FROM FAST, THE RETURN TO NORMAL IS BECOMING MORE ASYMPTOTIC

After a rapid restart in May and June, the economy was back to 95% of its normal level in August. However, the improvement is now slowing as the automatic catch-up effects fall away and as substantial disparities between sectors and persistent public health constraints and uncertainties remain in play. Even so, Q3 is expected to see a substantial rebound (of around 15% q/q). It will be in Q4 that growth is likely to fall back like a soufflé. This period will determine the next chapter in the recovery. Hence the significance of the stimulus package in its double role of softening the blow from the crisis and boosting the recovery now under way. We estimate that this package will add 0.6 of a point to growth in 2021, taking it to 6.9%, after a contraction of 9.8% in 2020.

AFTER THE GREAT CONTRACTION, A GREAT BUT TEMPORARY REBOUND

According to INSEE's second estimate, French GDP plunged by 13.8% q/q in Q2 2020, coming on top of the 5.9% q/q drop in Q1. The Q2 GDP contraction was slightly smaller than initial estimates from INSEE (-20% q/q) and the Banque de France (-15% q/q); these estimates were subsequently revised to -17% and -14% respectively. Matching, but amplifying, the pattern of the first quarter, all components of GDP saw substantial falls. In ascending order (by the size of the fall), public consumption was "least" affected (-10.3% q/q)[1], followed by private consumption (-11.8%), corporate investment (-13.4%), imports (-16.4%), household investment (-17.1%), public investment (-17.4%) and, hardest hit of all, exports (-25% q/q). The highly positive contribution from changes in inventories (+0.9 of a percentage point) went a little way to limiting the overall collapse.

We would also note, in the detailed figures for Q2, the very limited fall in gross disposable household income (-2.3% q/q, from -0.3% q/q in Q1), the ensuing increase in the household savings rate of nearly 8 points (to 27.4%, building on a gain of 5 points in Q1) and the marked deterioration of corporate mark-ups (-3 points, to 26%, in Q2, having already lost 4 points in Q1). The question now is at what speed these indicators will return to their pre-crisis levels (15% for the savings rate and 33% for margins) and the scale of the support (unblocking of forced savings) or drag (rebuilding margins) that GDP growth will experience as a result.

The slightly smaller than expected contraction of the economy in Q2 resulted from the strength of the economic rebound since lockdown ended on 11 May. This has been visible in the recovery of survey data on the business climate (the INSEE composite index gained 38 points between May and August, whilst the Markit PMI was up 46 points between May and July), consumer spending on goods, and industrial production (which gained 50% and 41% respectively between April and July).

However, the recovery is still incomplete. Both INSEE and the Banque de France estimate that in August the economy was around 95% of its normal level. In August, INSEE's composite business climate index was still 9 points below its reference level of 100. Consumption of goods has bounced back to above its pre-crisis levels, but consumption of services remains depressed, leaving total consumption at 2% below pre-crisis levels according to INSEE. Industrial production is still 7% below its February 2020 level. Moreover, the improvement is now slowing as the automatic catch-up effects fall away whilst persistent public health constraints and uncertainties remain in play. According to INSEE, the economy was running at 82% of its normal level in May, a 12-points gain on the low point in April (which marked the activity

GROWTH AND INFLATION (%)

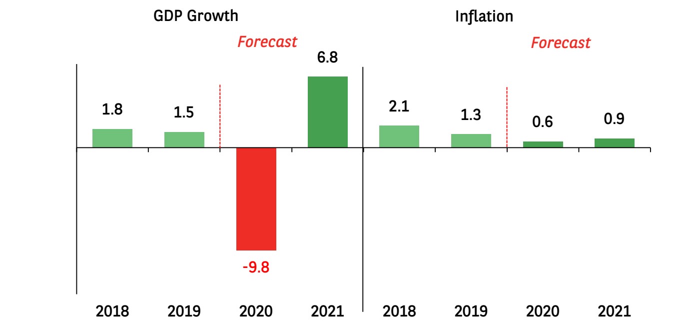


CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

SECTOR DISPARITIES

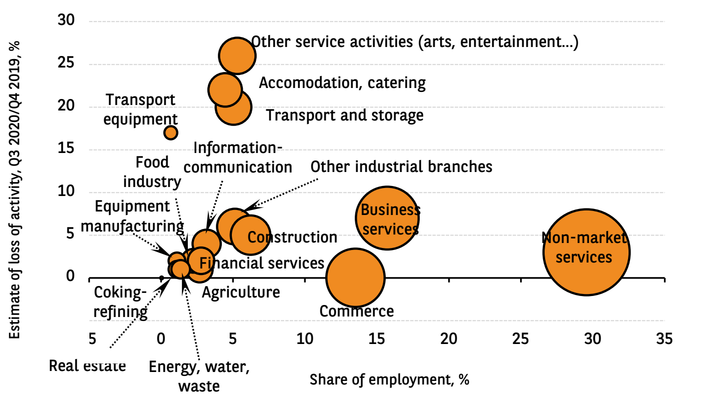


CHART 2 SOURCE: INSEE (8 SEPTEMBER ESTIMATES), BNP PARIBAS

trough). In June the increase was 9 points, in July 3 points and in August 1 point. August's 6-point fall in the composite PMI, to 51.6, marked a return to a less optimistic reality too.

The economic recovery is also being held back by significant disparities between sectors, which are affecting in return employment prospects. The hardest hit sectors (those where activity in Q3 2020 is 5% or more below Q4 2019 levels) account for around 40% of total employment (see Chart 2).

1 See INSEE for the methodological reasons behind this fall.

There will nevertheless be a sizeable automatic rebound in Q3 activity (the INSEE expects a growth rate of 17% q/q, the Banque de France 16% and ourselves 13%). But what is clawed back in the third quarter will come at the cost of the fourth: growth will collapse back like a soufflé, to 2.5% q/q according to our estimates (1% q/q according to INSEE). For 2020 as a whole, GDP is expected to contract by 9.8%. All other things being equal, the slower growth at the end of 2020 will carry into 2021. But this does not factor in the effect of the recovery plan, which we estimate at 0.6 points of additional growth (conservatively assuming a multiplier of 0.5 and that 30% of the EUR 100 billion France Relance programme will be injected in 2021). This would put average growth over 2021 at 6.9% (in line with the consensus). This estimate is surrounded by balanced risks: the stimulus package creates upside risk, whilst the health situation and uncertainties relating to Brexit and the US elections represent downside risks. To borrow INSEE's analysis, the engine of growth is both turbo-charged and throttled down. By way of comparison, the OECD is more pessimistic (with a 2021 growth forecast of 5.8%), whilst the Banque de France and the government are more optimistic (7.4% and 8% respectively) – with the former specifying that it has only taken partial account of the stimulus package as it does not have all the details. It is also worth noting the Banque de France's belief that French GDP will return to its pre-crisis levels in early 2022, earlier than the euro zone as a whole.

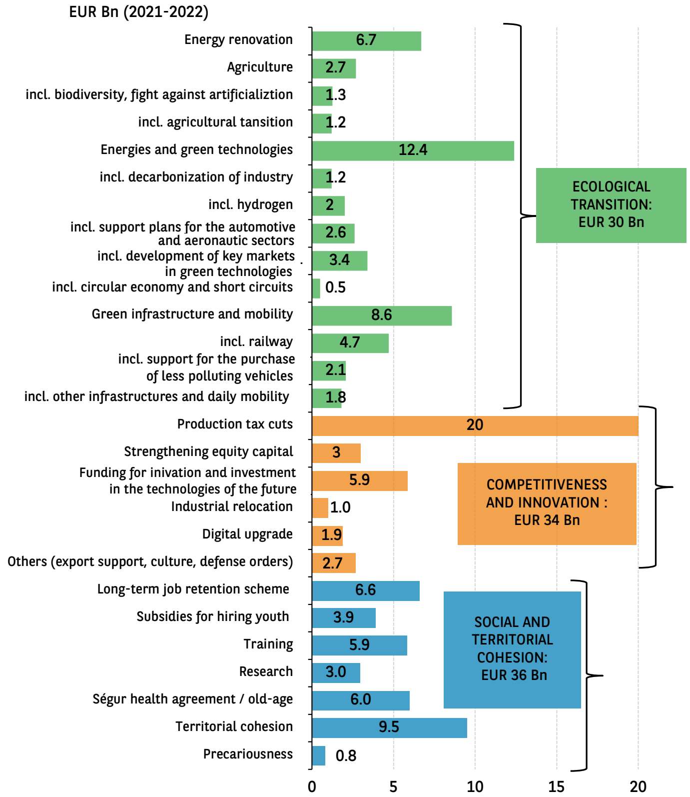
FRANCE RELANCE: SUBSTANTIAL FISCAL STIMULUS BUT IT IS STILL TOO EARLY TO JUDGE HOW EFFECTIVE IT WILL BE

The challenges for the France Relance programme are substantial, as it will not only have to support growth in the short term (avoiding the ongoing recovery to fizzle out, with a target of getting GDP back to pre-crisis levels by 2022), but also strengthen prospects for the medium to long term, or *"build the France of 2030 today"*. Hence the emphasis on supply-side rather than demand-side measures. The substantial support to businesses is also a result of the cost of the crisis, which has been higher for companies than for households. Under the recovery plan, support for households comes via measures to support employment, which in turn goes partly through support for companies contained in the "competitiveness" section of the programme. Other, more direct measures to support employment are contained in the "social cohesion" section too. Positive effects are also to be expected from the support provided to environmental transition. Employment is the key linking variable between supply and demand. It is no accident, therefore, that it is at the heart of the recovery package.

There is no doubt that the sums being made available are substantial. These are, by design, split more or less equally between the three pillars of the plan (environment, competitiveness, cohesion), which choice is hard to disagree with. The debate now relates to the likely effectiveness of the plan over both the short and long term. For the time being this is hard to judge. More precisely, although we might expect positive effects, their scale is unclear.

The first question is at what speed the EUR 100 billion will really be injected, and how the total will be split between 2021 and 2022 and between front-loaded and back-loaded measures. We hope that the presentation of the 2021 budget at the end of September will shed some light on this. The effectiveness of the programme might be undermined by its ambitions and by the risk of dilution. It is perhaps reasonable to ask if the double role of shock-absorber (addressing the scars left by the crisis) and support (for the recovery and for future growth) is not too ambitious for a single plan. One might also worry that a single instrument (for example the cut in production taxes) is

KEY MEASURES AND VALUES OF THE FRANCE RELANCE PLAN



SOURCE: GOVERNMENT, BNP PARIBAS

used to serve several purposes (competitiveness, employment, innovation, relocation). All of which raises the question of the adequacy of the resources committed, in terms of both value and duration. There is also an underlying issue of the targeting and proper allocation of resources: this will be watched closely by the government.

Nor is the decision to support the supply-side without risk. Since the summer, economic surveys have shown an emerging risk of a demand-side shock: according to INSEE, many companies express their fears of losing market prospects. Supporting them by reducing production costs and increasing their growth potential through innovation is necessary, but it is far from certain that this will be enough in current conditions: more direct, visible and immediate support for demand might need to be considered. To achieve this, attention is turning to the forced savings accumulated by households, how quick this could be unblocked and how to avoid it being converted into precautionary savings. There is no easy answer. Thus far, the government has opted against a temporary cut in VAT, as in Germany, which it considers inappropriate. Instead it is banking on the positive impacts of the recovery package on employment: the more households feel reassured in this area, the more they will consume.

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