LIGHT AT THE END OF THE TUNNEL

The huge recessionary shock in H1 was followed by an equally spectacular rebound of economic activity in Q3, with an 18.7% jump in real GDP, although it will remain short-lived. The recovery has turned out to be W-shaped: GDP is expected to fall again in Q4 because of lockdown measures reintroduced on 30 October to tackle the second wave of the covid-19 pandemic. However, the second V should be less pronounced than the first: the decline should be smaller because the lockdown measures are less stringent, and the rebound should also be smaller because restrictions will remain in place and the economy is weakened. There is still a long way to go, but the arrival of vaccines means that there is light at the end of the tunnel. The first positive effects of the France Relance plan should also underpin growth, possibly taking GDP back to its pre-crisis level in 2022.

THE Q3 REBOUND IN DETAIL

According to INSEE's second estimate, French GDP grew 18.7% q/q in Q3, a rebound as spectacular as the collapse that preceded it (-19% in H1 2020), and revised upward from the first estimate of 18.2%. France's Q3 rebound was the second-largest in the eurozone, behind Ireland with 21.4%. However, it was not enough to make up all the lost ground, and GDP remains 3.7% below its end-2019 level. On the one hand, this is a fairly small margin given the depths to which the economy sank in H1, but on the other it is still a significant shortfall, and recouping the last few percent will be a harder and slower process than the initial recovery, which was more of an automatic rebound from a low base.

All GDP components surged in Q3, although the rebound was held back by a large negative contribution of the change in inventories. Changes in business investment and consumer spending are worth noting in particular. Business investment fell by 21% in H1, before rising by the same proportion in Q3, similar to the movements in GDP whereas variations in investment are usually much larger. This time, the contraction was not made worse through the channels of expectations, deterioration in the business climate, increased uncertainty or the financial accelerator. INSEE's quarterly survey of investment in the manufacturing sector also shows this relative resilience: the expected 14% drop in 2020 is less than the 22% decrease seen in 2009. This illustrates the fundamentally different nature of the two crises and the fact that financial constraints are less severe today, because of the huge fiscal and monetary support provided since the spring.

Consumer spending and public-sector consumption were the GDP components that rebounded most in Q3: the latter ended the quarter back at its pre-crisis level while the former ended it 1.6% below, whereas investment was 5% lower and exports 15% lower. Consumer spending on goods rose 1% above its pre-crisis level, but spending on services remained 5% lower. As regards the upturn in spending on goods, we could see the glass as half-empty or half-full. On the one hand, we could be disappointed that it exceeded its pre-crisis level by only 1%, despite being less hampered by public health restrictions than spending on services. On the other hand, given the circumstances, we might be impressed by the fact that it rose above its pre-crisis level at all. The sharp fall in the household saving ratio in Q3, to 16.5% of gross disposable income, supports a positive reading of consumer spending figures. After jumping by 11.6 points in H1 2020, the savings rate fell by almost as much in Q3 (-10.2 points): the flow of forced savings, built up during the first lockdown, seems to have largely deflated.

THE RISK OF A W-SHAPED RECOVERY HAS MATERIALISED

The Q3 rebound was mainly an automatic response to the previous slump. We knew that it would be followed by weaker growth as catching-up effects faded, and because of ongoing large sector disparities along with public health constraints and uncertainties. The second lockdown, which began on 30 October as a way of tackling the second wave of infections, means that the question now is not how much growth will slow, but how large the contraction will be. The risk of a W-shaped recovery has therefore materialised (see chart 2). However, the second V should be less pronounced than the first:

- The contraction in Q4 2020 should be smaller because the second lockdown has been less stringent than the first, the sector

GROWTH AND INFLATION (%)

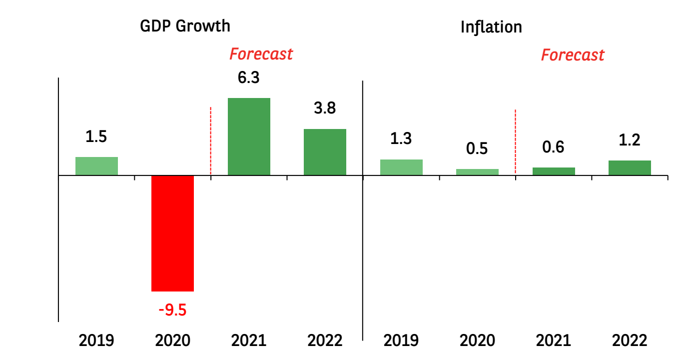

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

ILLUSTRATION OF THE W-SHAPE SCENARIO

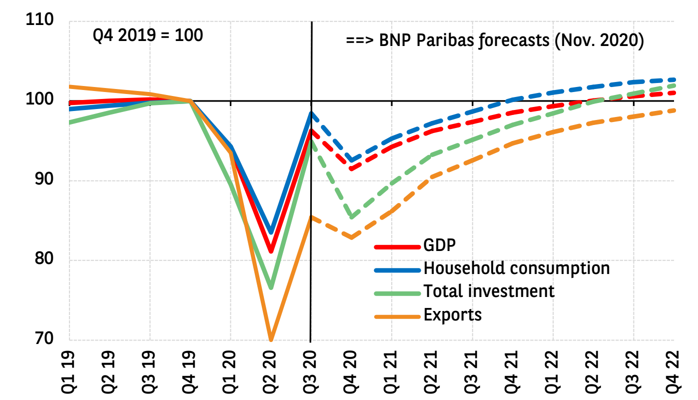

CHART 2 SOURCE: INSEE, BNP PARIBAS

impact has been more concentrated (see chart 3), businesses and consumers have adapted, and the international environment is less gloomy. Business-climate and consumer-confidence survey results fell sharply in October and November, but much less than in March and April[1]. One particular negative aspect of the Q4 lockdown is the fall in consumer spending, which is expected to be slightly greater than the fall in GDP, whereas it was smaller in Q2.

- As regards the rebound in early 2021, the lockdown is being eased only gradually and restrictions are being kept in place; the economy remains weakened by the first lockdown; public health constraints and uncertainties remain, as do sector disparities; and economic concerns (Brexit, faltering US growth) are continuing to cast a shadow.

The extent of the Q4 decline in GDP remains unclear. INSEE and the Banque de France estimate that the economy was running at 96% of its normal rate in October and 88% in November (as opposed to 71% in April 2020). With the second lockdown continuing into December, although it has been eased, that percentage should rise, but the question is how far? Our forecast of a 5% quarterly drop in GDP (made before lockdown-easing measures were announced on 24 November) is based on the rate rising back to 90%. That assumption, and therefore our projected fall in GDP (in Q4 and in 2020 as a whole) could prove overly pessimistic. In its Economic Outlook of 2 December, INSEE estimated the rate at 92% and forecast a 4.4% contraction in GDP in Q4 and 9.1% in 2020.

HOPES AND CHALLENGES FOR 2021 AND 2022

The economy should recover gradually but significantly from early 2021. The upturn will be gradual because of the reasons mentioned above regarding Q1, but also because of the sector characteristics of the French economy: it is highly dependent on market services, which are being hit harder by Covid-19 than manufacturing, and for longer[2]. The aftermath of the huge recessionary shock in 2020, the extent of which is currently unknown, will also hamper the recovery: business failures, higher unemployment, higher debt ratios and weaker productivity growth. However, we expect growth to be 6.3% in 2021, which is a significant rebound. That figure, and our 3.8% growth forecast for 2022, are higher than consensus and institutional forecasts. For 2021, we even see the balance of risks being on the upside, whereas it will be neutral in 2022.

Growth should be supported by activity levels continuing to return to normal, but also by the shock-absorbing effects of emergency measures and the first positive effects of the France Relance plan, particularly on investment. There is also potential for a rebound in consumer spending because of the amount of savings built up during the crisis. Those accumulated savings are generally in liquid form, and so are readily available to be spent. However, they are also concentrated among high earners, which may actually prevent a strong rebound in consumer spending, since wealthier people spend more on travel, entertainment and other leisure activities, which are more prone to Covid-19 restrictions. There is also the risk of this money being converted into precautionary savings. This will depend on confidence levels. It will also depend on the situation in the labour market, which will be subdued at best. We expect both employment and the unemployment rate to rise, although the size of the increase is uncertain. The upturn in employment could be small while we fear a sharp rise in unemployment.

SMALLER SECTOR IMPACT OF THE SECOND LOCKDOWN
LOSS OF ACTIVITY BY SECTOR COMPARED TO Q4 2019, % DIFFERENCE

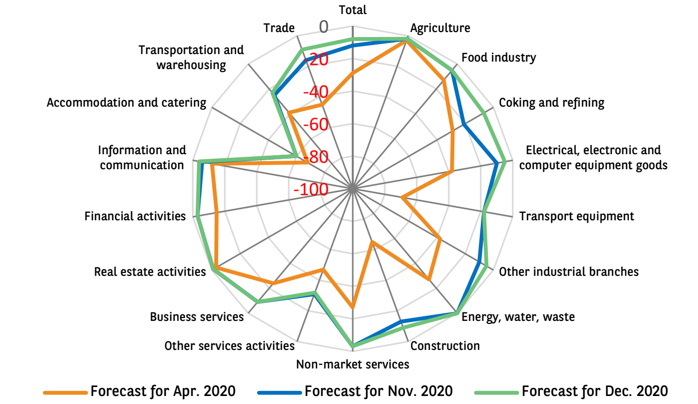

CHART 3 SOURCE: INSEE, BNP PARIBAS

FRENCH GDP BACK TO ITS PRE-CISIS LEVEL
BUT NOT ON ITS PRE-CRISIS TRAJECTORY

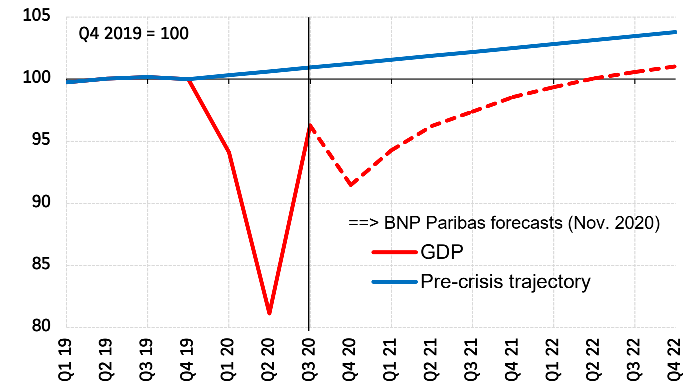

CHART 4 SOURCE: INSEE, BNP PARIBAS

The Covid-19 situation also matters. The development of vaccines and the large-scale roll-out starting in 2021, in France and elsewhere in the world, are a real source of hope. They are enabling people to see the light at the end of the tunnel and will smooth the growth profile, reducing the risk of an ongoing stop-and-go recovery. The gradual decrease in Covid-19 risks, related health constraints and uncertainties should have a positive impact on expectations and spending behaviour. However, there seems to be a high level of distrust among the French people regarding vaccines, and this represents a significant downside risk.

The road to recovery will be long, but a return to normal – with GDP returning to its pre-crisis level and the economy back running at 100% of its normal level – by 2022 seems achievable. However, GDP would still remain well below its pre-crisis trajectory (see chart 4), and is unlikely ever to close the gap, meaning that Covid-19 will constitute a permanent negative shock.

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1 Consumer confidence barely rose between the two lockdowns, so the renewed decline has taken it to its lowest level since December 2018.
2 The most exposed sectors (transport equipment, retail, transport services, accommodation and food service, and other recreational services) account for 22% of value added and 29% of jobs.