

EUROZONE: HOUSEHOLD SPENDING UNDER PRESSURE FROM INFLATION

A priori, rising inflation and inflation expectations, reflecting robust growth in demand and economic activity, should boost household spending by reducing real interest rates. Today's situation is different. In many advanced economies, inflation is exceptionally high and to a considerable degree explained by negative supply shocks. In the EU and the euro area, household confidence recorded a big drop in March. Although unemployment expectations have increased, the main reason seems to be concern about high and rising inflation. Eurozone consumer confidence measures provide information about spending up to three quarters into the future. Given their recent decline, one should expect below-average consumer spending growth over the coming months. However, unemployment expectations that are still below their long-term average should provide some support to spending.

A priori, rising inflation and inflation expectations, reflecting robust growth in demand and economic activity, should boost household spending by reducing real interest rates¹. This decline lowers the cost of credit and may stimulate households to frontload spending and save less, with the intention of saving more once interest rates have increased. Today's situation is different. In many advanced economies, inflation is exceptionally high and to a considerable degree explained by negative supply shocks – disruption of supply chains, higher commodity prices- which weigh on demand whilst pushing prices higher. In the EU and the euro area, household confidence recorded a big drop in March on the back of a collapse in expectations about the general economic situation and the gloomy assessment of their own future financial situation, which fell to a historical low. Worsening sentiment can reflect mounting concern about the pace of price increases or about the labour market outlook. Concerning the latter, unemployment expectations increased in March but at 19.9 they have remained below the average since 2000 (24.2). Moreover, thus far, the increase from recent lows is limited compared to previous episodes (chart 1). Nevertheless, as shown in chart 2, in March, households' expectations about their financial situation were abnormally grim given their unemployment expectations. This means that the other factor –inflation- may play an important role. This is confirmed in chart 3, which shows that price expectations are exceptionally high and well outside the historical range², whereas the net balance of households fearing a worsening of their financial situation over the next 12 months is at the upper end of the historical range³.

1. Research for the US shows a positive correlation between durable goods spending increases and expected inflation -but only for selected types of households-, no correlation between nondurables spending and expected inflation and a negative correlation between spending and expected unemployment. Source: *Household Inflation Expectations and Consumer Spending: Evidence from Panel Data*, Mary A. Burke and Ali Ozdagli, Federal Reserve Bank of Dallas, working paper 2110, August 2021.

2. Data start in January 1985.

3. A similar phenomenon has been observed in the US where consumer confidence has

declined despite a strong labour market. See *Weaker US household confidence, a source of concern?*, BNP Paribas, Ecoweek, 29 October 2021.

4. The European Commission's monthly survey of consumers covers the following questions: personal financial situation over next 12 months, general economic situation over last 12 months, general economic situation over next 12 months, price trends over last 12 months, price trends over next 12 months, unemployment expectations over next 12 months, major purchases at present, major purchases over next 12 months, savings at present, savings over next 12 months, statement on financial situation of household. The consumer confidence indicator represents the average of personal financial situation over the last and next 12 months, general economic situation over next 12 months and major purchases over next 12 months.

EURO AREA HOUSEHOLDS' UNEMPLOYMENT EXPECTATIONS



CHART 1

SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

Eurozone consumer confidence measures provide information about spending up to three quarters into the future. Given their recent decline, one should expect below-average consumer spending growth over the coming months. However, unemployment expectations that are still below their long-term average should provide some support to spending.



households' consumption expenditures⁵. The correlations between confidence measures and spending during the same quarter are high but several series also provide information about spending up to three quarters into the future. Considering that in March, four measures out of six were below their long-term average, sometimes significantly so (chart 5), one should expect below-average consumer spending growth over the coming months. However, unemployment expectations that are still below their long-term average should provide some resilience.

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5. The chart was inspired by *Does consumer confidence predict private consumption?*, ECB Economic Bulletin, issue 5, 2015.

EURO AREA HOUSEHOLDS' EXPECTATIONS: PERSONAL FINANCIAL SITUATION AND UNEMPLOYMENT

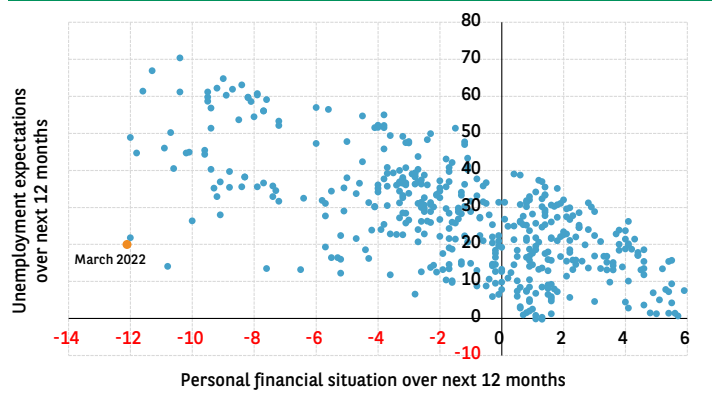


CHART 2 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

EURO AREA HOUSEHOLDS' EXPECTATIONS: PERSONAL FINANCIAL SITUATION AND INFLATION

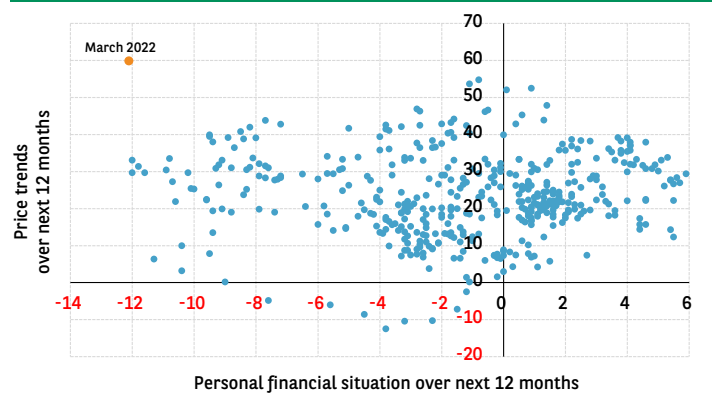


CHART 3 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

EURO AREA: CORRELATION BETWEEN CONSUMER CONFIDENCE AND CURRENT AND FUTURE CONSUMPTION GROWTH

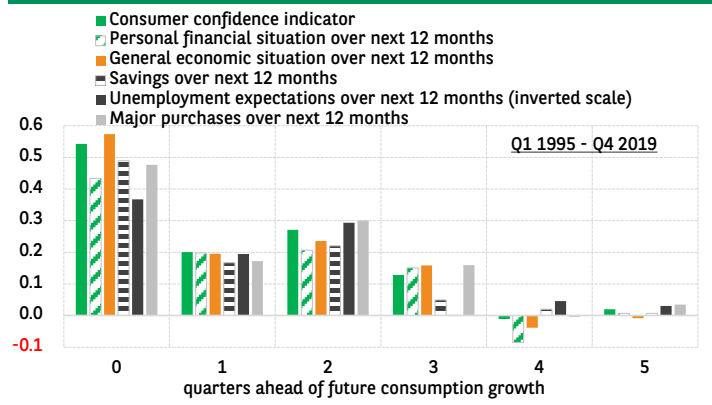


CHART 4 SOURCE: EUROPEAN COMMISSION, EUROSTAT, BNP PARIBAS

EURO AREA CONSUMER CONFIDENCE MEASURES

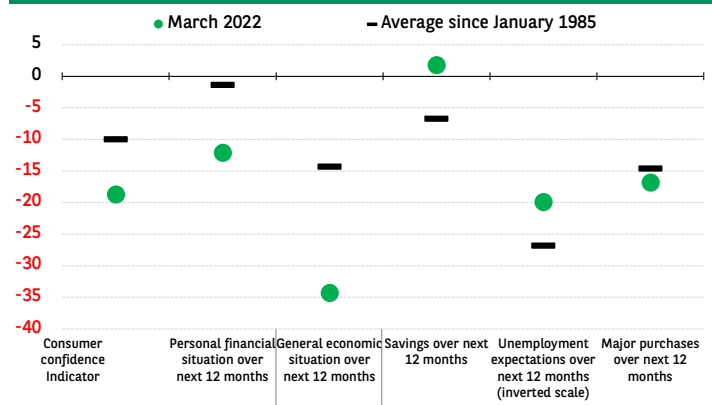


CHART 5 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS