# EDITORIAL



## WHAT COMES AFTER THE MECHANICAL REBOUND?

**The easing of lockdown measures has caused a significant improvement in business sentiment and a mechanical rebound in activity and demand. In the near term, the narrowing of the gap between observed and normal activity levels should gradually lead to less spectacular growth numbers. These are underpinned by pent-up demand, monetary and fiscal policy support and the possibility for households to use the extra-savings accumulated during the lockdown. A lot will depend however on how uncertainty evolves. The health situation is not under control in certain countries and there are concerns about the risk of a flare-up. Households face income uncertainty due to bleak labour market prospects. Against this background, companies may tune down their investment plans.**

### EASING OF LOCKDOWN MEASURES CAUSES MECHANICAL REBOUND

Economic recoveries following a recession tend to be gradual. In the initial stage, concerns about the high level of unemployment will weigh on household spending whereas companies will probably wait for better visibility before significantly stepping up their investments. This recovery is different, at least in its early phase, because the recession was very atypical. The lockdown measures to bring the spreading of the virus under control introduced physical limitations on activity and demand, causing them to drop very significantly from their pre-pandemic levels. The easing of the measures has partly removed this constraint, generating spectacular month-over-month growth numbers. This is not so much about a sudden increase in the willingness to spend, rather it reflects the fact that households are again able to go out and spend. The rebound is mechanical. Consequently, business sentiment has improved significantly, witness the purchasing managers' surveys that in many countries are approaching the 50 mark –the borderline between contraction and expansion. In China, France and the US they have moved beyond this level. We should be mindful though that improved sentiment compared to the previous month does not tell us where we are in level terms. Indeed, on this metric, we are still well below normal.

EUROZONE REAL GDP (Q4 2019=1)

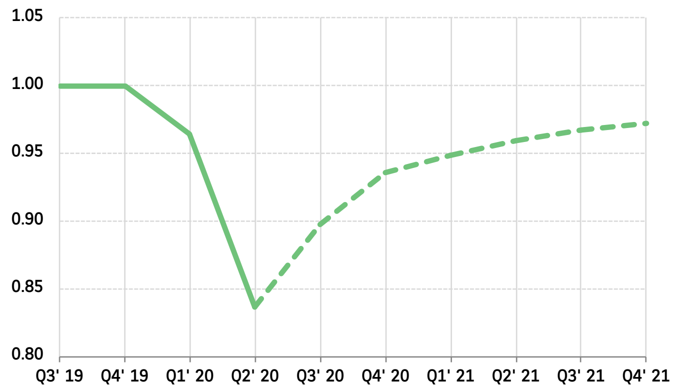


CHART 1

SOURCE: EUROSTAT, BNP PARIBAS FORECAST (JULY 2020)

### MOVING TOWARDS A MORE GRADUAL RECOVERY

Inevitably, the acceleration of demand and activity growth seen in recent weeks cannot be sustained and in many countries, the mechanical rebound is now largely behind us. In France for instance, INSEE recently reported that household consumption is approaching the level seen before the pandemic. According to the Banque de France, the gap between current activity and its normal level has narrowed to 9%, coming from -27% in April. This should pave the way for less impressive although still sizeable monthly growth numbers. It is a recovery like a square root sign. Support factors in this respect are pent-up demand, policy measures –e.g. the temporary reduction of VAT in Germany, incentives to purchase a new, more environment-friendly car, income support measures- and the possibility for households to spend part of the savings accumulated during the lockdown.

### UNCERTAINTY AS A KEY HEADWIND

However, important headwinds remain, as long as no vaccine or treatments have been found against the virus. In some countries and in several US states, the pandemic is not yet under control. In others, there is a flare-up of new cases, raising concern about the risk of a second wave. Households are confronted with income uncertainty due to the bleak labour market outlook that follows from cost-cutting initiatives by companies or their reluctance to hire new staff due to a lack of visibility. The central banks of Germany, France, Italy and Spain expect unemployment to be higher at the end of next year versus this year. A recent survey by the Atlanta Fed amongst 300 CFOs shows that, on average, hiring will be insufficient to reach by the end of 2021 the pre-pandemic employment level. This may cause a preference for precautionary saving over extra spending. Such behaviour, in combination with the significant increase in corporate indebtedness during the lockdown and a lack of visibility, should weigh on the willingness of companies to invest.

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