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FRENCH HOUSEHOLDS: PURCHASING POWER IS UNDER PRESSURE

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Purchasing power is a major concern for French households, a hot topic that is currently acute. For the first time since 1989, inflation is expected to rise above the 3% threshold for most of the year 2022.

Aggregate household revenue is growing at a dynamic pace, offsetting the observed inflation impact. Purchasing power has increased by 2.3% in 2021 and a slight gain at 0.2% is even possible in 2022.

Strong job creations have bolstered the total disposable income of French households. Looking at the average compensation, purchasing power has increased by 1.1% in 2021, but is expected to contract by 0.6% in 2022.

Differences in household situations are strong, especially as non-discretionary expenditures (rent, energy) have increased, resulting in cutbacks in households' discretionary income, i.e. the income left over that they have to live on. The purchasing power of discretionary income has increased by 1.8% in 2021 but may decline by 0.8% in 2022 according to our forecasts.

The question of purchasing power gains over the long term can be looked at by comparing the structural dynamics of inflation and wages. Inflation has eroded the purchasing power of low-income households because wage growth declined.

HOUSEHOLD PURCHASING POWER CHANGE: ALTERNATIVE ESTIMATES

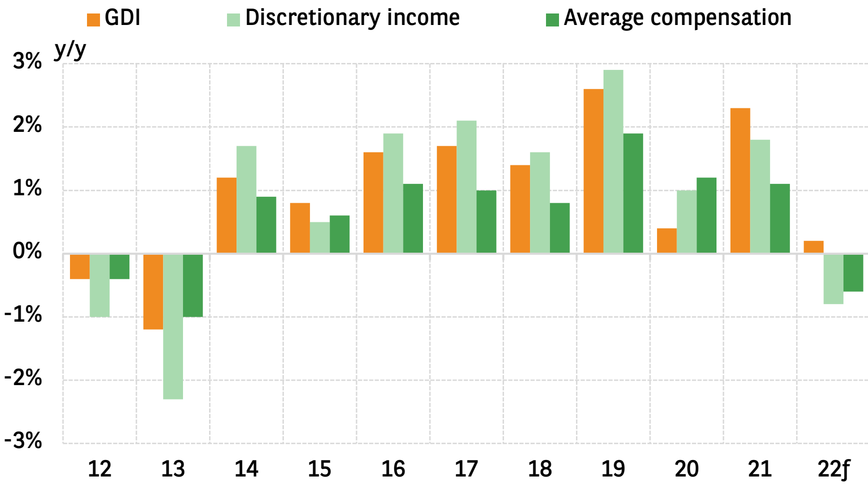

CHART 1

SOURCE: INSEE, BNP PARIBAS CALCULATIONS

Household purchasing power has resurfaced as a major issue in France again. According to pre-electoral surveys, it is even the number one concern of French households. This is not the first time that it has been an issue in recent years: it was also a hot topic in 2018, and more generally in 2012-2016, a period of slow economic and wage growth. After a steady increase at 2.3% in 2021, the gross disposable income estimate of purchasing power suggests a slight gain of 0.2% in 2022 (chart 1), the smallest gain since 2013. Yet this method is largely contested given the diversity of household situations that are not reflected in this aggregate figure. Other measurements, which we will come back to later in greater detail, are summarized below. According to these alternative measurements (discretionary income, average compensation), household purchasing power may contract in 2022.

THE HIGHEST INFLATION RATE IN 33 YEARS SHOULD CUT HOUSEHOLDS DISCRETIONARY INCOME

What makes the current situation more acute is higher inflation, and the fact that revenue growth is having a hard time keeping up the pace. Energy prices have risen significantly since last summer: the energy component of the consumer price index rose 21% y/y in February 2022.

At the same time, inflation seems to have broadened, primarily because other commodity prices have also increased, notably food prices.

All in all, inflation reached 3.6% y/y in February 2022. Major price increases are still expected in the first half of the year, with food prices rising as much as 3.2% between December 2021 and June 2022. Consequently, inflation is expected to average 3.5% for the year (the highest inflation rate since 1989, chart 2), with an upside risk due to energy prices.

Moreover, it is worth noting that inflation is not limited solely to consumer spending. Households also invest, and the cost of this investment has tended to rise, whether inflation is measured via overall house prices (+7.1% y/y in Q3 2021) or the GDP household investment deflator (5.1% y/y in Q4 2021).

Moreover, some difficulties in terms of purchasing power can also be attributed to the fact that fixed expenditures are subtracted from disposable income, and as they rise, they cut into discretionary income, the amount that is left over to live off. Comprised basically of pre-committed household expenses such as rent and energy, these fixed expenditures have been accelerating since Q2 2021 (chart 3).

Since then, the year-on-year growth of discretionary income (gross disposable income minus pre-committed expenditures) has fallen short of that of gross disposable income (it was not the case from 2014 and 2020). The purchasing power of discretionary income has increased by 1.8% in 2021 and may contract by 0.8% in 2022.

Moreover, the share of pre-committed expenditures is higher for low-income households (41% according to France Stratégie, vs 28% for the wealthiest households in 2017, the last available data). More importantly, it has increased by nearly 10 points for low-income households compared to 2001, mainly due to the housing component.

AVERAGE REVENUE GROWTH IS FAVOURABLE, BUT EVERYONE IS NOT BENEFITING

It is hard not to experience a loss of purchasing power, at least temporarily, when inflation accelerates so quickly. Yet household revenues are also trending upwards, both for capital income and compensations.

The pandemic had a unique impact on compensations, which were partially replaced by social welfare benefits (wages were covered in sectors offering short-time work schemes). Looking at the aggregate of compensations plus social welfare benefits, the increase is much more stable than compensation growth taken separately. In other words, higher welfare benefits offset the decline in wages in 2020. Currently, compensation growth continues to benefit from the job market's return to normal (chart 4).

Capital income has also surged, bolstered by higher corporate earnings. Even so, undermined by persistently low interest rates, it has yet to return to pre-Covid levels. A notable difference between the current period and 2018 is the role capital income plays in the growth of purchasing power gains. If we exclude capital income, purchasing power gains would be reduced by 0.6 percentage points in 2018, whereas currently the difference would be marginal.

There are sometimes very significant differences in total compensation growth and the increase in hourly wages or the minimum wage (chart 5).

FRANCE: INFLATION RATE

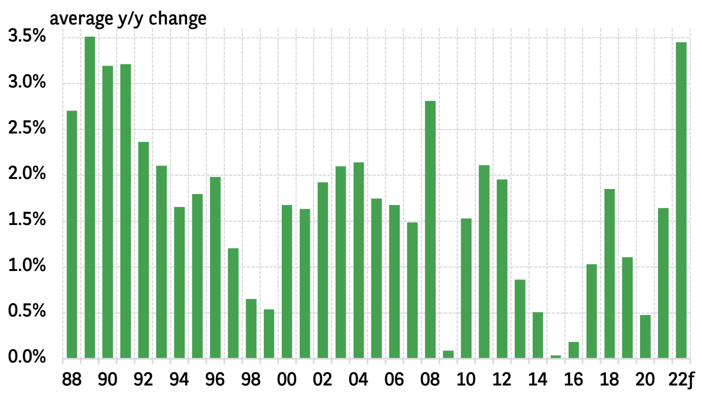

CHART 2 SOURCE: INSEE

FRANCE: NON-DISCRETIONARY HOUSEHOLD SPENDING CHANGE

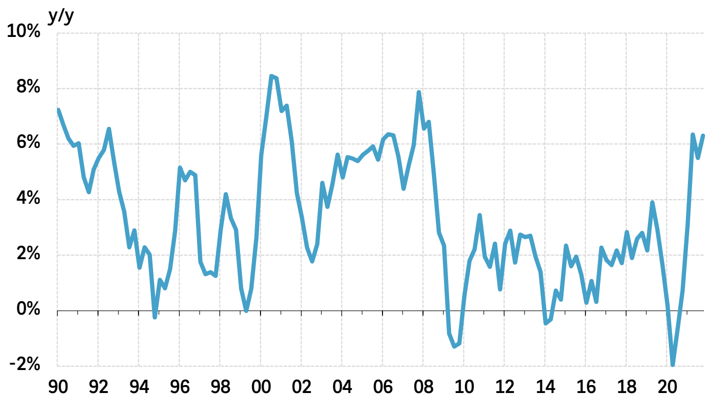

CHART 3 SOURCE: INSEE

FRANCE: HOUSEHOLD INCOME CHANGE

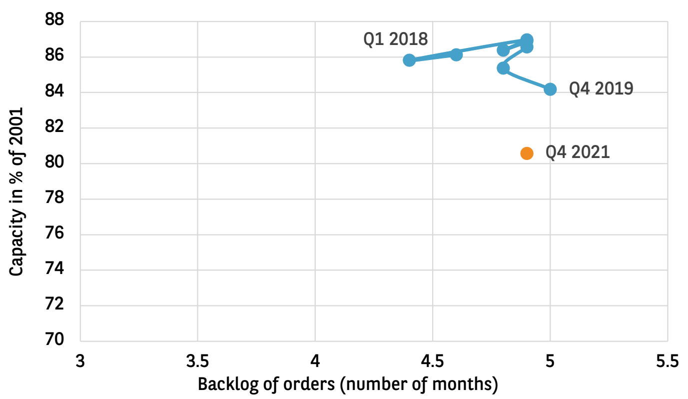

CHART 4 SOURCE: INSEE, BNP PARIBAS CALCULATIONS

One explanation is job market trends. France benefits from a large number of job creations, which has pushed the employment rate to a record high (67.8% in Q4 2021) and aggregate compensation is growing faster than average compensation. As a result, the purchasing power of average compensation has increased by 1.1% in 2021 and may contract by 0.6% in 2022.

The use of variable compensation schemes by companies (which are included in compensation estimates) is not generalized yet. There is no recent figure, but they probably increased with the introduction of the Pacte law (implemented since early 2020), which requires all companies with at least 50 employees to systematically offer such schemes. Beneficiaries of extra compensation would see their compensation increase over their fixed wage, notably during a period of high corporate profits.

Yet, since a big share of these performance incentives or profit-sharing schemes result in financial savings (notably pension financing), they do not boost household consumption in the same way as immediately available revenues, despite a possible substitution effect.

Moreover, small business employees and the self-employed are excluded from this type of compensation. All in all, households whose revenues are comprised essentially of fixed wages have seen their purchasing power growth cut during the last decade compared to the previous one. over the past ten years, hourly wages have increased 16.8% compared to cumulative inflation of 11.8%, a 5-point spread that is much smaller than the 11.6% increase in purchasing power observed for all types of compensation. Moreover, this problem has tended to increase recently (chart 6).

IS REDISTRIBUTION THE (ONLY) REMEDY?

One role of public finances is to provide social welfare benefits, which can take various forms. Some directly benefit the working-age population, either through unemployment benefits or job support measures. Between 2012 and 2018, redistribution generally had a very neutral impact on purchasing power. During a period of low inflation, public finances were guided more by a policy of boosting employment and by gradual fiscal consolidation (chart 7). On chart 7, the calculation excluding redistribution is considering household gross compensation along with other revenues and does not take into account the income tax or social benefits.

The situation changed in 2018 with the emergence of inflationary pressures. With the expansion of the activity bonus programme and other fiscal measures as of 2019, redistribution began to play a more important role in boosting purchasing power. It helped make 2019 one of the most favourable years in terms of household purchasing power gains. Purchasing power rose 2.6%, but if we only take into account earned income, it would have increased only 1.9%. This 0.7-point boost from redistribution was the highest since 2002 (excluding crisis years).

Recently, redistribution helped smooth the impact of the decline in wages during the Covid pandemic by substituting for wages (chart 4). As a result, France avoided a 4% loss of purchasing power in 2020.

Yet there was some divergence between public finance support for the labour income and the increase in benefits for the others. The idea of providing job incentives through a bigger increase in work-related revenues made other revenues more sensitive to rising inflation. Over the past 12 years, pensions have been revalued by nearly 10% (for basic pension plans paying less than 2,000 euros, above which they were not revalued as much), whereas cumulative inflation reached 18.4%.

FRANCE: MINIMUM WAGE AND HOURLY AVERAGE WAGE VS. COMPENSATION, ANNUAL CHANGE

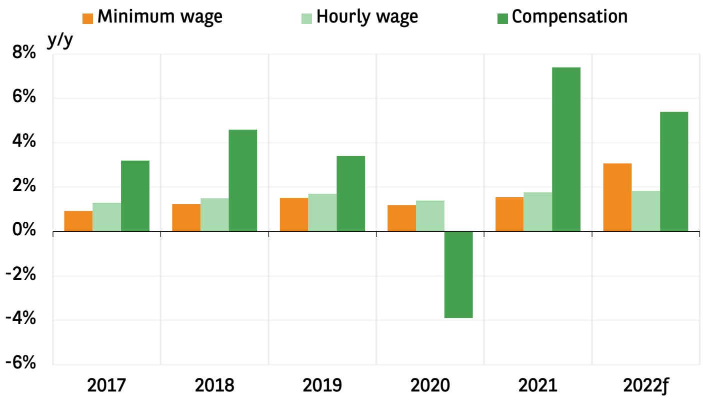

CHART 5 SOURCE: INSEE, BNP PARIBAS CALCULATIONS

FRANCE: PURCHASING POWER OF HOURLY WAGES VS. GDI

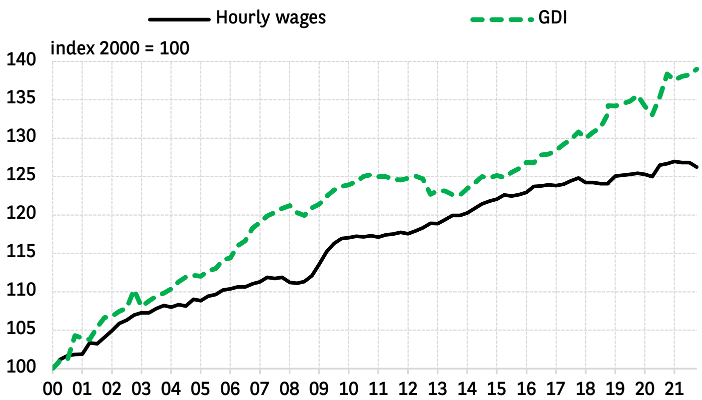

CHART 6 SOURCE: INSEE, BNP PARIBAS CALCULATIONS

FRANCE: PURCHASING POWER ANNUAL CHANGE EXCLUDING AND INCLUDING REDISTRIBUTION

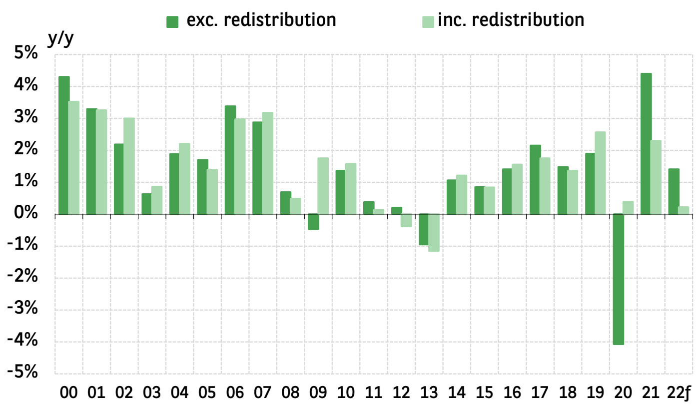

CHART 7 SOURCE: INSEE, BNP PARIBAS CALCULATIONS

Public intervention also had an impact on purchasing power by temporarily preventing increases in regulated prices. For example, the increase in regulated electricity rates was limited to 4% in February 2022, as opposed to increases that could have been as high as 35% to 45% according to estimates. This is certainly an effective method for limiting headline inflation. Yet this support comes at a high price (nearly EUR 16 billion), half of which is supported by public finances and the other half by EDF.

Acting on certain prices that are critical for the economy as a whole can have a positive impact in the short term by reducing the size of knock-on effects and thus headline inflation. Yet it is not a viable solution for more than a few months, because it would eventually erode the investment capacity of energy-producing companies.

On the whole, the increase in the share of housing expenditures in the budgets of low-income households shows that the question of purchasing power is not limited to the volatile nature of inflation. The recent rise in construction costs as well as transaction prices for existing homes does not augur well for a change of tendencies.

Redistribution can have a role to smooth short-term issues. However, in the long-run higher employment and wages growth should be a more viable support for households' purchasing power.

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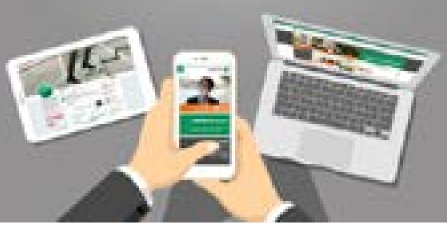

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