ALLIANZ RESEARCH

EUROPE'S PENT-UP DEMAND PARTY IS JUST GETTING STARTED

30 July 2021

ANA BOATA
Head of Macroeconomic Research
ana.boata@eulerhermes.com

SELIN OZYURT
Senior Economist France & Africa
selin.ozyurt@eulerhermes.com

The strong rebound in European Q2 GDP growth highlights that there is significant room to grow in the sectors most exposed to Covid-19 restrictions. We expect unleashed pent-up demand to provide a boost to these sectors through 2021, especially in Spain, France and Belgium. One major driver of pent-up demand, and in turn consumption growth, will be the rebound of consumer confidence above pre-crisis levels, especially in the context of significantly high household savings[1]. Several models show that consumer confidence can be a good predictor of consumption in the US and the Eurozone[2] and we previously found that the recovery of consumer confidence to pre-Covid-19 levels would explain up to one third of the consumption increase in France in 2021[3]. Our extended quantitative analysis[4] also validates the predictive power of household confidence for consumption growth in Belgium, Germany, Spain and Italy.

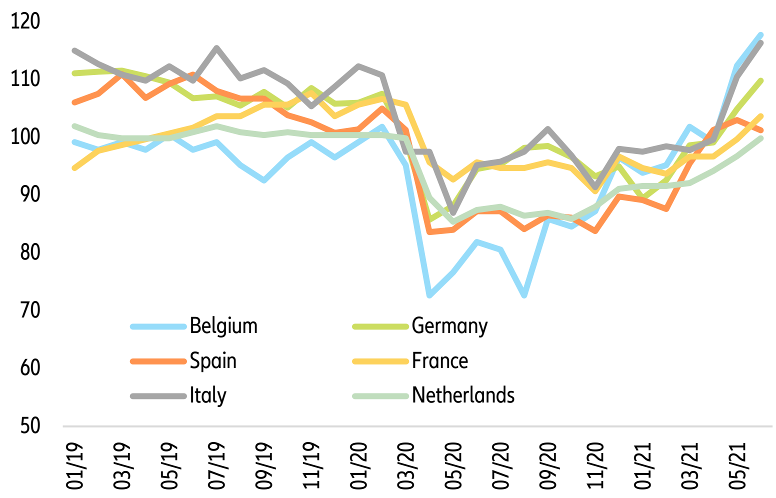
After the grand reopening in Q2 2021, consumer confidence has soared well above pre-crisis levels (+21%) in Belgium but also in Italy (+8%) and Germany (+4). In Spain and France, the indicator only returned to its pre-Covid-19 levels, signaling a more moderate boost to consumption (see Figure 1). When compared with historical maximums, confidence levels in France and the Netherlands actually stand well below their historical peaks (25% and 20%, respectively), hinting at strong potential for further confidence boosts (see Figures 1 and 2).

In this context, the accommodation and food services sectors (2.7% of European GDP) show strong catch-up potential for summer 2021. Despite the absence of most international guests, and operating at 25-30% below 2019 activity levels in H1 2021, the accommodation sector (1.8% of final consumption spending of European households) is enjoying a significant rebound in H2 2021 with the gradual lifting of restrictions. Indeed, the summer season accounts for 30-50% of annual turnover in countries such as France, Italy and Spain. In the same way, restaurants, cafés and bars have already begun enjoying a strong recovery in activity in H2 2021, driven by buoyant consumer appetite for food services they have long been deprived of and to a lesser extent major sports events (the European Football Championship, the Tokyo Olympics).

---

[1] *See our report European Households: The double dividend of excess savings*
[2] *Consumer Confidence as a Predictor of Consumption Spending: Evidence for the United States and the Euro Area*
[3] *See our report France: Improved confidence to boost consumer spending by EUR10bn in 2021*
[4] *We regressed the log of the quarterly change in consumption on the quarterly change on consumer confidence in the previous quarter over the period 1998-2019. In these cross-section reduced-form regressions, the associated coefficients to confidence appeared significant (at the 5% confidence level) with a positive sign in all countries. The semi elasticities obtained from these reduced-form models suggest that a 10 pt. increase in the confidence index would generate from 0.4% to 0.7% increase in future consumption.*

Figure 1 – Consumer confidence indicator



Sources: Euler Hermes, Allianz Research, Eurostat

Note: To make the series comparable, we first mean-centered them as of 1998 (1st observation available for Italy) and rebased to 100 and impose standard deviation to be the same as the French series.

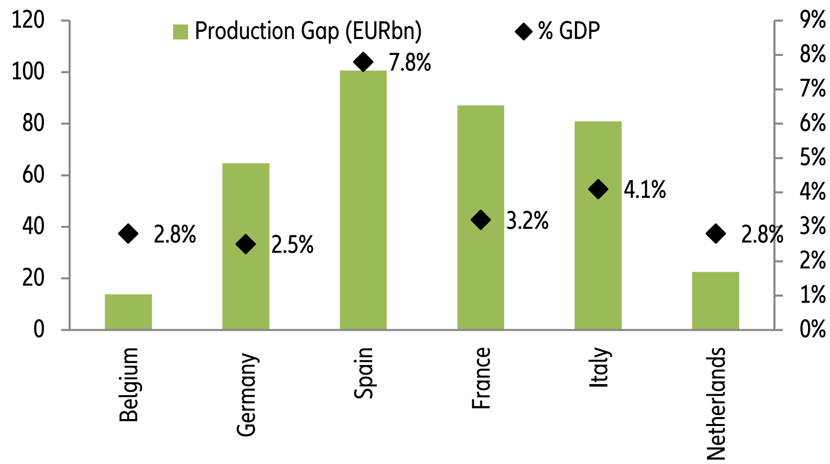
Figure 2 – Comparaison of the consumer confidence indicators vs. pre-crisis levels and historical peaks

	BE	DE	ES	FR	IT	NL
Q2 2021 - to Q4 2019 levels	21%	4%	0%	0%	8%	-1%
Q2 2021 - historical maximum	-11%	-8%	-14%	-25%	-3%	-20%

Sources: Euler Hermes, Allianz Research, Eurostat

But watch out for supply constraints! For the most exposed sectors (i.e. wholesale & retail trade, transport, accommodation & food services and leisure), the extension of restrictions have continued to keep production gaps high as of Q1 2021. Spain has the largest production gap (7.8% of GDP), reflecting the large share of sectors exposed to restrictions in its economy but also their sustained pace of growth before the outbreak of the pandemic. We find smaller production gaps in exposed sectors in Germany (2.6% of GDP), Belgium (2.8%) and the Netherlands (2.8%) as a result of the less stringent restrictions and the smaller shares of these sectors in the economy (see Figure 3, next page).

Figure 3 – Production gap* in sectors exposed to Covid-19 restrictions** (Q1 2020-Q1 2021), EUR bn – % of GDP



Sources: Euler Hermes Allianz Research, Eurostat
*Note: * See Appendix for methodology; **Wholesale & Retail Trade, Transport, Accommodation & Food Service and Leisure*

Supply, demand and sanitary constraints will determine the extent of the production gaps that could be transformed into actual consumption in exposed sectors. In sectors with limited production and import capacity (e.g. restaurants and accommodation), supply constraints are likely to put a lid on the pent-up demand that can be transformed into consumption. From a demand perspective, income constraints (although currently less relevant) and the impossibility to fully make up for all missed consumption (number of meals a week or vacation duration) may limit the catch-up.

We calculate total pent-up demand in exposed sectors (wholesale and retail trade, transport, accommodation & food services) by adding their production gaps to expected activity growth (using average growth rates) by end-2022. As for supply, we obtain local production constraints by adding up maximum value added and maximum increase over four consecutive quarters in exposed sectors. We find that only 73% of pent up demand could be absorbed locally in Spain versus 87% in Italy. In the Netherlands, Spain and France, local production capacities in these sectors appear insufficient to fully cover the pent-up demand over 2021-2022 (see Figure 4, page 4).

Residual household savings as of Q1 2021 could fully cover the pent-up demand in exposed sectors if households were to allocate them only to consumption over housing or financial investments. However, the exception is Spain, where household savings could only cover 65% of pent-up demand, reflecting weaker state support to protect purchasing power and depleted savings at the end of 2020.

Figure 4 – Pent up demand absorption estimates in exposed sectors (wholesale & retail trade, transport, accommodation & food services)

	BE	DE	ES	FR	IT	NL
Total 2020 value added, EURbn (a)	58.7	414.1	192.7	305.7	271.7	121.6
Estimated production gap (Q1 2020- Q1 2021), EURbn (b)	11	47	82	76	69	17
% of GDP	2.0%	1.6%	5.5%	2.6%	3.2%	1.8%
Trend growth by end 2022, EURbn (c)	2.2	2.5	14.4	7.0	1.8	4.3
Total pent up demand (d) = (b) + (c)	13	50	96	83	71	21
2022 max demand, EURbn) (e) = (a) + (d)	71.9	463.8	288.6	388.9	342.6	143.0
Max pre-Covid-19 value added*, EURbn (f)	69.9	453.8	262.3	376.7	333.2	135.6
Max EURbn additional demand to be absorbed (h) = (f) - (a)	11	40	70	71	62	14
Total pent up that can be absorbed (h) / (d)	100%	80%	73%	85%	87%	65%
Pent-up demand to be absorbed (% GDP, by end-2022)	2.0%	1.3%	4.7%	2.4%	2.9%	1.5%

Sources: Eurostat, Euler Hermes Allianz Research

In sectors with strong demand and limited local production capacities, pent-up demand can also create overheating, with significant price pressures. In this case, the adjustment to demand would happen through price increases, which we find are likely to build up in the Netherlands, Spain and Germany because of limited domestic production possibilities.

When domestic production cannot satisfy additional demand, import leakages are also likely to top up consumption, though the potential for this is limited in some exposed sectors. In transport and services activity, limited international supply (capacity) and ongoing travel restrictions, given the current fragile sanitary situation, are likely to limit imports. On the other hand, wholesale and retail trade sectors tend to have greater import potential.

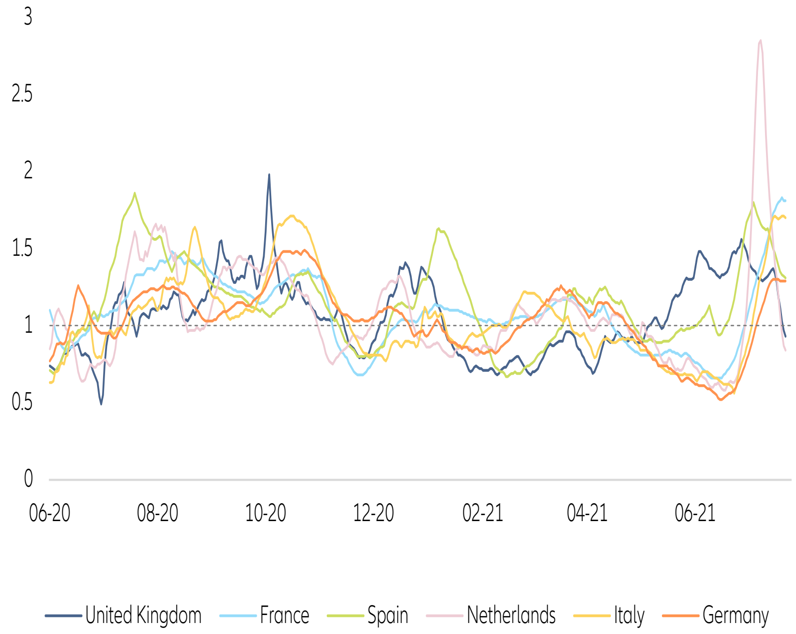
The spread of the delta variant is a moderate downside risk for consumption in countries in vulnerable situations, notably Netherlands, Spain and France. Despite the recent acceleration, vaccination penetration (at least one dose) is still below the indicated threshold of 80% (69% in the Netherlands, 65% in Spain and 58% in France) that would put an end to the multiplication of Covid-19 variants and the stop-and-go policies. The latest data from our proprietary Covid-19 Resilience Index[5] show that the Netherlands, Spain and France could see a possible tightening of restrictions, given their vulnerable situations.

However, the circulation of the delta variant may not translate into stringent measures. Overall, we expect only a mild negative impact on consumption from the spread of the Delta variant by the end of 2021. The experience from the UK so far shows a moderate impact of the new variant on mobility patterns and consumption behaviours. Despite the surge of the new cases, excess mortality (p-scores, all ages) remained at low levels in the UK, equaling the scores of June 2020 when the spread of the virus was much slower (see Figure 5, p. 5).

[5] *The Covid-19 Resilience Index assesses countries' vulnerability to renewed wave of infections (including the delta variant) based on criteria such as new cases, Delta variant penetration, reproduction rate, vaccination status, situation of the health system compared to previous peaks and recent evolution of restrictions compared to previous peaks.*

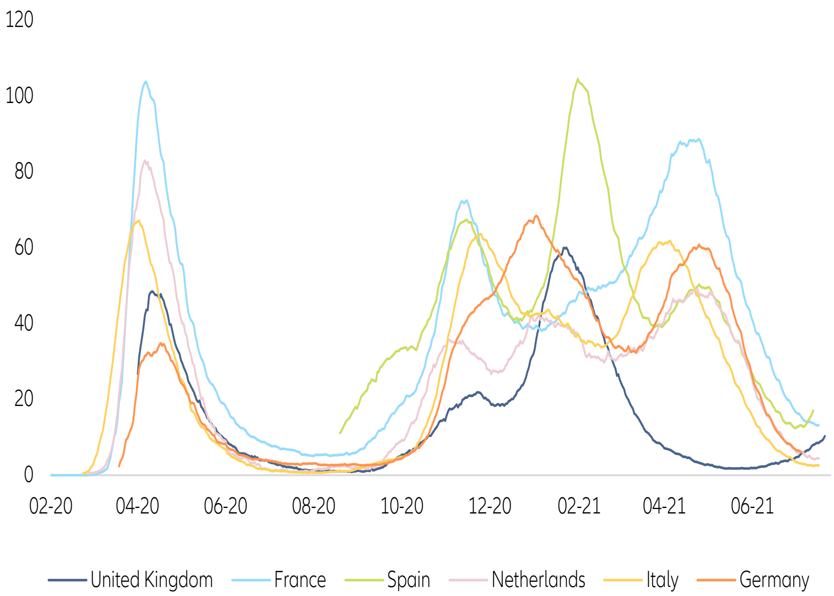
More importantly, the current break in correlation between Covid-19 cases and hospitalization rates is good news that may prevent a significant tightening of restrictive measures in exposed sectors (see Figure 6). For instance, in France, stringent measures appear to be correlated with the number of ICU patients rather than the number of new cases, thanks to increasing vaccine penetration (see Fig. 7, page 6). Moreover, the cost of containment measures has decreased significantly across time, thanks to higher adaptation to the new environment and higher digitalization.

Figure 5 – Covid-19 reproduction rates



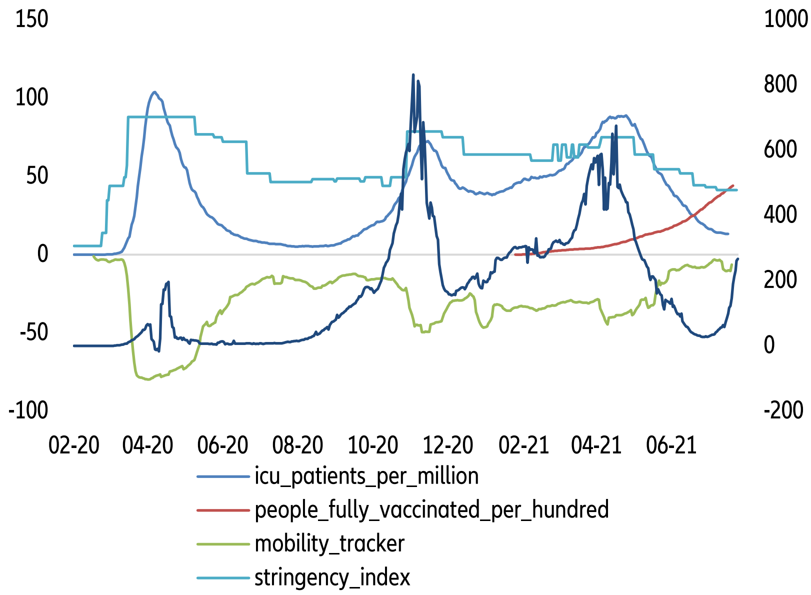
Sources : WHO, various sources, Euler Hermes, Allianz Research

Figure 6 – ICU patients per million



Sources : WHO, various sources, Euler Hermes, Allianz Research

Figure 7 – France evolution of stringency index (data until 22/07/2021)



Sources : WHO, various sources, Euler Hermes, Allianz Research

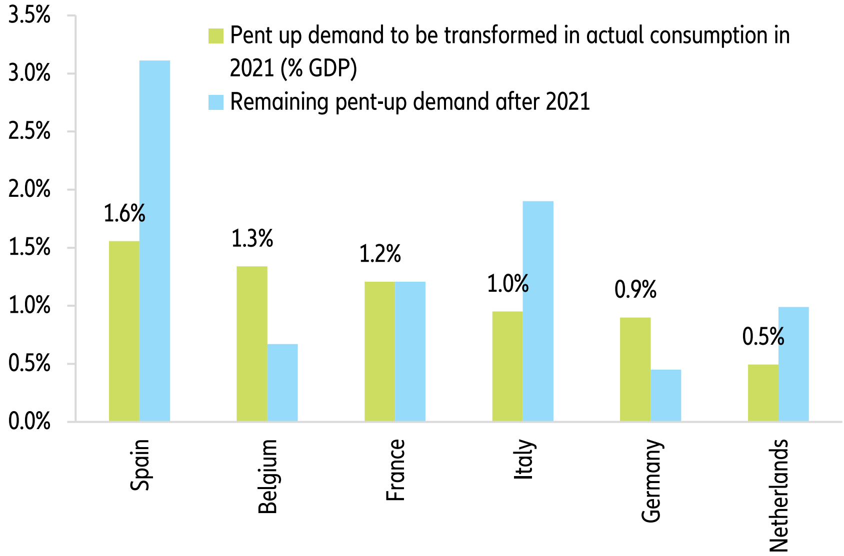
Overall, Spain (1.6% of GDP), Belgium (1.3%) and France (1.2%) will benefit from the largest boost from pent-up demand this year, provided that the sanitary situation remains stable and only 'soft stops' are implemented. Taking into account all factors discussed above (demand, supply, confidence and sanitary situation), Figure 8 summarizes the potential of pent-up consumption in 2021 for exposed sectors. Accordingly, Belgium and Germany show the highest scores for a strong catch-up. Crossing these scores with the pent up demand calculations from Figure 4, we find that the GDP boost from pent up consumption will be large in Spain (1.6% of GDP), Belgium (1.3%) and France (1.2%).

Figure 8 – Pent up demand absorption score card (green=favorable, red=unfavorable).

	Demand (income) constraint	Confidence boost	Production capacity constraint	Sanitary Situation
Belgium				
Germany				
Spain				
France				
Italy				
Netherlands				

Sources: various, Euler Hermes, Allianz Research

Figure 9 – Pent-up demand in exposed sectors to be transformed into actual consumption in 2021 (% of GDP)



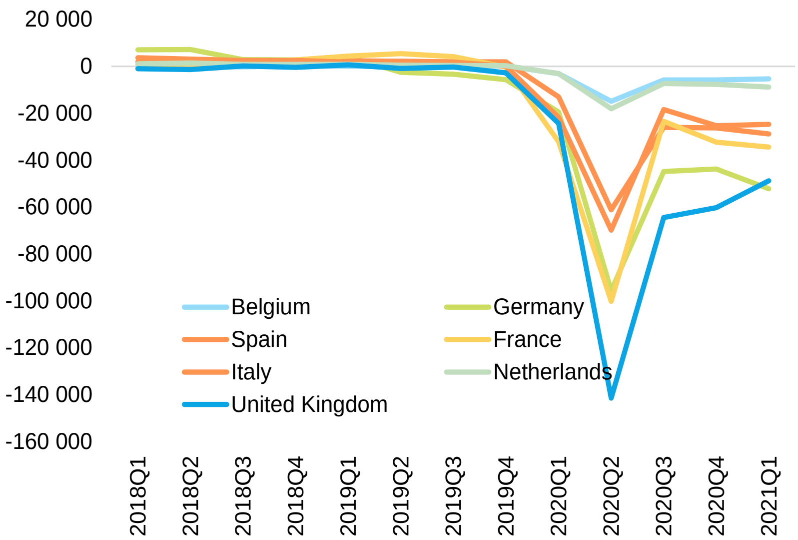
Sources: various, Euler Hermes, Allianz Research.

APPENDIX: Production gap estimations

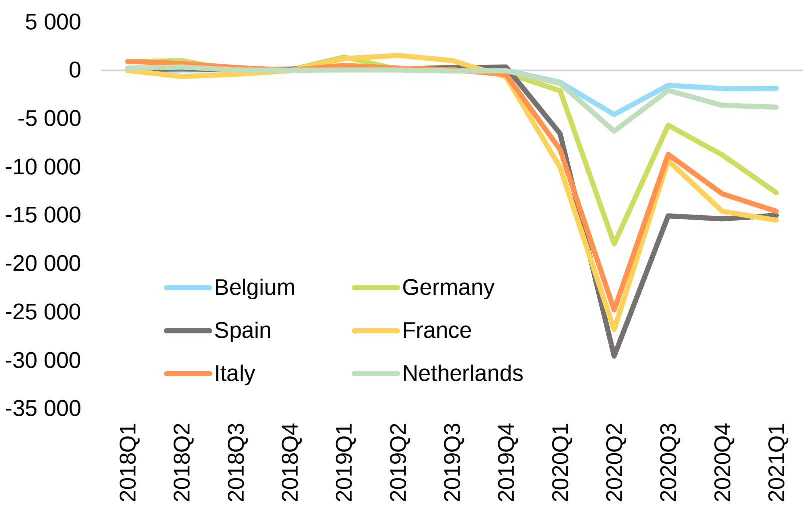
Methodology: We estimate the pre-Covid expansion trend for total and specific sectors to quantify the slack from Q1 2020 to Q1 2021. To obtain trend growth without being affected by the sharp drop in the latest observations, we filtered the ´artificial´ series for the Covid-19 period with the Hodrick-Prescott (HP) filter. These series are built until end 2022 using the underlying average growth rates since 2010. The catch up potential (or production gap) is calculated by taking the difference between HP trend obtained from the 'artificial' series and actual data during the crisis.

We find larger production gaps in Covid-exposed sectors (trade, transport, food & accommodation + leisure) in Spain, Italy and France. The production gap in the manufacturing is particularly high in Germany (3.5% of GDP), reflecting the predominant share of exposed sectors in the economy. The production gap in the construction sector is either extremely small (Spain, France or Belgium) or non-existent (Germany, Italy, the Netherlands) as the sanitary measures adopted after the second wave of the pandemic allowed activity to function at nearly full capacity.

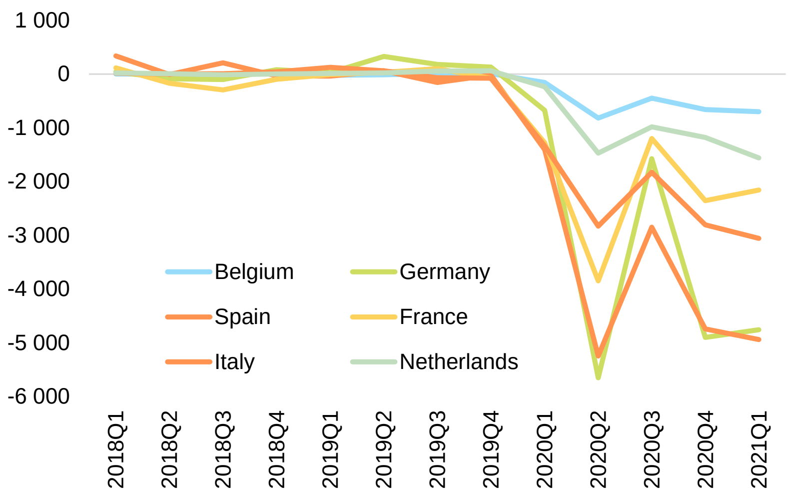
Total sector production gap (EUR Mn, Q1 2020-Q1 2021)



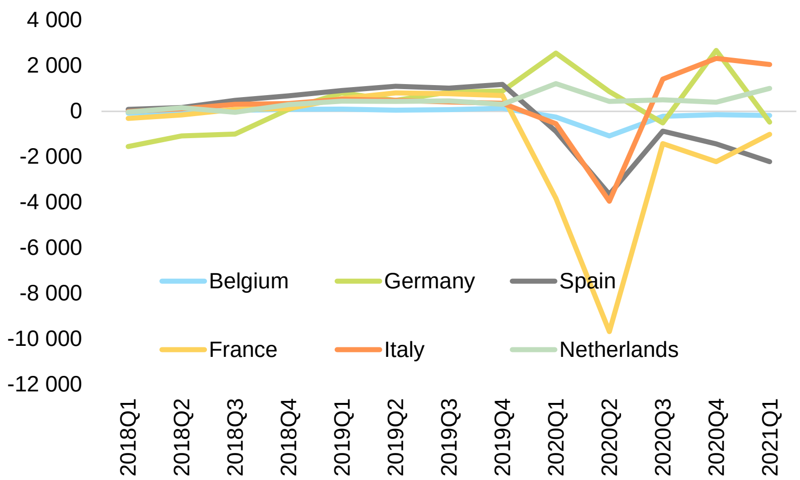
Retail, food & accommodation sector production gap (EUR mn, Q1/20-Q1/21)



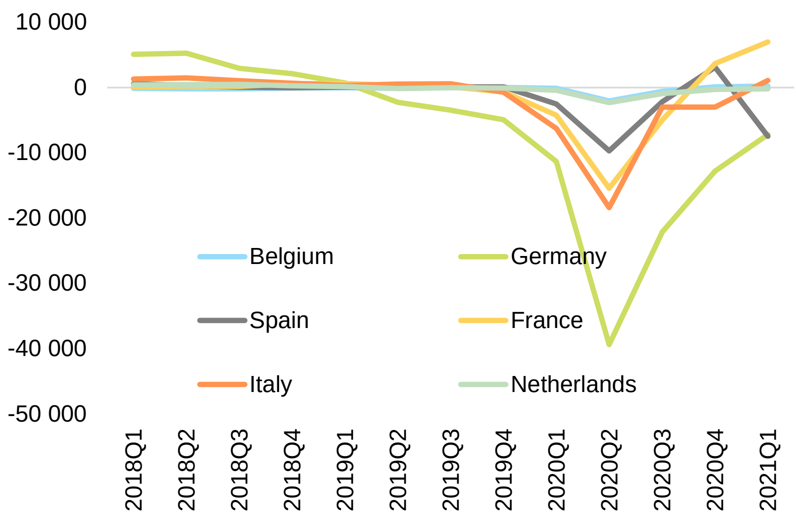
Leisure sector production gap (EUR mn, Q1 2020-Q1 2021)



Construction sector production gap (EUR mn, Q1 2020-Q1 2021)



Manufacturing sector production gap (EUR mn, Q1 2020-Q1 2021)



These assessments are, as always, subject to the disclaimer provided below.

FORWARD-LOOKING STATEMENTS

The statements contained herein may include prospects, statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties. Actual results, performance or events may differ materially from those expressed or implied in such forward-looking statements.

Such deviations may arise due to, without limitation, (i) changes of the general economic conditions and competitive situation, particularly in the Allianz Group's core business and core markets, (ii) performance of financial markets (particularly market volatility, liquidity and credit events), (iii) frequency and severity of insured loss events, including from natural catastrophes, and the development of loss expenses, (iv) mortality and morbidity levels and trends, (v) persistency levels, (vi) particularly in the banking business, the extent of credit defaults, (vii) interest rate levels, (viii) currency exchange rates including the EUR/USD exchange rate, (ix) changes in laws and regulations, including tax regulations, (x) the impact of acquisitions, including related integration issues, and reorganization measures, and (xi) general competitive factors, in each case on a local, regional, national and/or global basis. Many of these factors may be more likely to occur, or more pronounced, as a result of terrorist activities and their consequences.

NO DUTY TO UPDATE

The company assumes no obligation to update any information or forward-looking statement contained herein, save for any information required to be disclosed by law.