Impact of Great Recession lingers, researcher shows

By Editor Test *Mon, Apr 1, 2013*

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Median non-home wealth (total wealth minus home equity) in the U.S. declined by 27% from 2001 to 2004, according to “The Asset Price Meltdown and the Wealth of the Middle Class,” a new paper by Edward Wolff of New York University.

Then came the next boom-and-bust: From 2004 to 2007, median wealth grew by 20% and median non-home wealth by 18%, only to hit the Great Recession, when house prices fell by 24% in real terms, stock prices by 26%, and median wealth by 47%.
Wolff’s paper (NBER Working Paper No. 18559) shows how the debt of the middle class had already increased significantly over the previous two decades, and he investigates trends in wealth inequality from 2007 to 2010.

The top wealth (and income) groups saw the percentage increase in their net worth (and non-home wealth and income) rise rapidly from 1983 to 2010. The upper 20% of households saw the biggest gains in wealth and income. The top one percent received 38% of the total growth in net worth between 1983 and 2010.

The average wealth of the poorest 40% percent declined from $6,200 (in 2010 dollars) in 1983 to negative $10,600 in 2010. The share of households with zero or negative net worth rose to 22.5% from 18.6%, and the share with zero or negative non-home wealth rose from to 30.9% from 27.4%.

Middle class malaise
Among the middle class (the middle three wealth quintiles), the debt-to-income ratio rose to 157% from 100% between 2001 and 2007, while the debt-to-equity ratio rose to 61% from 32%.

From 2007 to 2010, however, while the debt-to-equity ratio continued to advance to 71.5%, the debt-to-income ratio fell to 135% because overall debt among the middle class fell by 25% in real terms. The continued rise in the debt-to-equity ratio over these years reflected the 47% drop in net worth.
Their high degree of leverage and the high concentration of assets in their home helps explain the damage done to middle class finances during the Great Recession, Wolff found.

The steep decline in median net worth between 2007 and 2010 was primarily due to the very high negative rate of return on net worth of the middle three wealth quintiles. This, in turn, was due to the big drop in home prices and the high degree of leverage of the middle wealth quintiles.

High leverage also helps to explain why median wealth fell more than house (and stock) prices over these years and declined much more than median household income.

African-American and Hispanic households suffered more than whites during the Great Recession, Wolfe found. Both groups had a higher share of homes in their portfolio than did whites and much higher leverage than whites.

The mean net worth of Hispanic households was cut in half, as was their mean non-home wealth. Hispanic home ownership rate fell by 1.9 percentage points, and their net home equity fell 48%. A high percentage of Hispanics evidently bought their homes close to the housing cycle peak.