

THE (ENERGY) PRICE OF WAR: WHEN INFLATION BITES US SAVINGS

15 March 2022

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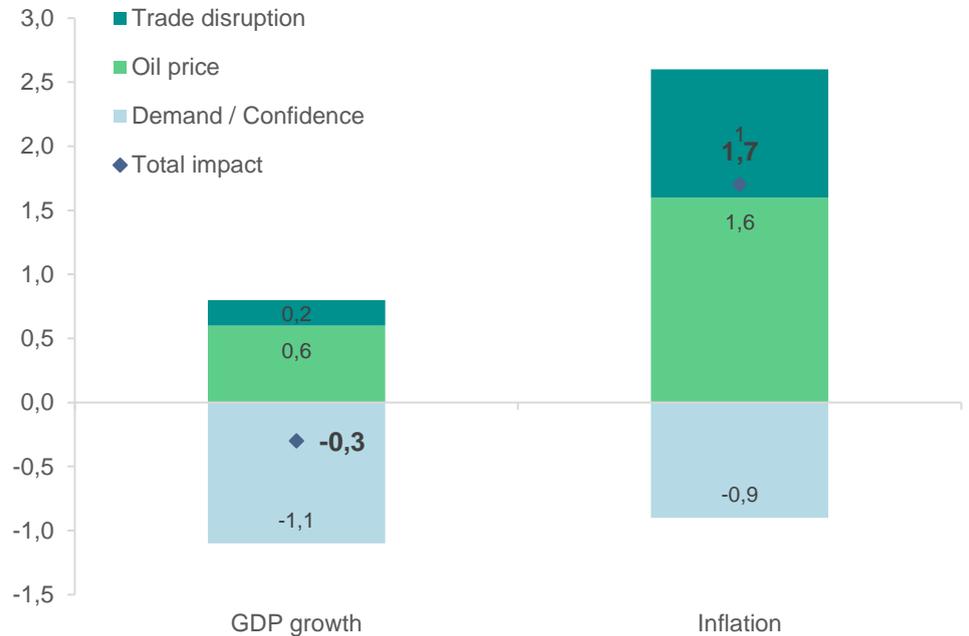
Executive Summary

- *The US economy is less directly exposed to the economic consequences of the invasion of Ukraine compared to Europe. But surging energy prices will drive inflation even higher (6.1% on average in 2022), accelerating the reversal of the "great resignation" as rising household expenses deplete the excess savings accumulated during the Covid-19 crisis (USD2.7trn). We expect the Fed to envisage only four hikes in 2022 and start reducing the size of its balance sheet from January 2023 only as lower excess savings, besides representing a diminishing tailwind for consumption, will be accompanied by higher jobs supply, therefore reducing the risk of a wage-price loop materializing in the US.*
- *Lower-income households would be forced to return to the job market first. We find that those with the lowest incomes (35% of total households) managed to accumulate 1.4 months of their average salary in excess savings (USD485). But with rising fixed expenses (+USD673 in 2022), these excess savings could be about to be fully depleted even sooner (3.3 months vs. 4.2 pre-war). In contrast, the wealthiest households hold more than 3.5 months of their average salary in excess savings, giving them more leeway to stay out of the job market.*
- *Only a severe negative shock on wealth (a -50% negative correction on the current level of equity prices) would have the potential to significantly erode the top quintile's excess savings.*
- *We estimate it will take two years to see a full normalization of the US job market, with the return of all 2mn missing workers. However, this normalization is likely to entail the higher participation rate of workers with lower educational attainment, offsetting the lower participation rate of elderly households, making life-long learning and the further education of the labor force particularly important.*

The US economy is less directly exposed to the economic consequences of the invasion of Ukraine compared to Europe. But surging energy prices will drive US inflation even higher, accelerating the reversal of the "great resignation" as rising household expenses deplete the excess savings accumulated during the Covid-19 crisis. The US economy is less directly exposed to imports from Russia (in particular oil & gas) compared to Europe but the geopolitical tensions will fuel uncertainties and price pressures in a context where inflation is already a major source of concern

for US households. We estimate the consequences of the attack via the energy, trade and domestic demand channels will add an additional +1.7pp to US CPI inflation in 2022.

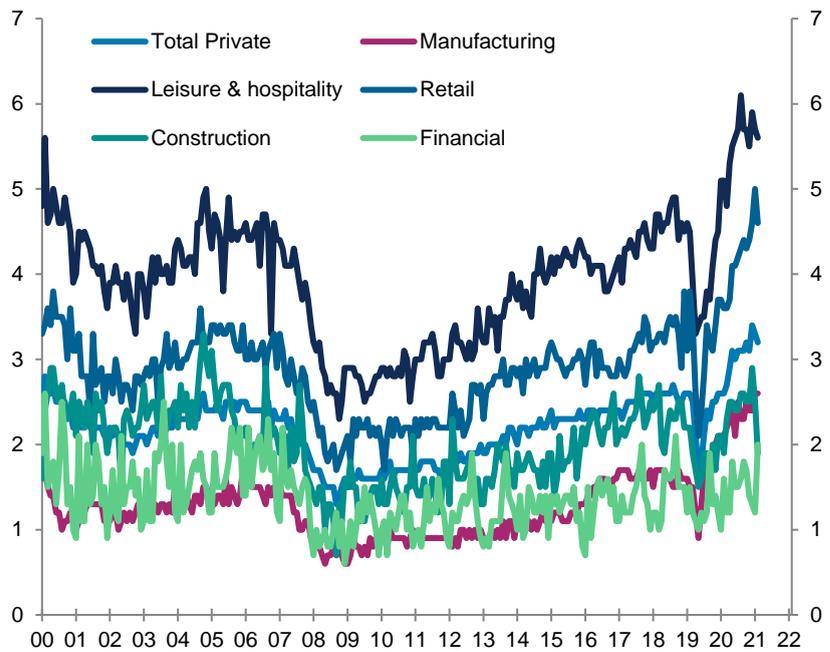
Figure 1 – Contribution to US GDP growth from energy, trade and confidence shocks arising from the invasion of Ukraine (pp)



Sources: Allianz Research, Refinitiv

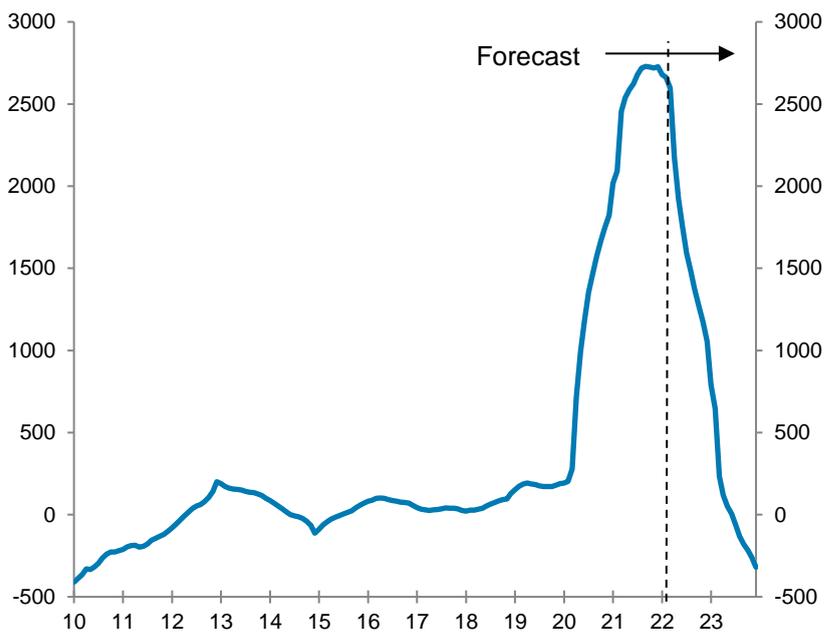
This context could accelerate the reversal of the “great resignation” in the US, which saw a record-high number of people quitting their jobs (see Figure 2). The rapidity of the recovery and return to full employment, different state initiatives aiming at increasing minimum wages, as well as increasing dissatisfaction with job conditions, triggered a significant rise in the bargaining power of US workers. To add to this, US households accumulated USD2.7trn in excess savings due to limited consumption opportunities during the lockdowns, positive wealth effects via strong support from the US government and the Fed and historic levels of social transfers, tax cuts and direct payments (Figure 3). As a result, the US job market was still missing more than 2mn people in February 2022 (compared with a peak of 17mn in April 2020). This lack of job supply as well as a reinforced bargaining power triggered a significant acceleration of average hourly earnings, which grew by +5.1% y/y in February.

Figure 2 – US quit rate (number of quits as % of total employees)



Sources: Allianz Research, Refinitiv

Figure 3 – US excess saving (USD bn)



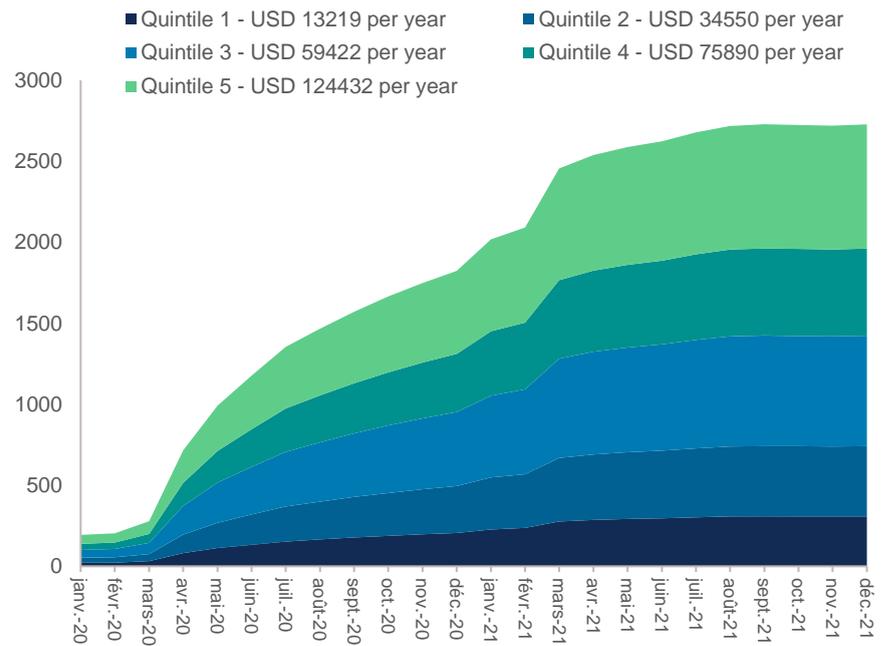
Sources: Allianz Research, Refinitiv

However, surging inflation will deplete excess savings even faster, forcing the lowest-income households to return to the job market even earlier. Based on the 2019 and 2020 Consumer Expenditure Surveys of the BLS¹, we estimate the contribution of each income quintile to the two-year (2020 and 2021) accumulation of US aggregate excess saving (deviation from normal trend, Figure 3). This survey allows us to have a rather accurate view on how US households' incomes (including exceptionally high social

¹ "The Consumer Expenditure Surveys (CE) program provides data on expenditures, income, and demographic characteristics of consumers in the US".

transfers for lower categories of incomes) were allocated between consumption and savings. We assume that this allocation was stable in 2021 as a second round of historically high social transfers was once again conditional on revenues, wealth effects did not differ significantly (both 2020 and 2021 saw very strong performances in the housing and equity markets) and the recovery of consumption was not drastically altered by the delta variant. These hypotheses allow us to calculate the excess savings accumulated by each income quintile of US households (Figure 4).

Figure 4 – US excess savings accumulated in 2020 and 2021 (USD bn, per quintiles)



Sources: Allianz Research, Refinitiv

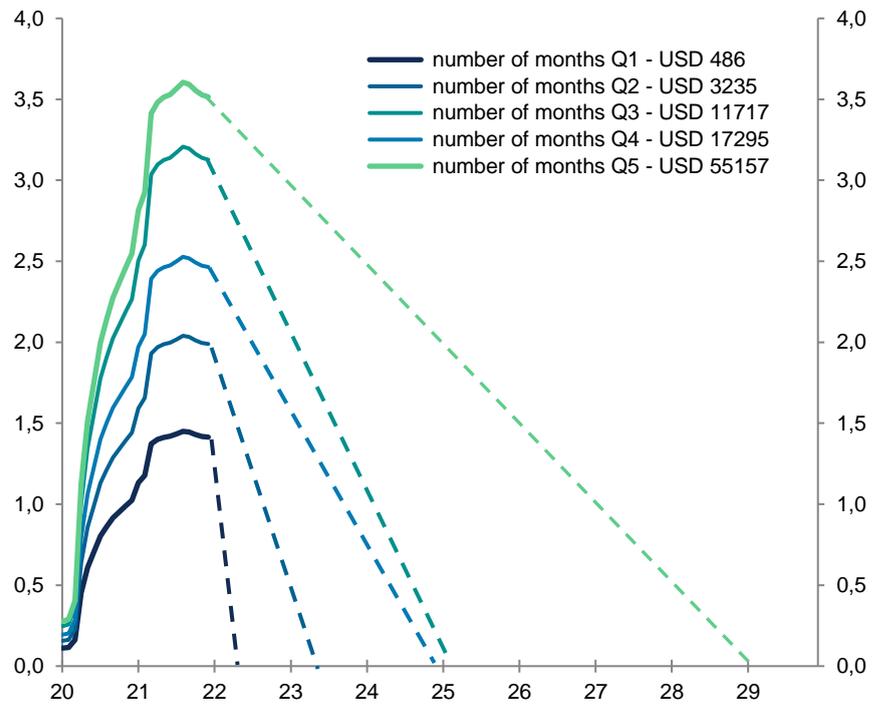
To calculate how long these excess savings could last, keeping households out of the job market, we calculate how much each pool of accumulated savings represents for an average earner of each quintile in terms of monthly salaries. We find that the lowest quintile average earner has accumulated only 1.4 months of salary, while the highest quintile disposes of more than 3.5 months of salary. These results are in line with other studies showing excess deposits amounted to a maximum value of USD1,000 in 2020 (before the second round of large social transfers in 2021).

Figure 5 below represents the pace at which these excess savings would be depleted in 2022 by assuming a rise of average salaries at the same pace as 2021 for every quintile of income, and taking into account asymmetric exposures of households to our inflation scenario. According to this analysis, the savings buffer of USD673 for the lowest quintile of households will be depleted in roughly three-and-a-half months, while it will take more than one year for the second quintile. For the third and fourth quintiles, this savings buffer could last until 2025 (2028 for the highest quintile). This means that the missing workers from the lowest-income households will have a strong incentive to find a job, given the

current high level of inflation.

In contrast, missing workers from the wealthiest households have a much lower incentive to return to the job market quickly. Only a significant blow to their wealth via a severe shock on the housing or financial markets could change this.

Figure 5 – US excess savings accumulated in 2020 and 2021 (months of average salary by quintile) and pace of depletion assuming an average 6.1% level of inflation in 2022



Sources: Allianz Research, Refinitiv

Table 1, shows the simulated effects of three possible equity market corrections (-10%, -20% and -50%): surprisingly, even the lowest-income households could see their portfolios grow despite a -10% market correction. The wealthiest households would only feel the pinch in an equity shock of -50%. For now, such a scenario has a low probability in a context where we expect the Fed to envisage only four hikes in 2022, and to start reducing the size of its balance sheet only from January 2023.

Table 1 – Impact of a negative equity shock on US households’ wealth per quintile of incomes

Portfolio impact by size of shock compared to Q4 2019	-10%	-20%	-50%
pct0to20	8,9	-0,8	-30,1
pct20to40	38,3	25,9	-11,4
pct40to60	13,9	3,6	-27,3
pct60to80	44,1	31,2	-7,5
pct80to99	33,8	21,8	-14,1

pct99to100	47,7	34,6	-4,8
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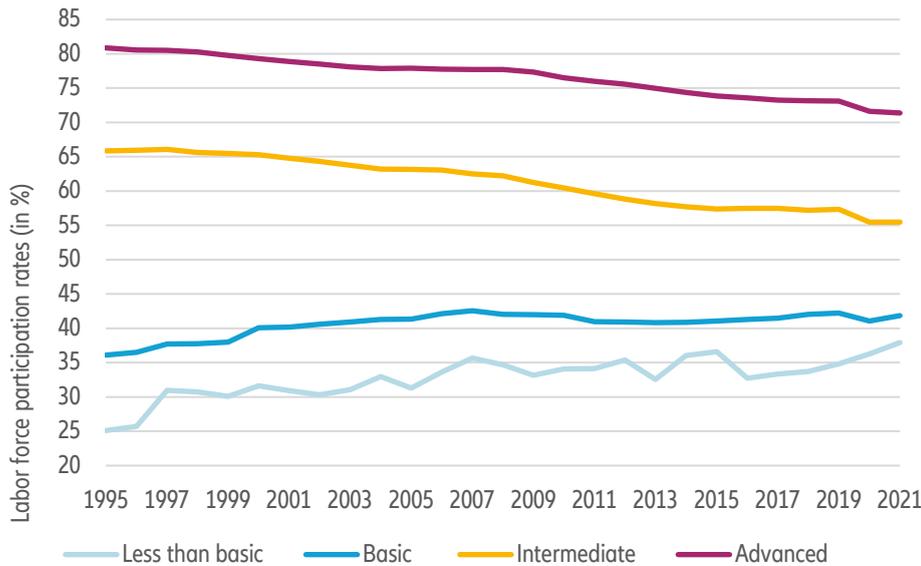
Sources: Allianz Research

We estimate it will take two years to see a full normalization of the US job market, with the return of all the 2mn missing workers. Taking into account the demographic weight of each quintile of incomes (the lowest-income quintile accounts for 35% of households, followed by 22% for quintile 2, 16% for quintile 3, 13.4% for quintile 4 and 12.7% for quintile 5), and assuming that a full depletion of the excess savings of each category is needed for a full normalization of the labor force participation rate, we estimate that it could take two years to see a full normalization of the US job market. In our view, there is a non-negligible probability that this normalization in the participation rate will materialize via the higher participation rate of workers with lower educational attainment, offsetting the lower participation rate of elderly households.

Appendix 1: Recent evolution of US participation rate

There are marked differences in the trends of labor force participation rates between the population groups. While the rates declined rather steadily in the population groups with advanced and intermediate educational levels, they increased in the groups with basic or less than basic levels. In fact, the Covid-19 pandemic did not put a halt on the upward trend in the group with the lowest educational level and seems to have stopped it only temporarily in the population group with basic education. In the population group with intermediate and advanced educational levels, the labor force participation rates have so far not increased significantly again (Figure 6). If the participation rates had already returned to pre-Covid-19 levels, there would have been 4.4mn more people in the labor market in 2021 than there actually were².

Figure 6: Differing trends in labor force participation



Source: ILO.

² Calculated based on US Bureau of Labor Statistics data. Labor force participation rates given by ILO and the US Bureau differ due to different definitions of the educational levels.

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

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