Seven fat years, seven lean years – Summary

After the crisis, Eurozone household finances finally start to look up

In the past seven years, the Eurozone has weathered a severe economic tempest, which has dramatically affected the income, consumption and saving of households. But after seven 'lean' crisis years, aggregate household disposable income in the Eurozone has still not recovered. After peaking at the end of 2009, disposable income was dragged down by the 'double whammy' of falling market incomes (gross incomes from labour and capital) and income tax hikes from 2010 to 2013. Although disposable income has been growing for two years, in spring 2015 it was still 1.7% below its end-2009 peak. In that respect, the Eurozone has fared much worse than the US and the UK, where aggregate disposable income has increased by 12.5% and 2.0% respectively over the same period.

The financial crisis has also triggered a stark divergence across the Eurozone, with households in core countries maintaining their disposable incomes at pre-crisis levels, while those in key peripheral countries have seen theirs plunge dramatically. As a result, income inequality between Eurozone countries has increased sharply. While disposable income per capita has risen by 5.4% in Germany since the start of 2008, it has fallen by 15.4% in Italy and by a dramatic 29% in Greece.

Remarkably, even the seven 'fat' years preceding the crisis were not that 'fat' in all Eurozone countries. In fact, there was hardly any cross-country convergence of household disposable income, despite the gradual economic and financial integration of Eurozone member states. Households in the largest peripheral countries did not meaningfully catch up with those in the core. In Italy (3.8%) and Portugal (4.2%), per capita disposable income growth in the seven years before the crisis was even markedly lower than in Germany (4.8%), which was characterised by strong wage moderation in the period.

When the financial crisis started, governments immediately launched strong counter-cyclical policies to support household incomes. Thanks to a big surge in social benefits, disposable income growth remained positive in 2009 (by 0.3%), despite the fall in the number of employees, in income of self-employed and in capital income. However, these policies were quickly reversed because high public debt levels in many countries, loss of investor confidence and European budget rules forced many governments to switch to fiscal consolidation.

Fortunately, the seven lean years are running to an end. Disposable income in the Eurozone has probably grown by a decent 1.7% in 2015 and we expect it to expand at a similar pace in coming years: 1.6% in 2016, 1.6% in 2017 and 1.7% in 2018. This means that it should have reached the end-Q2009 peak by mid-2016, and exceed it by 4.3% by the end of 2018. Labour income should continue to play an important role, and the adverse effect of higher inflation in the coming years is expected to be offset by a stronger contribution of the income of self-employed and of dividends.

The income divergence between the core and the periphery should have stopped in 2015. Moreover, disposable income of the periphery is projected to grow meaningfully faster than that of the core, mostly on the back of faster employment growth. That said, the better expected performance of peripheral households is essentially driven by Spain, while the pace of expansion in other key peripheral countries is likely to remain sluggish. Income in the largest core countries should expand at a more even pace, except in Belgium, where wage moderation is temporarily weighing on employee compensation.

Household consumption in the Eurozone is forecast to grow at the same pace as disposable income in 2015 and 2016, but a little faster in 2017 (1.7%, vs. 1.6%) and 2018 (1.9%, vs. 1.7%) as household deleveraging fades. As a result, the saving rate is forecast to fall slightly from the current 12.7% to 12.4% in 2018.

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