EDITORIAL

AFTER THE RECOVERY, THE QUESTIONS

For several weeks now, the improvement in economic data has been slowing down. On the one hand, this loss of momentum is unsurprising as it followed a substantial rebound which could not last. On the other hand, this development could reflect the economic reaction to the rise in the number of new Covid-19 cases in many countries. Furthermore, the level of uncertainty which remains very high, affecting households and businesses, should also play a role. As a result, monetary and especially fiscal policies remain crucial in ensuring that the recovery continues pending the release of a vaccine.

The pace of improvement in economic data is slowing down. This observation can be interpreted in one or two ways. The first is that this loss of momentum is unsurprising, perhaps even inevitable. It follows a substantial rebound which in turn followed a collapse in survey data, economic activity and demand during lockdown. This rebound was mechanical: businesses that had closed, or slowed to a crawl, have been able to start up again since lockdown ended. Consumption has also picked up. This again was a mechanical response. It had fallen because consumers could no longer go to shops and restaurants, rather than because of a lack of cash. Quite the contrary, savings rates rose sharply as a result of lockdown. After such a strong movement, it is only normal that the improvement in the business climate from one month to the next should slow down.

The second interpretation is less reassuring. It is based on the observation that certain survey data have weakened as of late. This is the case for the purchasing managers' index for the services sector. Services are more exposed to the health risk than manufacturing, so this fall could reflect the economic reaction to the rise in the number of new Covid-19 cases in many countries. But this is not the only factor. The outcome of negotiations on the future trading relationship between the UK and EU remains highly uncertain. A no-deal departure would represent a significant additional shock for the UK economy but also for those of its major European trading partners such as Ireland, Germany, the Netherlands and Belgium. In the US, there are growing concerns that the result of the presidential election will be challenged, which could create several weeks of considerable uncertainty for financial markets.

Over and above the effect of these factors that will play a role in the short term, the health situation will remain a key determinant of consumer and business behaviours. New measures to stop the spread of the virus will have not only a direct influence on demand and economic activity, but also an indirect effect as a result of increased caution. For households, forced saving during lockdown has created a substantial reserve of purchasing power. The possible use of this will nevertheless depend on confidence in future prospects, most notably when it comes to the labour market. Although expectations of unemployment in the euro zone have fallen recently, they remain at a high level. In the US meanwhile a number of major companies have recently announced substantial job cuts. Forced saving could thus be transformed into precautionary saving.

For businesses, surveys in Germany and the US show that, unsurprisingly, levels of uncertainty remain very high, albeit lower than they were a few months ago. Given lower profit margins and, for many, increased debt ratios due to the lockdown, company investment plans risk being held back. For these reasons, the Federal Reserve and the ECB have both sent out a very strong message: their policies will remain accommodating for a long period and, if needed, will be relaxed still further. However, as Jerome Powell, Chair of the Federal Reserve, observed, *"...these are lending powers and not spending powers [...] a loan that could be difficult to repay might not be the answer."*[1] Fiscal policy will therefore remain crucial in ensuring that the recovery continues pending the release of a vaccine.

EUROZONE: CONSUMER SURVEY, UNEMPLOYMENT EXPECTATIONS

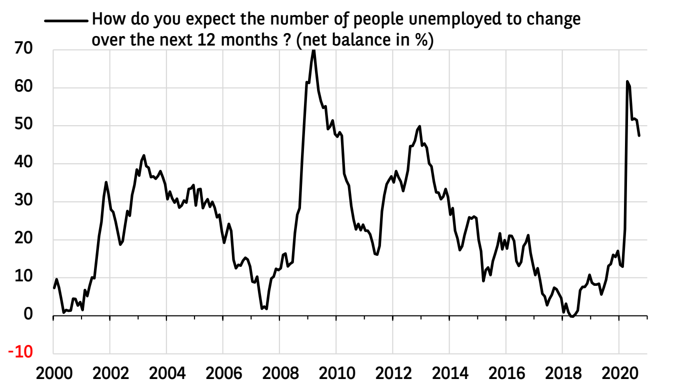

CHART 1 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

IFO DISPERSION - UNCERTAINTY OF GERMAN COMPANIES

CHART 2 SOURCE: IFO , BNP PARIBAS,

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1 Testimony of Jerome H. Powell, Chair of the Federal Reserve Board of Governors before the Committee on Financial Services of the US House of Representatives, 22 September 2020