Box 1.2: The impact of inflation on consumers’ financial situation – insights from the Commission’s consumer survey

Rising inflation between January 2021 and June 2022 has increased the cost of households’ per capita consumption by around €160 per month (1), on average. As energy bills and food prices go up, it is likely that it is households on lower incomes that suffer the most, as a larger share of their spending is on these basic items. (2) The analysis in this Box takes a close look at the results from the Commission’s harmonised EU-wide consumer surveys (3) until June 2022 to explore the impact of high and rising inflation on consumers’ assessment of the financial situation of their household and their consumption/saving intentions. Information on the socio-economic characteristics of the respondents in the survey allows to get insights into the distributional impact of rising inflation on consumption.

Reflecting inflation developments, an increasing share of consumers has been reporting rising prices since the beginning of 2021. In June 2022, a large and unprecedented share of consumers perceived a surge in prices over the previous 12 months (see Graph 1). (4) Similarly, consumers’ expectations of price developments for the next 12 months started to rise already in October 2020, reaching record levels one year later. Following some stabilisation between November 2021 and February 2022, consumers’ price expectations jumped to a new and unprecedented high in March 2022, in the aftermath of the outbreak of the war in Ukraine. In the same month, consumers’ confidence plummeted by 9.1 percentage points compared to February. While consumer price expectations have then been dropping since April, they remain at levels unseen since February 1991. (5)

It is interesting to note that there is no visible difference in perceptions about price developments across income groups. Also, consumers’ assessment of the financial situation of their household over the last 12 months (6) has been deteriorating for all income quartiles since July 2021, following several months

(1) Based on consumption per-capita from National Accounts.
(2) Based on the 2015 Household Budget Surveys, on average in the EU spending on food, electricity and gas accounts for 22.1% of total expenditure of the poorest quintile of EU households, compared to 15.4% for the highest-income quintile.
(3) Methodological information on the consumer survey is available on the User Guide.
(4) Question 5 reads “How do you think consumer prices have developed over the last 12 months? They have risen a lot/risen moderately/risen slightly/stayed about the same/fallen/don’t know.” Question 6 reads “By comparison with the past 12 months, how do you expect consumer prices will develop in the next 12 months? They will increase more rapidly/increase at the same rate/increase at a slower rate/stay about the same/fall/don’t know.” Percentage balances are the difference between positive and negative answer options, expressed as a percentage of total answers.
(5) Consumers are also asked by how much (in % changes) they expect prices to change over the next 12 months. These “quantitative” inflation expectations – which are only published at a quarterly frequency– only slightly decreased in April, picked-up in May and increased further in June 2022. Quarterly results are available on the DG ECFIN BCS website.
(6) Question 1 reads “How has the financial situation of your household changed over the last 12 months? It has got a lot better/got a little better/stayed the same/got a little worse/got a lot worse/don’t know.”

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of price increases. However, the deterioration has been more substantial for the lower-income group (1st quartile, see Graph 2).

Focussing on the percentage of consumers replying that the financial situation of their household got a lot worse over the last 12 months (see Graph 3), the gap between high- and low-income households becomes more significant.

When asked about their household’s financial situation, the share of respondents reporting to be in financial distress – that is, having to draw on their savings or running into debt (7) - is, as expected, higher among low-income groups. In July 2021, 21.6% of households from the 1st income quartile reported being in financial distress, against around 6% of respondents from the 4th quartile. Importantly, the gap between low-income and high-income groups has widened. Since July 2021, reported financial distress has risen sharply for the first quartile while the increase has remained contained for the fourth income quartile (see Graph 4).

Consumers are pessimistic about the future

Consumers’ expectations about their household’s financial situation (8) has also deteriorated strongly over the past year, impacting all income groups (see Graph 5).

However, zooming into the different response options, the share of respondents reporting that they expect their households’ situation to get a lot worse has increased more sharply amongst the poorest households (see Graph 6).

(7) Question 12 reads “Which of these statements best describes the current financial situation of your household? We are saving a lot/saving a little/just managing to make ends meet on our income/having to draw on our savings/running into debt/don’t know.”

(8) Question 2 reads “How do you expect the financial position of your household to change over the next 12 months? It will get a lot better/get a little better/stay the same/get a little worse/get a lot worse/don’t know.”

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Consumers’ savings and consumption intentions

As shown in Graph 7, since January 2021, consumers’ saving intentions have continued to rise but at a slower pace than during the COVID crisis, as they intended to spend part of their income on major purchases. Since July 2021, however, consumers have been scaling down their expectations to both spend on major purchases and save money. This may indicate awareness that their real disposable income is being eroded by high inflation.

Saving intentions have been decreasing in all income categories. In July 2021, the percentage balance was positive, at 35%, for households from the highest income quartile, and negative, at -20% for respondents from the lowest quartile. Since then, the gap between low income and higher income groups has remained broadly the same (see Graph 8), with the balance for the highest income group declining and the one for the lowest one becoming more negative.

The decline in expected savings goes along with a decrease in the balance of intentions to spend on major purchases. This is particularly the case among richer households (see Graph 9), whose price elasticity of demand is in principle higher.

Overall, according to the Commission’s consumer survey, consumers’ assessment of the past and expected financial situation of their household has been deteriorating for all income quartiles since July

(*) Based on questions Q11 and Q9 of the Commission’s harmonised consumer survey. Question Q11 reads “Over the next 12 months, how likely is it that you save any money? very likely/fairly likely/not likely/not at all likely/don't know.”. Question Q9 reads “Compared to the past 12 months, do you expect to spend more or less money on major purchases (furniture, electrical/electronic devices, etc.) over the next 12 months? I will spend much more/a little more/about the same/a little less/much less/don't know.”

(9) The percentage balance is the difference between the percentage of respondents saying it is likely that they will save money over the next 12 months and those saying it will be unlikely.
External price pressures are now increasingly accompanied by domestic inflation. While imported inflation has been a key driver of headline inflation, domestic price pressures are gaining in importance. The ECB’s “Low Import Intensity” (LIMI) inflation indicator, which tracks HICP items with a relatively low import intensity, almost tripled between May 2021 and May 2022. Broadening price pressures lifted core inflation to historic highs. Core inflation (excl. energy and unprocessed food) rose to an all-time high of 4.6% y-o-y in June (flash estimate) as price pressures broadened well beyond energy and food to services and other goods. This is clearly illustrated by the share of individual goods and services recording positive monthly growth which is rising steadily since mid-2021, to reach an all-time high in May 2022. Likewise, all available alternative measures of core inflation (e.g. average, median, trimmed means) indicate a steady rise in underlying price pressures, well beyond usual volatility (see Graph 1.16).

The bulk of intra-EU inflation differentials is driven by differences in energy and food inflation. Annual inflation in June ranged from 6.1% in Malta to 22.0% in Estonia, a difference of almost 16 pps., compared to 11pps. in March and 9 pps. in January. While inflationary pressures at individual country level broadened steadily to core components, intra-EU divergences in headline rates in May still largely reflected differences in contributions from energy and food, due to differentials in both price growth and shares in consumption baskets (see Graph 1.17).

References:

15) 265 non-overlapping categories at the COICOP five-digit level, seasonally adjusted
16) Even if the coefficient of variation suggests that dispersion remained broadly stable over the same period.