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EUROPEAN HOUSEHOLD ACCOUNT: A TURBULENT STORY

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Once protected by the logic of "whatever the cost", household purchasing power in Europe is now threatened by inflation.

After the pandemic, public policies are being solicited once again to help reduce the loss of purchasing power, albeit without really succeeding. In 2022, the real disposable income of Eurozone households is expected to decline by about 2.5%.

Consumption is still rising, but only because the household savings rate is declining, a trend that masks extremely diverse situations.

HOUSEHOLD SAVINGS RATE IN THE EUROZONE

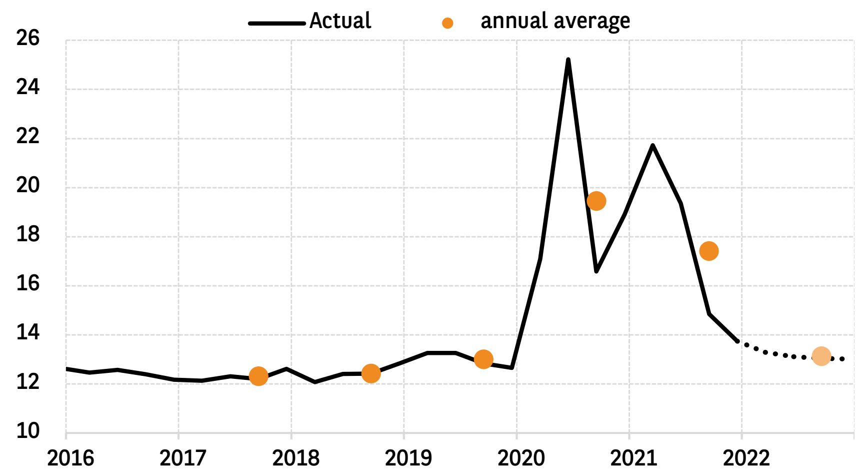

CHART 1 SOURCE : EUROSTAT / BNPPARIBAS FORECASTS

In 2020, household purchasing power (i.e. real disposable income) in the Eurozone was preserved, even though economic activity had collapsed, halted by the Covid-19 pandemic. Exempt from bankruptcies and unemployment, the worst recession to date (Eurozone average GDP declined 6.5% in volume) was also the most unusual one.

ACTIVITY PLUNGES IN 2020, BUT REVENUES HOLD UP

The household accounts published by the European Central Bank (ECB) reveal the manner in which "whatever the cost" helped absorb the shock. Foremost, governments sought to preserve employment and revenues by financing job retention schemes. In some countries, such as Germany and Spain, the loss of activity was offset by benefits paid directly to workers, the net amount of which nearly tripled at the Eurozone level in 2020. In other countries like France, Italy and the Netherlands, companies were given subsidies in order to maintain wages. Indirectly, state-backed loans played the same role. By receiving emergency funds or through the deferred payment of charges (fees, rent, etc.), self-employed workers were also able to limit their operating losses. In the end, after taking into account tax cuts, disposable household income was preserved in nominal terms, and only declined marginally in real terms (see Table 1).

In a space where social transfers account for a quarter of GDP, making automatic stabilisers very powerful, it is not all that exceptional that households should be buffered against the collapse of economic activity. During the Great Recession of 2009, household purchasing power did not decline much, notably because Germany was pioneering its effort to systematize the use of job retention schemes ("*Kurzarbeit*"). What was new this time was the unprecedented amount of public resources that were called into play. In the Eurozone, direct transfers to households and companies amounted to about EUR 1,400 billion, or 12 points of annual GDP, according to the International Monetary Fund (IMF)[1], which is more than the loss of production due to the Covid-19 pandemic. Supported by ECB asset purchases (EUR 1,850 billion devoted to the pandemic emergency purchase programme) public aid was deployed even as private spending was being hampered, which is illustrated in the agents account by the swelling of savings (up 50% for Eurozone households in 2020).

In 2021, the situation gradually returned to normal thanks to the easing of health restrictions. Consumption rebounded while savings rate contracted. Europe – and the United States even more – successfully managed to support demand, but at the price of a growing disequilibrium with supply, which at the global level, continued to be strapped by the Covid-19 pandemic. For roughly 150 million Eurozone households, the price tag for "whatever the cost" ended up taking the form of inflation, which was only exacerbated by the war in Ukraine. With the ECB forecasting average annual inflation of nearly 7% this year – the fastest price inflation in 40 years – it will be hard to avoid a net decline in household purchasing power in 2022, unlike in 2020.

PRICES SOAR IN 2022, ERODING HOUSEHOLD PURCHASING POWER

Although bolstered by minimum wage increases, which in some cases were very substantial[2], wages will decline in real terms in 2022. In the short term, wages have only partially adjusted to the inflationary shock (for skilled workers in France, the INSEE estimates wage elasticity at 0.45 over two quarters[3]), and the catching-up movement will take time. This inertia seems to have increased since the 2008 crisis, and is due above all to institutional factors. With a few exceptions, like in Belgium, automatic wage indexation systems have been eliminated in the Eurozone. The declining weight of unions and a series of flexibility laws have accompanied the decentralisation of wage negotiations, with companies playing an ever more important role. Wage increases are now based on agreements that cover longer periods of time and do not integrate instantaneous pricing trends but rather price expectations (Insee, 2022[4]). At a time when soaring input prices are already squeezing margins, many business leaders would prefer to offset inflation for their employees via profit-sharing plans or bonuses rather than to increase their fixed expenses, especially when they fear the cyclical environment could deteriorate in the months ahead.

According to the ECB's most recent outlook (June), per compensations per head in the Eurozone are expected to increase 4.2% in 2022, with a 1.9% increase in the number of employees. As a result, total labour incomes should rise by about 6%, or possibly a little less considering the recent dip in hiring intentions[5]. Since transfers continue to decline (essentially due to the halting of emergency measures decided as of fall 2021, but also thanks to the decline in unemployment) and taxes are bound to increase in proportion to revenues, the rise in disposable income should hold to a less steep slope of about 4.5%. With 7% inflation, the decline in household purchasing power can be calculated at 2.5% in 2022. Note that the loss of purchasing power, which is already significant, would have been much worse without government action. In France, Germany Italy and Spain, various measures were taken to buffer the inflationary shock (price freezes, tax cuts and subsidies), which totalled EUR 110 billion in 2022, the equivalent of nearly two points of disposable income[6].

EUROZONE HOUSEHOLD ACCOUNT

EUR billion	2019	2020	2021	2022e
(1) Labour incomes	7 533	7 364	7 767	8 217
Annual variation, %	3.5	-2.2	5.5	5.8
(2) Property incomes	790	673	681	722
Variation annuelle, %	-2.1	-14.8	1.2	6.0
(3) Net transfers	158.0	420.0	334.0	267.2
Annual variation, %	29.9	166.4	-20.5	-20.0
(4) Taxes	1 223	1 192	1 272	1 348
Annual variation, %	3.6	-2.5	6.7	6.0
(5) Gross disposable incomes = (1) + (2) + (3) - (4)	7 258	7 265	7 510	7 858
Annual variation, %	3.3	0.1	3.4	4.6
Annual variation, real, %	2.1	-0.4	1.1	-2.4
(6) Gross savings	952	1 428	1 319	1 048
Variation annuelle, %	8.3	50.0	-7.6	-20.5
Percent of disposable income (savings rate)	13.1	19.7	17.6	13.3
(7) Final consumption = (5) + (8) - (6)	6 407	5 933	6 293	6 912
Annual variation, %	2.5	-7.4	6.1	9.8
Annual variation, real, %	1.4	-7.9	3.7	2.8
(8) Adjustment (change in pension funds net worth)	101	96	102	102
Private consumption expenditures deflator	2 019	2 020	2 021	2022e
Annual variation, %	1.1	0.6	2.3	7.0

TABLE 1 SOURCE: ECB ; BNP PARIBAS ESTIMATE (E)

The loss of purchasing power did not result in a decline in consumption because European households dipped into their savings. Yet this formula is somewhat misleading. From a macroeconomic perspective, households rarely dip into savings to consume more than they bring in, or in other words, when the savings flow becomes negative. The "freeing up" of funds that were not spent during lockdown periods are now resulting in less accumulation of savings: EUR 1,050 billion in 2022 (13.3% of disposable income, which is close to the pre-pandemic level) compared to EUR 1,320 billion in 2021 (17.6% disposable income)

1 Direct transfers, deferrals and exempted charges, excluding guaranteed loans. See IMF (2021), Country Fiscal Measures in Response to the COVID-19, Fiscal Monitor Database, October.
2 In Germany, the hourly minimum wage will be raised from EUR 9.82 to EUR 10.45 in July and then to EUR 12 in October. In 2022, the average annual minimum wage will be EUR 10.52, a 10.2% increase compared to 2021 (EUR 9.55).
3 Insee (2017), The Mesange macroeconometric model, re-estimations and innovations, Working document 2017 /04, pp 61-62, May.
4 Insee (2022), Economic Note, pp 37-38, March.
5 European Commission surveys of business leaders indicate that hiring intentions eased slightly in all sectors after peaking in February 2022. This leading indicator is highly correlated with annual employment trends, with a lead of one or two quarters.
6 Colliac S., Derrien G., Krief E. (2022), *Energy price inflation in the Eurozone: government responses and the implication for household purchasing power,* BNP Paribas Eco Flash n°22-09, May.

resulting in the transfer of EUR 270 billion (4.3 percentage points) towards consumption (see chart). In real terms, it would continue to grow by a little less than 3% in 2022.

This being an aggregate trend, it does not say anything about the heterogeneity of situations in the face of resurging inflation. Inflation can be seen as an arbitrary tax that strikes low income households the hardest. Faced with price shocks, low-income households can hardly opt to reduce savings, which are quasi-inexistent. Hedging between expenditures is all the more difficult when pre-committed or unavoidable expenses (mainly housing and food) gobble up the lion's share of household budgets[7]. Eurozone consumption might be resilient, but only in a very unequal manner.

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In 2020 and part of 2021, government policies sought to counter the depressive effects of the Covid-pandemic and successfully managed to preserve household purchasing power. In 2022, the inflationary counter shock has led them to take similar actions, albeit with much less fiscal manoeuvring room in a less accommodating financial environment (the ECB has halted its securities purchasing programmes and interest rates are rising), but also through necessary greater discrimination.

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7 In 2017, French households in the first income quintile (the 20% with the lowest income) had a savings rate of 2.7%, compared to a national average of 15.9%. Pre-committed or unavoidable expenditures accounted for 65% of their total consumer spending, compared to 50% for households in the 5th quintile. See Accardo J., Billot S., (2020), High income households save more, low income households spend more on unavoidable expenses. Insee Première n°1815, September.

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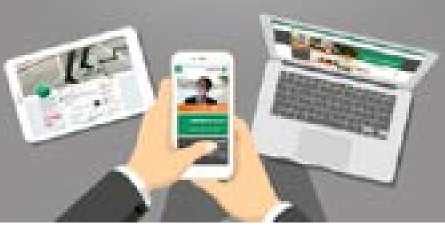

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