A GROWTH SPURT OR MARATHON?

The recession of 2020 is unique in nature and, in recent history, in depth. It should be followed by an equally unique recovery. The first phase should be particularly strong and driven by the easing of lockdown measures. Thereafter, growth should be essentially demand-driven. The lockdown-induced drop in demand led to forced savings. Tapping into these excess savings should provide a considerable boost to consumption. However, a significant deterioration in the employment outlook would mean that the forced savings during the lockdown would morph into precautionary savings, implying growth disappointments and a negative feedback loop.

The recession of 2020 is unique in nature and, in recent history, in depth. Judging by most forecasts, it should be followed by an equally unique recovery. The first phase should be particularly strong, which is quite understandable as it is driven by the easing of lockdown measures. This lifts many of the constraints weighing on production and spending. Sequential monthly increases in output give rise to large base effects when comparing growth in a given quarter with the previous one. This implies that after a stellar performance in the third quarter, the fourth quarter should benefit from this carry-over effect. Even though most businesses are operating close to normal, targeted containment measures and demand shortfalls are assumed to extend further into 2021.

Next year, growth should be essentially demand-driven, but the further easing of restrictions might give some further impetus to it. In its summer forecast, the European Commission expects strong quarterly growth for the euro area next year. The same applies for consensus forecasts, although they are less strong than the Commission's expectations (chart 1). This largely explains why growth remains well beyond potential[1], and also beats anything seen in the past 20 years. Nevertheless, in Q4 2021 GDP is still well below the level it would have reached without the coronavirus.

Since the end of the nineties, we have seen quarterly growth of 0.9% or higher only on a number of occasions. Moreover, they can be called growth spurts with –except in 1999- one very strong quarter preceded and followed by a less strong performance (chart 2). Based on the Commission's forecasts as well as those of many other institutions, including private sector forecasters, we seem to heading for a genuine growth marathon of several quarters of robust growth. This begs the question which GDP components will drive this performance. Since 1999, quarters of strong growth –defined in an ad hoc way as 0.6% or more- have seen as main contributors household spending (36%) and fixed investment (28%). Net exports contributed 14%, inventory changes 12% and government spending 10%. Chart 3 also shows the average growth of the GDP components as well as their strongest quarterly growth rate in any given quarter. Leaving fiscal reflation aside–it remains to be seen what kind of stimulus will be implemented next year-, which arguments can be put forward to underpin these forecasts?

1. This is estimated by the European Commission to be slightly below 1.5% (source: European Commission Autumn Forecast 2019, p. 35).

EUROZONE QUARTERLY GROWTH FORECAST

Eurozone real GDP (quarterly growth in %, non-annualised)

	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q3 2021
European Commission	8.8	3.4	1.6	1.2	1.0	0.8
Bloomberg Consensus	8.7	2.8	1.4	1.0	0.6	0.5

CHART 1 SOURCE: EUROPEAN COMMISSION SUMMER FORECAST, BLOOMBERG

EUROZONE : QUARTERS WITH REAL GDP GROWTH > 0.9%

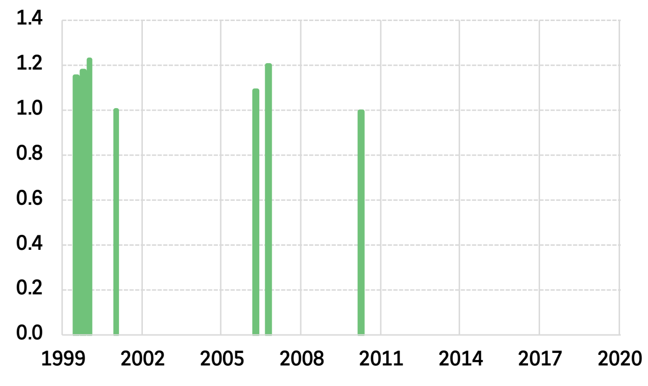

CHART 2 SOURCE: EUROSTAT, BNP PARIBAS

> Household spending holds the key to the strength of growth in the coming quarters. A significant deterioration in the employment outlook would mean that the forced savings during the lockdown would morph into precautionary savings, implying growth disappointments and a negative feedback loop

One candidate is the depth of the recession but this is only half convincing. After a very strong rebound, the traditional drivers of spending should take over.

Moreover, the deep recession can leave households and companies with scars –such as respectively higher unemployment and higher debt levels- creating a reluctance to spend. In addition, as long as there is no vaccine, (self-imposed) social distancing can weigh on certain types of household expenditures whereas companies may prefer waiting before launching big investments. Nevertheless, the specificity of the recession, which was the result of lockdown measures to bring the spreading of the virus under control, implies that the case for robust private consumption looks strong. The lockdown-induced drop in demand led to forced savings: households had to save more because they were unable to shop as before –on-line sales increased but did not compensate the decline in bricks-and-mortar spending. Tapping into these excess savings can provide a considerable boost to consumption. For France, OFCE has calculated that 8 weeks of lockdown has caused forced household savings of EUR 55 bn[2]. This corresponds to 4.4% of final household consumption. Clearly, should households decide to run down their excess savings, there would be a considerable boost to consumption growth[3].

Whether that will happen remains an open question. Rising unemployment traditionally causes an increase in precautionary savings because income uncertainty rises. So it seems that the labour market holds the key to the strength of growth in the coming quarters. A significant deterioration in the outlook would mean that the forced savings during the lockdown would morph into precautionary savings, implying growth disappointments and a negative feedback loop to companies and their investment and hiring decisions. This explains why despite the strong near-term growth numbers, policy support will remain a necessity in order to provide comfort about the employment outlook.

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GROWTH OF REAL GDP AND ITS COMPONENTS*

	GDP q/q	Private consumption q/q	Government consumption q/q	Fixed investment q/q	Net Exports	Stocks change
Average	0.52	0.38	0.38	0.75	0.05	0.03
Maximum	1.22	1.03	1.28	7.92	1.59	0.50

*For quarters with positive GDP growth. For net exports and stocks change: contribution to GDP growth.

CHART 3 SOURCE: EUROSTAT, BNP PARIBAS CALCULATION

2. Source: OFCE Policy brief 66, 20 April 2020
3. This can be illustrated by the following back-of-the-envelope calculation. In quarters with strong real GDP growth –defined as at least 0.6% growth versus the previous quarter- the non-annualised growth of consumption is on average 0.7%. Annualising and using 2019 consumption as a basis, this corresponds to EUR 35 bn. Supposing that the EUR 55 bn of forced savings would be spent in a single year, this would mean total consumption growth of about 7%. With consumption representing 54% of French GDP, consumption growth would lead to about 3.8% of real GDP growth in a given year..