PICTET WEALTH MANAGEMENT

Euro area private consumption

Conditions are in place for a gradual recovery in euro area consumer spending

04 SEPTEMBER 2024, CIO OFFICE & MACRO RESEARCH

AUTHORS
NADIA GHARBI
ngharbi@pictet.com
ALAN LEMANGNEN
alemangnen@pictet.com

FLASH NOTE

SUMMARY

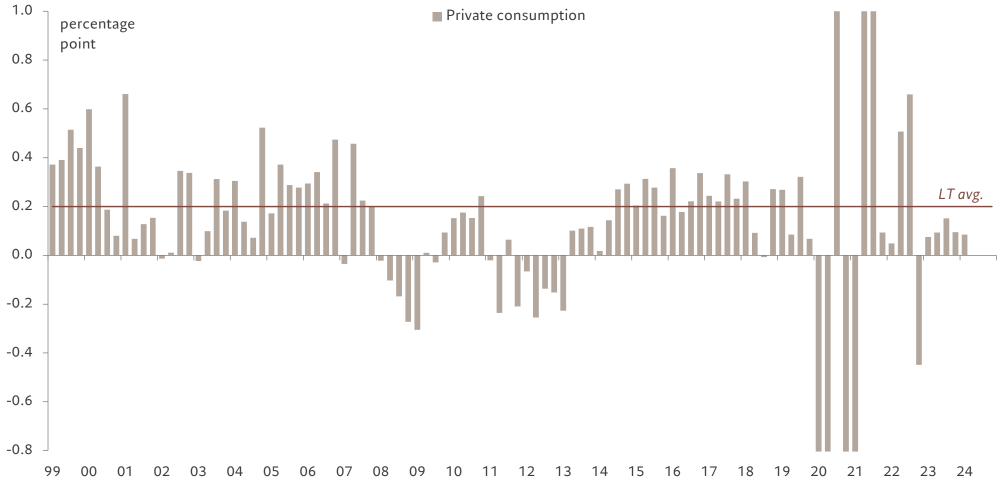
- Private consumption expenditure in the euro area has been subdued since 2022, almost stalling in sequential terms on average. High inflation and high savings are the main reasons for the sluggishness, but structural factors also play a role.
- The improvement in real labour income dynamics creates the conditions for consumption to pick up. However, this recovery will not be a surge, as wage growth is expected to have peaked and the propensity to save is likely to remain high.
- Risks to this scenario are high and mainly related to household saving behaviour: should political uncertainty increase, inflation reappear or fiscal policy tighten sharply, rising savings would weigh on consumption dynamics and vice versa.

CONSUMPTION AT HALF-MAST SINCE 2022

Household consumption expenditure, which accounts for just over half of the euro area's GDP, has been under pressure since the energy shock of 2022 and the subsequent sharp rise in inflation, with sequential growth close to zero on average since the end of 2022. In volume terms, spending has returned to its pre-Covid-19 level, but it remains well below where it would be had the trend dynamics of the previous cycle (2014-2019) continued.

At first sight, this weakness in private consumption seems paradoxical. The unemployment rate in the euro area has never been so low and the employment rate never so high since the introduction of the euro. Admittedly, the vacancy rate has fallen somewhat recently (from a high level), but the overall labour market remains tight, which is usually associated with sustained growth in private consumption. But we believe there are several other reasons why household consumption remains subdued.

Euro area: private consumption's contribution to sequential GDP growth

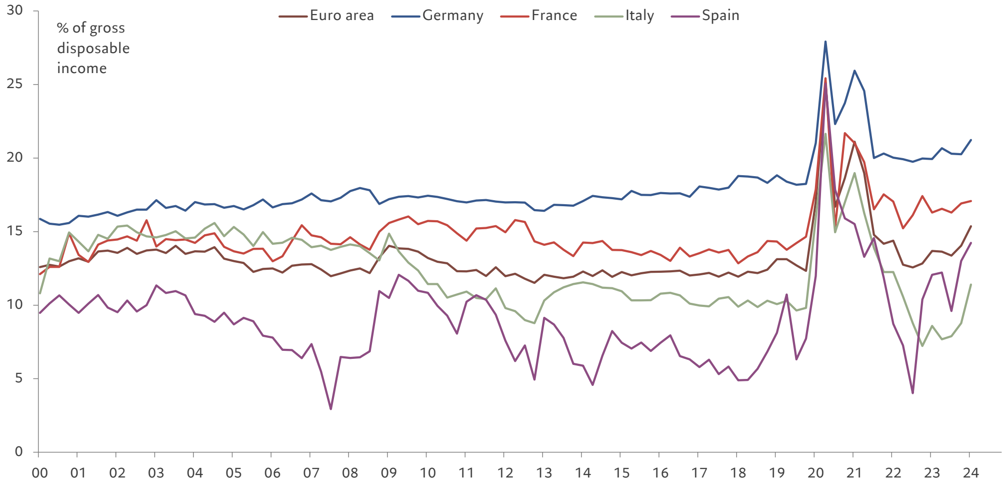


Source: Pictet Wealth Management, Eurostat, as of 04.09.2024

First, consumer prices have risen sharply as a result of inflation in the years following the pandemic. The disinflation underway since 2023 is moderating this rise—but not reversing it. Consumer prices are now 13% higher than they were in Q4 2021, just before the Russian invasion of Ukraine triggered an energy crisis in Europe. Over the same period, nominal hourly wages have risen by 10%, so have not fully kept pace with prices, squeezing many households.

Second, real interest rates are back in positive territory, making savings more attractive for many households. Combined with inflation, which erodes households' real financial wealth, higher real interest rates have triggered what economists call 'real-balance effects', a mechanism whereby households try to compensate for the loss in the purchasing power of their previous savings by saving more.

Euro area: households' saving rates



Source: Pictet Wealth Management, Eurostat, as of 04.09.2024

For illustrative purposes. Past performance should not be taken as a guide to or guarantee of future performance. Performances and returns may increase or decrease as a result of currency fluctuations. There can be no assurance that these projections, forecasts or expected returns will be achieved. The projection is not based on simulated past performance.

Savings rates had already risen sharply during the pandemic because of the impact of health restrictions on consumption. In some countries, savings have remained at high levels despite the reopening of the economy, mainly thanks to the richest households, which have a lower propensity to consume. As real interest rates have risen, there has been a second wave of rising savings rates, this time with lower-income households also increasing their savings.

Finally, we should not underestimate the impact of uncertainty and precautionary behaviour in an uncertain political environment, as well as more structural factors such as ageing populations and durable changes in consumption patterns. Supply constraints may also have affected consumption in some sectors, such as the automotive sector, where the slow electrification of production may have played a role in the decline in new car purchases, as demand for electric vehicles was not met by adequate supply.

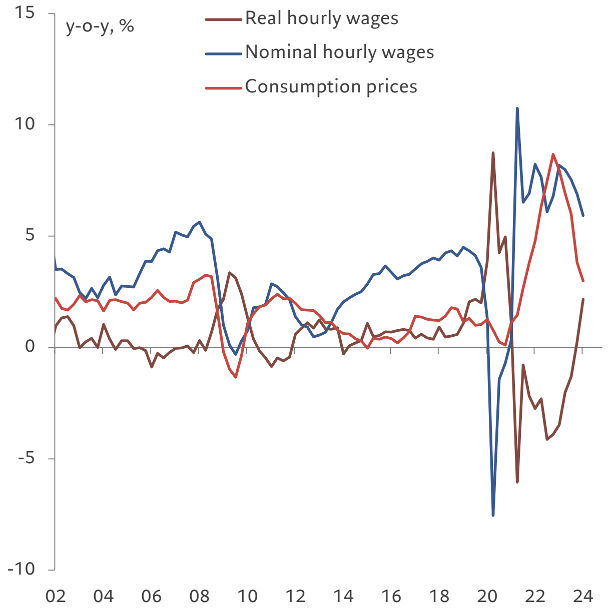
A RECOVERY, NOT A BOOM

After two sluggish years, conditions are gathering for a pick-up in private consumption in the euro area. The main catalyst for this is a continued recovery in household purchasing power, especially labour income. First, nominal wages have started catching up with prices since 2023 and their growth will stay elevated this year. Second, with the bulk of the disinflation process now behind us, wages are also catching up in real terms. The first signs of this recovery in consumer spendings are already visible in high frequency data and surveys. Retail sales have been on an upward trend for several months, car registrations have stabilised, and consumer surveys have been pointing to a sustained improvement in confidence for several months.

But this recovery in consumption will not be a boom. First, wages are unlikely to accelerate from last year (although wage growth will still be significant). Real hourly wages returned to their 2019 level at the start of the year, bringing them closer to the trend in hourly productivity, which drives real wage growth in the long run. Temporary real wage growth above the productivity trend is of course possible, but in our view not in the long run.

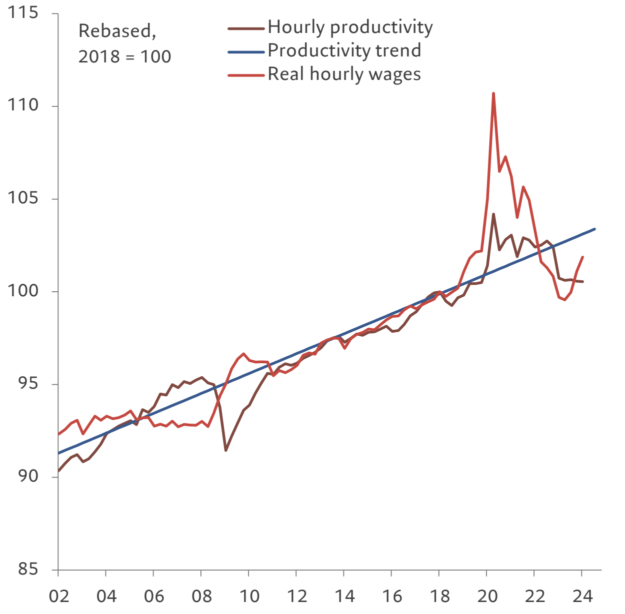
Second, containing wage growth will be the key variable for companies to prevent profits from falling too sharply after two years of strong growth. First, as household demand has weakened over the past two years due to inflation, firms have lost pricing power and cannot simply pass on rising costs to consumer prices as they did previously. Second, productivity has fallen over the same period and is not mitigating the upward pressure on unit labour costs from rising wages. Therefore, in our view, a decline in unit profits is inevitable, although firms will try to limit wage increases as much as possible.

Euro area: nominal and real hourly wages



Source: Pictet Wealth Management, Eurostat, as of 04.09.2024

Euro area: real wages and productivity



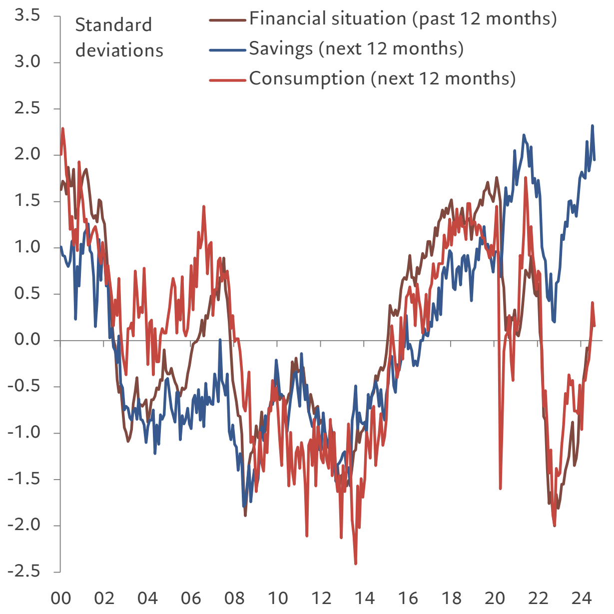
Source: Pictet Wealth Management, Eurostat, as of 04.09.2024

A PERSISTENTLY HIGH PROPENSITY TO SAVE...

Another factor supporting only a moderate recovery in consumption is the continued strong propensity of households to save. This is one of the findings of the European Commission's consumer confidence surveys: while households report a clear improvement in their financial situation over the past 12 months, this is reflected in a simultaneous increase in their intentions to buy but also to save. In other words, the surveys point to an increase in consumption while the savings ratio remains high, a situation made possible by an increase in disposable income.

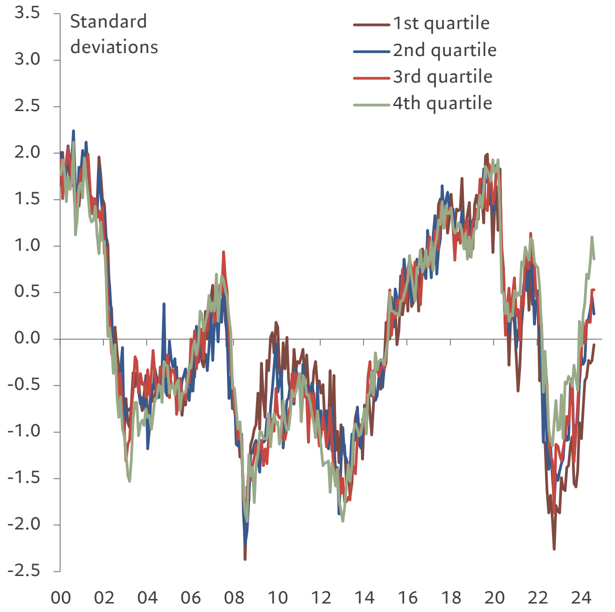
As mentioned, the persistence of high short-term real interest rates and precautionary behaviour are two factors driving this high propensity to save. A third factor could be the bias in income growth toward the highest-income households. This is difficult to verify but the European Commission's survey data suggest as much. In other words, the data show that the incomes of households in the top quartile, which tend to save more, are growing faster than those in the bottom quartile, which tend to consume more.

Euro area: consumer confidence



Source: Pictet Wealth Management, European Commission Economic Sentiment Index, as of 04.09.2024

Euro area: financial situation according to revenue



Source: Pictet Wealth Management, European Commission Economic Sentiment Index, as of 04.09.2024

… MAYBE TOO HIGH?

This scenario of a measured recovery in household consumption in the euro area is of course subject to both upside and downside risks. A further increase in the saving rate would cast doubt on our scenario. This would be the case if precautionary behaviour were to prevail—for example, in the event of political instability or very strong fiscal consolidation. This would also be the case if inflation were to reaccelerate: the real-balance effects would come into full play again, with households saving more to compensate for the loss of the purchasing power of past savings.

Conversely, a fall in the saving rate from current levels would boost consumption and growth. A reduction in uncertainty could be a catalyst, as could stronger-than-expected disinflation. In this case, the real balance effects would work in the opposite direction, with disinflation supporting the purchasing power of past savings.

For illustrative purposes. Past performance should not be taken as a guide to or guarantee of future performance. Performances and returns may increase or decrease as a result of currency fluctuations. There can be no assurance that these projections, forecasts or expected returns will be achieved. The projection is not based on simulated past performance.

DISCLAIMERS

Distributors: Banque Pictet & Cie SA, Route des Acacias 60, 1211 Geneva 73, Switzerland and Bank Pictet & Cie (Europe) AG, Neue Mainzer Str. 1 60311 Frankfurt am Main Germany.

Banque Pictet & Cie SA is established in Switzerland, exclusively licensed under Swiss Law and therefore subject to the supervision of the Swiss Financial Market Supervisory Authority (FINMA).

Bank Pictet & Cie (Europe) AG is established in Germany, authorised and regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht, the German Federal Financial Supervisory Authority (Bafin).

This marketing communication is not intended for persons who are citizens of, domiciled or resident in, or entities registered in a country or a jurisdiction in which its distribution, publication, provision or use would violate current laws and regulations.

The information, data and analysis furnished in this document are disclosed for information purposes only. They do not amount to any type of recommendation, either general or tailored to the personal circumstances of any person. Unless specifically stated otherwise, all price information is indicative only. No entity of the Pictet Group may be held liable for them, nor do they constitute an offer or an invitation to buy, sell or subscribe to securities or other financial instruments. The information contained herein is the result neither of financial analysis within the meaning of the Swiss Bankers Association's Directives on the Independence of Financial Research, nor of investment research for the purposes of the relevant EU MiFID provisions. All information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness.

Except for any obligations that any entity of the Pictet Group might have towards the addressee, the addressee should consider the suitability of the transaction to individual objectives and independently assess, with a professional advisor, the specific financial risks as well as legal, regulatory, credit, tax and accounting consequences.

Furthermore, the information, opinions and estimates in this document reflect an evaluation as of the date of initial publication and may be changed without notice. The Pictet Group is not under any obligation to update or keep current the information contained herein. In case this document refers to the value and income of one or more securities or financial instruments, it is based on rates from the customary sources of financial information that may fluctuate. The market value of financial instruments may vary on the basis of economic, financial or political changes, currency fluctuations, the remaining term, market conditions, the volatility and solvency of the issuer or the benchmark issuer. Some investments may not be readily realizable since the market in the securities can be illiquid. Moreover, exchange rates may have a positive or negative effect on the value, the price or the income of the securities or the related investments mentioned in this document. When investing in emerging countries, please note that the political and economic situation in those countries is significantly less stable than in industrialized countries. They are much more exposed to the risks of rapid political change and economic setbacks.

Past performance must not be considered an indicator or guarantee of future performance, and the addressees of this document are fully responsible for any investments they make. No express or implied warranty is given as to future performance. Moreover, forecasts are not a reliable indicator of future performance. The content of this document can only be read and/or used by its addressee. The Pictet Group is not liable for the use, transmission or exploitation of the content of this document. Therefore, any form of reproduction, copying, disclosure, modification and/or publication of the content is under the sole liability of the addressee of this document, and no liability whatsoever will be incurred by the Pictet Group. The addressee of this document agrees to comply with the applicable laws and regulations in the jurisdictions where they use the information reproduced in this document.

This marketing publication is issued by Banque Pictet & Cie SA. This marketing publication and its content may be cited provided that the source is indicated.

Distributor: Bank Pictet & Cie (Europe) AG, London branch ("Pictet London Branch")

This is a marketing communication distributed by Pictet London Branch.

This document sets forth neither a personal recommendation tailored to the needs, objectives and financial situation of any individual or company (investment advice as defined in the Financial Conduct Authority's Handbook of rules and guidance (the "FCA Handbook")), nor the results of investment research within the meaning of the FCA Handbook. Moreover, it does not constitute an offer, or an invitation to buy, sell or subscribe to securities or other financial instruments, nor is it meant as a proposal for the conclusion of any type of agreement. Furthermore, this document should not be considered a suitability report as Pictet London Branch has not received all the necessary information on the recipient to complete its suitability assessment that covers the recipient's knowledge and experience, tolerance to risk, sustainability preferences, if any, investment needs and the recipient's ability to absorb financial risk. Should its addressee decide to proceed to any transaction in relation to a financial product referred to herein, this will be in his sole responsibility, and the suitability/appropriateness of the transaction and other financial, legal and tax aspects should be assessed by an expert.

Any information contained in this document is disclosed for information purposes only, and neither the producer nor the distributor can be held liable for any fluctuation of the price of the securities. No express or implied warranty is given as to future performance. The opinions expressed reflect an objective evaluation of information available to the general public, such as rates from customary sources of financial information. The market value of securities mentioned may vary on the basis of economic, financial or political changes, the remaining term, market conditions, the volatility and solvency of the issuer or the benchmark issuer. Moreover, exchange rates may have a positive or negative effect on the value, the price or the income of the securities or the related investments mentioned in this document. It is also expressly noted that forecasts are not a reliable indicator of future performance, while past performance is not a reliable indicator of future results.

You shall only take investment decisions when you fully understand the relevant financial product and the involved risks. In particular, the relevant product documentation (such as the issuance program, final terms, prospectus, simplified prospectus and key (investor) information document), as well as Appendix 4: Risk Warnings Relating to Trading in Financial Instruments of the Terms and Conditions of Pictet London Branch, shall be read. Structured products are complex financial products and involve a high degree of risk. The value of structured products depends not only on the performance of the underlying asset(s), but also on the credit rating of the issuer. Furthermore, the investor is exposed to the risk of default of the issuer/guarantor.

In respect of any product documentation, including key information documents of

Packaged Retail and Insurance-based Investment Products ("KIDs"), please note that these may change without notice. You should therefore ensure that you review the latest version of them prior to confirming to Pictet London your decision to invest. If you have been provided with a link to access the respective KID/other product document, you should therefore click on the link immediately before confirming to Pictet London Branch your decision to invest, in order to review the most recent version of the respective KID/other product document. If you have not been provided with a link to access the relevant document, or if you are in any doubt as to what the latest version of the respective KID/other product document is, or where it can be found, please ask your usual Pictet London Branch contact.

Pictet London Branch is not the manufacturer of the product(s) and the KID/other product document is provided by a third party. The KID/other product document is obtained from sources believed to be reliable. Pictet London Branch does not make any guarantee or warranty as to the correctness and accuracy of the data contained in the KID/other product document. Pictet London Branch may not be held liable for an investment decision or other transaction made based on reliance on, or use of, the data contained in the KID/other product document.

By subscribing to the product(s) proposed herein, you acknowledge that you have (i) received, in good time, read and understood any relevant documentation linked to the product(s), including, as the case may be, the respective KID/other product document; (ii) taken note of the product(s) restrictions; and (iii) meet the applicable subjective and objective eligibility conditions to invest in the product(s).

Pictet London Branch may, if necessary, rely on these acknowledgements and receive your orders, to transmit them to another professional, or to execute them, according to the relevant clauses of your mandate, as well as the Terms and Conditions of Pictet London Branch.

The content of this document shall only be read and/or used by its addressee. Any form of reproduction, copying, disclosure, modification and/or publication in any form or by any means whatsoever is not permitted without the prior written consent of Pictet London Branch and no liability whatsoever will be incurred by Pictet London Branch. The addressee of this document agrees to comply with the applicable laws and regulations in the jurisdictions where they use the information provided in this document.

Pictet London Branch is a branch of Bank Pictet & Cie (Europe) AG. Bank Pictet & Cie (Europe) AG is a credit institution incorporated in Germany and registered with the Handelsregister, the German Commercial Register under the no. HRB 131080. Its head office is at Neue Mainzer Str. 1, 60311 Frankfurt am Main, Germany. Bank Pictet & Cie (Europe) AG is authorised and regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht, the German Federal Financial Supervisory Authority (BaFIN)

Pictet London Branch is registered as a UK establishment with Companies House (establishment number BR016925) and its UK establishment office address is Stratton House, 6th Floor, 5 Stratton Street, London W1J 8LA. Authorised by the Prudential Regulation Authority (PRA) and subject to regulation by the Financial Conduct Authority (FCA) and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

Distributors: Bank Pictet & Cie (Asia) Ltd ("BPCAL") in Singapore and/or Banque Pictet & Cie SA, Hong Kong Branch ("Pictet HK Branch") in Hong Kong.

The information, tools and material presented in this document are provided for information purposes only and are not to be used or considered as an offer, an invitation to offer or solicitation to buy, sell or subscribe for any securities, commodities, derivatives, (in respect of Singapore only) futures, or other financial instruments (collectively referred to as "Investments") or to enter into any legal relations, nor as advice or recommendation with respect to any Investments. This document is intended for general circulation and it is not directed at any particular person. This document does not have regard to the specific investment objectives, financial situation and/or the particular needs of any recipient of this document. Investors should seek independent financial advice regarding the appropriateness of investing in any Investments or adopting any strategies discussed in this document, taking into account the specific investment objectives, financial situation or particular needs of the investor, before making a commitment to invest.

BPCAL/Pictet HK Branch has not taken any steps to ensure that the Investments referred to in this document are suitable for any particular investor, and accepts no fiduciary duties to any investor in this regard, except as required by applicable laws and regulations. Furthermore, BPCAL/Pictet HK Branch makes no representations and gives no advice concerning the appropriate accounting treatment or possible tax consequences of any Investment. Any investor interested in buying or making any Investment should conduct its own investigation and analysis of the Investment and consult with its own professional adviser(s) as to any Investment including the risks involved.

This document is not to be relied upon in substitution for the exercise of independent judgment. The value and income of any Investment mentioned in this document may fall as well rise. The market value may be affected by, amongst other things, changes in economic, financial, political factors, time to maturity, market conditions and volatility, and the credit quality of any issuer or reference issuer. Furthermore, foreign currency rates of exchange may have a positive or adverse effect on the value, price or income of any Investment mentioned in this document. Accordingly, investors must be willing and able to assume all risks and may receive back less than originally invested.

Past performance should not be taken as an indication or guarantee of future performance and no representation or warranty, expressed or implied, is made by BPCAL/Pictet HK Branch regarding future performance.

This document does not constitute the investment policy of BPCAL/Pictet HK Branch, or an investment recommendation, and merely contains the different assumptions, views and analytical methods of the analysts who prepared them. Furthermore, the information, opinions and estimates expressed herein reflect a judgment at its original date of publication and are subject to change without notice and without any obligation on BPCAL/Pictet HK Branch to update any of them. BPCAL/Pictet HK Branch may have issued or distributed other reports or documents that are inconsistent with, and reach different conclusions from, the information presented in this document.

While the information and opinions presented herein are from sources believed to be reliable, BPCAL/Pictet HK Branch is not able to, and do not make any representation or warranty as to its accuracy or completeness. Accordingly, BPCAL/Pictet HK Branch accepts no liability for loss arising from the use of or reliance on this document presented for information purposes only. BPCAL/Pictet HK Branch reserves the right to act upon or use any of the information in this document at any time, including before its publication herein.

BPCAL/Pictet HK Branch and its affiliates (or employees thereof) may or may not have long or short positions in, and buy or sell, or otherwise have interest in, any of the Investments mentioned herein, and may or may not have relationships with the issuers of or entities connected with Investments mentioned in this document. BPCAL/Pictet HK Branch and their affiliates (or employees thereof) may act inconsistently with the information and/or opinions presented in this document.

The information used to prepare this document and/or any part of such information, may have been provided or circulated to employees and/or one or more clients of BPCAL/Pictet HK Branch before this document was received by you and such information may have been acted upon by such recipients or by BPCAL/Pictet HK Branch.

This document is provided solely for the information of the intended recipient only and should not be reproduced, published, circulated or disclosed in whole or in part to any other person without the prior written consent of BPCAL/Pictet HK Branch.

Singapore

This document is not directed to, or intended for distribution, publication to or use by, persons who are not accredited investors, expert investors or institutional investors as defined in section 4A of the Securities and Futures Act 2001 ("SFA") or any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or would subject BPCAL and any of its affiliates or related corporations to any prospectus or registration requirements.

BPCAL is a wholesale bank regulated by the Monetary Authority of Singapore ("MAS") under the Banking Act 1970 of Singapore, an exempt financial adviser under the Financial Advisers Act 2001 of Singapore ("FAA") and an exempt capital markets licence holder under the SFA. Please contact BPCAL in Singapore in respect of any matters arising from, or in connection with this document.

Hong Kong

This document is not directed to, or intended for distribution, publication to or use by, persons who are not "professional investors" within the meaning of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) and any rules made thereunder (the "SFO") or any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or would subject Pictet HK Branch and any of its affiliates or related corporations to any prospectus or registration requirements. If you do not want Pictet HK Branch to use your personal information for marketing purposes, you can request Pictet HK Branch to stop doing so without incurring any charge to you.

In distributing an investment product as agent for a third party service provider, Pictet HK Branch distributes the product for the third party service provider and the product is a product of the third party service provider but not Pictet HK Branch. In respect of an eligible dispute (as defined in the Terms of Reference for the Financial Dispute Resolution Centre in relation to the Financial Dispute Resolution Scheme) arising between Pictet HK Branch and you out of the selling process or processing of the related transaction, Pictet HK Branch is required to enter into a Financial Dispute Resolution Scheme process with you; however any dispute over the contractual terms of the product should be resolved directly between the third party service provider and you.

Banque Pictet & Cie SA is a limited liability company incorporated in Switzerland. It is an authorized institution within the meaning of the Banking Ordinance and a registered institution (CE No.: BMG891) under the SFO carrying on Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management) regulated activities. The registered address of Pictet HK Branch is 9/F., Chater House, 8 Connaught Road Central, Hong Kong.

Warning: The contents of this document have not been reviewed by any regulatory authority in Hong Kong. You are advised to exercise caution in relation to the offer. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice. Please contact Pictet HK Branch in Hong Kong in respect of any matters arising from, or in connection with this document.