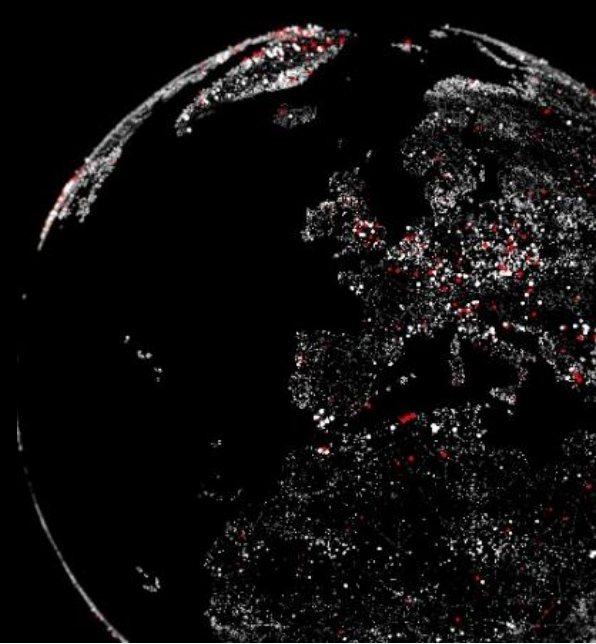


Europe Insights

Unusual patterns

December 2023

For professional clients and institutional investors only



In a nutshell:

Savings in Europe versus the US

- Eurozone household savings rates average 15%, contrasting with the US's 8%, displaying a structural shift influenced by improved credit conditions and globalisation.
- The economic cycle, uncertainty, and structural factors shape household saving behaviour. The eurozone's lower growth and higher unemployment contribute to the saving gap with the US.
- Intentions for increased savings and reduced major purchases signal a potential prolonged elevated saving rate in the eurozone, with OECD estimates suggesting persistently higher rates compared to pre-COVID, influencing consumer spending and fiscal deficits.

Fixed Income: Will refinancing the 'COVID Maturity Wall' be an issue?

- Opportunistic funding at low rates during and just after the pandemic was a prudent step at the time, but it has created a 'maturity wall' in 2024 and 2025 which could create refinancing difficulties at the higher rates now prevailing.
- We do not believe that there will be a widespread problem, but there are likely to be pockets of pressure which may pose risks to certain sectors.

Equities: Deciphering the corporate earnings

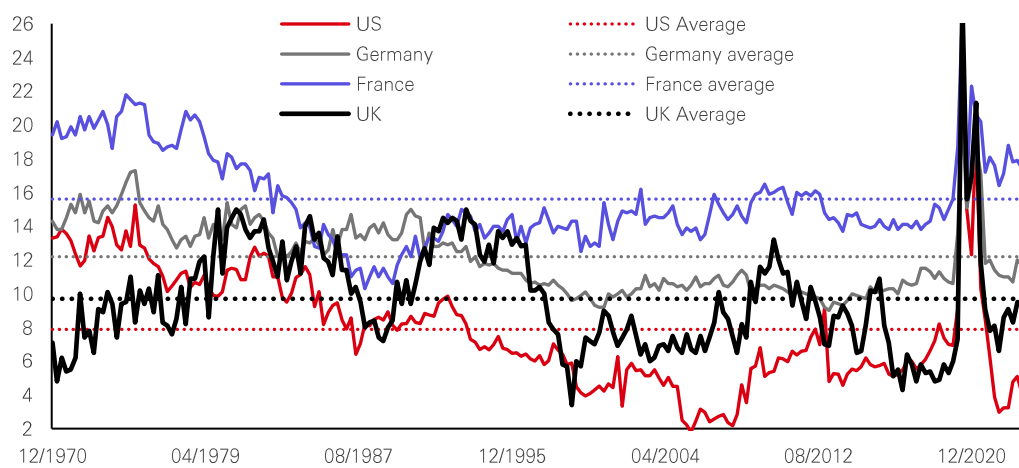
- After a robust post-pandemic recover, European corporate earnings have encountered challenges, with negative 12-month forward earnings estimates and downgrades in key growth sectors like banks and energy.
- European corporate margins have declined, and economic indicators like composite PMI and manufacturing have experienced consecutive contractionary months.
- A cautiously optimistic earnings outlook for 2024 is contingent upon a turnaround in manufacturing dependent segments or regions such as Germany. Sectors like IT and Consumer Discretionary maintain momentum, while challenges persist in Healthcare, Materials, Energy, and Consumer Staples.

Savings in Europe versus the US

Savings behaviour in Europe differs significantly from that in the US. Household savings rates in the eurozone are notably higher, averaging 13% compared to 8% in the US. Over the past fifty years and amid the pandemic, savings rates have structurally decreased below their long-term averages. This shift is likely supported by improving credit conditions due to the transformation of the banking sector and the globalisation of financial markets. The decline in savings rates is more pronounced in the US, dropping from around 14% in the early 1970s to its current level of 4% (Figure 1). The UK saving rate has been volatile, fluctuating between 3% and 15%. In contrast, French and German households tend to adopt a more cautious approach, maintaining relatively stable savings rates ranging from 10% to 14% since the mid-1980s.

The structural decrease in the savings rate below their long-term average is supported by improving credit conditions.

Figure 1: Gross household saving rate in % of household disposable income



Source: Eurostat, Refinitiv – Data as of 14/12/2023

Several factors influence household saving behaviour, including the economic cycle, uncertainty, and various structural and idiosyncratic factors. Recent analysis indicates that unemployment and economic growth influences long-term saving propensity.¹ The eurozone's lower economic growth and higher unemployment rates compared to the US may explain the saving gap between the two regions.

Influenced by the economic cycle and uncertainty, the eurozone's saving rate remains higher than pre-pandemic levels, unlike the US.

Beyond structural factors, the economic cycle and uncertainty also impact consumer behaviour. The energy shock following the Ukraine-Russia crisis has had a more significant effect on the eurozone's economy than on the US. Despite a decline in consumer confidence in both regions, the eurozone's indicator is now below its average, unlike the US (Figure 2). Low confidence and uncertainty about the future have prompted eurozone households to refrain from fully depleting their excess savings. As of Q2 2023, the eurozone saving rate stands at 15%, slightly above its pre-pandemic level, while the US saving rate is now close to 4%, significantly below its pre-pandemic level.

A closer look at household excess savings

The uncertainty surrounding whether and when the accumulated excess savings in the eurozone during the pandemic will be utilised remains a critical factor with implications for the economic outlook. Although a significant portion of these excess savings has been spent, the total amount as of Q2 2023 was approximately EUR 100 billion, equivalent to 1.3% of the eurozone's GDP.²

¹ Malmendier, U and L S Shen (2021), "Scarred Consumption", Working paper

² Excess savings are the cumulated sum of quarterly saving flows over the past four quarters relative to the levels that would have occurred if the saving rate had been equal to the average 2015-19 saving rate.

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Notably, household saving rates increased over the first half of 2023, potentially attributed to low consumer confidence and the income distribution of these savings. The inclination to spend is typically higher for low-income households, which commonly keep their savings in liquid forms ready for immediate use, such as currency or bank deposits. Conversely, wealthier households tend to hold savings in less liquid assets like term deposits, equities, or bonds. According to OECD estimates, the share of excess savings held by the top 10% of the income distribution increased from 50% in Q1 2020 to 67% by the end of 2022 in the eurozone and surpassed 75% in the US. A similar shift in the distribution of excess savings towards wealthier households may explain the observed increase in saving rates during the first half of 2023 in both regions.

The rise in household saving rates in H1 2023 is potentially because of low consumer confidence and income distribution of these savings.

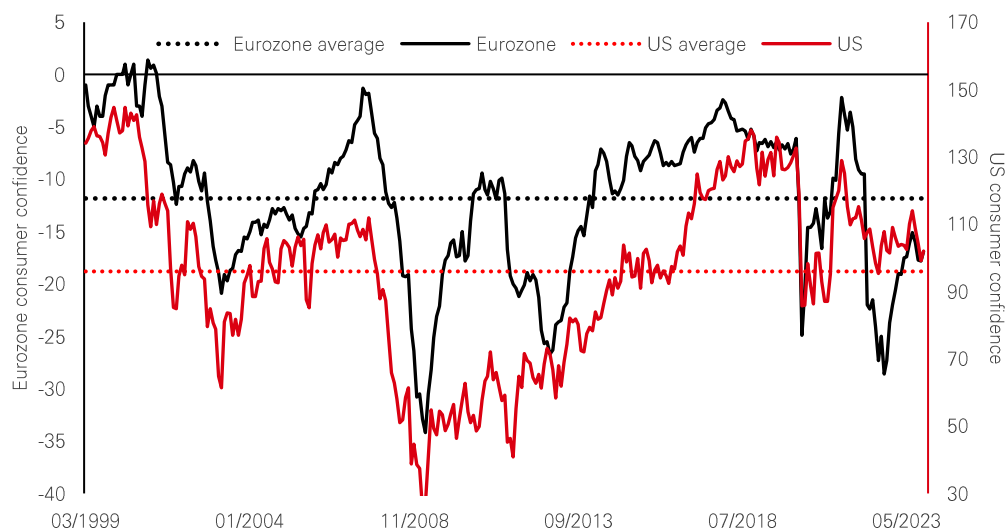
Overall, both the distribution by household income and the composition of excess savings suggest that these funds may not be readily available for spending. However, contrary to general expectations, the saving rate has decreased again in the US over the summer, and it has roughly stabilised in France and Germany (Q3 2023 eurozone data to be released in January).

A structurally higher savings rate?

The likelihood of fully depleting excess savings in Europe appears restricted. Insights from household surveys suggest intentions for increased savings and a reduction in significant purchases, including cars. Queries related to home improvement or house purchases also indicate an anticipated decline over the next twelve months. Consequently, there are concerns that the saving rate will persist at a level higher than pre-COVID. OECD estimates, for example, suggest that eurozone saving rates for 2024-2025 will remain higher than the pre-COVID period, in contrast to a lower projected saving rate in the US.³ Such estimates imply subdued consumer spending, which could further impact the eurozone’s economic outlook. However, cautious projections may allow room for potential upside growth surprises, as lower saving and stronger consumer spending are plausible. If a cautious saving behaviour endures, assuming an unchanged current account position, this could result in fiscal deficits remaining structurally wider than pre-COVID.

Persistent cautious saving behaviour, alongside an unchanged current account, may sustain structurally wider fiscal deficits compared to pre-COVID levels.

Figure 2: US and Eurozone consumer confidence



Source: Refinitiv, National Statistics – Data as of 14/12/2023

³ OECD World Economic Outlook – November 2023

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Fixed income: Will refinancing the 'COVID Maturity Wall' be an issue?

Opportunistic funding at low rates during and just after the pandemic was a prudent step at the time, but it has created a 'maturity wall' in 2024-2026 which could create refinancing difficulties at the higher rates now prevailing or force deleveraging.

We expect 21% of the \$3.4 billion European investment grade market to arrive to maturity before end of 2025. This proportion rises to 26% for European high yield markets. This is slightly more than what we expect in the US, but a lot less than what we expect in Asia.

After record issuance in 2020 and 2021 driven by the low-rate environment and the ECB Corporate Sector Purchase Programme, supply was soft in 2022, recovered somewhat this year and we expect the trend to continue next year. Both investment grade and high yield companies have sound liquidity positions and committed credit lines, although some deterioration in credit metrics is expected from a position of strength – notably on coverage ratios. Besides, it would be important to watch the identified sectors such as Auto or Healthcare with maturities over 2024 and 2025 more than doubling.

European investment grade credit metrics are at peak quality with low leverage, elevated cash balances and margins at record levels – a strong starting point that should limit the volume of fallen angels next year. High Yield credits have recovered post-COVID thanks to deleveraging and earnings growth, but weaker economies might weigh again on company fundamentals. While weakest credits remain in a fragile position in a rising rate environment, high-cash balances should sustain an increasing but moderate default rate. Particular stress is ongoing in REITs, where asset sales and search for alternative refinancing remain at the top of the agenda for most players.

Overall, maturity walls in European investment grade and high yield markets look manageable, but certain sectors in high yield such as automotive, chemicals, retail and real estate might experience more stress.

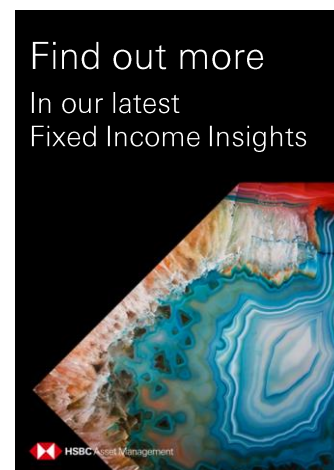


Figure 1: EUR investment grade maturities (USD billion)

Sector	2023	2024	2025	% of total bonds	Variation 23/25
Autos	34	26	24	37%	-29%
Basic industry	13	15	19	26%	45%
Capital Goods	16	16	20	29%	25%
Consumer goods	15	21	23	24%	55%
Energy	12	13	13	25%	17%
Healthcare	16	15	18	20%	15%
Media	5	3	4	20%	-5%
Real Estate	11	12	20	19%	76%
Retail	6	9	8	28%	37%
Services	4	6	3	31%	-4%
Technology	8	5	10	25%	31%
Telecoms	15	14	15	21%	4%
Transportation	12	12	13	17%	10%
Utilities	19	23	33	20%	70%
Non-financial senior	190	200	228	23%	20%
Non-financial hybrid	9	10	12	14%	34%
A	70	65	75	21%	7%
BBB	109	120	139	25%	27%

Source: HSBC AM, Macrobond data, November 2023.

Figure 2: EUR high yield maturities (USD billion)

Sector	2023	2024	2025	% of Total	Variation 23/25
Autos	3,8	7,5	7,2	39%	87%
Basic industry	2,5	4,0	4,8	34%	94%
Capital Goods	3,8		3,5	17%	-7%
Consumer goods	2,2	4,7	0,8	66%	-63%
Energy	1,4	1,5	2,4	40%	73%
Healthcare	0,6	1,0	4,9	22%	721%
Leisure	2,6	1,3	1,4	21%	-44%
Media		0,5	1,7	29%	
Real Estate	1,1	2,4	3,3	35%	216%
Retail	1,6	3,1	1,6	33%	2%
Services	1,2	3,0	4,3	28%	260%
Technology		1,5	2,5	23%	
Telecoms	3,1	4,5	6,1	26%	102%
Transportation	2,3	2,2	3,6	47%	60%
Utilities	0,3	1,5	0,9	37%	163%
Non-financial senior	26,4	38,7	49,1		86%
Financial senior	3,3	9,5	11,7		261%
Non-financial hybrid	4,8	10,7	10,6	36%	120%
Financial Subordinated	3,6	8,6	6,2	61%	71%
BB	21,6	33,3	38,8	45%	80%
B	4,8	11,7	17,8	30%	272%
CCC & below	3,2	3,2	4,2	33%	30%

Source: HSBC AM, Macrobond data, November 2023.

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Equities: Deciphering the corporate earnings

European corporate earnings, which surged in 2021 and 2022 following the initial pandemic shock, have stumbled in the latter half of 2023. In the last three months, 12-month forward earnings estimates have turned negative, with downgrades in key growth sectors like banks and energy. While the consensus still anticipates mid-single digit growth in the coming year, its realisation depends on the depth and duration of current recessionary trends, influenced by factors such as the global economic health, China as a key export market, low energy prices, and the resilience of the European consumer.

In December, composite PMI and manufacturing experienced a consecutive contractionary month, while the European corporate margins declined with a swift recovery being unlikely. The catalysts for a recovery would be a bottoming of PMIs and a more expansionary fiscal policy in China. Geo-economic risks are also key as half of European corporate earnings rely on diverse regional demand outside of Europe. In equities, despite a 10% surge over the last month, valuations are still below their ten-year average. The trailing P/E is 25% below the 2021 peak in Europe while US valuations are just off their peak levels. On YTD basis, Europe saw a 14.3% rise, led by IT, industrials and financials surpassing their 52-week highs (Figure 1).

Figure 1: Ranking of European sectors by peak returns year-to-date and projected EPS growth

	YTD	From 52 week high	EPS growth	
	As of 13 Dec		2023e	2024e
MSCI Europe	14.3	3.8	-2.8	6.1
IT	32.9	3.0	12.4	6.4
Industrials	21.2	2.6	-0.8	8.2
Financials	15.3	0.6	16.6	5.7
Consumer Discretionary	14.1	-6.1	9.6	3.3
Real Estate	11.4	-8.5	12.4	-3
Com. Services	11.3	-5.9	-6.8	11.2
Utilities	10.0	-1.2	1.5	-0.8
Health Care	4.9	-4.6	2.3	9.4
Materials	4.0	-5.3	-37	9.6
Energy	2.9	-8.4	-29.5	1.4
Consumer Staples	-1.6	-10.5	1.4	6.6

Source: Bloomberg / IBES, Eurostat, Reuters – Data as of 18/12/2023

Despite this year's outperformance, Industrials maintain relatively low valuations. Electrification drives capital goods, but weak new orders and backlogs persist. Construction grapples with weakened new orders, and the automotive sector faces intensified competition from the US and China. In Financials, earnings momentum wanes as rates peak, while insurance sees improved consensus due to higher rates. IT anticipates sustained strength, propelled by tech hardware recovery. Consumer discretionary maintains supportive momentum, despite slowing job growth and luxury goods reliant on the Chinese consumer. Health Care, tied to macro developments, eyes a potentially optimistic 9% EPS growth consensus. Materials may witness a recovery from depressed valuations, aided by low backlogs fostering chemical rebounds, and mining benefiting from Chinese developments. The Energy sector confronts challenges from rising US supply and global growth deterioration, but robust cash flow persists. Consumer Staples, the weakest performer in 2023, eyes potential recovery if inflation subsides.

In summary, the robust post-COVID earnings recovery in Europe has ceased. The European economy's weakness could persist, especially if global growth momentum falters. However, on the positive side, European equities stand to benefit from easing cycles by the ECB and FED, and a more expansionary fiscal policy in China.

Anticipated mid-single digit growth in the next year will depend on the depth and duration of current recessionary trends .

The slightly positive earnings outlook for 2024 hinges on the reversal of manufacturing dependent segments or regions like Germany for a comprehensive recovery.

Data watch

As of 15 December 2023

Eurozone growth contracted slightly in Q3, with a downturn in manufacturing and services sector. Both headline and core inflation surprised to the downside for third consecutive month. The ECB announced the reduction of its Pandemic Emergency Purchase programme (PEPP) over the second half of 2024.

Economic Indicator	Data as of	Last data	Consensus	Previous data	Analysis
PMI composite	Dec	47.0	48.0	47.6	Eurozone PMI surveys keep pointing to a contraction of the business activity, with a downturn across the manufacturing and services sectors, further hiring pullback, inventory depletion and a drop of the order book. Inflation signals slowing input costs and increasing output prices. Despite current weakness, firms grew more confident about the outlook, at its highest level since August
GDP growth qoq	Q3 2023	-0.1%	-0.1%	0.1%	Eurozone GDP contracted slightly in Q3 and was just flat excluding Ireland. A rise of household consumption in France, Italy and Spain, in addition to capex growth in Germany and France were more than offset by a negative contribution from inventories and net trade. Across countries, Q3 GDP contracted in Ireland (-1.9% qoq), Portugal and the Netherlands (-0.2% qoq), followed by Germany and France (-0.1% qoq). Q3 GDP expanded in Spain (+0.3% qoq), Italy (+0.1% qoq) and Belgium (+0.4% qoq)
Industrial production % yoy	Oct	-6.6%	-4.6%	-6.6%	Eurozone industrial production has been falling for the past four quarters and stood around -1% below its 3Q average. The October release showed a significant contraction of intermediate goods and metal products, while motor and transportation keeps expanding. Across the eurozone economies, industrial production fell most in Germany, followed by Italy and the Netherlands, but was flat in Spain, and rose in France
Unemployment rate	Oct	6.5%	6.5%	6.5%	The eurozone unemployment rate keeps stabilising at a record low level of 6.5% since last March, despite a broadly flat economy. However, unemployed persons have been rising for the second consecutive month, notably in Italy and Germany with rising vacancies. Country-wise, the unemployment rate rose slightly in Germany (3.1%) and Italy (7.8%) and was stable in France (7.3%) and Spain (12%)
Trade balance (goods, ex EMU) EUR billion (12Mth cumulative)	Oct	-5.9	-7	-44.3	The eurozone trade deficit keeps decreasing, from the record level observed last year. Over the 12 month to October, imports have been contracting (-8% yoy), while exports have been relatively more resilient (+2% yoy). However, as external demand may keep weakening, eurozone trade deficit may widen again
Retail sales % yoy	Oct	-1.2%	-1.1%	-1.2%	Eurozone retail sales stabilized, led by further drop in fuel spending. Consumption of goods excluding fuel were broadly stable, with ongoing growth in car registrations. Looking ahead, household consumption should remain resilient, as real income keeps improving due to ongoing wage growth and a sharp decline in inflation
Inflation					
- Headline CPI, % yoy	Nov	2.4%	2.7%	2.4%	Eurozone inflation surprised to the downside for the third consecutive month, driven by the negative base effects from energy prices (-11.5% vs. -11.2%), with further easing inflation of food (6.9% vs. 7.4%). Core inflation eased to 3.6%, led by sharp price declines of core industrial goods (2.9% vs. 3.5% in Oct) and services (4.0% versus 4.6% in October), probably helped by erratic items, such as temporary discounts of rail fares in Germany and in France. Country-wise, headline inflation ranged from 0.7% in Italy and 3.8% in France, with Germany at only 2.3%
- CPI core*, % yoy	Nov	3.6%	3.9%	3.6%	
ECB Refinancing rate	14 Dec	4.50%	4.50%	3.75%	The ECB announced the reduction of its Pandemic Emergency Purchase programme (PEPP) over the second half of 2024 by EUR 7.5 billion per month on average, with a termination of bond reinvestments at the end of 2024. The ECB staff revised its projections downward for 2024, with GDP growth at 0.8% in 2024 (versus 1.0% previously) and inflation at 2.7% (3.2% previously). After a weak H2 2023, the economy is expected to recover in 2024, supported by real income and foreign demand, and a resilient labour market, which altogether would more than offset tight credit conditions
Deposit rate		4.00%	4.00%	3.25%	

■	Improved or better-than-expected
■	Worsened or below-expectations
■	Unchanged or in line with expectations

* Eurozone Core CPI is CPI excluding energy, food, alcohol & tobacco
Sources: Bloomberg, Refinitiv, Eurostat, HSBC Asset Management – data as of 15/12/2023

F: Final A: Advanced P: Preliminary estimate

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