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EUROZONE: FROM REBOUND TO RELAPSE

Hélène Baudchon, Louis Boisset

The Q3 2020 rebound in the Eurozone GDP growth was stronger than expected: 12.7% q/q, compared to expectations of 10.5%. Of the region's four biggest economies, France reported the strongest rebound followed by Spain, Italy and Germany.

This rebound only partially erased the massive negative shock earlier this year. In Germany, France and Italy, GDP was still about 4% below the Q4 2019 level, while Spanish was still down by 9%.

All components of demand contributed to French GDP growth. Sector differences reveal the heterogeneous impact of the shock.

In all four countries, the rebound was largely mechanical, but other factors also came into play. Emergency measures to offset the impact of the lockdown last spring constituted a strong support. The shock was essentially absorbed by the public sector.

Unfortunately, the rebound will be very short-lived. To curb a second wave of the Covid-19 pandemic, lockdown measures lasting at least a month were reintroduced at the end of October. Economic forecasters now expect Q4 GDP to contract, although the size of the downturn remains to be seen.

QUARTERLY GDP GROWTH (%)

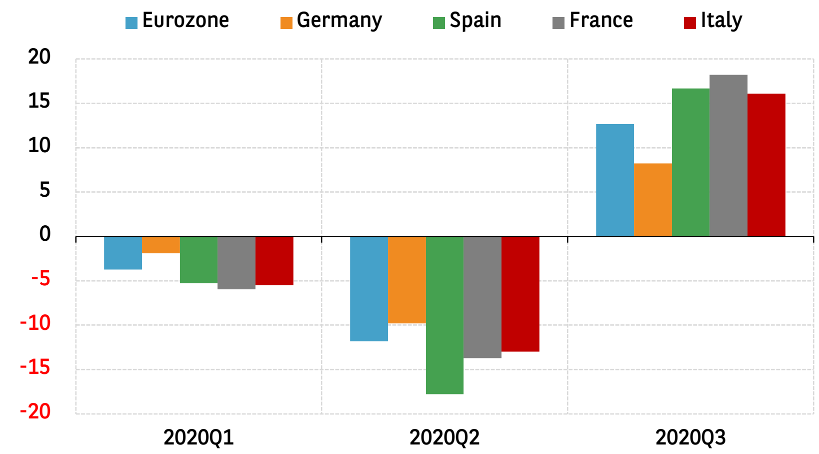


CHART 1

SOURCE: EUROSTAT

A STRONGER-THAN-EXPECTED REBOUND, BUT THE GAP HAS NOT BEEN CLOSED YET

Social distancing and lockdown measures implemented to halt the spread of the Covid-19 pandemic triggered an historic recession throughout all of the European countries. Widespread measures to lock down local populations in March and April 2020 created a triple shock: supply, demand and uncertainty. As a result, Eurozone GDP plummeted at a quarterly rate of 11.8% in Q2 2020, after declining 3.7% q/q in Q1. By country, Spain was hit hardest with growth plummeting 17.8%, followed by France and Italy (about -13%) and then Germany (-9.8%)[1].

Certain sectors were hit harder than the others by these lockdown and social distancing measures. The services sectors, especially those related to tourism, accommodation and food services, were hit harder than the manufacturing sector. Consequently, the size of the shock and the countries' post-crisis capacity to rebound depend on its economic structure. The severity of the lockdown and the economic support measures accompanying these restrictions also play a role. Although the recovery's profile depends in part on the intensity of the preceding decline, the rebound in Eurozone growth was surprisingly strong in Q3 2020, up 12.7% q/q compared to a consensus forecast of 9.4% and our forecast of 10.5%. This observation was replicated for the four biggest Eurozone economies, especially Italy (+16.1% vs. a consensus forecast of +11.2%) and France (+18.2% compared to +15.4%).

1 Comparisons of growth rates between Eurozone member States must be interpreted cautiously. The statistics institutes have indeed observed that different reporting methods were used for certain activities (notably public administrations).

Given the amplitude of the Covid-19 shock on the Eurozone economies, it seems better to look at the level of activity rather than at growth rates. The big question is when Eurozone member states will return to pre-crisis levels of GDP. At Q3 2020, Eurozone GDP was still more than 4% below the year-end 2019 level, prior to the health crisis. Germany, France and Italy are basically positioned in the same catch-up phase. Spain is the only country that still lags behind, and its GDP is 9% below pre-crisis levels. Looking beyond the severity of lockdown measures, the Spanish economy is also suffering from its structure, especially its high exposure to the tourism sector[2], which was very hard hit by the lockdown and social distancing measures implemented all across Europe.

All components of demand contributed to the rebound in French GDP. It was offset only by the very negative contribution of changes in inventory, which was expected after major involuntary stocking during the first half of 2020. Quarterly growth rates were impressive, with household consumption up 17.3% (which explains half of quarterly growth); household investment, +30.3%; public expenditure, +15.4%; and business investment, +20.2%. It is also worth noting that consumption of services grew faster than that of goods (+20.2% and +16.4%, respectively). Yet since it also followed a bigger decline, the consumption of services is still 5% below the Q4 2019 level, while the consumption of goods is 1% higher. Along with public consumption, these are the only two components of GDP that have returned to normal. Total investment is still 5% below pre-crisis levels, while exports are lagging even further behind, down 15%. By sector of activity, there was also a general rebound in value added in Q3 2020, although sector disparities were still high, revealing the heterogeneous impact of the shock (see chart 3).

AN AUTOMATIC REBOUND, ALTHOUGH OTHER FACTORS ALSO CAME INTO PLAY

Although activity was expected to rebound in Q3 2020, there was great uncertainty over its amplitude. The certainty of a rebound can be attributed to its automatic nature, as the economy opens up again after being shut down during the lockdown. The size of the rebound is uncertain for several reasons. First, there was uncertainty over the evolution of the pandemic. Second, it was hard to anticipate how households and corporates would react to such an unusual situation. The gradual, partial reopening of the economy at the end of the lockdown period was also a source of uncertainty: not all sectors had the same capacity to return to normal. Uncertainty over the size of the rebound can also be attributed in part to doubts about the effectiveness of the emergency fiscal measures that were taken during the initial lockdown. The rapid, massive response used a combination of measures, from short-time schemes to direct subsidies, debt moratoriums, the postponement or exoneration of charges, and the issue of state-backed loans. The goal was to cushion household and corporate revenues in real time as best as possible from the impact of the lockdown, thereby creating the conditions for restarting the economy more rapidly once the lockdown phase was lifted.

As to France, these measures proved to be effective, as illustrated by the mild decline in household purchasing power compared to the sharp drop in GDP (see chart 4). The importance of preserving revenues is also illustrated by the big increase in the household saving ratio in Q2 2020 and its downturn in Q3 (see chart 5). Estimates by the French

2 H. Baudchon et al., *Eurozone: four countries, four ways to recover*, BNP Paribas, May 2020

QUARTERLY GDP (100 = Q4 2019)

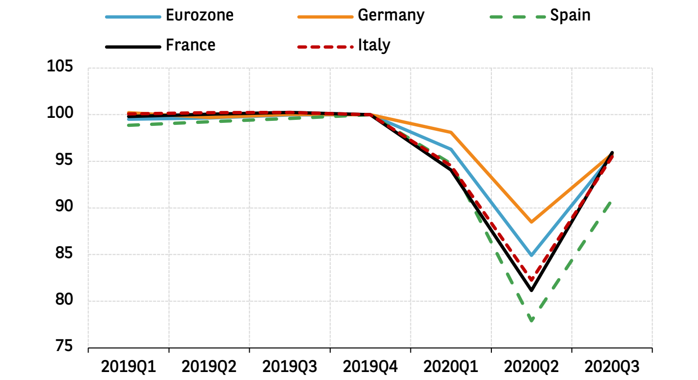
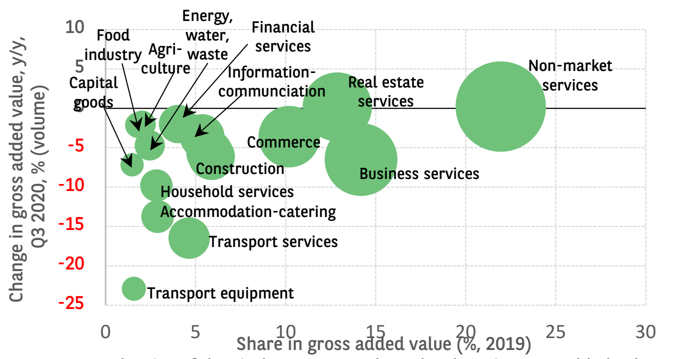


CHART 2

SOURCE: EUROSTAT

FRANCE: SECTORAL HETEROGENEITIES



The size of the circles corresponds to the share in gross added value

The "coking-refining" sector (plunge of 40.2% of its added value) is not shown on the chart because of its tiny share in gross added value (0.1%).

CHART 3

SOURCE: INSEE, BNP PARIBAS

FRANCE: ILLUSTRATION OF THE CUSHIONING EFFECT OF EMERGENCY MEASURES

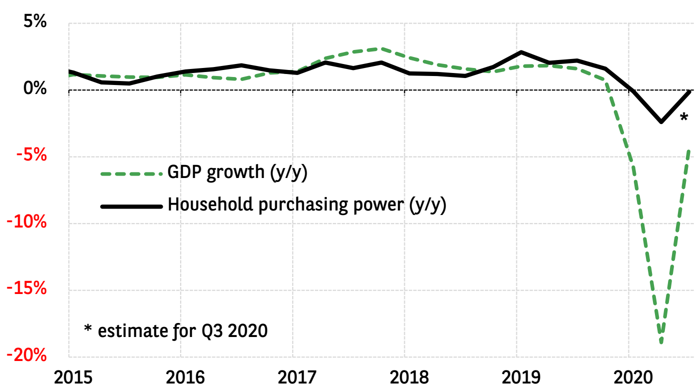


CHART 4

SOURCE: INSEE, BNP PARIBAS

Ministry of Finance on the distribution of the shock between economic agents also shows the size of the buffer created by these emergency measures[3]. Before the intervention of the public sphere, companies were more directly and massively affected since they suffered nearly 80% of the loss of income, with public administrations and households both accounting for around 10%. After government intervention, the bulk of the shock was absorbed by public administrations (63%), compared to 23% for companies and 14% for households.

A SHORT-LIVED REBOUND

The good news concerning the Eurozone's strong Q3 2020 rebound was quickly brushed aside by the introduction of new lockdown restrictions in most of the member countries, in order to struggle against a second wave of the pandemic. These restrictions will hamper the recovery and the economic catching-up dynamics. Most economic forecasters have significantly revised down their Q4 2020 GDP growth estimates for the Eurozone countries, which are expected to swing rather largely into negative territory.

It is difficult to determine the size of the economic downturn and the medium-term impact of the new restrictions. The new lockdown measures do not seem to be as strict as in March and April. Consequently, the supply-side shock might not be as severe (schools, for example, will remain open, which will enable parents to go about their business activities). Yet some companies – already weakened by the first wave of the epidemic and strapped with a higher debt burden – are now in a more delicate financial situation, which will place a further damper on investment. On the demand side, even though fiscal support measures have been maintained, there is still high uncertainty over the spread of the pandemic and the difficulty of bringing it under control, as well as the health of labour market conditions. So far, Eurozone unemployment has increased relatively mildly (to 8.3% of the labour force) given the size of the shock.

Nonetheless, there are some upside risks to this macroeconomic scenario. Less exposed to social distancing measures and lockdown restrictions, the manufacturing sector continues to catch up at a quite decent pace. The manufacturing Purchasing Managers Index (PMI)[4] for the Eurozone continued to pick up in October, which augurs well for the year-end period. Secondly, China is in better economic situation than during the first phase of the European lockdown, which should benefit the Eurozone's export manufacturing sector. Lastly, economic policy will remain largely expansionist. The European Central Bank (ECB) is expected to introduce additional monetary stimulus before year-end 2020, notably to guarantee that governments have access to particularly favourable financing conditions and to limit the risks of financial fragmentation (i.e. increase in sovereign rate spreads between member countries). Member states should also maintain fiscal support measures, which will help partially offset the shortfall in private demand.

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FRANCE: HOUSEHOLD CONSUMPTION, PURCHASING POWER AND SAVING RATIO

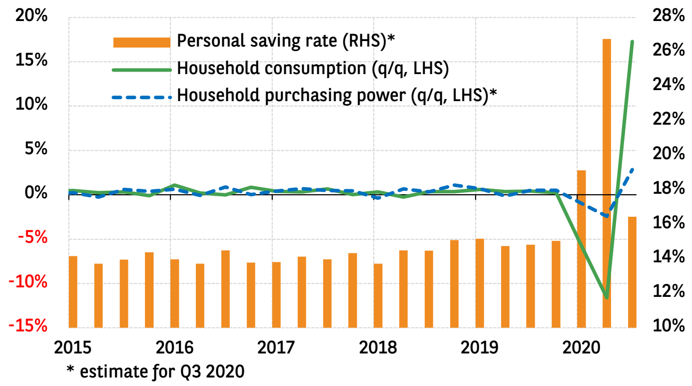

CHART 5

SOURCE: INSEE, BNP PARIBAS

3 See Economic, social and financial report (2021), October 2020 (pp. 142-158).
4This survey of business leaders provides a snapshot of the economic health of various sectors of activity (manufacturing, tradeable services and construction).

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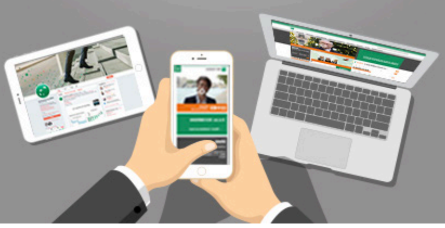

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