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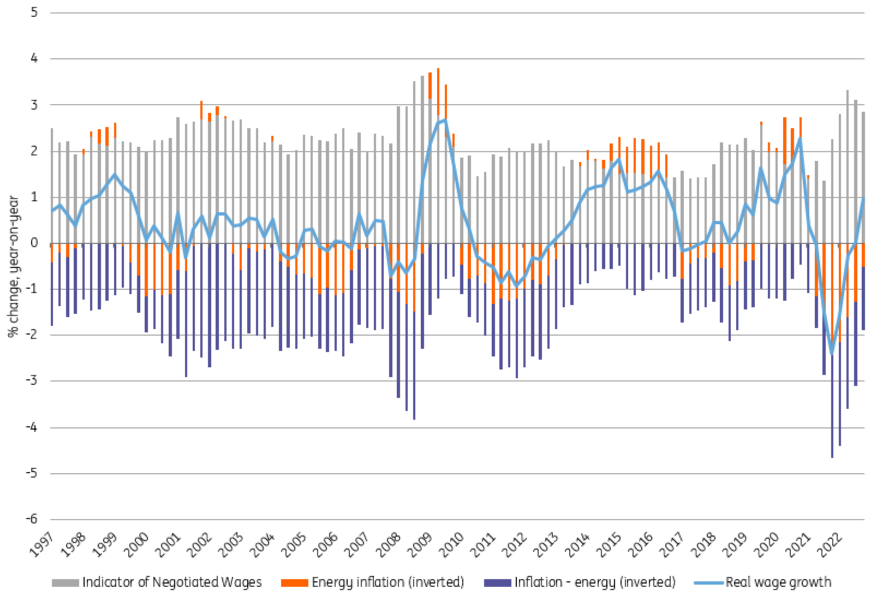
Eurozone energy inflation to drag on household consumption throughout 2022

The eurozone energy crisis lingers on as market gas prices remain elevated and Brent oil prices continue to trend higher. For the eurozone economy, this is bad news. The higher consumer and producer prices are resulting in negative real wage growth and squeezed margins, weighing on private consumption

Energy inflation remains elevated for most of 2022, hurting real wages

From a consumer perspective, the jump in energy prices is a significant dent in purchasing power. Real wage growth in the eurozone has been declining at a pace not seen in decades, at least since the early seventies. Chart 1 shows that energy inflation plays a key role here. Without it, we would have seen real wage growth roughly flat in the third quarter of 2021. While we expect nominal wage growth to pick up from here, we expect real wage growth to remain negative for at least the first half of 2022. This adds to a sizeable squeeze in purchasing power for the consumer and dampens growth prospects.

Real wage growth has been squeezed substantially in recent months as energy inflation soars



Source: Eurostat, ECB, ING Research

ING Research forecasts from Q4 2021 onwards

Energy inflation is set to remain elevated for quite some time in the eurozone as high natural gas prices have yet to be fully priced through to the consumer. This effect usually lags by about 5 months, which means that early 2022 will be characterised by elevated energy inflation. Still, when you look at futures markets, we expect energy inflation to drop over the course of 2022 after the peak seen in the fourth quarter of last year even though this does not mean a reduction back to normal levels, far from it. Read more on market energy price expectations in our Energy Outlook 2022.

Government support is ample, but not enough to mitigate impact

Governments have come up with mitigating measures to soften the blow for consumers. They're relatively similar - as you can see in the chart below - focussing mainly on protecting vulnerable groups' incomes and reducing taxes for a period in time. In Germany, the previous government had decided to lower the green transition tax, which is part of energy prices, from the start of this year. Relief for low-income households is currently under discussion but not decided yet.

France has capped consumer gas prices until the end of the year and has provided 100 euros of compensation to a large number of households. It is also working on regulation changes for energy providers.

Italy and Spain have introduced a wide array of measures, including lowered VAT rates on energy. These measures have already been in place for a few months, but as chart 2 shows, have proven only to be partially helpful in reducing costs to consumers.

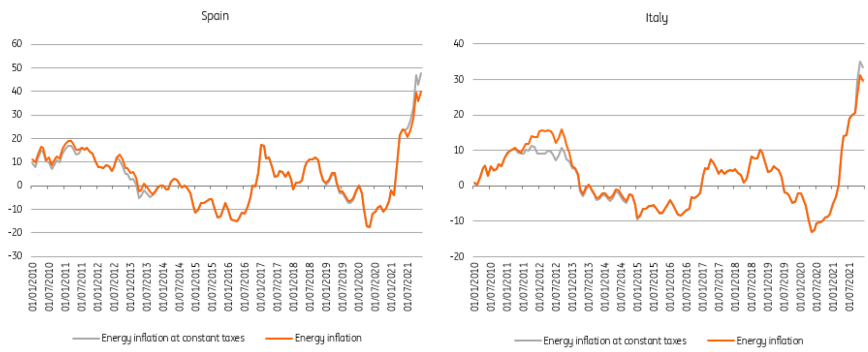
Measures taken by different countries fall into roughly similar categories

	🇩🇪	🇫🇷	🇮🇹	🇪🇸	🇳🇱	🇧🇪
Lowered taxes	✓		✓	✓	✓	✓
Price regulation (retail or wholesale)		✓		✓		✓
Transfers to vulnerable groups		✓	✓	✓	✓	✓

Source: Bruegel, ING Research

While mitigating measures do help, they seem only to put a dent in the inflation rate so far. Of course, income support doesn't show in price measures, but the reduction in taxes on energy has not had a huge impact as of yet and outside of measures shielding vulnerable groups, most consumers remain relatively unshielded from the rising energy costs at this point. That said, the actual impact so far remains broadly moderate when you consider the confidence figures.

VAT reductions have only mitigated energy inflation to a small degree so far in Italy and Spain



Source: Eurostat, ING Research

Consumers are not yet feeling the squeeze, but expect downward impact on spending

Consumers still report very favourably on their current financial situation, which indicates that higher energy prices are not yet causing widespread financial problems that derail other consumption significantly. Mind you, much of the impact from higher gas prices will only show in the months ahead. Therefore, it doesn't come as a surprise that consumers expect a deterioration in their financial situation over the next 12 months and we should see private consumption being affected soon.

In the past, consumers tended to offset higher energy prices with less spending on other services or goods. As we found in this note from late last year, consumers in eurozone countries have different elasticities for higher energy prices. Only consumers in Belgium, Finland and Slovakia see a negative correlation between prices and the share of spending on energy, essentially they'd rather put on an additional sweater.

Right now, the difference with past episodes of high energy prices is excess savings due to the lockdowns. It could very well be that consumers eat into their excess savings to pay for at least one period of higher energy prices. In such a scenario, private consumption in the eurozone could be relatively unharmed through the current period but chipping in excess savings would still mean less post-pandemic consumption later in the year. One way or the other, high energy prices will weigh on private consumption.

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