Economics

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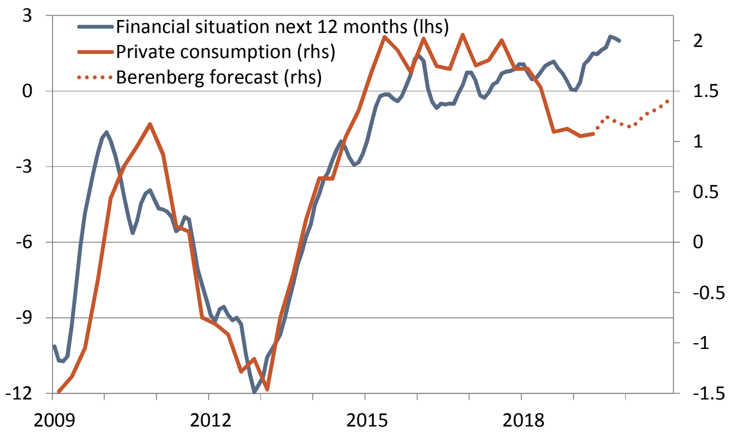
29 November 2019

Consumption: upside potential despite the pressure

Eurozone: solid household finances support private consumption



The expected financial situation of Eurozone households in the next 12 months, left-hand scale; Eurozone real private consumption, yoy change in %, right-hand scale. Source: European Commission, Eurostat, Berenberg forecasts

- **Strength at home:** Across the advanced world, three major domestic forces are supporting gains in aggregate demand: households are opening their wallets, residential construction is rising and governments are spending more than before. As a result, most economies continue to weather the fallout from Donald Trump's trade wars, the Brexit mess and the Chinese slowdown reasonably well. Even in the trade-dependent Eurozone, which has been hit particularly hard by these external shocks, private consumption (54% of GDP) is still expanding at a rate just above 1% yoy. Data from major member countries suggest that consumption growth even ticked up slightly in Q3.
- **Modest damage so far:** Two factors shape the outlook for consumption. First, households need to have the means to spend. Second, they need to be confident enough to do so. The series of external shocks that started in early 2018 with the first major round of US tariff threats has not left Eurozone households unscathed. Most importantly, employment growth in the Eurozone has slowed from 1.5% yoy in 2018 to 1.2% in Q2 and 1.1% in Q3 2019. So far, a modest acceleration in wage inflation has more than offset this, lifting gains in nominal disposable incomes to 3.3% yoy in Q2 2019 (latest available data), from 3.1% in 2018. While wage growth is likely to stagnate or even decelerate slightly in the next few quarters, low inflation will keep the real spending power of households on a rising trajectory.
- **A matter of confidence:** The financial situation that households expect for themselves in the 12 months ahead tends to lead actual consumer spending. But the correlation is not perfect. As our chart shows, consumer spending decelerated in 2018 and early 2019, whereas households' expectations for their own financial situation stayed at near-record levels. Responding to elevated global uncertainty, consumers raised their savings rate from 12.1% in 2017 to 13.2% in Q2 2019. In some member countries, a perceived need to save more for retirement at record-low interest rates may have added to this.
- **A comfortable position:** Over the summer, Eurozone households turned even more optimistic about their personal finances. In September, this forward-looking component of consumer confidence reached its highest level since 2001, receding only marginally in October and November. This suits our call that private consumption growth can edge up to at least 1.3% yoy in 2020, from 1.1% this year. Of course, if global trade tensions escalate again, that could shatter consumer confidence. Households may raise their savings rate further instead of spending more next year. But the prospect of an orderly Brexit at last and the recent lull in US-Chinese and US-EU trade tensions, given the approaching US election season, suggest that the external risks are more likely to fade a little than to get worse.
- **A virtuous circle?** With luck, Eurozone consumption could be supported by a virtuous circle. With less elevated global uncertainty, bond yields could continue the gradual rebound that started in September. In turn, this could reduce the urge to save. The risks to our outlook for consumption seem balanced rather than tilted to the downside.

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