

EUROZONE: TOO PESSIMISTIC ABOUT THE PANDEMIC'S ECONOMIC IMPACT?

Louis Boisset

The cyclical trough seems to be behind us in the Eurozone at a time when vaccination campaigns in the member states are accelerating.

From a macroeconomic perspective, the catching-up dynamic seem to be stronger than expected by many analysts.

Yet the general economic improvement masks important sector disparities. The Covid-19 crisis will have stronger and more lasting effects on certain sectors, like hotel and restaurant services.

In the months ahead, there is a risk that more companies will go bankrupt, especially in the hardest hit sectors.

REVISIONS OF 2020 GDP GROWTH FORECASTS FOR THE EUROZONE

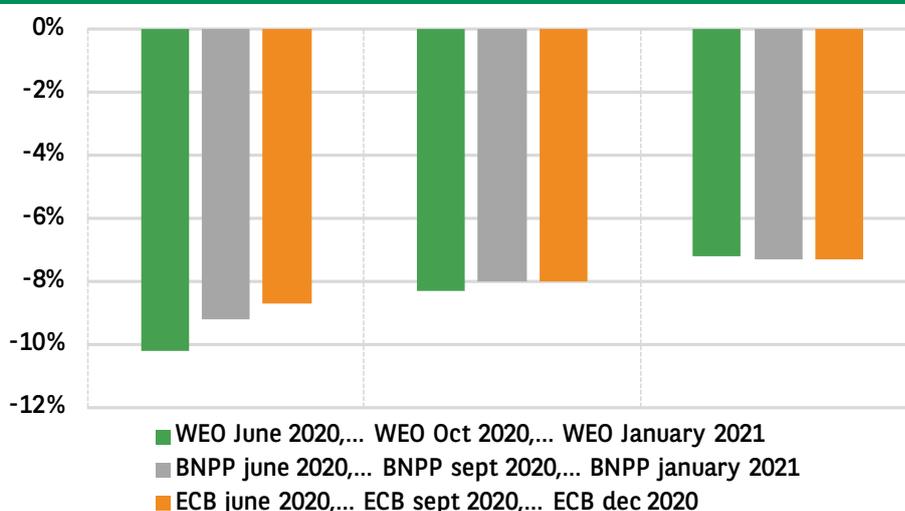


CHART 1

SOURCE: ECB, IMF WEO, BNP PARIBAS

The Covid-19 economic crisis is unprecedented. The health restrictions imposed by European governments to curb the pandemic led to severe distortions within their economies. Economic agents (households, companies and public administrations) had to adapt their routines and change their behaviour. These changes make analysis harder and can lead to diagnostic and forecasting errors.

OVERLY PESSIMISTIC GROWTH FORECASTS

Since the outbreak of the pandemic in the Eurozone in February-March 2020, many institutions have revised upwards their GDP growth forecasts. In other words, the economic situation was less deteriorated than forecasters previously thought. This observation can be seen in Chart 1. In June 2020, the International Monetary Fund (IMF) expected Eurozone GDP to contract by more than 10%, while the European Central Bank (ECB) was looking for a recession of -8.7%. In September-October and again in December-January, the IMF and the ECB revised upwards their Eurozone growth forecasts. In the end, Eurozone GDP contracted by a record 6.8%, but much less than what the institutions initially expected.

The impact of the crisis in the labour market was also difficult to assess, and it still is today. Forecasts made in H1 2020 called for a much steeper rise in the unemployment rate than what was finally observed.

ECONOMIC RESEARCH



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As we can see in chart 2, the ECB lowered its projections for the Eurozone unemployment rate from about 10% in June 2020 to about 8% in March 2021. So far, massive public support has helped buffer the increase in Eurozone unemployment given the size of the shock on economic activity. The unemployment rate dropped to 8.1% of the labour force in March 2021, a decline of about 0.6 points from its peak in August 2020.

WHY DID ANALYSTS LACK CONFIDENCE IN THE RESILIENCE OF THE EUROZONE?

As we pointed out above, the crisis changed the behaviour of all economic agents. Although the average loss of households' income was relatively limited, households did not consume much in 2020 – whether out of necessity or precaution – and thus accumulated additional savings. Companies had to absorb part of the Covid-19 shock. The services sector in particular was hard hit by significant liquidity needs. In this context, households and companies have however been resilient. Their adaptability was insufficiently taken into account when analysing the economic impact of Covid-19.

The capacity of economic agents to adapt to health restrictions is partially reflected in the two charts below. They show the services PMI and the Oxford Stringency Index for Germany and France. The Stringency Index measures the severity of health restrictions set up in each country. Intuitively, we would expect that an increase in the Stringency Index (tighter restrictions) would lead to a decline in PMI (less economic activity). In both Germany and France, this was clearly the case during the first lockdown in spring 2020. The severe tightening of health restrictions abruptly halted economic activity, and the services PMI declined sharply. Since then, however, this negative correlation is not as obvious. At the end of last year, tighter restrictions to halt the second wave of the pandemic had a lesser impact on economic activity. Moreover, the Stringency Index in France rose in March-April 2021 but was accompanied by a slight increase in the services PMI.

To go beyond simple correlations, a more in-depth analysis would be needed to determine a robust relationship. Yet these charts may be showing the adaptability of economic agents to restrictions. The resilience of the services PMI despite tighter health restrictions can also be explained by the behaviour of Eurozone households: consumption surged after lockdown measures were lifted.

A MARKED CYCLICAL IMPROVEMENT

The most recent data show a significant improvement in the Eurozone's overall economic situation. The manufacturing sector reported a strong rebound buoyed by the dynamic momentum of global trade in goods, which returned to pre-crisis levels last winter. Manufacturing PMI has now reached historical highs, supported by the "new export orders" component.

In tradeable services, in contrast, the rebound has been slow in the making. For the past two months, however, the services PMI has risen above 50, the threshold that separates economic expansion from contraction. The upturn in the services PMI was unexpectedly strong in May. It rose to 55.5, the highest level observed since mid-2018. After holding below 50 for seven consecutive months, the Eurozone's services sector has finally swung back into growth.

REVISIONS OF 2020 FORECASTS OF THE EUROZONE UNEMPLOYMENT RATE

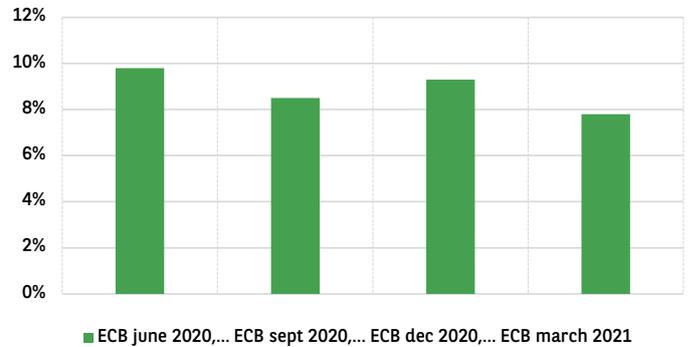


CHART 2

SOURCE: ECB

GERMANY: PMI SERVICES AND STRINGENCY INDEX

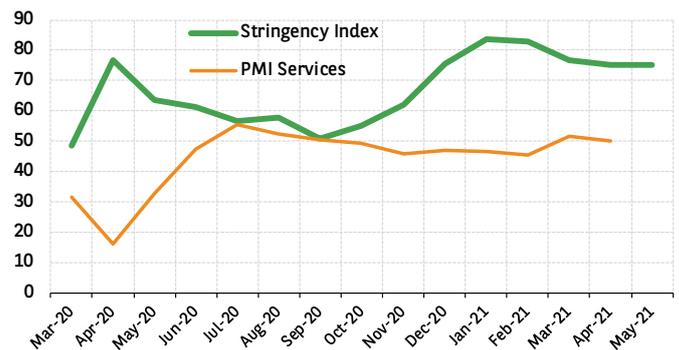


CHART 3

SOURCE: MARKIT, OXFORD UNIVERSITY

FRANCE: PMI SERVICES AND STRINGENCY INDEX

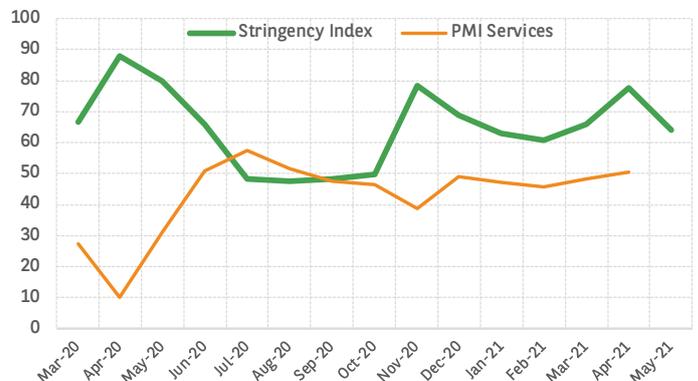


CHART 4

SOURCE: MARKIT, OXFORD UNIVERSITY



As to consumers, the most recent statistics are also upbeat. The consumer confidence index has risen buoyantly since February 2021 and is rapidly approaching pre-crisis levels. This augurs well for the vigour of the Eurozone’s economic recovery and for the catching-up movement in the months ahead.

THE LIMITS OF MACROECONOMIC ANALYSIS

With this crisis, we can see the limits of a macroeconomic approach. It tends to describe average behaviour and masks disparities in economic momentum at sectoral level. And yet, the Covid-19 crisis is above all a sector shock. Although the catching-up process seems to be well underway at the global level, some sectors continue to be hard hit by the crisis and the imposed restrictions. In Q4 2020, total value added of the Eurozone economy (in volume) was only 5% below the Q4 2019 level (see charts 7 and 8). Yet the shortfall was still 13% for the “retail, transport, hotel and restaurant services” sector and nearly 25% for recreational activities. Health restrictions hit these activities hardest, and they will only gradually return to normal conditions. These divergences tend to underscore the need for a very careful and gradual withdrawal of public support, which can now be targeted towards the economic sectors experiencing the greatest difficulties.

The same observation can be made when looking at the Eurostat corporate bankruptcies indicator. As a whole, the level of bankruptcies declined in the Eurozone in Q1 2021 compared to Q4 2019. This paradox is largely due to fiscal support policies that have helped prevent numerous bankruptcies. At the sector level, in contrast, “hotel and restaurant services” saw a huge increase in bankruptcies over the same period, echoing the economic troubles described in the previous paragraph. In the months ahead, there is a big risk that the number of bankruptcies will increase¹, many of which have been postponed due to public support. The ECB recently expressed its worries about corporate bankruptcies². Companies in the sectors hit hardest by the Covid-19 crisis are likely to be the most at risk.

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EUROZONE: MANUFACTURING PMI AND SERVICES PMI

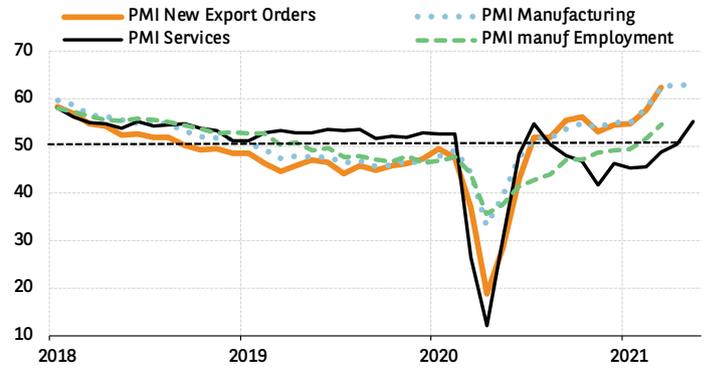


CHART 5

SOURCE: MARKIT

EUROZONE: BUSINESS SENTIMENT AND CONSUMER CONFIDENCE

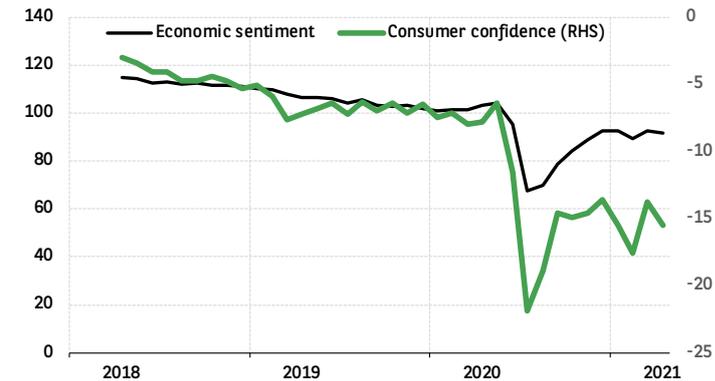


CHART 6

SOURCE: EUROPEAN COMMISSION

¹ M. Carlas, et al., *The business insolvency paradox in Europe: Miracle and mirage*, Coface Economic Publications, March 2021
² *Financial Stability Review*, ECB, May 2021

EUROZONE: GDP IN VOLUME (100 = Q4 2019)

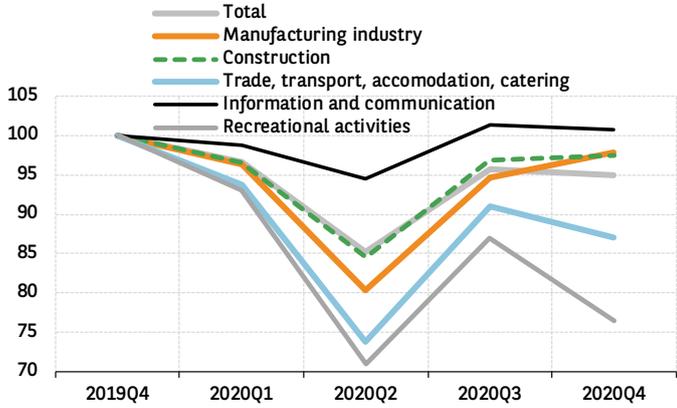


CHART 7

SOURCE: EUROSTAT

EUROZONE: CHANGE IN GDP IN VOLUME (Q4 2020 VS Q4 2019)

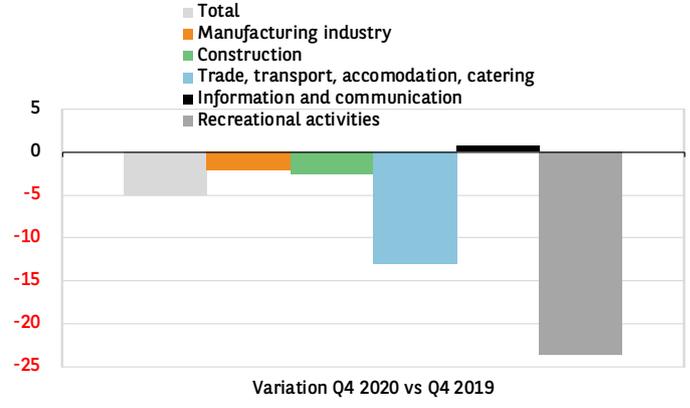


CHART 8

SOURCE: EUROSTAT

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