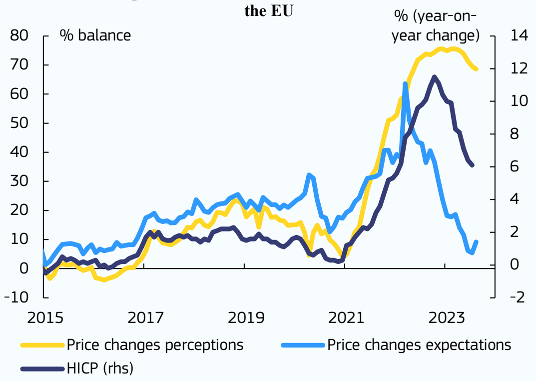
Box 1.1: **Insights from the Commission's consumer survey: how inflation is shaping consumer confidence and spending.**

The analysis presented in this box takes a close look at the results of the European Commission's harmonised consumer survey up to August 2023 to explore the impact of recent price developments on consumers' sentiment, savings and consumption intentions. The understanding of these dynamics helps inform expectations for consumer spending over the forecast horizon.

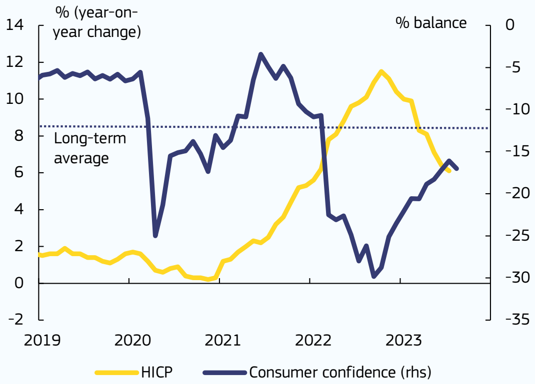
Reflecting developments in HICP inflation, an increasing share of consumers in the EU reported rising prices from early 2021 until autumn 2022. After a period of stabilisation at record-high level, (1) the balance of replies reporting fast increasing prices started to decline in April 2023, while remaining high (see Graph 1). From October 2020 to March 2022, consumers' expectations of future prices soared as well. Thereafter, an increasing share of consumers expected future prices to increase at a slower rate or stabilise. In August 2023, the latest available data point, consumers once again revised their expectations of future prices upwards. (2)

Graph 1: **Consumers' perceptions of price developments over the past and next 12 months, and HICP inflation in the EU**

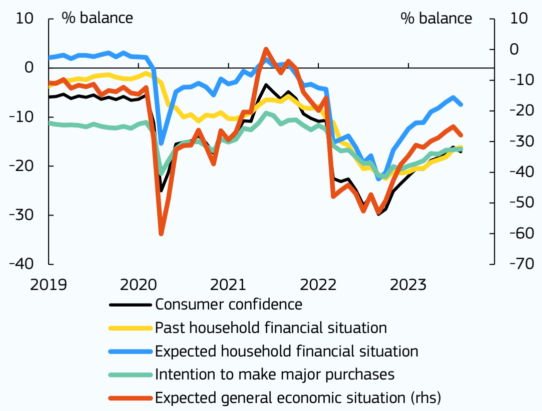


Consumer confidence in the EU reached an all-time low in September 2022, as HICP inflation was about to peak at 11.5% the following month. Since then, consumer confidence has steadily increased towards its long-term average (see Graph 2), while inflation has gradually eased. This suggests that moderating inflation has had a positive influence on consumer confidence. As consumer sentiment remains well below its long-term average, inflation (and prices) remains high. Moreover, in August, consumer confidence decreased once again. This coincided with consumers' inflation expectations moving up for the first time in several months.

Graph 2: **Consumer confidence and HICP inflation**



Graph 3: **Consumer confidence and its components**



The consumer confidence indicator is composed of four variables: past and expected household financial situation (3), intentions to make major purchases (4) and the general economic situation in their country (5). Graph 3 shows that all components improved as inflation eased between autumn 2022 and July 2023, but remained below both their pre-COVID-19 levels and their long-term averages. This suggests that an important share of

(1) For the formulation of question 5 and question 6 of the consumer survey, see the User Guide: bcs_user_guide.pdf (europa.eu)
(2) See question 61 in the User Guide. These "quantitative" inflation expectations continued to increase up to October 2022, reaching an all-time high of 17.5%. Since then, they have decreased but remain relatively high, at around 12%.
(3) See questions 1 and 2 in the User Guide
(4) See question 9 in the User Guide.
(5) See question 4 in the User Guide.

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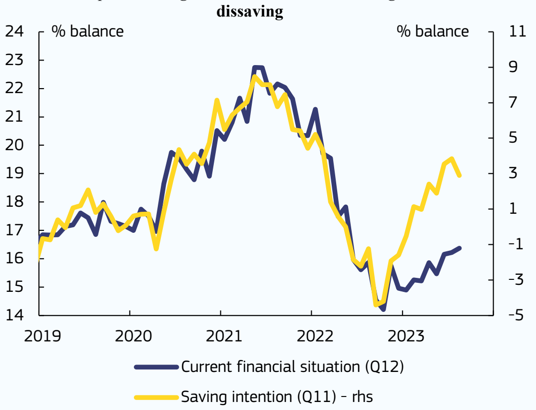
Box (continued)

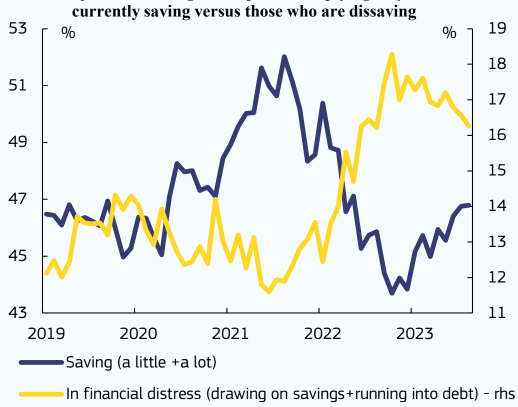
consumers have not yet shrugged off the negative confidence shocks incurred over the past three years (COVID-19, war in Ukraine, steep increase in energy costs and high inflation).

A gap opened between consumers' forward-looking and backward-looking assessments of their household's financial situation, with the former rebounding more strongly. The recovery in consumers' intentions to make major purchases was also slow compared to the expectations of an improved financial situation. In August 2023, however, the gap shrank as consumers' expectations of their household's future financial situation slipped back down again. A similar pattern is apparent when looking at consumers' assessment of their household's current financial situation, expressed as the balance of saving and dissaving status ([6]), and their savings' intentions over the 12 months following the survey ([7]). Between early 2020 and autumn 2022, developments in the two variables had been very similar: after increasing steeply until the summer of 2021, they both fell rapidly to a trough in October 2022, when inflation peaked. When inflation started to decline, consumers' intentions to save started soaring, beyond their pre-COVID-19 level, before tipping down again in August (see Graph 4). Savings intentions increased mainly among consumers with the highest incomes, the group with the largest saving potential. By contrast, the balance of households' current savings/dissaving situation improved much more slowly. It is worth noting that the share of respondents reporting to be drawing on their savings or running into debt – an indicator of financial distress - increased rapidly between August 2021 and October 2022, when it reached an all-time high (see Graph 5). The percentage of respondents reporting to be saving (a lot or a little) decreased to a similar extent. Since inflation started to ease, both series have been showing some improvement, but the share of consumers reporting to be in financial distress remains very high.

Graph 4: **Saving intentions vs Current saving and dissaving**



Graph 5: **Percentage of respondent replying they are currently saving versus those who are dissaving**



Overall, the ongoing moderation in inflation and the associated partial recovery in consumer confidence have not yet translated into clear improvements in the assessments of households' balance sheet positions. This, compounded with increasing intentions to save by the most affluent consumers, suggests subdued growth in private consumption ahead. The recent deterioration in many of the observed variables in August - if confirmed in the months ahead - could further dampen the prospects for household spending.

([6]) See question 12 in the User Guide.
([7]) See question 11 in the User Guide.