilizing short-term interest rates conflicts with another high-frequency objective, such as targeting exchange rates.

No. 176, December 2003
Are Banks Really Special? New Evidence from the FDIC-Induced Failure of Healthy Banks
Adam B. Ashcraft
The Federal Deposit Insurance Corporation (FDIC) used cross-guarantees to close thirty-eight subsidiaries of First RepublicBank Corporation in 1988 and eighteen subsidiaries of First City Bancorporation in 1992 when lead banks from each of these Texas-based bank holding companies were declared insolvent. The author uses this exogenous failure of otherwise healthy subsidiary banks as a natural experiment for studying the impact of bank failure on local-area real economic activity. He finds that the closings of the subsidiaries were associated with a significant decline in bank lending that led to a permanent reduction in real county income of about 3 percent.
Recently Published


Other New Publications

- *An Introduction to Economic Research at the Federal Reserve Bank of New York*. This online guide, updated for 2003–2004, is designed to give economists interested in joining the Research and Market Analysis Group a fuller understanding of our activities.

  www.newyorkfed.org/research/intro/rmagtoc.html

- *The Research Group of the Federal Reserve Bank of New York*. This online guide, which complements *An Introduction to Economic Research*, offers economists an overview of our research and policy work and a description of our distinctive culture.

  www.newyorkfed.org/research/research_group/index.html
Presentations by Economists in the Research and Market Analysis Group


“Monetary Policy Coordination under Complete Markets,” Cédric Tille and Paolo Pesenti. Swiss National Bank, Zurich, Switzerland, November 27. Also presented at the University of Lausanne, Lausanne, Switzerland, December 4.

“Using Home Maintenance and Repairs to Smooth Variable Earnings,” Joseph Tracy. City University of New York Graduate Center, New York City, November 12.

Publications and Papers: October-December 2003

Publications are available at www.newyorkfed.org/research/publication_annuals/

Current Issues in Economics and Finance, Vol. 9

No. 10, October 2003
Taking the Pulse of the Tech Sector: A Coincident Index of High-Tech Activity
Bart Hobijn, Kevin J. Stiroh, and Alexis Antoniades

No. 11, November 2003
Coping with Terms-of-Trade Shocks in Developing Countries
Christian Broda and Cédric Tille

No. 12, December 2003
After the Refinancing Boom: Will Consumers Scale Back Their Spending?
Margaret M. McConnell, Richard W. Peach, and Alex Al-Haschimi

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The views expressed in the publications and papers summarized in Research Update are those of the authors and do not necessarily reflect the position of the Federal Reserve Bank of New York or the Federal Reserve System.