EDITORIAL

THE STOP-START RECOVERY

Activity was already slowing before the new lockdown measures and the latter will act as an additional brake. We are living in a stop-start economy. The contraction of activity should be more limited than in March-April. The measures are less strict for economic activity, businesses are better prepared and exports should benefit from a more dynamic business environment, in particular in Asia, compared to what happened in spring.The stop-start recovery should also have negative consequences that go beyond the near term. Uncertainty may last for longer which entails increased risk of bigger scars like a rise in long-term unemployment or corporate bankruptcies. It may intensify disinflationary forces and increases the burden on public finances. It will also take more time until the pre-pandemic activity level will be reached.

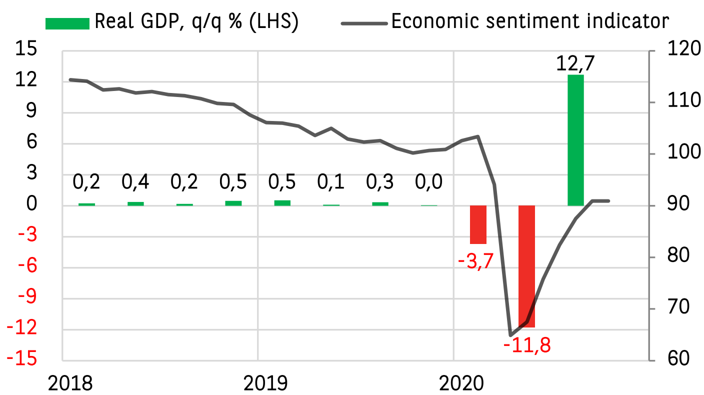
The rate of real GDP growth in the third quarter versus the second quarter has been particularly strong and even better than elevated consensus expectations [1] (shown in brackets): France +18.2% (15.0%), Germany + 8.2% (7.3%) and the euro area +12.7% (9.6%). In the US, where contrary to the EU, data are reported at an annual rate, quarterly growth in the third quarter was 33.1% (32.0%). This spectacular performance comes after an equally spectacular contraction of activity in the previous quarter. Yet, in normal times, it should have been reason for cheer. However, these are not normal times. In several European countries, the second wave of the pandemic is accelerating at an alarming rate, triggering the re-introduction of lockdown measures. The US is even experiencing a third wave of new infections and according to Brookings, a non-profit public policy organization, the recovery is losing steam. The number of hours worked at small businesses has decreased slightly in September and job creation in metropolitan areas is slowing[2] . On the other hand, the Federal Reserve of New York's weekly economic index continues to improve. In the European Union, the situation looks worse. At the release of its economic sentiment index for October, the European Commission commented that for both the euro area and EU the recovery of the economic sentiment index came to a halt and that employment expectations turned negative. The tone at the ECB press conference last Thursday was decidedly gloomy[3] and Christine Lagarde was very clear that more easing measures will be decided at the next meeting on 10 December [4]. This is warranted, considering that activity was already slowing before the new lockdown measures and the latter will act as an additional brake. We are living in a stop-start economy: the first wave of infections necessitated a lockdown, causing a sudden stop to activity. Once the number of new infections were sufficiently down, easing measures were instrumental in re-starting the economy.

1. The consensus data were established by Bloomberg.
2. Source: *As COVID-19 cases surge, the country's economic recovery is losing steam*, Brookings, 30 October 2020.
3. *"Incoming information signals that the euro area economic recovery is losing momentum more rapidly than expected [...]. The rise in COVID-19 cases and the associated intensification of containment measures is weighing on activity, constituting a clear deterioration in the near-term outlook"*. Source: *ECB, Introductory statement*, Press conference, Christine Lagarde, President of the ECB, Luis de Guindos, Vice-President of the ECB, Frankfurt am Main, 29 October 2020

After the current stop, a start will follow. It is as if we are experiencing a succession of short-lived V recoveries.

For the near term, the extent of the drop in activity and the timing and size of the rebound are more important questions than the label of the recovery. Arguably, the contraction of activity should be more limited than in March-April. The measures are less strict for economic activity, businesses are better prepared and exports should benefit from a more dynamic business environment, in particular in Asia, compared to what happened in spring. Supposing that in the course of December, restrictions could be eased –which is the equivalent of hitting the 'start' button-, we should again see a mechanical recovery, whereby the power of pent-up demand could be particularly strong considering the approaching festive season.

EURO ZONE: GDP GROWTH AND ECONOMIC SENTIMENT INDICATOR



SOURCE: EUROSTAT, EUROPEAN COMMISSION, BNP PARIBAS

4. *"We have little doubt, given what is expected as a result of the risks that we are seeing, that circumstances will warrant the recalibration and the implementation of this recalibrated package."*

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Under such a scenario –which of course crucially depends on the assumption of the lifting of restrictions- activity in the fourth quarter would be close to normal in October, significantly down in November and rebounding during the course of December. In addition, one should take into account the positive spillover effect from the third quarter[5] . Still, on balance, this would lead to quite a contraction in real GDP. For France, we estimate it at about 5% quarter over quarter[6] . The stop-start recovery should also have negative consequences that go beyond the near term. Households and businesses may wonder how many waves will follow until we embark on a lasting, uninterrupted recovery. The answer to this question is of course closely linked to when a vaccine will be found. As a consequence, uncertainty may last for longer which entails increased risk of bigger scars like a rise in long-term unemployment or corporate bankruptcies as support measures are withdrawn. A stop-start cycle may intensify disinflationary forces and increases the burden on public finances. It will also take more time until the pre-pandemic activity level will be reached. Based on health but also economic considerations, there is a clear, shared interest in everybody undertaking the necessary efforts to try to limit the spreading of the virus.

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5. To illustrate this point, suppose that GDP has been growing month after month during the third quarter but that during the fourth quarter, it stays constant. This would still imply that demand, income and value added generated in the fourth quarter would be higher than during the previous quarter. For France, this *acquis de croissance* is estimated at 1% for the current quarter (see the Pulse section on France in this Ecoweek).
6. For more detail, see the Pulse section on France in this Ecoweek written by Hélène Baudchon.