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FINANCIAL POSITION OF EURO AREA HOUSEHOLDS IN 2018

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ABSTRACT

Drawing on the accounts for the institutional sectors, this article describes how euro area households' income, savings, borrowing and financial wealth evolved in 2018. The improvement in the labour market and the more dynamic wage performance continued to boost household income and this, together with the increase in asset (especially housing) values, and against a backdrop of very low interest rates, sustained household expenditure. The saving rate rose slightly in the euro area overall, although with considerable differences between countries. Households' demand for finance continued to grow at a moderate pace, resulting in a slight dip in their debt-to-income ratio.

Keywords: households, income, consumption, investment, saving, wealth, debt.

JEL codes: E21, E22.

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Introduction

This article examines the changes, at the aggregate euro area level, in households' income, consumption and savings, and in their financial transactions and financial position, in 2018.

In general, the financial position of euro area households changed favourably in 2018, despite the economic slowdown. The lower economic dynamism largely reflected the deceleration in net external demand and the effect of certain ad hoc factors that had a particular impact in some euro area countries (such as Germany and Italy) and some economic sectors (such as the car industry).[1] Yet the labour market was resilient and, together with the increase in wealth, helped sustain household expenditure, which remained quite robust. Against a backdrop of greater global uncertainty, the household saving rate rose slightly in the euro area as a whole, while the differences in the saving rate between countries held steady or even widened.

Economic growth and low interest rates underpinned households' demand for finance, both for consumption and house purchases. In any event, the gradual deleveraging process in the sector continued.

Euro area household income rose briskly in 2018

Household income in the euro area continued to grow in 2018, as employment and wage levels both rose. In nominal terms, gross disposable income (GDI)[2] continued

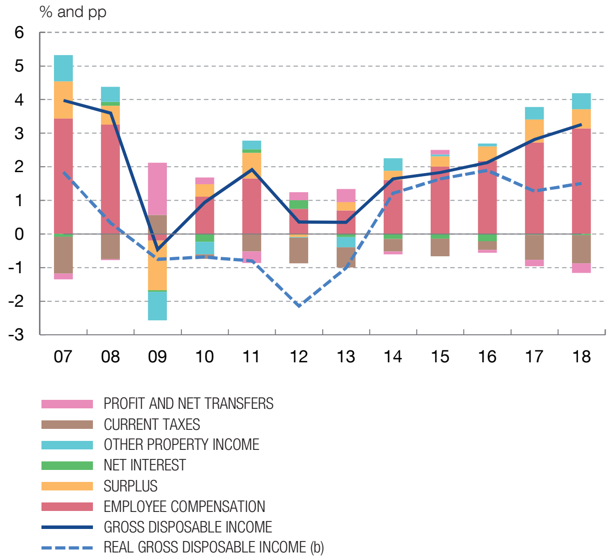
1 See, for example, "The impact of the car industry slowdown from a global value chain perspective", Box 5, "Quarterly report on the Spanish economy", *Economic Bulletin* 2/2019, Banco de España.

2 The household sector includes sole proprietorships without legal personality and not-for-profit institutions. GDI comprises employee compensation (including employers' Social Security contributions), mixed income (from self-employment), gross operating surplus (from family businesses and from imputed income from owner-occupied housing), net income from property (essentially interest and dividends received less interest paid) and transfers to and from the public sector (Social Security benefits less contributions made and tax paid). In the article, GDI is adjusted for the net change in pension fund assets.

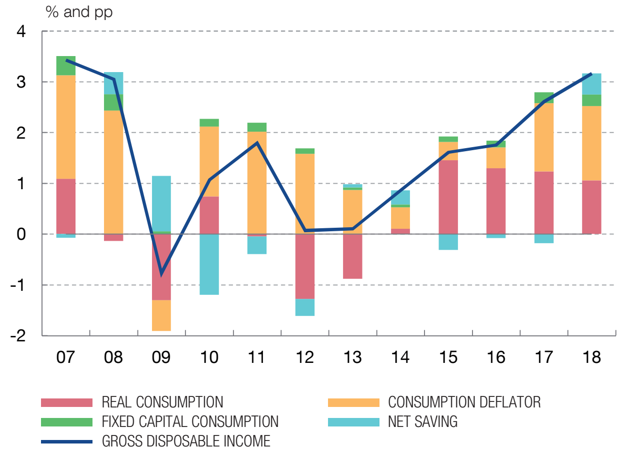
Chart 1
EURO AREA HOUSEHOLDS' INCOME AND CONSUMPTION PROVED RESILIENT TO THE ECONOMIC SLOWDOWN

Robust wage income drove household income in 2018. Higher income and higher wealth, together with accommodative financing conditions, continued to sustain consumption, within a gradual pattern of slowdown and higher saving.

1 GROWTH IN NOMINAL AND REAL HOUSEHOLD INCOME (a)
Contributions of components to year-on-year growth



2 USE OF GROSS DISPOSABLE INCOME PER CAPITA
Contributions to year-on-year growth



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SOURCE: Eurostat.

a See footnote 2.
b Deflated by average HICP growth.

to accelerate, recording year-on-year growth of 3.3%, the highest rate in the last ten years (see Chart 1.1). By country, nominal GDI growth was over 3% in general, save in France (2.7%) and Italy (1.9%), although in both cases the rate of growth was higher than in 2017.

In real terms household income growth was also robust in 2018: real GDI rose by 1.5%, a rate similar to the average of the last five years. The highest increases were recorded in the smaller countries, including Greece, where after a long period of notable purchasing power losses, real household income rose by 1.9%, underpinned by the improvement in labour market conditions. The most modest increases in real household income were observed in France, Italy and Belgium (around 0.7% in all cases).

Good labour market momentum continued

Since the start of the economic recovery in 2013, the improvement in the labour market has underpinned growth in household income, which in turn has afforded consumption a crucial role in boosting momentum in the euro area. After a long phase of intense job creation, which peaked in 2017, employment growth moderated somewhat in 2018, albeit less so than the rate of growth of GDP. Employment rose by 1.5% on average, compared with 1.6% in 2017. The most recent indicators continue to point to employment growth, although at a slower pace. In 2019 Q1, employment grew by 1.3% year-on-year.

Although the unemployment rate is very low in countries such as Germany and the Netherlands, there is still labour market slack in some euro area economies, as shown in Chart 2.1 which depicts the change in the unemployment rate and other broader measures of unemployment.[3]

Wage growth has begun to reflect the lower level of slack in the labour markets and the increase in inflation. Compensation per employee started to accelerate in mid-2017; at end-2018, the year-on-year rate of growth stood at 2.2%. Taking into account the average HICP rate, compensation per employee in real terms also rose slightly, by 0.5%, after remaining unchanged in 2017.

Strong income, wealth and consumption dynamics

In this setting, wage income grew as a proportion of household income. Aggregate compensation per employee – which includes both wage and employment growth – continued to accelerate, increasing by slightly more than 4% in 2018, accounting for 78% of household income. However, the second component in terms of importance in gross household income, included under the gross operating surplus and mixed income heading, decelerated. This component includes self-employment income (mixed income) and non-wage income from family businesses and from imputed income from owner-occupied housing. Specifically this income heading – denoted as Surplus in Chart 1.1 – rose by 2.4% in 2018, slightly less than in 2017 (+2.8%).

Moreover, both interest[4] paid and interest received as return on savings continued in the downward pattern of recent years, reaching new all-time lows. In net terms, households received interest equivalent to 0.5% of their GDI. By contrast, "other property income", which includes, for example, distribution of corporate dividends,[5] which account for around 12% of GDI, rose by almost 4%.

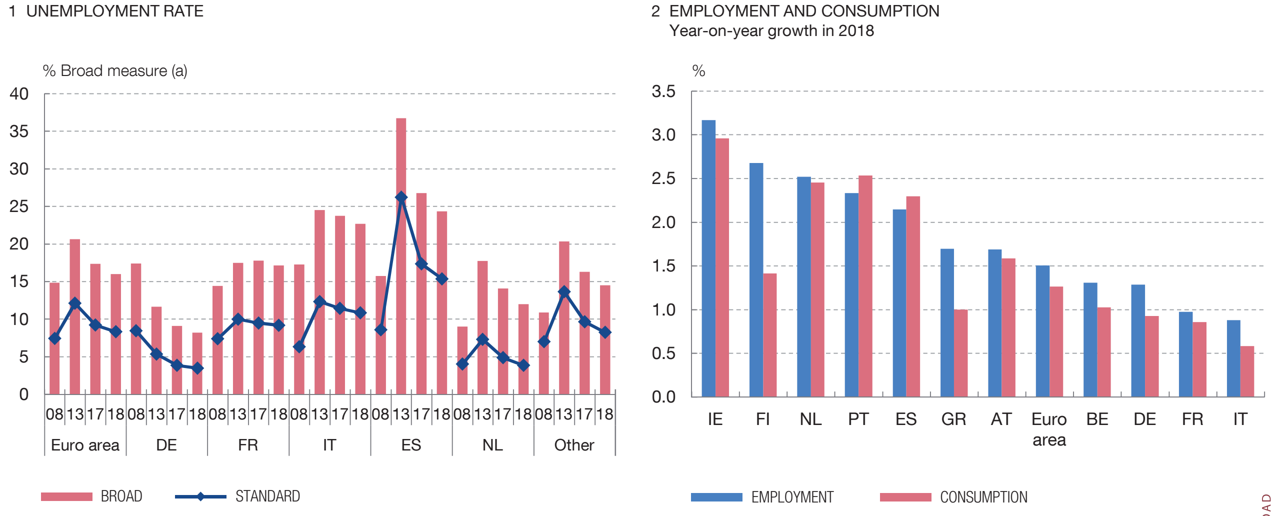
3 These measures take into account part-time workers who are underemployed and the potential additional labour force. This includes those who are not actively seeking but are available for employment (discouraged workers), and those actively seeking employment but who are not available to start work within the next two weeks.

4 Interest comes from deposit holdings, debt securities, loans and other accounts receivable.

5 Dividends come from equity holdings and holdings in investment funds. Other property income also includes investment income attributable to insurance policyholders, among others.

Chart 2
EURO AREA LABOUR MARKET

Although the unemployment rate is very low in countries such as Germany and the Netherlands, there is still labour market slack in some euro area economies. Growth in private consumption in 2018 was strongest in the countries with higher job creation rates.



SOURCES: Eurostat, ECB and Banco de España.

a Labour force plus those who are available for but not actively seeking employment and those actively seeking but not available for employment.

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Lastly, tax payments continued to increase as a proportion of nominal GDI, accounting for more than 16% of GDI, the highest figure recorded since 1999. This higher taxation, combined with lower net general government transfers, detracted more than 1 pp from GDI growth.

Higher income was accompanied by higher wealth. The value of households' assets increased by almost 5% in 2018, especially as a result of the contribution of real estate assets. Financial wealth rose by barely 1%, compared with more than 7% for real estate wealth, significantly higher than the 4% recorded in 2017 (see Table 1). Housing values increased across the board, and in some cases – such as the Netherlands, Portugal, Luxembourg, Latvia and Slovenia – by more than 6% in real terms. Italy was the only country where real estate prices fell, albeit very moderately.

Higher income, higher wealth and job creation continued to sustain euro area households' consumption, within the gently slowing pattern that began in 2015 (see Chart 1.2). Consumption expenditure (in real terms) rose by 1.3% in 2018, compared with 1.8% in 2017. In general, consumption growth on average in 2018 was stronger in countries where employment creation was higher, such as Spain, the Netherlands, Portugal and Ireland (see Chart 2.2).

Table 1
HOUSEHOLDS

	Balances (€bn)	Financial transactions (% of GDP)						
	2018	2012	2013	2014	2015	2016	2017	2018
FINANCIAL ASSETS	23,758	2.3	2.5	3.4	3.9	4.1	4.2	4.2
Currency and deposits	8,229	2.4	1.8	1.7	1.8	2.8	2.3	2.8
Debt securities	565	-1.0	-1.8	-2.0	-1.6	-0.9	-0.8	-0.2
Shares and other equity	6,361	0.4	1.1	1.2	1.8	0.6	1.1	0.2
Of which:								
Listed shares	*903*	*0.0*	*-0.3*	*0.1*	*-0.2*	*-0.1*	*-0.1*	*0.1*
Unlisted shares and other equity	*3,382*	*0.5*	*0.7*	*-0.4*	*0.7*	*0.4*	*-0.1*	*0.1*
Investment funds	*2,076*	*-0.1*	*0.6*	*1.5*	*1.2*	*0.4*	*1.3*	*0.1*
Insurance technical reserves and pension funds	7,500	1.2	1.5	2.2	1.8	1.6	1.4	1.3
Other	1,103	-0.6	0.0	0.2	0.0	0.0	0.2	0.1
LIABILITIES	7,518	-0.3	-0.2	0.2	1.3	1.5	2.1	2.0
Loans	6,678	0.1	-0.3	0.1	0.8	1.2	1.7	1.7
Of which:								
Loans extended by resident credit institutions (a)	*6,027*	*0.1*	*-0.2*	*0.0*	*0.7*	*1.0*	*1.5*	*1.6*
Other loans	*651*	*0.0*	*-0.1*	*0.0*	*0.1*	*0.2*	*0.2*	*0.1*
Other	840	-0.3	0.1	0.1	0.6	0.3	0.4	0.3

	Balances (€bn)	Year-on-year growth (%), unless otherwise indicated						
	2018 Q2	2012	2013	2014	2015	2016	2017	2018
FINANCIAL POSITION								
Gross disposable income (GDI)	…	0.4	0.3	1.6	1.8	2.1	2.8	4.8
Gross saving (% of GDI)	…	12.3	12.4	12.6	12.2	12.1	11.8	12.1
Net lending (+)/net borrowing (–) (% of GDI) (b)	…	3.8	4.3	4.5	4.1	3.5	3.0	2.9
Net lending (+)/net borrowing (–) (% of GDP) (b)	…	2.4	2.7	2.8	2.6	2.2	1.9	1.8
Borrowing (total liabilities)	7,518	-0.4	-0.3	0.3	2.1	2.3	3.3	3.2
Total gross wealth	58,125	0.1	0.8	2.1	3.0	3.2	4.0	4.8
Gross financial wealth	23,758	4.1	3.6	4.5	4.3	3.8	3.7	1.3
Non-financial wealth	34,366	-2.3	-1.0	0.4	2.0	2.7	4.2	7.3
Real estate wealth	32,437	-2.5	-1.2	0.6	2.2	2.9	4.4	7.5
Total net wealth (c)	50,607	0.2	1.1	2.4	3.1	3.3	4.2	4.9
Debt burden (% of GDI)	…	2.1	1.7	1.4	1.1	1.0	0.9	0.9
Debt (% of GDI)	…	97.1	96.0	94.7	94.0	94.3	94.0	93.5
Debt (% of GDP)	…	62.5	61.4	60.2	58.8	58.6	58.0	57.7
Debt (% of total financial assets)	…	31.4	30.0	28.8	28.0	27.6	27.3	28.1

SOURCES: Eurostat and ECB.

a Adjusted for securitisation and other transfers.
b Balance on non-financial accounts.
c Gross wealth less liabilities.

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That said, there was a significant slowdown in consumption over the course of 2018 in the euro area as a whole: private consumption rose by 0.7% in H1, and by just 0.3% in H2. Durable goods consumption was particularly affected by this loss of momentum, largely owing to consumption in Germany where both car manufacturing and the demand for cars felt the brunt of the entry into force of the new emissions protocols.

Saving rate disparities remained

The sustained growth in real household income, against a backdrop of gradual slowdown in consumption, prompted a slight increase in saving. The gross household saving rate in the euro area stood at slightly more than 12% of GDI in 2018, and at 12.5% in 2019 Q1. This is not very far from the historical average since 1999 (13% of GDI), but it masks significant differences between countries (see Chart 3.1). From a historical standpoint, the household saving rate is low in most countries, excluding Germany, the Netherlands, Ireland and Slovenia. German households have the highest saving rate in the euro area (over 18% of GDI in 2018), followed by households in the Netherlands (16%), Slovenia (15%) and France (14%). In historical terms, the saving rate is particularly low in Finland, Spain, Portugal and Greece. The negative gross saving rate in Greece suggests that some current spending is being funded through non-income sources, for example through sales of financial assets or debt.[6]

Differences in the saving rate between countries tend to be persistent and may respond to a multitude of factors. Household saving varies according to income levels and age; it also depends on socioeconomic and institutional considerations.[7] All these factors give rise to persistent differences between countries.[8] As Chart 3.2 shows, at the aggregate level there is a clear positive relationship between levels of income per capita and saving rates. There is also a certain correlation between age demographics and saving rates. For instance, the higher dependency ratio[9] could explain the lower saving levels in Finland (see Chart 3.3).

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6 In aggregate terms, Greek households had made net redemptions of loans since 2010. In 2018 Q4 net lending was positive in quarter-on-quarter terms for the first time since the crisis.

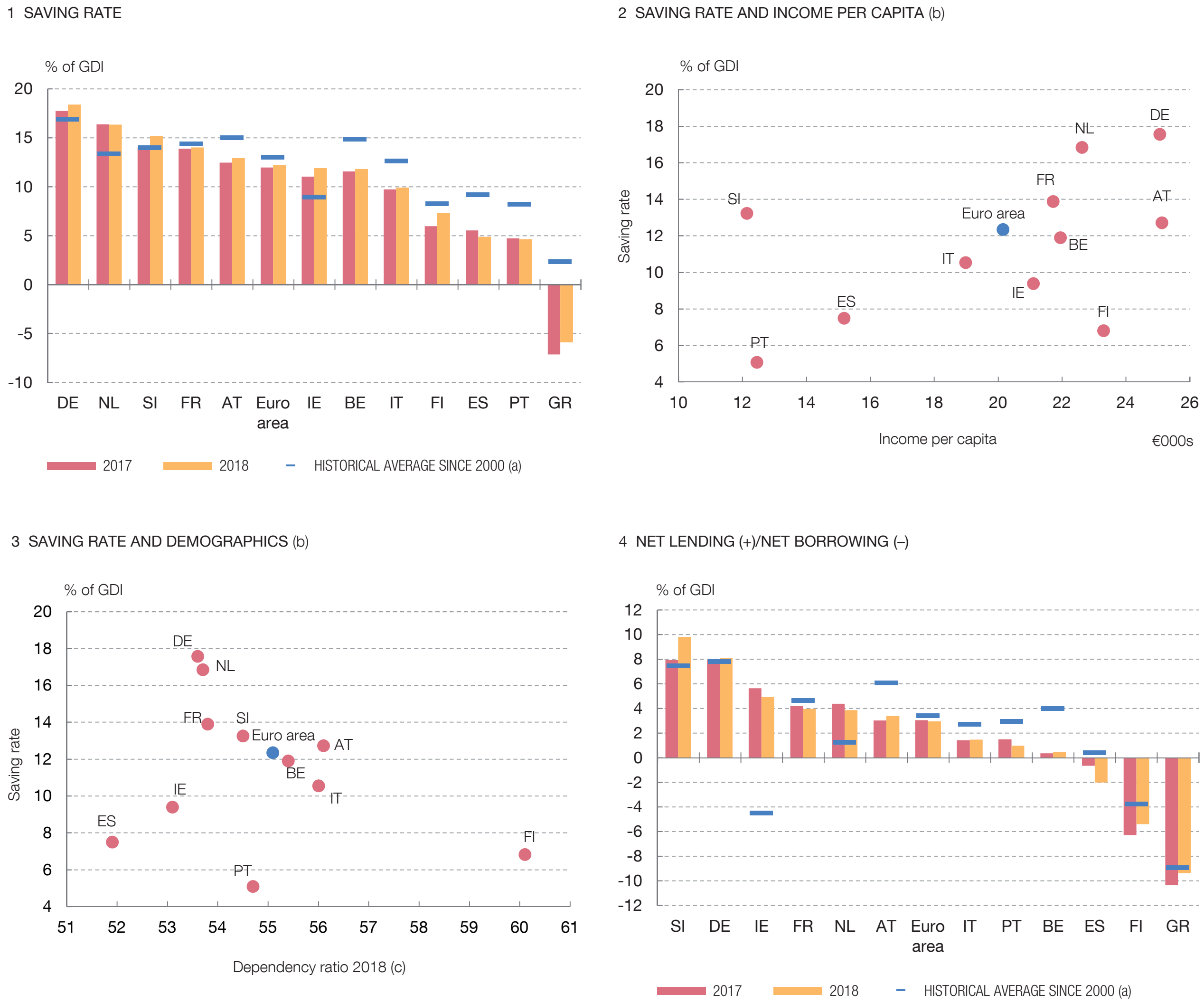
7 For instance, in Empirical Determinants of Household Saving: Evidence from OECD countries, Working Paper 181 (1997), the IMF finds that the greater the importance of direct taxation (compared with indirect taxation) and the more generous the welfare systems, the lower the saving rate.

8 See S. Rocher and M. H. Stierle (2015), Household saving rates in the EU: Why do they differ so much?, Discussion Paper 005, European Commission. The authors point to a large number of institutional factors that can affect comparisons between saving rates. Using a panel for the EU countries they confirm some of the determinants of the saving rate, but many of the differences observed between countries remain unexplained.

9 The chart depicts the population aged under 15 and over 64 as a proportion of the population aged 15 to 64.

Chart 3
DIFFERENCES IN THE HOUSEHOLD SAVING RATE, BY COUNTRY

The gross household saving rate in the euro area was slightly above 12% of GDI in 2018, with significant differences by country. The saving rate varies according to income per capita and age demographics; it also depends on institutional and socioeconomic factors.



SOURCE: Eurostat.

a Since 2005 for Slovenia.
b Average of five years for saving rate and income. Excludes Greece, which has an average saving rate of –6% of GDI, income per capita of €11,000 and a dependency ratio in 2018 of 56.7.
c Population aged under 15 and over 64 as a proportion of the population aged 15 to 64.

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The function of saving is to ensure a stable life-cycle consumption profile, with higher saving in the years of higher income generation. Wealth accumulation through saving may also be underpinned by altruistic motives (such as a desire to build up wealth to pass on to the next generation) or by the need to fund major expenses (to acquire durable goods, fund education or make a house purchase). These expenses generally mean that households must have saved in advance, and in many cases that they must also borrow, resulting in the need for subsequent saving to repay the debt acquired.

Chart 4
HOUSEHOLD SAVING AND INCOME MOMENTUM POST-CRISIS

The gross household saving rate in the euro area has not changed significantly over the last five years. The largest increases in saving have been in the countries with the highest growth in real wages (Germany, Slovenia and Ireland).

SOURCE: Eurostat.

Caution is also an important factor in saving, especially in times of uncertainty, prompting households to build up financial buffers with which to meet unforeseen expenses or unexpected drops in income. In consequence, the improvement in the labour market and the increase in wealth could have reduced the need for precautionary saving in 2018, while the greater uncertainty deriving from the economic slowdown, global financial market volatility or political, and especially fiscal uncertainty in some countries, could have increased it.

In view of the economic recovery since the last crisis, in general there has been little change in the household saving rate in most euro area countries since 2013. Thus, for the euro area overall, the saving rate changed by barely 1 pp of GDI over the last five years. Nevertheless, the changes have tended to heighten the differences in saving levels across countries. Thus, the main increases were recorded in Germany, Slovenia and Ireland: in Germany and Slovenia the saving rate reached a high 18% and 15% of GDI, respectively, while in Ireland it amounted to almost 9% in 2018, closer to the euro area average. By contrast, household saving rates in Spain[10] and Portugal recorded the largest decreases, from relatively low levels, down to all-time lows below 5% in 2018.

10 See “The household saving rate in Spain: developments and outlook”, Box 5, “Quarterly report on the Spanish economy”, *Economic Bulletin* 3/2018, Banco de España.

As Chart 4.1 shows, there is a positive correlation between household saving by country over the last five years and higher household income. The pattern differs according to whether the increase in income comes from growth in real wages or in employment. Thus, as shown in Chart 4.2, increases in saving rates were concentrated among the countries with the highest rate of average increase in real employee compensation (Germany, Ireland and Slovenia), whereas in countries such as Spain and Portugal, where the increase in income was driven by higher employment, the effect was most marked on consumption.[11]

Despite the greater dynamism of the real estate markets and the increase in household gross fixed capital formation[12] (chiefly investment in housing), the sector's net lending held relatively steady, at 3% of GDI in 2018, albeit with notable disparities between countries (see Chart 3.4).

Financial investment and financing

Turning to financial assets, households' investment flow held steady at around 4% of GDP in 2018 (see Table 1). Liquid instruments – currency and deposits – continued to attract a high volume of financial investment; this is associated in part with the low opportunity cost of holding savings in these instruments. Portfolio rebalancing in favour of higher return and higher risk instruments also continued, through net subscriptions to investment funds, to the detriment of debt securities. However, investment flows into equity instruments and investment funds were considerably lower than the volumes recorded in 2017.

Against a backdrop of historically low interest rates, higher income and higher wealth continued to underpin the demand for loans in 2018. Household borrowing continued along its moderately expansionary path, with growth rates steady at around 3%, which is below the growth rate of nominal GDP (see Chart 5.1). Although housing loans are the main component of lending to households, consumer loans have become the most dynamic component, growing by more than 6% in 2018, slightly less than in 2017. The larger euro area countries all saw a slowdown in consumer lending, although the deceleration was more marked in Spain, where growth in consumer loans had also been stronger in the recent period. Thus, consumer lending rose by more than 13% in 2018 in Spain (3 pp below the 2017 rate), by 9% in Italy, by 6% in France and by 5% in Germany. The low interest rate scenario continued to encourage fixed rather than variable rate lending (see Charts 5.2 and 5.3); 70% of

11 See Banco de España (2016), "Competitive adjustment and recovery in the Spanish economy", Chapter 2, *Annual Report, 2015*.

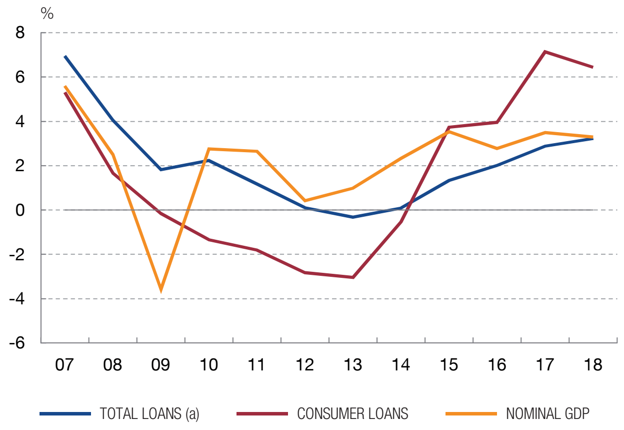
12 An increase of 5% for the third consecutive year.

Chart 5

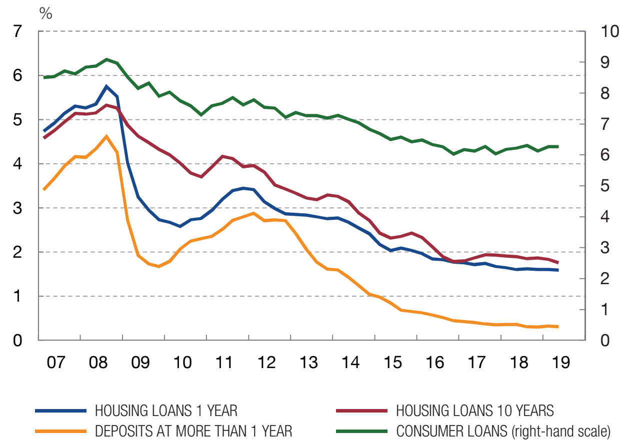
GROWTH IN LENDING TO HOUSEHOLDS HAS STABILISED AT MODERATE LEVELS, CONSTRAINED BY THE NEED FOR DELEVERAGING IN SOME EURO AREA COUNTRIES

Economic recovery and low interest rates continued to drive the demand for finance. But credit growth was moderate (below nominal GDP growth) and gradual deleveraging continued in the sector. Fixed-rate loans grew as a proportion of housing loans.

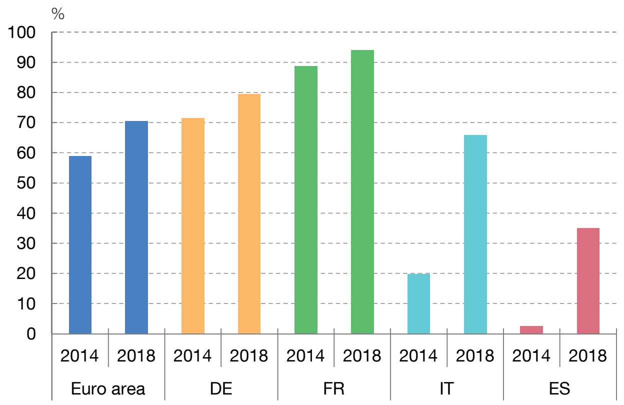
1 HOUSEHOLDS: BANK LOANS AND GDP
Year-on-year growth



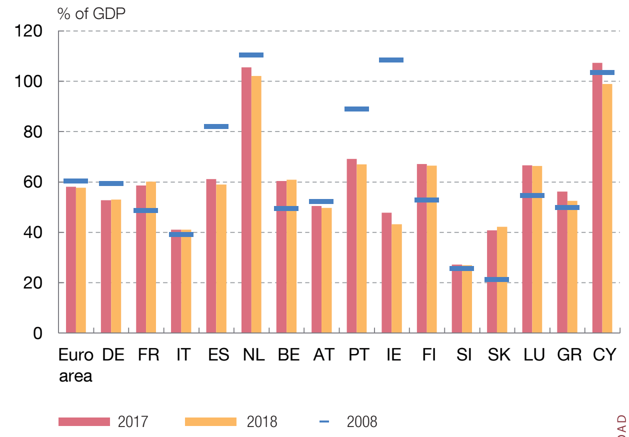
2 BANK INTEREST RATES
New lending



3 FIXED-RATE AGREEMENTS IN HOUSING LOANS
Fixed-rate agreements (for more than 5 years) as a proportion of all new housing loans



4 HOUSEHOLD DEBT (b)



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SOURCES: Eurostat and ECB.

a Loans adjusted for securitisation and other transfers.
b Loans based on financial accounts.

new housing loans in the euro area overall were arranged at a fixed rate for more than five years.

In any event, growth in lending to households remained constrained by the need to deleverage in some countries. In the euro area as a whole there was no major change in the household debt to GDP ratio, which at end-2018 stood at around 58%, slightly lower than before the financial crisis. Across countries, however, there were significant differences. Cyprus and the Netherlands, which are the economies with the highest level of household debt (almost 100% of GDP), continued to gradually reduce the debt ratio. Deleveraging also continued in Spain, Portugal and Ireland. Household debt in Spain and Portugal has been reduced by some 25 pp of GDP from its peak in 2009-2010, down to less than 60% of GDP in Spain;[13] in Ireland it has been reduced by more than 70 pp,[14] down to less than 45% of GDP. By contrast, in both France and Belgium, growth in lending to households drove up the debt ratio to just over 60% of GDP.

11.7.2019.

13 For more details, see V. García-Vaquero and J. C. Casado (2019), "Financial flows and balance sheets of households and non-financial corporations in 2018", Analytical Articles, *Economic Bulletin* 2/2019, Banco de España.

14 Explained in part by the upward revision of Irish GDP in 2015.