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Household Final Consumption in the EU: The key driver for a sustainable recovery?

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After 4-5 years of poor performance, final consumption of households in the 28 EU member states is expected to recover significantly in 2015 and 2016. This is all the more important since final consumption of households has been the main driver of economic growth during the 12 years preceding the financial crisis. However, some obstacles are still in the way preventing a sustainable recovery in private consumption.

1. Overall gloomy macroeconomic performance in the EU-28 between 2010 and 2014

According to the latest forecast of the European Commission (November 2015), 2014 growth in real GDP reached +0.9% in the euro area and +1.4% in the EU-28 (versus +2.4% in the US and +4.0% in the world).[1] The weak performance in the EU-28 is partly due to the poor cumulative contribution of France and Italy (+0.02 pp of contribution for 26.7% of the total GDP).[2] On the other hand, two much smaller economies provided a larger contribution in 2014: although they accounted for only 1.8% of the EU-28 GDP, Ireland and Luxembourg registered a positive cumulative contribution of +0.08 pp

The average growth recorded in the EU-28 stood at +1.0% over the 2010-14 period, down from +2.3% in 2001-07 and +2.9% in 1996-2000 (see Figure 1).[3] After controlling for demographic trends, the assessment is broadly similar: the average growth per capita reached a sluggish +0.8% in 2010-14 versus +1.9% in 2001-07 and +2.6% in 1996-2000. Admittedly, the performances recorded in the last quarter of 2014 and forecasted for 2015 show some encouraging signs of economic recovery after two consecutive years in the doldrums;

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[1] The data on world real GDP are provided by the IMF in its World Economic Outlook (July 2015).

[2] pp stands for percentage points.

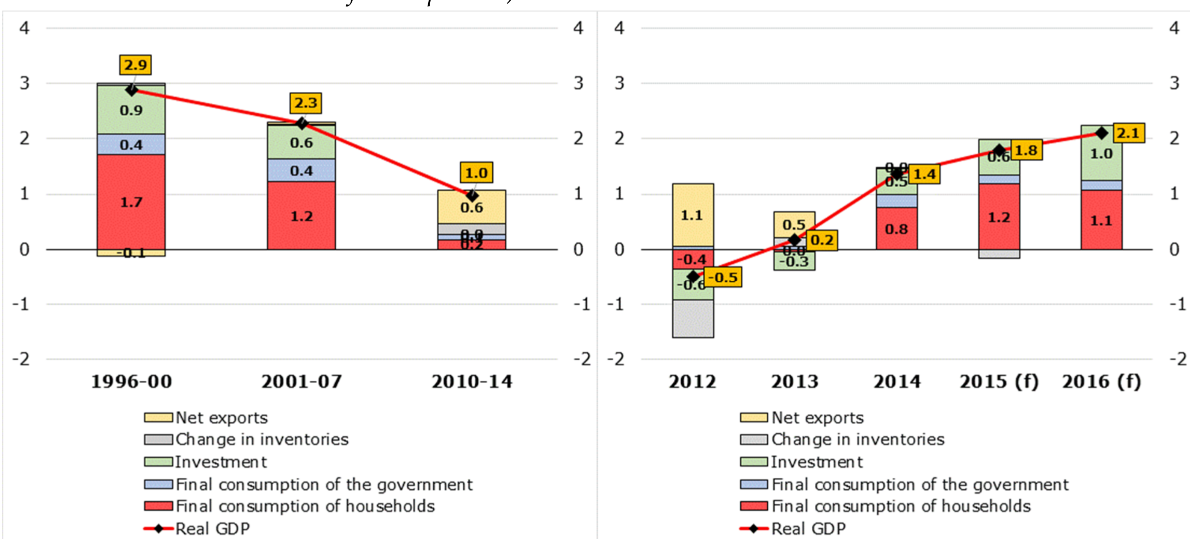
[3] The years 2008 and 2009 have been excluded, due to the high distortions observed in GDP time series during these two consecutive years.

nevertheless, the broad consensus among international institutions is that growth in the coming years will remain in the 1.7-2.1% range, still below pre-crisis levels.[4]

2. Limited contribution of household private consumption since 2010

Figure 1 reveals that the main driver behind economic growth in the decade preceding the financial crisis was private consumption of households (+1.7 pp in 1996-2000 and +1.2 pp in 2001-07). However, despite accounting for almost 60% of total GDP in the EU-28, private consumption contributed a mere 0.2 pp over the 2010-14 period, thereby acting as a drag on imports (which partly explains why net exports became the main driver of growth in 2010-14). The corresponding average contribution was even null for the euro area, whereas it stood at +1.5 pp in the US.

Figure 1. Real GDP growth and main contributors in the EU-28 (in percentage points of contribution, arithmetic mean for the periods)



Note: Net exports is the difference between exports and imports.
Sources: Eurostat and ECRI 2015 Statistical Package on Lending to Households in Europe (www.ceps.eu/publications/ecri-statistical-package-2015-lending-households-europe).

Aggregate contribution masked different patterns at country level in 2010-14 (see Table 1). On the one hand, resulting from a combination of convergence processes and a favourable macroeconomic environment, the contribution of private consumption of households to real GDP has been robust in Latvia (+2.8 pp), Lithuania (+1.9 pp), Estonia (+1.6 pp), Poland (+1.3 pp) and Romania (+1.3 pp). Economies with better resilience to the depressing effects caused by the financial crisis recorded a noticeable contribution of private consumption during the same period: Sweden (+1.2 pp), United-Kingdom (+0.9 pp), Luxembourg (0.7 pp), Germany (+0.7 pp) and Belgium (+0.5 pp). However, economies that have been engulfed by the sovereign debt crisis of 2011-12 were all countries with negative contributions from private

[4] According to Eurostat, quarterly consumption of households contracted year-on-year (seasonally adjusted) between Q4 2011 and Q2 2013, slightly increased between Q3 2013 and Q3 2014 and increased by more than 1.5% in Q4 2014, Q1 2015 and Q2 2015.

consumption of households: Spain (-0.4 pp), Italy (-0.6 pp), Portugal (-0.8 pp) and Greece (-4.0 pp). For the period 2010-14, overall, it is worth mentioning that only Germany in the whole EU-28 recorded a contribution above pre-crisis levels.

Table 1. Contribution of private consumption to GDP growth (in real terms, in percentage points)

	1996-2000	2001-2007	2008-2009	2010-2014		1996-2000	2001-2007	2008-2009	2010-2014		1996-2000	2001-2007	2008-2009	2010-2014
LV	3.3	7.2	-9.9	2.8	BG	1.2	4.9	-1.4	0.7	HU	1.5	2.2	-2.0	-0.3
LT	3.4	5.9	-4.8	1.9	FI	1.7	1.8	-0.3	0.6	NL	2.2	0.4	-0.2	-0.4
EE	4.0	5.1	-5.7	1.6	BE	1.2	0.7	0.6	0.5	ES	2.4	2.0	-1.2	-0.4
US	**3.0**	**2.0**	**-0.7**	**1.5**	AT	1.1	0.8	0.4	0.4	SL	1.9	1.8	0.6	-0.5
PL	3.8	2.2	2.4	1.3	FR	1.4	1.2	0.1	0.3	CY	2.7	3.0	0.0	-0.6
RO	1.9	6.8	-0.5	1.3	**EU28**	**1.7**	**1.2**	**-0.3**	**0.2**	IT	1.5	0.5	-0.7	-0.6
SE	1.7	1.2	-0.1	1.2	DK	0.7	1.2	-1.0	0.1	HR	1.5	2.9	-1.8	-0.7
MT		1.2	1.5	1.0	CZ	1.1	1.9	0.7	0.1	PT	2.7	1.0	-0.3	-0.8
UK	3.0	2.0	-1.5	0.9	SK	2.5	3.0	1.7	0.1	EL		2.9	0.9	-4.0
LU	1.8	0.8	-0.4	0.7	**EA18**	**1.5**	**0.9**	**-0.2**	**0.0**					
DE	0.9	0.2	0.3	0.7	IE	4.0	2.3	-1.3	-0.1					

Sources: ECRI 2015 Statistical Package on Lending to Households in Europe (www.ceps.eu/publications/ecri-statistical-package-2015-lending-households-europe) and Eurostat.

3. Recovery in private consumption

Spurred by an improving labour market, a low inflation environment and the sharp fall in energy prices, private consumption "increased gradually throughout 2014 and should reach a growth rate comparable to pre-crisis levels in 2015. According to the latest forecast of the European Commission, increasing consumer confidence throughout 2014 and 2015 and rising disposable income (net taxes and labour income were positive in 2013 and 2014 for the first time since 2009), as well as stagnant savings rates, have also contributed to the recovery in household final consumption.

Nevertheless, one question remains. As shown in a companion ECRI Commentary,[5] the development of the credit markets have played a significant role in the dynamics of private consumption since 1995. Continuous economic growth during the decade preceding the financial crisis partly resulted from the build-up of significant amounts of household debt in the EU-15 (see Figure 2). Better access to retail finance, especially in peripheral economies, and an environment of low interest rates due to the creation of the monetary currency union partly explain these upward trends in household debt. For example, over the 2000-07 period, the ratio of outstanding household debt to household disposable income increased by a stunning 87 pp. in Denmark and Ireland, to reach 249% and 107.6% in 2007, respectively. The increase was lower in Finland and the UK, but still above 50 pp, and significant in the Netherlands (27.1 pp), Portugal (28.3 pp), France (38.6 pp), Spain (48.3 pp), Greece (19.1 pp) and Italy (15.4 pp).

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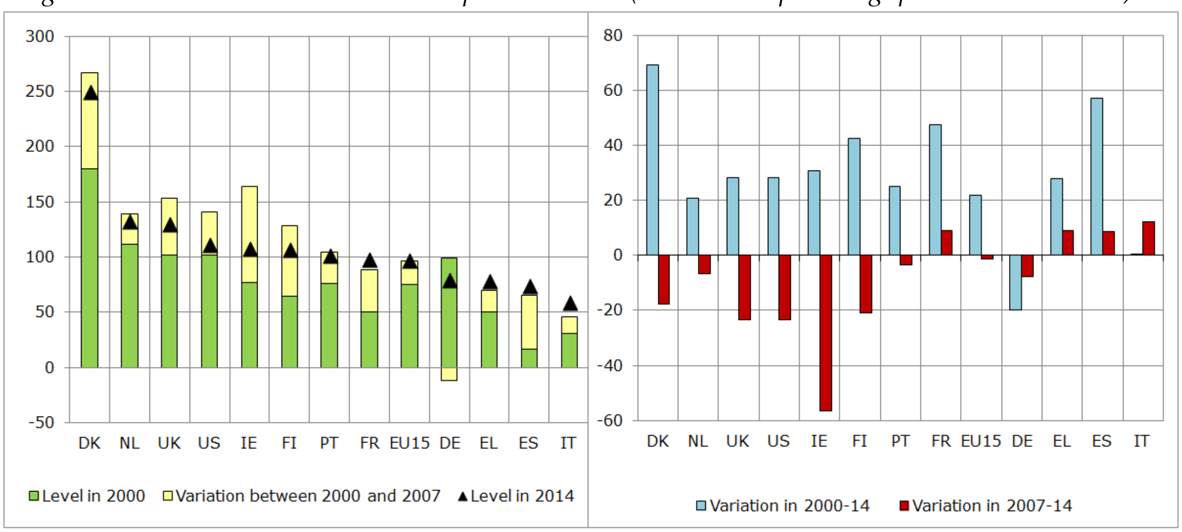
[5] Sylvain Bouyon, "What drives household consumption in the EU-28?", ECRI Commentary No. 19, 4 December 2015.

The German market recorded an opposite trend, as its ratio contracted by 12.1 pp over the same period.

The marked increases in outstanding household debt observed in most EU-15 countries before the crisis is often blamed for being one of the main drivers of the financial crisis and its persistent negative effects in the aftermath. Six years after the sharp economic contraction recorded in 2009, the deleveraging process has been significant only in Denmark (-17.8 pp between 2007 and 2014), Ireland (-56.5 pp), the UK (-23.3 pp) and Finland (-20.8 pp), although household debt remains high in these countries. Owing notably to the poor macroeconomic performance recorded in recent years and the reasonable levels of household debt prior to the crisis, the debt-to-disposable income ratio increased by 8.8 pp in Spain, 9.0 pp in France and 12.2 pp in Italy over the same period. Overall, between 2007 and 2014, the ratio has stagnated in the EU-15 (-1.2 pp), as opposed to the US where it contracted by more than 23 pp. All around Europe, numerous households still need to deleverage before re-entering a sustainable consumption path. Some specific rules could help accelerate these balance-sheet adjustments, such as further flexibility in the bankruptcy rules of specific retail loan markets in countries like Spain. A better assessment of the ability of household credit markets (primarily consumption credit markets) to support future growth in household final consumption could contribute to the reinforcement of economic recovery.

Figure 2. Household debt to household disposable income (variations in percentage points and level in %)



Source: ECRI 2015 Statistical Package on Lending to Households in Europe (www.ceps.eu/publications/ecri-statistical-package-2015-lending-households-europe).