FRANCE

BETWEEN A V-SHAPE OR U-SHAPE, THE RECOVERY

After a massive recessionary shock, the French economy has been showing signs of recovering rather rapidly since May, raising hopes for a V-shaped recovery. Markit's composite PMI index and household spending on goods both rebounded spectacularly, which is encouraging. But these gains were largely automatic and will lessen as the catching-up effect wears off. To return to pre-crisis levels, it will probably take longer to close the remaining gap than it took to regain lost ground so far. There are several explanations: sector heterogeneity, ongoing health risks and the scars of the crisis. We foresee a U-shaped recovery (-11.1% in 2020, +5.9% in 2021). The risks seem to be well balanced, thanks notably to support measures that have already been taken or are in the pipeline.

THE SIZE OF THE SHOCK TO GDP

According to the INSEE's preliminary estimate, French GDP contracted 5.8% q/q in Q1 2020. This contraction provides a first glimpse of the size of the recessionary shock triggered by the Covid-19 pandemic and the lockdown measures taken to halt its spread. The second estimate was revised to -5.3% q/q, still the sharpest decline since 1949, matching the all-time record of -5.3% q/q in Q2 1968. Looking at the GDP breakdown, the only component that made a positive contribution was the change in inventory. Household consumption, public consumption, investment, exports and imports all plummeted.

Yet the Q1 contraction provides only a foretaste of what is expected to come in Q2. The first quarter was impacted by 15 days of the lockdown, whereas the second quarter will accumulate the negative carry-over, a full month of the lockdown in April plus another ten days in May. Moreover, the lockdown has been lifted very gradually. In its 27-May economic note, the INSEE warned of a 20% q/q decline, before revising its forecast to -17% q/q in its 17 June update. In early June, the Bank of France was forecasting a contraction of about 15% q/q (which is our central scenario), before revising it slightly to 14% in early July.

The size of the contraction, which was comparable to the ones that hit Spain and Italy, but was harder than the one in Germany, can be attributed to the stringency and duration of the lockdown, the sector structure of the French economy (heavy weight of market-related services), and the quasi-halting of key sectors at the beginning of the lockdown, whereas they continued to operate, albeit at a slower pace, in other countries (construction and public works, for example).

FIRST SIGNS OF A V-SHAPED RECOVERY

The sharp drop in Q2 GDP masks widely differing monthly trends. Most of the decline occurred during the trough month of April, while May marked the beginning of a turnaround. According to some indicators, the rebound was as spectacular as the preceding plunge, raising hopes for a V-shaped recovery, i.e. a rapid return to pre-crisis levels.

This was the case for the results of Markit's business climate survey. In June, the composite PMI index rebounded by 19 points (preliminary figure) after a 21-point gain in May. This brought the composite index to 51.3, slightly above the 50 threshold that marks the beginning of expansion territory. The rebound could be seen in both manufacturing (52.1) and services (50.3). As a result, the composite index has basically returned to pre-crisis levels (52 in late 2019-early 2020) after recovering virtually all of the 41 points lost in March-April. For once, France's performance was stronger than in Germany and in the Eurozone as a whole.

GROWTH AND INFLATION (%)

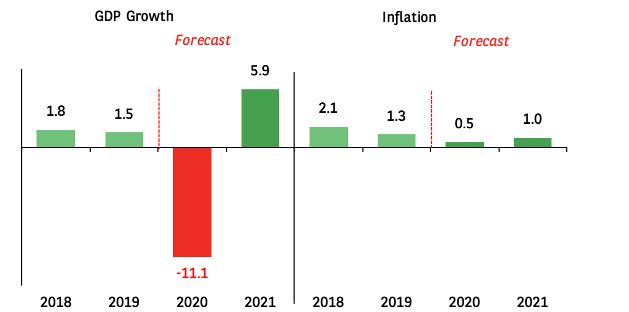

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

CONFIDENCE SURVEY

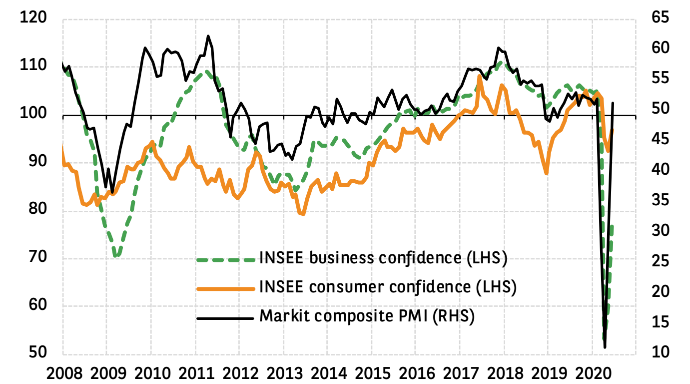

CHART 2 SOURCE: INSEE, MARKIT, BNP PARIBAS

Several other economic indicators also showed spectacular rebounds. In May, household consumption of goods rose 37% m/m, hiring reports for jobs lasting more than a month excluding temporary employment was up 76% m/m[1], and business start-ups increased 60% m/m. In June, new car registrations rose 79% m/m (after leaping 384% m/m in May), bringing them back to February levels. According to the first edition of the Boston Consulting Group's Recovery Barometer, France recovered relatively faster between mid-April and mid-June than Germany, Italy and the UK, judging by both business activity and consumer activity[2].

1 The decline in the number of category A jobseekers is less impressive (-3.3% m/m) but we welcome the news that it began to decline as early as May.
2 BCG, Economic Recovery Barometer, 1st edition, 26 June 2020

Yet between mid-February and mid-April, growth contracted even more sharply, which means the net result is still unfavourable: France was the country that regained the least lost ground. Along the same lines, household consumption of goods is still 9% below the year-end 2019 level, while hiring and new business start-ups are 50% and 25% below pre-crisis levels. Although these indicators seem to suggest that a V-shaped recovery is well underway, others tell a different story, such as the milder rebound in goods exports and industrial production (17% and 20% m/m in May, respectively). These figures serve as a reminder that there is still a long road ahead. May's rebound provides no guarantees of what will follow, and the V-shaped recovery is neither complete nor a given. The same question can be seen from a different angle: according to the most recent INSEE estimate, economic activity in June was 12% below the "normal" level. This is a significant improvement compared to April and May, when the economic loss was estimated at 30% and 22%, respectively. But will it continue at this pace in the months ahead? Will the remaining 12% gap close just as quickly? We cannot be sure, it is still a high step.

REASONS FOR A U-SHAPED RECOVERY

The less optimistic signals from the INSEE surveys also dampen hopes for a V-shaped recovery. In May, the composite business climate index gained only 7 points. Although the June figure rebounded strongly, up 18 points, the overall score of 78 was simply not as low as before. It was still far below the benchmark average of 100 (which is consistent with the trend growth rate of the French economy) and had barely made up half of the 52 points lost in March and April. Another mixed signal to keep in mind is the gap between the more optimistic view that companies have on their activity prospects and the lack of improvement in the balance of opinions relating to past trends. As to household confidence, the situation would seem to be better. In June, the composite index stood at 97, much closer to the 100 benchmark than the business climate. But this was not due to a stronger rebound (only 4 points) but to the fact that household confidence did not plunge as much during the lockdown (11 points). And while households are showing much more optimism about the opportunity to purchase big-ticket items, they are still a bit more pessimistic when it comes to unemployment future trends.

There is still great uncertainty over the shape of the recovery. Granted, growth rates are expected to be very high in Q3 (possibly even in the double digits), and to a lesser extent in Q4, but this rebound is largely automatic. It will taper off as the catching-up effects wind down, as the Bank of France points out in its July economic note. This is why growth is expected to decrescendo in a kind of tango-step recovery: quick, quick, slow...

Under our scenario, it will take time to return to pre-crisis levels, which is not expected to occur before 2022. This gradual pace is the reasoning behind a U-shaped recovery, although it might be more accurate to compare it to a square root sign or bird wing. The first explanation is sector heterogeneity: not all sectors are on the same page when it comes to the speed of the recovery and the return to normal. This is clearly outlined in the third edition of the Labour Activity and Employment Conditions Survey (Acemo-Covid) by Dares, which also states that business leaders are increasingly alarmed by the lack of demand prospects[3].

JOB SUPPORT MEASURES

As part of the emergency relief plan, the job retention scheme was largely strengthened to encourage companies to keep their workforce. Several parameters illustrate the generosity of the short-time working scheme during the lockdown: 1/ the state and the Unedic fully covered the compensation paid by companies (up to 70% of gross wages, but without dropping below the minimum wage); 2/ wages were covered up to 4.5 times the minimum wage; 3/ coverage was expanded to include payroll workers, employees working at home and sales representatives. The generosity of the scheme is now being phased out gradually. Since 1 June, with the exception of companies shutdown for health-related reasons, companies are fully covered for 60% of gross wages. As of 1 October, this coverage drops to 60% of what the company pays out, and employees will receive 60% of their gross salary (72% of net), compared to 70% and 84%, respectively, currently (minimum wage earners are still covered 100%), for a three-month period that can be renewed once.

Since 1 July, this basic scheme has been coupled with a long-term job retention scheme (APLD). This scheme offers more incentives (coverage is the same as that in effect on 1 June), and is geared towards sectors hit by a lasting decline in activity. It must be submitted to company or sector approval for a six month period minimum or two years maximum, and validated by the Dirrecte (regional directorates for enterprise, competition, consumer affairs, labour and employment).

The recovery plan, which is underway, will give special attention to youth employment. In early June, an internship support package was announced. Its key measure is a big increase in hiring subsidies so that the first year of training does not cost the company anything, or at least not much. Other measures are being negotiated that aim to boost youth employment more broadly. Two options are on the table: a hiring bonus or a cut in employee contributions. Consultations are also on the agenda on vocational training and the unemployment insurance regime reform.

SOURCE: FRENCH GOVERNMENT, THE PRESS, BNP PARIBAS

Another explanation is that the Covid-19 pandemic is not over yet, neither its impact on growth, its surcharges nor the wait-and-see and precautionary behaviour it engenders. Lastly, the crisis risks leaving deep scars (defaults, unemployment, debt, precautionary savings, loss of productivity), despite the emergency measures deployed to buffer the recessionary shock: these scars will also strain the return to normal. The recovery needs support. While awaiting the global stimulus package, major sector support measures have already been announced and plans to support employment will all be revealed soon (see box).

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3 dares_acemo_covid_synthese_juin_2020.pdf