ECO FLASH

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Eurozone: four countries, four ways to recover

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- **The shape of the post-crisis recovery will depend on the characteristics of each economy, the fiscal response and the level of integration in global value chains.**
- **Even before the COVID-19 crisis, some eurozone economies were more vulnerable than others. High levels of debt or unemployment could limit the strength of the recovery.**
- **At a domestic level, the sectoral structure, the pattern of private consumption and the labour market situation will be crucial. A high dependency on tourism, a sector durably impacted by the crisis, could hold back the recovery.**
- **At the external level, a slow recovery in global trade would hit the most open economies. Moreover, the distortions in global value chains during this crisis could weaken the most highly-integrated economies over a longer period.**

The COVID-19 economic shock has been particularly significant for the eurozone countries (see Figure 1). The full consequences of this crisis are not yet known, and there is considerable uncertainty regarding the pace of recovery in the second half of 2020. Are the eurozone's four biggest economies on an equal footing for the recovery? This is the central question we will address in this article. The shape of the recovery will depend on the specific features of each member state (initial position, labour market structure, trade-off between savings and consumption, productive fabric. The fiscal policy response and the strength of world trade will also play key roles. The answer to this question is not yet fully clear, each country having its own strengths and weaknesses.

Eurozone GDP growth

In %, quarterly change, in real terms

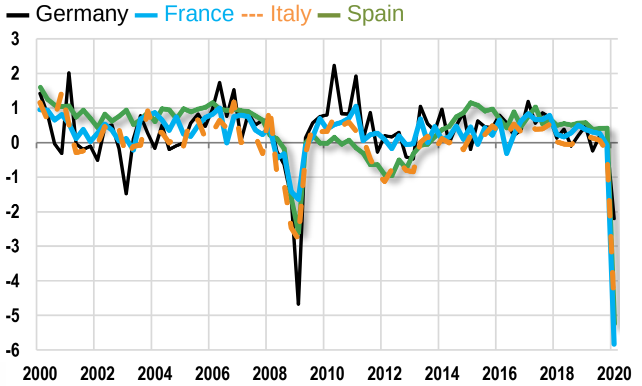

Figure 1 Sources: AMECO, BNP Paribas

One can, however, attempt to sketch out a ranking. Germany leads the way, followed by France, Spain, and Italy.

Contrasting economic starting points

Before the COVID-19 crisis, eurozone member states were in different economic positions, particularly with regards to their public finances and labour markets. From a public finances perspective, level and trend of debt-to-GDP ratios had diverged significantly. Whilst the public debt to GDP ratio has fallen by more than 20 points in Germany between 2010 and 2019 (to 60% of GDP), France experienced a sharp increase of 15 points over the same period (to 98% of GDP). France is also the only major eurozone economy not to have stabilised its debt-to-GDP ratio. Italian debt - structurally higher - was close to 135% of GDP in 2019, whilst the ratio in Spain has fallen steadily since 2014 (from 100.7% in 2014 to 95.5% in 2019).

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The COVID-19 crisis will result in a significant increase in government debt in the eurozone, through both a contraction in nominal GDP and a widening in public deficits. This could hold back the recovery. Although the short-term risks are mitigated by the massive intervention of the European Central Bank (ECB), this could lead, over the medium term, to greater vulnerabilities. Rising public debt may result in higher interest rates, due to increased risk premiums, which could, on its turn, limit a fiscal stimulus. Moreover, household may step up their savings in anticipation of higher future taxes.

There were also marked initial differences in the labour market (see Figure 2). Whilst Germany had a historically-low unemployment rate of 3.2% in December 2019, it was still 14.1% and 10% in Spain and Italy, respectively. Italy and Spain are still recovering from the crises of 2008-09 and 2011. However, they had both seen a steady decline in their unemployment rates in 2019. France's recently registered encouraging improvements in the labour market. The unemployment rate dropped to 8.1% in the final quarter of 2019 (INSEE data), its lowest level for 12 years. However, the coronavirus crisis will erase all these positive trends.

Specific endogenous features more or less favourable to a strong recovery

Jobs at risk

Workers on temporary contracts have generally been hit harder by the COVID-19 crisis, often losing their jobs, and having more limited access to short-time working schemes. Moreover, several service sectors that use intensively temporary contracts will continue to face low or no activity after the end of the lockdown. This is particularly true for the cultural, tourism, and sport sectors. Spain – due in large part to the importance of the tourist industry – is the European country that relies the most on temporary contracts (22% of total employment). France and Italy are slightly above the European average, with 13.7% and 13.1% respectively, while the figure is 10% in Germany (see Figure 3).

The fragility of jobs should also take into account the importance of SMEs in the economy. These differ significantly between the major European countries. According to Eurostat, half of jobs in the business sector within the EU27 are in small companies with fewer than 50 employees (see Figure 4). This figure rises to 64% in Italy and 58.3% in Spain. Conversely, in Germany, whose economy is based more on the industry and economies of scale, 'only' 43% of employment is in small companies. The figure in France is even lower at 40.6%[1].

Significant questions remain concerning the ability of these small companies to overcome the economic crisis, particularly once government support comes to an end. SMEs are the most vulnerable to the current situation, given their weakest cash positions. Small firms often also face more difficulties to benefit from the existing support schemes. In Italy, only one-third of claims from SMEs or employees on short-time working have resulted in a payment so far[2]. Moreover, Italy and Spain are the two countries where the economic contraction could be the greatest in the second quarter of 2020, which would further accentuate the financial difficulties of small companies in these countries.

[1] If we widen the scope to companies with up to 249 employees (Eurostat's definition of an SME), the share of employment is 67% in the EU27, 76.8% in Italy, 71.8% in Spain, 63.2% in Germany and 53.4% in France.

[2] Coronavirus : la survie des entreprises italiennes entravée par la bureaucratie [Coronavirus: the survival of Italian companies threatened by bureaucracy], *Les Echos*, 11 May 2020.

Unemployment rate

% of labour force

--- Germany --- France — Italy --- Spain (rhs) — Eurozone

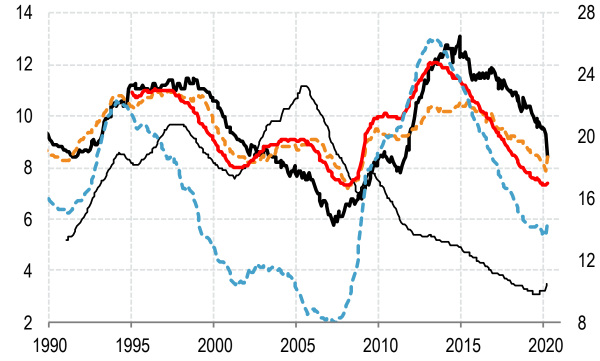


Figure 2 Sources: Eurostat, BNP Paribas

Share of temporary employment

% of total employment (2018)

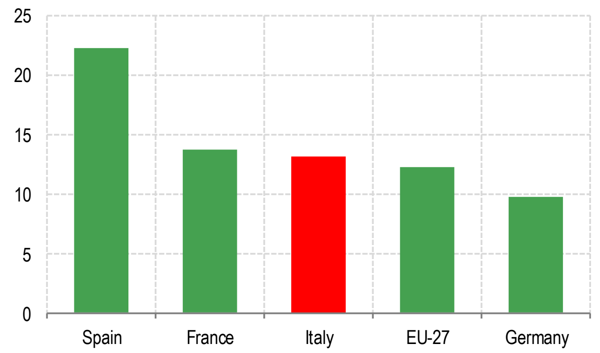
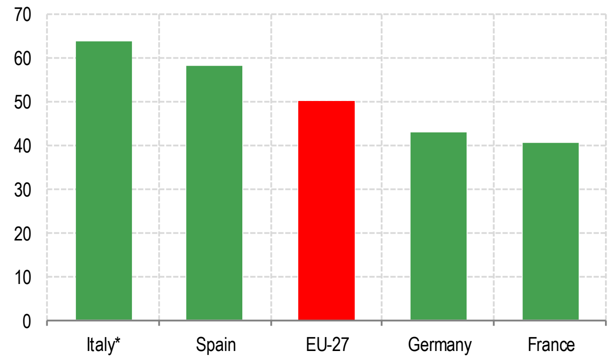


Figure 3 Sources: Eurostat, BNP Paribas

Employment in companies with fewer than 50 employees

% of total employment (2017)



* 2016

Figure 4 Sources: Eurostat, BNP Paribas

Forced savings: a guarantee of recovery in consumption?

The resumption of consumer spending will play a key role in the recovery. First and foremost, consumer spending is the most important part of GDP (slightly over 50% for Germany and France, 60% for Italy and Spain). It is also the demand component most likely to recover fast, in particular because of the substantial savings accumulated during the lockdown period. These "forced" savings are the automatic result of a collapse in household consumption, whilst disposable income has been broadly preserved. The European Commission's spring forecasts evaluate the scale of this forced savings[3]. The Commission expects the household savings rate to rise in 2020 by between 6 and 7 points in Germany, France, Italy, and Spain. This would push the households' savings rates to 25% in Germany, 22% in France, 17% in Italy and 14% in Spain. It must be added that the EC forecasts include not only forced savings but also precautionary savings.

The question is at what speed and to what extent this forced savings will be unblocked and consumed once the lockdown ends and the economy starts recovering. On one hand, consumers' purchasing power is likely to benefit from falling oil prices. It was of little help during the lockdown but it represents a significant support for the post-crisis period. However, what matters eventually the most is consumer confidence with regards to both the health risk and the state of the labour market. The scale of the shock on income and on financial wealth will also play a role. For some, the question will not be to what extent they can run down their savings, but how to rebuild them.

The state of the labour market is a key factor as it will determine to what extent households increase their precautionary savings, thereby limiting the expected recovery in consumption. The persistence of the shock on employment and unemployment is hard to assess, but the risk is not negligible. Given the situation before the crisis, the strengths and weaknesses of the labour markets in each country and the measures taken to mitigate the shock, Germany appears less exposed than France, Spain, or Italy. Although the better situation of its labour market plays favourably (assuming it passes the test of the current crisis), the recovery in German consumption could be restrained by the cautiousness of its citizens, compared to French, Italians and Spanish counterparts.

Uncertainty over the shape of the recovery in consumer spending also relates i) to the composition of consumption, ii) the share of spending that has been unaffected by the lockdown (pre-committed spending and food in particular). Among the part that has been affected, we need to differentiate the part that can quickly be caught up, from the part which will take longer to recover, and even the one that has been definitively cancelled. Unfortunately, it is difficult to make any assumptions about future consumption behaviour. Some of the spending affected falls into different categories, such as travel, vehicle purchase or spending on clothes. Some areas could also see a rush effect after the lockdown, producing thus a temporary surge in consumption: this could be true of bars and restaurants, cinemas, and leisure activities in general. However, if this rush effect and the overall rebound in consumption may not be subjected to income constraints, it

■ Structure of consumer spending

Share of major items in consumer spending (2018)

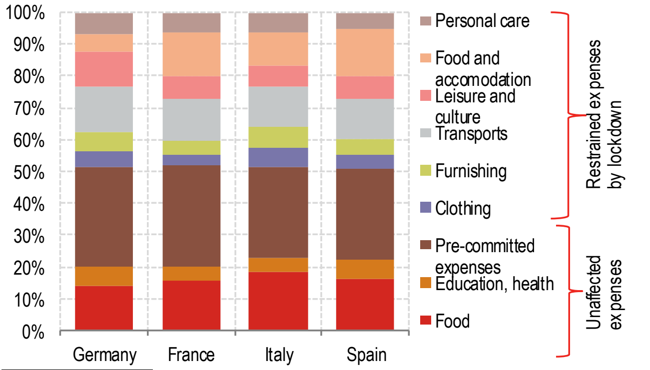


Figure 5 Sources: Eurostat, BNP Paribas

will be limited by the continuation of social-distancing measures. They will also depend on any possible changes in consumption habits. From this perspective, the issue of a return to normal is not much about how long it will take, but whether it will happen at all. In this regard, all four major eurozone economies are on an equal footing. Nor are the structures of their consumption sufficiently different for this to be a differentiating factor in the speed of their recoveries (see Figure 5).

Sectoral structure: one point for Germany?

The exit from the crisis and the speed and scale of economic recovery will depend on many parameters. The sectoral structure of the economies is one of these. It is worth noting the specific features of this crisis, namely that market-related services are fully affected and play an unusual aggravating role instead of being a shock-absorber. The significant weight of this sector in France, Italy, and Spain (nearly 60% of Gross value added, compared to 51% in Germany) is a comparative disadvantage for these countries in the current situation (see Figure 6). How might this factor play out after the crisis?

It would be nice to be able to say that the steeper the fall during lockdown, the more vigorous the recovery. The uncertainty surrounding demand, linked with the gradual easing of lockdowns and the social distancing measures will probably mitigate the speed of the rebound. The same is true for construction and industry. These two sectors are more cyclical - steep contractions are usually followed by strong recoveries. But it looks as though it might be harder to restart building sites and factories than to reopen shops: the return to normal in these sectors could therefore be slower, especially given that lockdown measures have been substantial and production capacity has been underutilised. These factors play in favour of Germany, where the lockdown has been less stringent than for the three other countries[4], whilst French business leaders (across all sectors) seem pessimistic[5].

[3] *European Economic Forecast, Spring 2020*, European Commission, May 2020

[4] "*Resilient builders lay foundation for German economy to Outperform*", Financial Times, 14 May 2020.

[5] According to a survey of 1,300 French business leaders published by Xerfi in early May, 90% of respondents do not expect to re-establish full production capacity until the summer of 2021 (In French https://www.xerfi.com/flash/COVID19-Enqu%C3%AAte-entrepreneurs.pdf?utm_source=EMAIL_COVID_19_ENQUETE_VIDEO_08052020&utm_medium=email&utm_campaign=%40EMAIL_COVID_19_ENQUETE_VIDEO_080520)

In any of these sectors, a rapid recovery could be impeded by labour constraints and hiring difficulties too. Activity is also likely to be held back by increased costs and reduced productivity as a result of 'barrier' health protection and social-distancing measures. The productive fabric that underlies the sectoral structure of each economy, its financial solidity, will also matter. Industry will also be affected by the global trade variable and the uncertainty about its recovery, against a background of a possible 'deglobalisation' and the necessary 'greening' of economies, both trends that could affect this sector.

As a result, it is possible, but by no means certain, that Germany will draw on the power of its export industry to recover faster than its eurozone partners. More precisely, this could have a favourable effect in the short term, but over the longer term, in the post-crisis world, it could prove a handicap. Germany looks more exposed than its partners to any questioning of its growth model (based on its powerful export industry) in the event of a paradigm shift (towards a decarbonised growth and less dependent on trade). But this is not to say that things will go much better for the other major eurozone economies, which would also need to find new sources of growth. The specific case of tourism is a good illustration of this. Its significant weight in France[6], in Italy and even more in Spain (see Figure 7) is a clear obstacle in the current path to recovery. Its future remains unclear in the post-COVID world.

The weight of value chains

Participation in global value chains (GVCs) has been a key driver of the global economy over the last few decades. It has stimulated growth by boosting productivity through increased specialisation. However, it has also made value chains more vulnerable to economic disruption. Shocks in one country are rapidly transmitted to other economies. In the case of the COVID-19 crisis, companies have faced disruption to supply, caused by restrictions on transport and the shutting down of production chains. The scope for recovery will therefore also depend on these being restored.

The fall in trade will particularly affect the most open economies. Thus, Germany is likely to be the hardest hit of the eurozone's major economies. In 2019, its exports of goods and services represented 47% of GDP, a figure much higher than for Spain (35%), Italy (32%) and France (31%; see Figure 8).

Participation in GVCs is often measured in terms of the share of foreign inputs in exports. Figure 9 shows that this share is higher in the smaller countries, making them more sensitive to disruption to GVCs in the current crisis. The involvement in GVCs of a major economy with technology-rich production may be relatively low. Such an economy is capable of producing a sizeable share of value added locally. This explains why in Germany the share of foreign inputs in its exports is relatively low.

In recent decades, the exposure of the German manufacturing sector to the economies of South and East Asia, which includes China, Japan, and South Korea, has increased rapidly. In 2015 (the most recent year for which

[6] This substantial weight should be seen in the context of the large share of domestic tourism: of the 7% of GDP represented by tourism in French GDP, 5 points come from domestic visitors and 2 points from non-residents.

Sectoral structure of economies

Share of each branch in total GVA (2019)

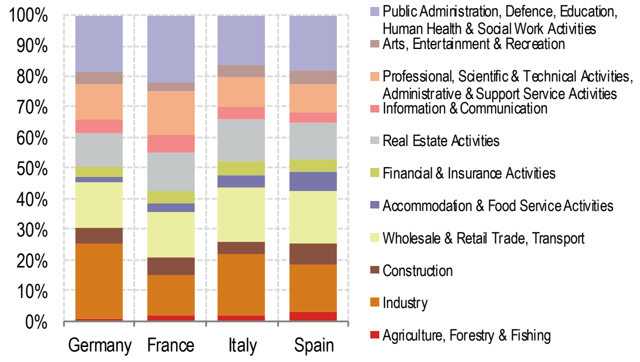


Figure 6 Sources: European Commission, BNP Paribas

The weight of tourism (2018)

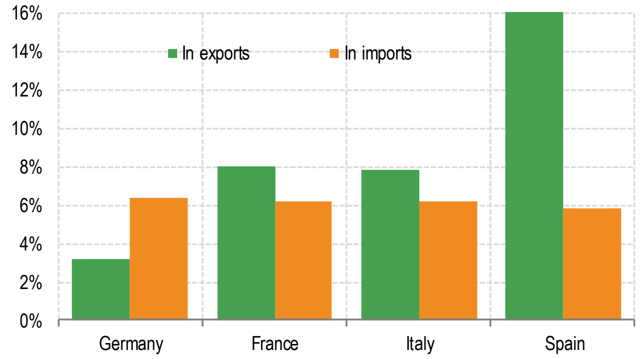


Figure 7 Sources: World Bank, BNP Paribas

figures are available), this region represented 20.6% of imports of manufactured goods to Germany, compared to 18.6% for France. Moreover, Germany is one of the biggest exporters to China. In 2015, 7.6% of Chinese imports of manufactured products came from Germany, compared to 2.4% for France, 1.8% for Italy and 0.7% for Spain. As a result, the sharp drop in Chinese industrial activity put the brakes on German manufacturing output.

Given the important role of the German manufacturing sector, this disruption was rapidly transmitted to neighbouring countries. Final demand for manufactured products in France, Italy and Spain contains respectively 9.2%, 6.5% and 6.7% of value added from Germany. This highlights the importance of a recovery in Germany's manufacturing industry for other European countries. Meanwhile, German industry also depends on demand from its neighbours and imports of essential components from them.

In the short term, the gradual upturn in Chinese industrial activity will be favourable, particularly for German industry. But it will not be enough. European manufacturing sectors will rely to a large extent on a recovery in demand within Europe, which will in turn depend on the lifting of lockdowns and the easing of restrictions.

The COVID-19 crisis has highlighted the vulnerability of GVCs. It is not only the complexity of supply chains that has drawn attention, but also the dependence on China for certain products. In particular, European countries are now questioning the dependence on China for the production of personal protection equipment and certain pharmaceutical products. Thus, the crisis has heightened calls for a repatriation of certain industries. A shortening of value chains would also be welcome from an environmental standpoint.

Turning on the fiscal taps

All governments responded rapidly to the crisis, by introducing a range of sizeable emergency fiscal measures[7]. These measures can be split into those providing a direct fiscal stimulus (short-time working schemes, health investments to cope with the epidemic, exceptional support to companies and the self-employed), and those addressing liquidity and cash flow issues (government loan guarantees, recapitalisations). The direct measures will have a significant impact on the economic recovery over the short and medium term.

A large number of these measures are summarised in Table 1, extracted from the IMF's latest Fiscal Monitor for April[8]. It should be noted that these figures do not include deferrals and cancellations of employers' social security contributions, which represent - in the case of cancellations - additional direct spending (positive for growth, negative for the public deficit).

One fact emerges: direct fiscal support, as a percentage of GDP, has been much higher in Germany than in the three other large eurozone economies (first line of the table). Direct support in Germany totalled 4.4% of German GDP, compared to 1.2% in Italy and Spain and 0.7% in France. It is clear that Germany, due to its large budget surplus before the crisis, had more room to manoeuvre in tackling the crisis.

This said, on the specific question of short-time working, the *Kurzarbeit* programme in Germany is less generous, both in terms of the benefit paid and its ceiling. A German worker will receive 60% of its net income (67% if they have dependent children), compared to 84% (70% of gross) in France and 70% of gross income in Spain. The corresponding figure in Italy is 80%, making it the most generous scheme on this measure. With regards to the ceiling, it ranges between EUR 1,098 and EUR 1,400 per month in Spain and Italy, between EUR 2,750 and EUR 2,890 in Germany and at a much higher level of about EUR 5,500 in France (70% of 4.5 times the minimum hourly wage)[9]. In addition, France has by far the highest number of workers enrolled in this scheme. By mid-May, the Labour Ministry had received 12.4 million applications for prior authorisation[10], equivalent to about 40% of the labour force. Germany recorded 10.1 million of applications at mid-May or 23% of the labour force. There were about 8 million applications in Italy (30.1%) and 3.39 million in Spain (14.7%).

Exports as a percentage of GDP (2019)

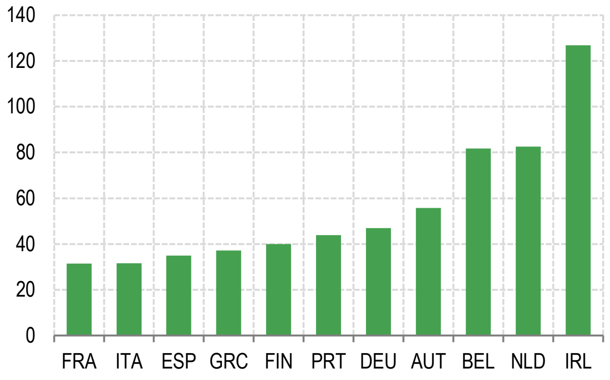


Figure 8 Sources: Eurostat, BNP Paribas

Share of foreign inputs in exports

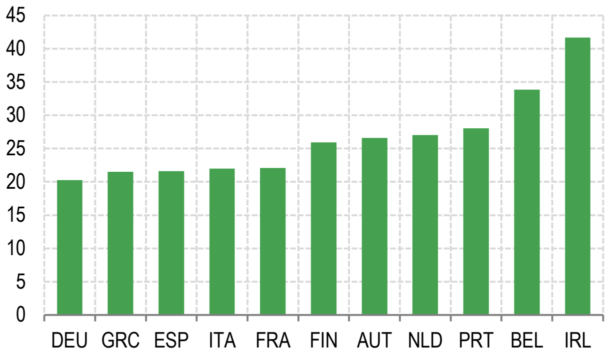


Figure 9 Sources: TIVA (OECD/WTO), BNP Paribas

Fiscal measures in response to COVID-19

At 8 April 2020. Billions of Euros

	Germany	France	Italy	Spain
Direct spending*	143	17	20	14
% of GDP	*4.4*	*0.7*	*1.2*	*1.2*
Bank guarantee, loans, recapitalisation	962	312	530	112
% of GDP	*29.6*	*13.9*	*32.4*	*9.8*
Total	1105	329	550	126
% of GDP	*34*	*14.6*	*33.6*	*11*

** Includes spending on temporary unemployment programmes, social transfer to companies/self-employees, health expenditure linked to the Covid-19.*

Note: The table does not incorporate tax and social contribution payment deferrals, which are postponed outlays.

Table 1 Source: IMF, BNP Paribas

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Spain and Italy are the two countries likely to suffer most from this crisis. Their greater dependence on small businesses and tourism, their chronic unemployment and the already very high levels of public debt leave them very vulnerable. France stands in-between. The country shares these handicaps, albeit to a lesser degree. This is also a more resilient economy and should, in this regard, have fewer difficulties to bounce back than Italy and Spain. Germany, both from a

[7] For a list of measures taken by each government see EcoFlash "COVID-19: Key measures taken by governments and central banks", 11 May 2020.

[8] https://www.imf.org/en/Publications/FM/Issues/2020/04/06/fiscal-monitor-april-2020

[9] See https://www.unedic.org/publications/covid-19-les-differents-systemes-dindemnisation-du-chomage-partiel-en-europe (in French)

[10] To be distinguished from actual claims for compensation. According to Unédic preliminary estimates, released on 12 May, 70% of the applications for prior authorisation gave rise to an actual claim for compensation in March.

structural and fiscal perspective, is better placed to engineer a quicker recovery in the coming months. That said, there is a questions mark about the ability of global trade to help drive German growth, as it did during the financial crisis of 2008. China's economy is slowing and resurgence in trade tensions between China and the US could have significant repercussions for the German economy. Table 2 summarises the different indicators reviewed in this article and classifies the four countries according to their level of vulnerability for each indicator.

More globally, the COVID-19 crisis represents a test for the resilience of the European model. Indeed, differences in the shape of the recovery between countries could increase economic disparities between eurozone member states. The process of economic convergence - having been in struggle since the creation of the single currency – could be significantly impacted or even reversed. A concerted and powerful European response is expected, with discussions under way on the creation of a fund to finance the post-crisis economic recovery.

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Potential for a recovery

Rather high potential		Rather low potential	
Low share of SMEs :	France, Germany	**High share of SMEs:**	Italy, Spain
High weight of the manufacturing sector:	Germany, Italy	**Low weight of the manufacturing sector:**	France, Spain
Net importer of tourism :	Germany	**Net exporter of tourism :**	France, Italy, Spain
Low level of public debt:	Germany	**high level of public debt:**	France, Italy, Spain
Low level of private companies debt:	Germany, Italy, Spain	**High level of private companies debt:**	France
Low level of households debt:	Italy	**High level of households debt:**	France, Germany, Spain
Low unemployment rate prior to the Covid-19 crisis:	France, Germany	**High unemployment rate prior to the Covid-19 crisis:**	Italy, Spain
Low share of temporary employment:	France, Germany, Italy	**High share of temporary employment:**	Spain
Low share of foreign inputs in exports:	Germany, France, Italy, Spain	**High share of foreign inputs in exports**	
Small contribution of exports to GDP:	France, Italy, Spain	**Large contribution of exports to GDP:**	Germany

Table 2 Source: BNP Paribas

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