Box I.2.2: **Household wealth and savings in the euro area – the effect of inflation**

Household wealth in the euro area has increased significantly since the onset of the pandemic, on the back of the exceptional accumulation of savings and surge in house prices. Increased wealth was set to support private consumption even over and above the boost provided by the post-pandemic re-opening, but the uptick in inflation since the second quarter of 2021 is eroding its real value. This box explores the magnitude and drivers of household wealth accumulation, and examines changes in the real wealth, with focus on the role of recent price increases.

Households' net worth tends to increase steadily over time due to accumulation of savings and valuation effects.

Household wealth can be proxied by the sector accounts concept "households' net worth", which is the value of the total assets of households minus the value of their total outstanding liabilities.

Housing wealth includes dwellings and land, and makes up the bulk of non-financial wealth. Net financial wealth is the difference between financial assets (such as deposits, pension entitlements, bonds and equity) and financial liabilities (mainly mortgage loans). Households' gross savings increase net wealth through the acquisition of (net) financial and non-financial assets. Households' net worth is also affected by changes in real estate prices (which increase the value of the stock of housing) and in the value of financial assets. Such valuation effects can produce important short-time variation in the stock of net worth. [1]

After the onset of the pandemic, sustained increases in savings and house prices have boosted household net worth.

The household savings rate in the euro area increased from a quarterly average of around 13% of GDI in 2019 to an average of around 21% between 2020-Q2 and 2021-Q2. The increase in the saving rate above its long-term average was partly the result of a surge in precautionary savings, amidst heightened uncertainty, but resulted to a large extent from the combination of severe limitations to consumption opportunities – especially of contact intensive services – and policy measures aimed at supporting incomes and jobs. Starting in the second half of 2021, the saving rate dropped gradually back to around pre-pandemic levels, settling at 13.2% in 2022-Q2. All in all, between 2020-Q2 and 2022-Q2, households in the euro area accumulated 3167 billion euros of savings. This is almost 1 trillion more (i.e. 12% of 2021 GDI) than if savings had followed their pre-crisis trend. [2] The large increase in holding of liquid assets also supported the view that much of this additional net worth would support consumption.

The increase in house prices also contributed to the increase in household net worth. Between 2014 and 2019, house prices increased on average by 3.2% y-o-y per quarter. Yet, between 2020-Q2 and 2022-Q2, the average increase in housing prices surged to 7.4% y-o-y per quarter. Overall, valuation effects in real estate have added some 6000 billion euros to household wealth since 2020-Q2, of which more than 4500 billion euros (or 60% of 2021 GDI) can be ascribed to above-trend increases in real estate prices (see Graph 1).

Valuation effects on financial assets, in contrast, detracted from the accumulation of net wealth between 2020-Q2 and 2022-Q2. Following a sharp adjustment in financial asset prices in the wake of the pandemic, bonds and especially stocks recovered. Since the start of Russia's war of aggression against Ukraine, however, high uncertainty resulted in sharp adjustment in stock markets. The surge in interest rates, in a context of high inflation, resulted in a drop in value in bonds.

All in all, households accumulated more than 7 trillion euros of new wealth between the onset of the pandemic (2020-Q1) and the start of the war (2021-Q4). Around 2.7 trillion euros can be considered to

(1) See European Central Bank (ECB) (2020). ECB *Economic Bulletin*, Issue 1, "Household wealth and consumption in the euro area".
(2) All excess accumulations are estimated by extrapolation of the 2014 to 2019 trend using ordinary least squares.

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Box (continued)

be “in excess” of the normal accumulation trend. The negative developments in financial markets in the first half of 2022 resulted only in a modest reduction in net worth (around 400 billion euros).

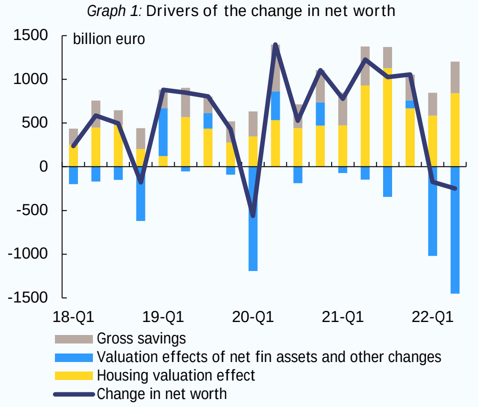
The real value of household net worth decreased sharply in the first half of this year.

For consumption decision, however, what matters is the level of real net worth. The strong increase in nominal net worth must therefore be seen in relation to price developments. Graph 2 decomposes the cumulative change in real net worth (i.e. deflated to 2019 prices with the consumption deflator) in cumulative flows and valuation effects discussed above, as well as the cumulative effect of rising cost of living over the 2020-Q1 to 2022-Q2 horizon.

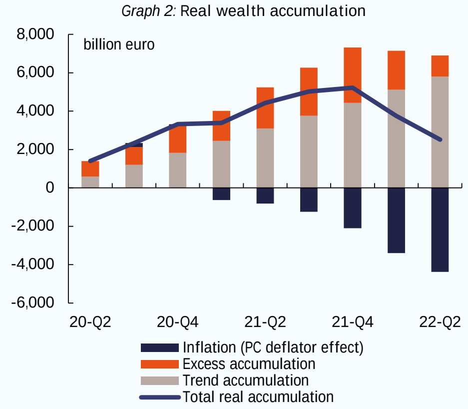
Up to the end of 2020, movements in prices have been negligible. This means that the increase in nominal wealth broadly corresponded to the increase in real wealth. In the second half of 2021, prices started to pick up, but wealth accumulation dynamics remained strong, mainly on account of valuation effects on the stock of housing, which continued to outpace inflation. At the end of 2021, households' real stock of net worth corresponded to roughly 9.4 times the volume of real consumption in 2021, that was slightly below the peak of 9.5 of 2020-Q1. This led many forecasters, including the European Commission, to expect a continued robust expansion of household consumption. As an important share of the increase in net worth came from capital gains on stock of owned houses, households were supposed to increase consumption only slowly.[3] Saving rates were expected to decrease and eventually undershoot their long-term average, supporting a steady and prolonged consumption growth even after reopening dynamics were to fade away.

In the first half of 2022, the sharp increase in prices, however, strongly reduced the real value of net worth. Consequently, by mid-2022 the real value of additional wealth had decreased by almost 50%. Taking into account also the recovery in consumption, household net worth corresponded to 8.7 times the volume of consumption, much closer to the long-term ratio of around 8. This suggests that potential tailwinds to consumption assumed in previous forecast rounds have by now largely vanished.

Graph 1: Drivers of the change in net worth



Graph 2: Real wealth accumulation



(3) The marginal propensity to consume out of financial wealth is significantly larger than of housing wealth. See [Wealth effects in the euro area (europa.eu)]

2.4. LABOUR MARKET

Despite a challenging environment, the EU labour market continued performing well. In 2022, total employment increased and the unemployment rate reached new record lows. While wages and disposable incomes declined in real terms, more persons took up work and/or worked for more hours. As a result, labour market slack continued its downward trend, reflecting inter alia the large number of transitions of formerly inactive people to the labour force. At the same time, labour shortages were relatively large in several Member States, pointing to tightness of labour markets.

Strong employment gains were observed as the economy rebounded. The relaxation