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Can the European consumer hold on?

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EXECUTIVE SUMMARY

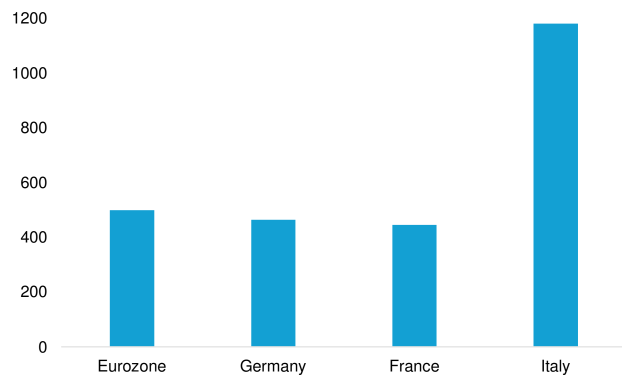
- **Consumers were meant to drive the post-Covid-19 recovery in 2022, but elevated geopolitical uncertainty and sky-high inflation have derailed these expectations.** Following Russia's invasion of Ukraine, consumer surveys suggest that Eurozone households are as pessimistic – or even more – as they were during the height of the pandemic. Based on the deterioration in consumer confidence, we estimate that the resulting lost household consumption in the Eurozone tallies up to EUR70bn, or close to EUR500 per household, in 2022 alone.
- **Things will get worse before they get better: Our Allianz Pulse survey shows that a majority of consumers in Germany, France and Italy intend to cut back on their real consumption as well as their savings in the coming months.** Based on a panel regression that takes into account consumer confidence, the unemployment rate, real disposable income, monetary and financial conditions as well as global demand, we estimate that gross savings rates in Germany, France and Italy will decline back to pre-Covid long-term averages by end-2022 (-4.7pp, -3.7pp and -4.8pp, respectively).
- **Savings flows might return to normal, but the accumulated excess savings stock remains in place, even if it provides an unequal safety net.** According to our calculations, the stock of excess savings currently tallies up to more than EUR380bn in the Eurozone. But heterogeneity is significant across income groups, with EUR93 per household for the lowest-income households against more than EUR8700 per household for the wealthiest. For comparison, the food bill for Eurozone households is expected to increase on average by EUR550 per household in 2022, while the energy bill is set to rise by more than EUR750. Hence, for almost two-thirds of households, excess savings will be insufficient to shield them from the inflation hurricane this year.

In 2022, the deterioration in consumer confidence could lead to EUR70bn in lost consumption, or close to EUR500 per household in the Eurozone.

Following Russia's invasion of Ukraine, consumer confidence in key Eurozone countries has dropped to the lows last seen during the height of the Covid-19 crisis. Consumer confidence usually predicts trends in consumer spending with a lag of one to two quarters. Eurozone consumers already cut back their spending by 0.7% q/q in the first quarter of the year against the backdrop of fresh sanitary restrictions triggered by the omicron wave and Russia's invasion of Ukraine. However, we believe the fall in consumer spending will continue in Q2 and Q4, with a respite only during the summer, thanks to a rebound in services consumption (mostly hospitality and travel).

Overall, we calculate that the lost consumption explained by the deterioration of consumer confidence since the start of the war stands at EUR70bn (in real terms), or close to EUR500 per household in the Eurozone as a whole. This is what households will not spend in 2022 due to the lack of confidence - not considering the effect of any fiscal transfers. Across major Eurozone economies, the loss translates into EUR20bn for Germany (or EUR470 per household), EUR13.5bn for France (or EUR440 per household) and EUR31bn for Italy (or more than EUR1100 per household) - see Figure 1. In Italy, the loss is higher as the drop in consumer confidence since the end of 2021 has been twice as high as, for example, in France.

Figure 1: Lost consumption in 2022 due to deteriorating consumer confidence (EUR per household)

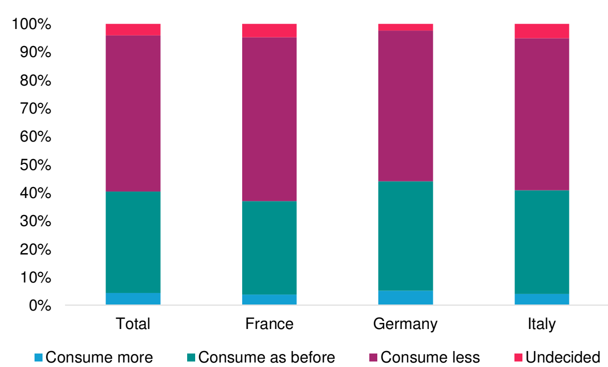


Source: Allianz Pulse Survey

Our Allianz Pulse Survey reveals that most European consumers will reduce both expenditures and savings in the coming months, notably in France.

In May 2022, we asked more than 2,500 consumers in Germany, France and Italy about their consumption plans in the coming months compared to pre-inflation times. In all three countries, a majority plan to cut back on spending: 53.5% in Germany, 58.5% in France and 54.0% in Italy. However, more than one third do plan to maintain spending levels, reflecting either the inertia usually expected in consumption after a shock or economic resilience (see Figure 2).

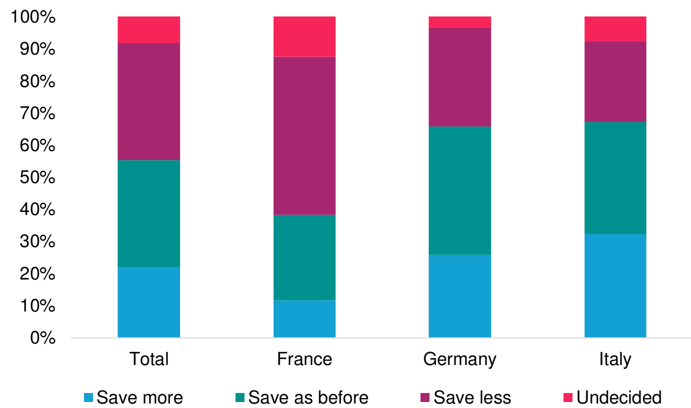
Figure 2: Consumption behaviours in the coming months by country (% of total)



Source: Allianz Pulse Survey

Overall, 36.5% of the European consumers we surveyed said they intended to save less in the coming months, with the highest share found in France (49.3%). However, in Germany, 40% of consumers intend to save as before while in Italy the ratio between those that want to keep savings constant and those that want to save more (see Figure 3) appears more balanced.

Figure 3: Saving behaviour in the coming months by country (% of total)



Source: Allianz Pulse Survey

We expect gross savings rates to return to the status quo ante, with declines in Germany, France and Italy to 18.3%, 15.6% and 10.9%, respectively, by end-2022.

In order to establish the determinants of changes in household savings in key countries in Europe, we estimate a country fixed-effect regression as a function of the unemployment rate, which is often used as a proxy of labor income uncertainty[1]. We also controlled for the effects of disposable income and interest rates, both in real terms, hence capturing the effects of inflation. Moreover, as household savings may also be influenced by global factors, we consider the difference between the US-German 2Y bond yields and the copper-to gold ratio as a proxy of future economic growth. Finally, we include consumer-confidence indicators, both the aggregate index and subcomponents.[2]

Using the results of our model, we estimate a drop in the savings rates in Germany, France and Italy to the status quo ante before Covid-19: 18.3%, 15.6% and 10.9%, respectively, by end-2022. We make two important assumptions in the model: The first is relative to the unemployment rate, which we expect to remain relatively stable this year as in times of economic contraction, governments tend to adopt labor-retention policies such as partial unemployment schemes to preserve employment. The second hypothesis is in relation to consumer confidence. In our baseline scenario, we assume that the level of aggregate confidence will remain close to current levels, which are already considerably low and close to the levels observed during the Covid-19 crisis. By stressing confidence levels to the lowest levels reached in the historical series, we

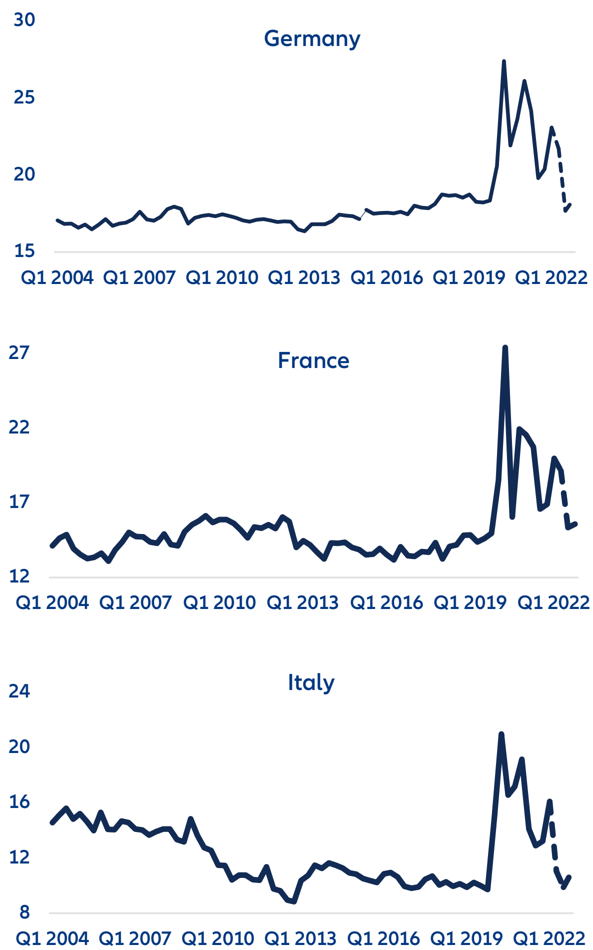
[1] Specifically, there are 15 countries in our sample. The full list can be found in the annex.

[2] More details can be found in the annex. We acknowledge that the inclusion of additional control parameters such as wealth and fiscal variables could improve the fit of the model and our model historical predictions, i.e. reduce forecast errors over the estimation period. We used a limited number of variables for reason of parsimony in this study and left the search for explanatory factors of the residuals for further research. In addition, introducing dummies to flag, for example, crises or specific events, could fictively enhance the model forecasting performance.

observe an increase in the savings rate by +0.2pp in every country at year-end in relation to the baseline scenario.

When considering the Consumer Confidence sub-components, we notice a larger discrepancy in the "unemployment expectations in the next 12 months" as it points to a higher savings level by about +0.5pp. On average, the subcomponents indicate that the savings rate in Germany comes in at 18.5%, slightly above the aggregate measure (18.3%).

Figure 4: Projected gross savings rate (%) in Germany, France and Italy



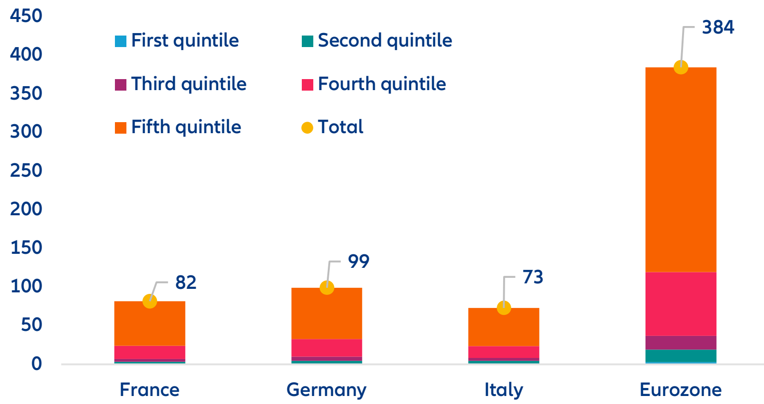
Sources: Eurostat, Allianz Research calculations.

High-income households hold more than two-thirds of the EUR380bn in excess savings remaining in the Eurozone.

We calculate that there is still more than EUR380bn in excess savings in the Eurozone but it is unevenly distributed: wealthier households have a much higher share of the total. We find that the lowest-income households have excess savings equivalent to just EUR93 per household, compared to more than EUR8700 per household for the wealthiest (see Figure 6).

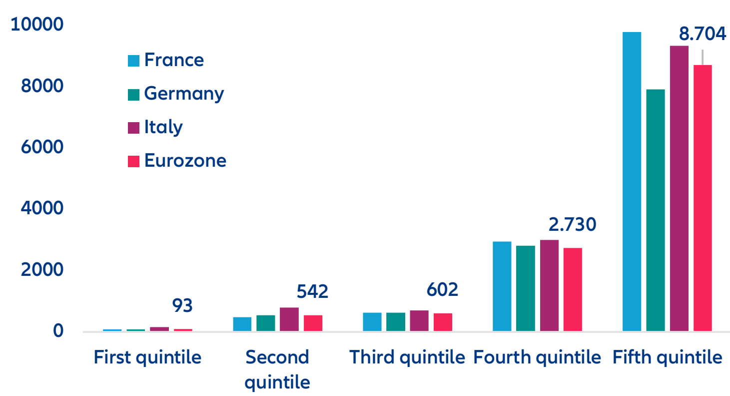
For comparison, the food bill in the Eurozone is expected to increase on average by EUR550 per household in 2022[3] and the energy bill by more than EUR750, with prices up by +50% over the year[4] (see our report). In this context, for close to two-thirds of households, excess savings will not be enough to shield them from the inflation hurricane this year.

Figure 5: Household excess savings, EUR bn



Sources: Eurostat, Allianz Research

Figure 6: Household excess savings, EUR per household



Sources: Eurostat, Allianz Research

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3 See our report [European food inflation: and the loser is the consumer]
4 See our report [The (energy) price of war for European households]

ANNEX

A. List of Countries

1. Germany	6. Finland	11. Netherlands
2. Belgium	7. France	12. Austria
3. Czech Republic	8. Hungary	13. Poland
4. Denmark	9. Ireland	14. Portugal
5. Spain	10. Italy	15. Sweden

B. Data Description

- **Household Savings Rate.** We considered the variation of gross savings rate in relation to the same quarter in the previous year. Data extracted from the Eurostat – European Commission.
- **Unemployment Rate.** We considered the variation of unemployment in relation to the same quarter in the previous year. Data extracted from Datastream.
- **Real short-term deposit rate.** Data extracted from Datastream.
- **Copper-to-Gold price.** Data extracted from Datastream.
- **US -Germany 2Y bond yield spread.** Data extracted from Datastream.
- **Consumer Confidence indicators (Conf).** Data extracted from the European Commission Consumer Survey and we considered both aggregate and subcomponent indicators. Detailed questions can be found in Annex C.

Table 1: Consumer Confidence Indicators

Indicator Code	Description
ConfAgr	Confidence Indicator (Q1 + Q2 + Q4 + Q9) / 4
ConfFCPast	Financial situation over last 12 months
ConfFinCond	Financial situation over next 12 months
ConfEconSitPast	General economic situation over last 12 months
ConfPricePast	Price trends over last 12 months
ConfPrice	Price trends over next 12 months
ConfUnemExp	Unemployment expectations over next 12 months
ConfPurchases	Major purchases at present
ConfFuturePurchases	Major purchases over next 12 months
ConfSavingsNow	Savings at present
ConfFutureSav	Savings over next 12 months
CapacitySave	Statement on financial situation of household2.

Source: Eurostat. Indicator Code is however defined by the authors.

C. Econometric Approach

For this analysis, we estimate a panel data model using Least Squares Dummy Variable (LSDV) techniques, hence capturing differences between countries. The model specification is as follow:

$$\Delta s_{i,t} = \alpha_i + \beta_1\, \Delta UR_{i,t} + \beta_2\, RealIR_{i,t} + \beta_3 RealGDI_{i,t} + \beta_4 CopperGold_{i,t} + \beta_5 USBD2Y_{i,t} + \beta_6 Conf_{i,t} + \varepsilon_{i,t}$$

For i = 1, … N and t = 1, … T.

Where N is the number of countries and T is the number of periods. Δs_t is the variation of the savings rate in relation to the same quarter of the previous year, Δu_t is the variation of the savings rate in relation to the same quarter of the previous year, $RealIR$ is the real deposit interest rate, $CopperGold$ is the ratio of gold-to-copper price, $USBD2Y$ is the spread between the US 2Y bond yield and the German 2Y Bond yield, $Conf$ represents one of the consumer confidence indicators, aggregate or sub-components as described in the Annex B. $(\beta_1, \dots, \beta_6)$ is the vector of slope coefficients, α_i is the individual intercept (or fixed effects) and $\varepsilon_{i,t}$ is the residual. The model is estimated in quarterly basis from Q1 2004 to Q4 2019. Results are showed in Table 2.

Table 2: Model results: Savings rate and control variables

VARIABLES	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
UR	0.448***	0.453***	0.424***	0.455***	0.436***	0.457***	0.471***	0.386***	0.480***	0.462***	0.460***	0.439***
	(0.0527)	(0.0529)	(0.0519)	(0.0543)	(0.0564)	(0.0530)	(0.0525)	(0.0656)	(0.0549)	(0.0526)	(0.0542)	(0.0532)
RealIR	0.335***	0.328***	0.306***	0.319***	0.322***	0.303***	0.369***	0.323***	0.320***	0.334***	0.317***	0.318***
	(0.0497)	(0.0499)	(0.0485)	(0.0495)	(0.0525)	(0.0528)	(0.0521)	(0.0494)	(0.0495)	(0.0501)	(0.0496)	(0.0493)
RealGDI	0.191***	0.189***	0.199***	0.185***	0.165***	0.182***	0.191***	0.194***	0.178***	0.178***	0.185***	0.195***
	(0.0158)	(0.0159)	(0.0155)	(0.0158)	(0.0159)	(0.0159)	(0.0157)	(0.0165)	(0.0166)	(0.0160)	(0.0163)	(0.0162)
CopperGold	-0.210***	-0.211***	-0.165***	-0.206***	-0.214***	-0.192***	-0.249***	-0.205***	-0.203***	-0.205***	-0.203***	-0.203***
	(0.0328)	(0.0331)	(0.0328)	(0.0331)	(0.0350)	(0.0360)	(0.0359)	(0.0328)	(0.0328)	(0.0328)	(0.0332)	(0.0327)
USBD2Y	0.00187***	0.00178***	0.00197***	0.00173***	0.00194***	0.00163***	0.00246***	0.00233***	0.00140**	0.00140**	0.00170***	0.00239***
	(0.000553)	(0.000554)	(0.000542)	(0.000556)	(0.000563)	(0.000555)	(0.000606)	(0.000644)	(0.000603)	(0.000573)	(0.000573)	(0.000616)
ConfAgr	-0.0236***											
	(0.00895)											
ConfFinCond		-0.0143										
		(0.00927)										
ConfUnemExp			0.0202***									
			(0.00323)									
ConfFutureSav				-0.00570								
				(0.0112)								
ConfSavingsNow					0.00908							
					(0.00565)							
ConfPrice						-0.00409						
						(0.00521)						
ConfPricePast							0.0115***					
							(0.00383)					
ConfEconSitPast								-0.00887*				
								(0.00465)				
ConfFCPast									0.00995			
									(0.00839)			
CapacitySave										0.0221*		
										(0.0120)		
ConfFuturePurchases											-0.000917	
											(0.0102)	
ConfPurchases												-0.0163**
												(0.00650)
Observations	960	960	960	960	910	960	960	960	960	960	960	960
R-squared	0.219	0.216	0.245	0.214	0.196	0.214	0.221	0.217	0.215	0.216	0.214	0.219

Standard errors in parentheses. Coefficients for country dummies not reported.
*** p<0.01, ** p<0.05, * p<0.1

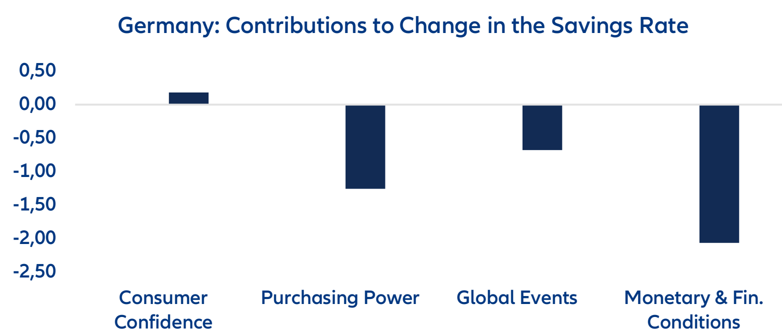
Source: Allianz Research calculations.

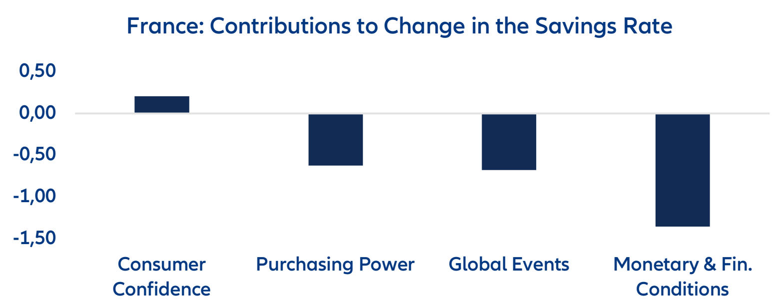
Overall, the regression coefficients have the expected signs and are highly statistically significant. Specifically, a positive change in the unemployment rate may lead to a positive variation in the savings rate prompted by an increase in the labor income uncertainty. A drop in the real disposable income is associated with a decrease in the savings rate, suggesting that households might use savings to compensate for the loss in the purchasing power. Consistent with the intertemporal substitution mechanism, a drop in the real short-term deposit rate is associated with lower savings rate as households have greater incentive to consume than saving. We also found that global shocks influence the savings rate. For instance, prospects for stronger future economic growth (proxied by copper-to-gold ratio) reduces the need for saving while an increase in the transatlantic spreads are associated with positive changes in the savings rate, an indication that economic conditions in Europe might be less robust than in the US.

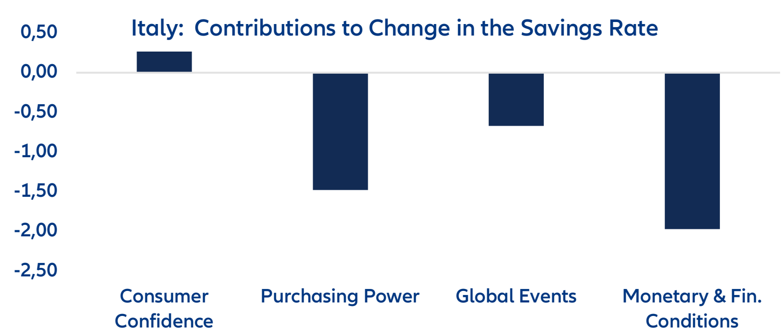
A decline in consumer confidence on an aggregate basis is associated with an increase in the savings rate. When using the subcomponents of the consumer survey, however, we observe that not all indicators seem to influence changes in savings, but mainly three of them: i) “Unemployment expectations over next 12 months”; ii) “Price trends over the last 12 months” and iii) “Major purchases at present”. Unsurprisingly, the first two indicators show positive signs, signaling that future income risks - whether through job loss or lower purchasing power - drive savings rate higher. Meanwhile, prospects for purchases of durable goods - an indicator of confidence in the economy - are associated with lower savings.

D. Additional Figures

The figures below show the contributions to the decline in the savings rate according to our estimates. We note that monetary and financial conditions play an important role, followed by purchasing power issues.







Source: Allianz Research calculations.

These assessments are, as always, subject to the disclaimer provided below.

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