Article | 5 December 2024

Three calls for European households: C’mon and spend!

European consumers have been frugal, saving a high share of their increasing real incomes. We expect things to normalise gradually next year, and there's still the potential for an upside surprise

Incomes will keep catching up next year, but we're not yet seeing a big spending spree

1 Call 1: Real wages support consumption

This year, real incomes have been catching up, driven by a rise in real wages. However, households are still holding back on spending, avoiding purchases of cars and other durable goods. The share of income not being spent hovers around 15%, compared to 12.5% pre-Covid. This ‘savings ratio’ is peaking, with Poland and Romania as rare exceptions, while the UK’s savings ratio has nearly doubled. In Spain and the Netherlands, a gradual decline has begun, albeit from a high level. This contrasts starkly with US consumers.

Real incomes will continue to catch up next year but at a slower pace. Wage growth is slowing, inflation is decreasing less, and government fiscal consolidation is impacting households. Slower employment growth further dampens income growth.

Uncertainty remains high, and consumers are increasingly fearful of unemployment as the manufacturing sector announces restructuring. We expect an actual rise in unemployment, further damaging confidence. Additionally, interest rates still encourage saving over spending, limiting the expected decline in the savings ratio.

2 Call 2: The housing market turns savers into spenders

In Europe, unlike the US, recent 'savings' haven't significantly increased households' bank accounts. Total bank deposits haven't kept pace with nominal income, limiting the potential for a spending spree.

The high savings ratio did lead to gradual mortgage deleveraging, with outstanding debt declining relative to nominal income. Lower house prices and high mortgage rates encouraged down payments, while fewer housing transactions reduced demand for new mortgages.

Recently, this trend has started to reverse. In 2025, with lower average mortgage rates and higher nominal incomes, house prices will rise, and housing transactions will increase. This will support household consumption, for example, as moving often involves new furnishings. Overall, we expect a slight increase in household consumption.

3 Our bold call: From frugality to economic boom

History shows that sudden jumps in real income are rarely spent immediately. It takes time for consumers to adjust their behaviour. We also know that savings ratios are primarily driven by higher-income households. Next year, they may decide to finally go out and spend. Since higher-income households' additional spending is a significant share of total consumption, this could provide an important boost. If the housing market picks up more than we expect, it could also play a pivotal role.

A full normalisation of the savings rate to around 12.5% could lift GDP by up to 1.5%. Amidst the economic gloom, it's heartening to remember that we have at least one bright spot that might well be an upside surprise.

Author

Marieke Blom
Chief Economist and Global Head of Research
marieke.blom@ing.com

Disclaimer