AN ACCORDION-LIKE EXIT FROM THE CRISIS

Contrary to what we were led to expect in late 2020, the discovery of vaccines did not end the stop-and-go nature of the recovery. In early 2021, due to the emergence of variants and the slow pace of the vaccination campaign, the exit from the crisis continues to follow a jagged trajectory. The light at the end of the tunnel seemed to be getting closer (Q4 2020 GDP did not decline as sharply as feared; a technical recession was apparently avoided in Q1 2021, with feeble but positive growth) but now it is fading again (the rebound has been pushed back until Q3, with Q2 growth verging on zero, and it could even slip into negative territory). The strong upturn in March confidence surveys is good but fleeting news, because it does not integrate the recent series of tightening of lockdown measures. We should expect a relapse in April before a turnaround in May, which we hope will be sustainable this time, thanks to the acceleration of vaccinations and support from the policy mix. The expected rebound in H2 would lift growth to an average annual rate of 6.1% in 2021, followed by 4.4% in 2022.

THE YEAR 2020 IN REVIEW

If we had to summarize the year 2020 in a few figures, we would use the following seven indicators. First, GDP plunged at an average annual rate of 8.2%, a record for France. It was also the third largest contraction in the Eurozone, behind Spain, the leader at -10.8%, and Italy, -8.9% (compared to a Eurozone average of -6.8%). Second, payroll employment declined only 1.3%. Third, household disposable income rose a slight 1.1%. These two trends, which are correlated, are remarkable given the massive recessionary shock that slammed the French economy. They attest to the effectiveness of emergency measures. Fourth, the household savings rate rose strongly, up 6.4 points to 21.4%, as households built up a combination of forced and precautionary savings, the corollary of the prevailing uncertainty and the preservation of gross disposable income at a time when consumption plummeted (-7%), largely restrained by a series of lockdown phases[1]. Fifth, the profit margins of non-financial companies declined sharply, down 4 points to 29.2%, the lowest level since 1985.

The sixth and seventh indicators are the fiscal deficit and the public debt ratio. According to preliminary INSEE estimates, both reached record levels at -9.2% and 115.7% of GDP, respectively. Yet these figures are not as bad as the government estimated in its fourth revised finance bill for 2020 (PLFR4 2020), which called for a deficit of 11.3% and a debt ratio of 119.8%. This means the enormous cost of the crisis was not as high as feared (+6.1 points for the deficit relative to 2019 and +18.1 points for the public debt). This can be explained in part by the smaller contraction in GDP than the government had forecast in its PLFR4 (-11%). All other factors being the same, this favourable forecasting error of GDP growth accounts for 83% of the erroneous deficit (1.7 points out of a total of 2.1). The wider deficit (in EUR billions) can be broken down as follows: 47% is due to the drop-off in revenues and 53% to higher spending. This created an open scissors effect that will probably be much harder to close than it was to open (see chart 2).

In our review of 2020, one of the key characteristics of this crisis was the jagged ups and downs of quarterly GDP growth, according to the series of lockdown and reopening phases. After a 5.9% q/q decline in Q1, GDP plummeted 13.5% q/q in Q2 before rebounding vigorously by 18.5% q/q in Q3. The economy then relapsed, declining 1.4% q/q in Q4, leaving it 5% below the pre-crisis level of Q4 2019. Household consumption was down nearly 7% from pre-crisis levels, while corporate investment and exports were down 5% and 10%, respectively. Another characteristic of this crisis is that consumption was hit harder than business investment, while the heavy toll paid by exports can be attributed to the weight of the aeronautics and tourism sectors in the French economy[2].

GROWTH AND INFLATION (%)

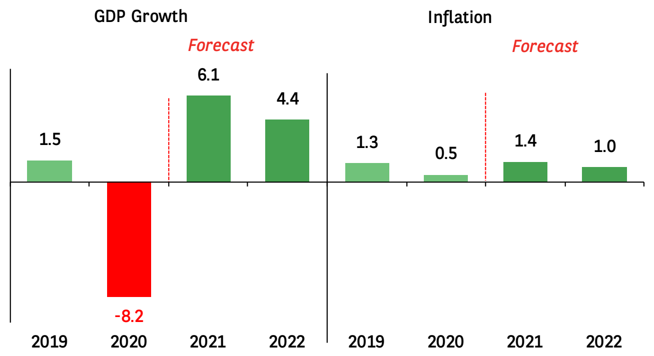

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

FISCAL REVENUE AND SPENDING: AN OPEN SCISSOR EFFECT

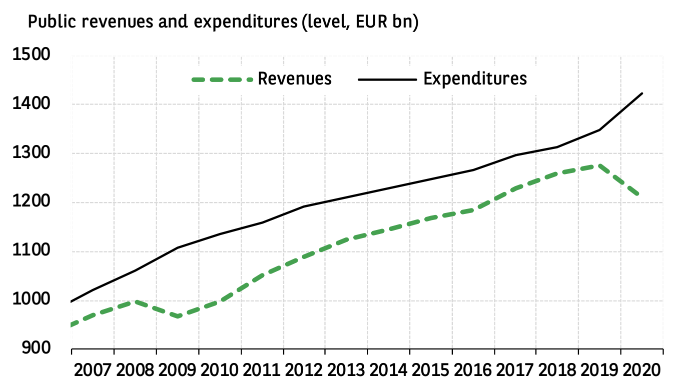

CHART 2 SOURCE: INSEE, BNP PARIBAS

1. Gebauer, J-F. Ouvrard, C. Thubin (2021), *Uncertainty over Covid-19 drives up French household savings*, Bank of France, Bloc-note Eco billet n°206, 3 March
2 INSEE, *Troubles in the aeronautics sector are preventing French exports from taking off again*, Note de Conjoncture, March 2021

THE RECOVERY IS DELAYED AGAIN

The economic situation is mixed in the first 3 months of 2021. GDP is expected to grow slightly in Q1, but thanks solely to a positive carry-over effect due to the rebound in activity in December 2020 after the end of November's lockdown restrictions. In January and February 2021, the French economy continued to operate at about 95-96% of its pre-crisis level according to INSEE and Bank of France estimates. In March and April, we expect France's operating capacity to deteriorate to about 93-94% of pre-crisis levels following the tightening of lockdown measures on 20 March for at least four weeks in 16 departments, which was then expanded to 19 departments. Fears of another decline in Q1 GDP seem nonetheless to have been put to rest. As a result, France is likely to have avoided a technical double-dip.

The strong upturn in March confidence surveys is good news, but it was a false start, illustrating the expression "one swallow does not spring make" (see chart 3). The improvement in business sentiment in the services sector and in household opinions on future living standards in France illustrate the country's rebound capacity, while the strength of business sentiment in industry illustrates the power of external support factors. It also brings to mind the dichotomy between industry, which is not hit as hard by restrictive health measures, and the services sector, which is more directly impacted. Yet March's improvement, notably in the services sector, was more of a technical rebound after February's decline, two movements that are uneasy to square with the relative stability of the Google mobility indices. Above all, for the different surveys, it was probably a very short-lived rebound because it does not include the impact of the most recently announced lockdown restrictions. These so-called leading indicators are lagging behind the times, a lag due to the rapid reversals in the health crisis. Consequently, we should expect the surveys to deteriorate again in April, before hopefully entering a more lasting upturn starting in May.

Seen in this light, Q2 prospects are not very encouraging. Assuming that activity rebounds as of May, based on the assumption that lockdown measures will be eased, GDP could rise slightly. Yet we cannot rule out the possibility of negative growth if the most recent health restrictions have a bigger than expected impact on activity in March and April, if new restrictions are announced, and/or if the expected rebound fails to materialise once lockdown restrictions are lifted. In a nutshell, there is still enormous uncertainty and any improvement in the economic situation hinges directly on the evolution of the health crisis.

Contrary to what we were led to believe in late 2020, the discovery of vaccines and the announced start-up of vaccination campaigns did not end the stop-and-go nature of the economic recovery. In early 2021, due to the emergence of variants and the slow pace of vaccinations, the exit from the crisis continues to follow a jagged trajectory. We still see the light at the end of the tunnel, but it keeps getting closer or farther away depending on the evolution of the health situation. As we write these lines, the light seems to be fading, whereas four months ago, in our previous analysis published in early December, we seemed to be nearing the tunnel's end. The economy's rebound capacity, and the potential for a vigorous recovery, are not called into question. Rather it is the timing of the rebound that has been pushed back by two quarters, from Q1 to Q3 2021. Given this background, although there has been some discussion on the various steps of the exit strategy, the time is not ripe to withdraw support measures, much to the contrary.

In 2021 as a whole, we expect GDP growth to average 6.1%. This is a rather optimistic forecast, a half point higher than the March consensus. Our optimism is based on the expected acceleration of the vaccination campaign and the effective support of the policy mix.

FRANCE'S REBOUND CAPACITY AS SEEN IN SOFT DATA

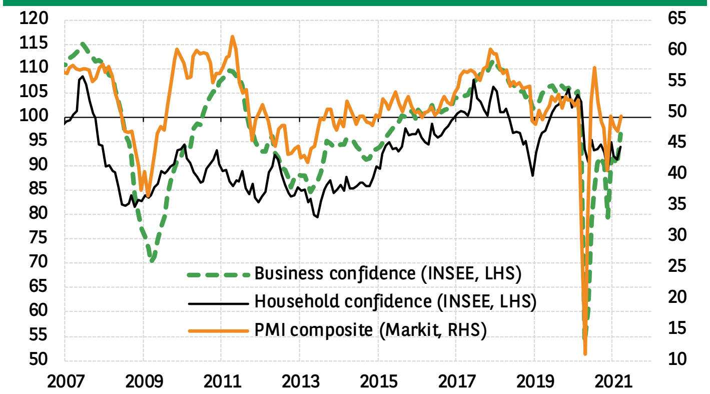

CHART 3

SOURCE: INSEE, MARKIT, BNP PARIBAS

FRANCE'S REBOUND CAPACITY AS SEEN IN HARD DATA

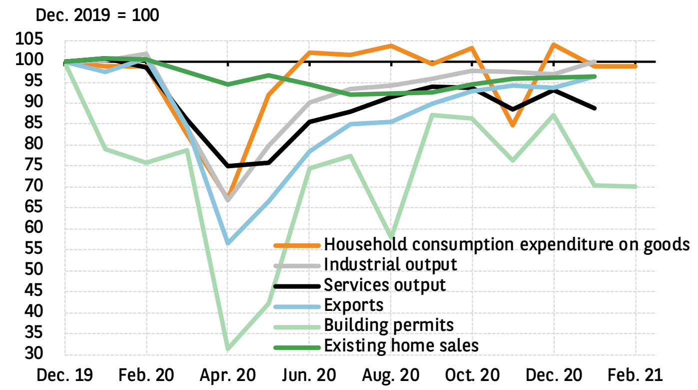

CHART 4

SOURCE: INSEE, BNP PARIBAS

In 2022, GDP growth should remain strong at an estimated 4.4%. According to our scenario, French GDP will surpass pre-crisis levels in Q1 2022. This would mark a first step. There can be no doubt that it will occur at one moment or another: the big question is one of timing, just how long will it take? Returning to pre-crisis levels in the span of about a year can be considered a relatively short period of time considering the severity of the shock. In contrast, there is a big difference between returning to pre-crisis levels and returning to the pre-crisis trajectory, i.e. the level of GDP that would have been reached in the absence of the crisis. The size of this gap is a measure of the scars left by the crisis. While the United States seems to be well on its way to returning to this pre-crisis trajectory as of 2021, which would be remarkable, the same cannot be said for France. Based on our outlook through 2022 and those of the IMF from 2023 to 2025, there could still be a gap of slightly less than 1% in 2025.

Completed on 31 March 2021

Hélène Baudchon
helene.baudchon@bnpparibas.com