Prospects

No. 20/178 – 15 July 2020

FRANCE – Impact of Covid-19

What prospects does the French economy have for recovery?

- **Given the estimated economic cost of the lockdown and still-sparse information about the resumption of business once restrictions were lifted, we expect French GDP to decline by -10.2% in 2020. This record contraction should be followed by a significant rebound in 2021 (+7.5%).**
- **After contracting 5.3% in the first quarter, GDP likely declined 17% in the second quarter; this quarter was marked by six weeks of lockdown, compared to just two in the previous quarter.**
- **So far, business has restarted more quickly than initially anticipated. Consumption, which was down 35% compared to normal during the lockdown, was able to recover in May as shops reopened. The resumption of construction, which had been halted in March, also helped restart investment.**
- **Supportive measures should preserve productive capacity to a large extent and will also protect employment and incomes, in order to allow economic activity to restart as quickly as possible. The massive sign-up for short-time work benefits and measures intended to support companies' cash flow are expected to limit the rise of both unemployment and bankruptcies but will not stop them from growing. Finally, long-term support plans have been set up to help the hardest hit industries as time goes on, and Europe is currently negotiating a stimulus plan to support the recovery.**
- **The scale and speed at which surplus forced savings accumulated during the lockdown are reinjected into the economy will determine the trajectory of consumption and therefore the profile of the recovery, with the potential for some products to see a partial consumption catch-up. One of the keys is the return of confidence. However, the uncertain outlook, particularly when it comes to health issues, may lead households to remain cautious. This is the biggest downside risk to our scenario in the second half of the year and beyond.**

Main numbers of our scenario:

	Annual average (y/y, %)				Quarterly growth (q/q, %)							
					2019				2020			
France	2018	2019	2020	2021	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	1,8	1,5	-10,2	7,5	0,5	0,3	0,2	-0,1	-5,3	-17,1	16,8	2,5
Household consumption	0,8	1,5	-9,3	8,6	0,6	0,3	0,5	0,3	-5,6	-18,0	20,2	3,0
Investment	3,2	4,3	-20,6	10,9	1,1	1,4	1,2	0,1	-10,5	-29,4	24,9	4,8
Corporate investment	3,9	4,5	-19,5	12,2	1,1	1,3	1,3	0,1	-9,4	-29,8	26,0	5,0
Change in inventories*	0,0	-0,4	0,1	0,0	0,2	-0,2	-0,1	-0,5	0,7	0,1	-0,3	0,0
External trade*	0,4	-0,3	-0,3	-0,4	-0,3	-0,2	-0,4	0,1	0,0	0,0	-0,4	-0,3
Unemployment Rate (Insee)	8,7	8,2	9,6	10,3	8,4	8,2	8,2	7,8	7,6	10,1	10,2	10,3
Inflation (y/y) Insee	1,9	1,1	0,3	0,4								
Government balance (% GDP)	-2,5	-3,1	-10,5	-6,8								

* Contributions to GDP growth

Source : Crédit Agricole SA, forecast

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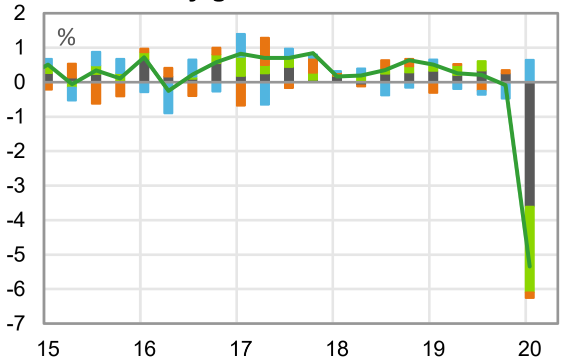
Economy expected to bottom out in the second quarter

Marked decline in GDP in the first quarter

After a slight decline in GDP in the fourth quarter of 2019, France officially entered recession (two consecutive quarters of declining GDP) with a 5.3% drop in GDP in the first quarter compared to Q4 2019.

Quarterly growth and contributions



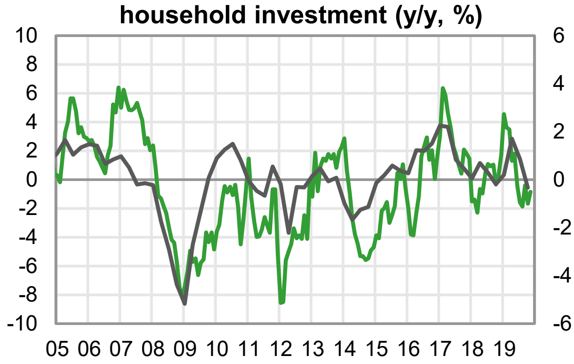
Sources: Insee, Crédit Agricole S.A.

This decline is particularly due to the sizeable drop in consumption as a result of the lockdown, which led to the closing of many shops, cafés and restaurants, as well as numerous services. Retail sales data also indicates that households started acting cautiously and reducing their purchases of manufactured goods as early as February. During the lockdown, INSEE estimated that household consumption was 30 to 35% lower than normal. Due to the two weeks of lockdown in March, household consumption was down 5.6% in the first quarter.

The sudden halt of construction projects also contributed to falling demand and the decline in investment in the first quarter. Construction accounts for 55% of business investment in France, and about 80% of household investment. For this reason, household investment contracted 13.6% in the first quarter, while business investment fell 9.4%.

With a quarterly 13.6% drop in construction investment stemming from the two weeks of lockdown, which amounted to one-sixth of the quarter, and assuming that investment in the sector was at a normal level until the last two weeks of March, we can estimate that construction fell by 81.6% over the first two weeks of lockdown. This figure is in line with INSEE estimates that indicate that 80 to 90% of construction projects were halted over the last two weeks of March and the first few weeks of April.

Activity in construction and household investment (y/y, %)



Sources: Insee, Crédit Agricole S.A.

Foreign trade was also affected. Imports declined 5.7%, in line with the drop in domestic demand, while exports fell 6.1% in the first quarter, driven down by the fall in demand for products and services from France.

Meanwhile, inventory changes contributed positively, adding 0.7 points to GDP growth in the first quarter. Industrial output, which had substantially declined in December, had rebounded in the first two months of the year. The sudden halt in demand (both domestic and international) led to significant storage of still-unsold output.

Second-quarter record decline and low point

Let's start with a quick calculation. Two weeks of lockdown led to a 5.3% decline in quarterly GDP relative to a comparatively normal quarter of business in Q4 2019. Given that there were six weeks of lockdown in the second quarter, economic activity would be expected to be 15.9% lower than a normal quarter (assuming that the shutdown of activity remained the same as over the first two weeks of lockdown, a reasonable assumption given INSEE's economic data). Second-quarter GDP would therefore be expected to decline 11.2% quarter-on-quarter. However, although it gives an order of magnitude as to the scale of the coming contraction, this is still only a rough figure, and is not enough to estimate the second-quarter decline in GDP. This is because the post-lockdown return to normal has been gradual. Shops have reopened (except for large shopping centres at first), but health guidelines and cautionary habits are preventing an immediate return to pre-crisis consumer behaviours. Furthermore, bars and restaurants remained closed until late May, and were only partially reopened at first in Ile-de-France. The consumption of certain services, including travel, lodging, tourism and culture, are still far below the norm.

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According to our estimates, when accounting for a gradual resumption of economic activity over the second half of the quarter, GDP likely dropped about 17% in Q2. A significant mechanical bounce of +16.8% is expected to follow in the third quarter. Consumption looks set to resume as shops reopen, while the return of construction will help give investment a fresh boost. Despite this bounce, GDP will not rebound to pre-crisis level in the third quarter. The recovery will be spread out over a longer period and will depend on multiple factors.

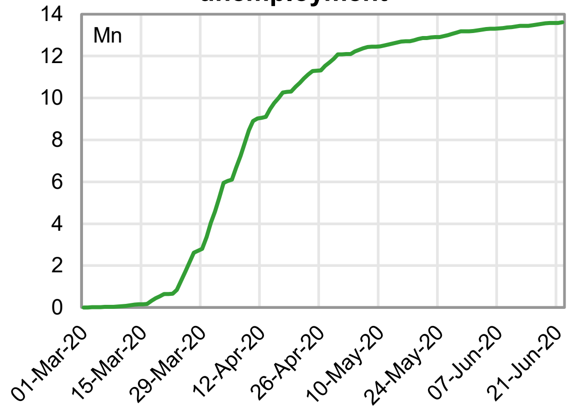
As lockdowns end, what potential is there for recovery?

Preserving the foundations of our economy

The impact of the crisis on the economy is expected to be largely mitigated by the supportive measures set up since mid-March.

Short-time work benefits have been collected in large numbers, which should limit the rise in unemployment. DARES has recorded 13.5 million employees, about 70% of all private-sector employees, as having applied for short-time work benefits. The average application per employee has been for 420 hours, equivalent to twelve 35-hour work weeks.

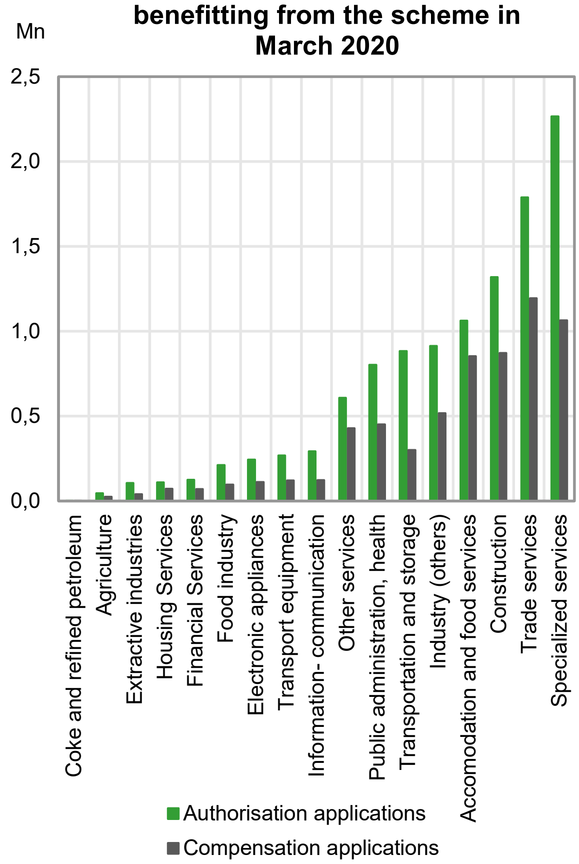
Workers covered by partial unemployment



Sources: DARES, Crédit Agricole S.A.

As these applications represent the maximum number of hours that can be subject to short-time work, actual benefits are lower. For instance, in March, only 60% of employees covered by short-time work benefits applied for compensation (payment of short-time work benefits by the government and UNEDIC), amounting to 6.3 million employees. It seems that many companies submitted short-time work authorisation applications so that they could react quickly and adjust the size of their staff if business were to suddenly decline.

Workers covered by partial unemployment and actually benefitting from the scheme in March 2020



Sources: DARES, Crédit Agricole S.A./ECO

As a reminder, this entirely government-funded system allows employees to keep 70% of their gross salary, i.e. 84% of their net salary up to 4.5x minimum wage, and 100% for minimum-wage employees. These benefits remained in place as the lockdown ended for sectors most affected by the crisis, under equally advantageous conditions. For other sectors, the system was scaled back; now the government only covers 85% of the short-time work benefits, to encourage companies to resume business as soon as possible (companies will be responsible for paying the other 15%).

This way, short-time work enables companies to keep their staff on payroll so that they could resume business more quickly once the lockdown ended. It also allows workers to keep a large share of their income, which is a good sign for post-lockdown consumption levels. Additionally, it reduces households' uncertainty as to their financial future, which should limit cautious behaviour.

However, the short-time work system cannot entirely prevent an increase in joblessness. In particular, most short-term employment contracts were not renewed during the lockdown. Fixed-term contracts (CDDs) account for 12% of wage employment in France, lasting an average of 46 days. In 2017, for instance, 83% of fixed-term

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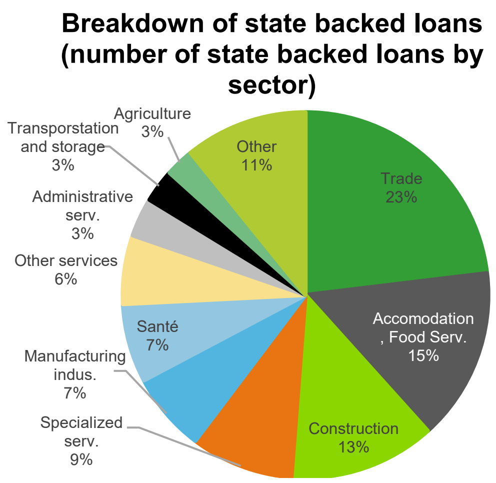
contracts were for less than a month (which is not to say that 83% of workers on such contracts worked under them for less than one month, as one worker could have multiple short-term contracts in succession). Short-term and temporary employees are therefore very vulnerable to becoming jobless.

An initial rough estimate is that there were nearly 700,000 additional job-seekers in the first half of 2020, an abrupt 2.3-point increase in the unemployment rate to 10.1% in the second quarter in mainland France, compared to 7.8% in the fourth quarter of 2019. Paradoxically, unemployment went down in the first quarter of 2020 for what were essentially technical reasons. This is because job-seekers can only be considered unemployed if they are actively looking for employment, and job searches were interrupted in many industries due to the lockdown. Naturally, this forecast is uncertain, but it does take into account the rise in registrations at national job centres (*Pôle Emploi*) in March at the same time that job listings were falling sharply during the lockdown compared to pre-crisis levels, per weekly DARES data. In the post-lockdown period, however, short-term contract hires are expected to pick up again, as shown by May data (up 75.9% compared to April and 92% higher for fixed-term contracts), though without reaching pre-crisis levels. Subsequently, the difficulties that some companies will encounter in resuming business could lead to low production capacity utilisation and an increase in bankruptcies, which could cut open-ended contract jobs by year's end. The unemployment rate might therefore peak at the start of next year, and then decline gradually beginning in the second half of 2021.

Sources: Insee, Crédit Agricole S.A.

The supportive measures also aim to limit bankruptcies by reducing the cash requirements of companies during the lockdown (by allowing them to postpone the payment of social security contributions, taxes, rents, and invoices) and guaranteeing free-flowing access to credit from banks thanks to €300 billion in state-guaranteed loans (PGEs), thereby offsetting lost revenue, with generous terms for repayment. As of 26 June, €100 billion in state-guaranteed loans had been disbursed by banks, about one-third of the amount allotted. Most of these loans went to small businesses, with the very smallest accounting for 50% and small-to-medium businesses getting 36%. Companies also get to pause the repayment of their loans.

Broken down by sector, the leading recipients of PGEs were retail (23% of recipients), lodging/food service (15%), and construction (13%), which are the sectors most affected by the crisis.



Sources: Ministère de l'Économie, Crédit Agricole S.A.

The total cost of the measures was revised upward in April. Not counting the bank guarantees, the cost of the support measures was €134 billion, €57 billion of which had a budget impact according to the third version of the finance bill. Setting aside the postponement of taxes and social security contributions, which are merely cash advances, the public deficit could stand at 11% of GDP in 2020, and the public debt-to-GDP ratio could exceed 120%, compared to 98% in 2019.

The end of the lockdown comes with an automatic rebound in demand

The reopening of shops is expected to trigger an automatic rebound in household consumption. During the lockdown, household consumption was about 35% below normal. The near-zero consumption of capital goods, especially manufactured goods, is therefore projected to resume, although a return to consumption levels similar to those seen pre-crisis is not expected to come immediately.

The recovery of consumption is also visible in May with a 36% jump compared to April and overconsumption of certain goods relative to normal pre-crisis levels in the weeks following the end of the lockdown. We are witnessing a phenomenon in

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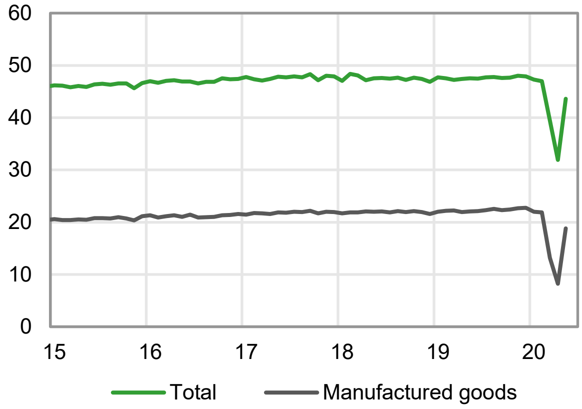
which some consumption that had been prevented by the shops being closed is being made up for, particularly with respect to industrial goods (textiles, capital goods, etc.).

Household consumption of goods (EUR bn)



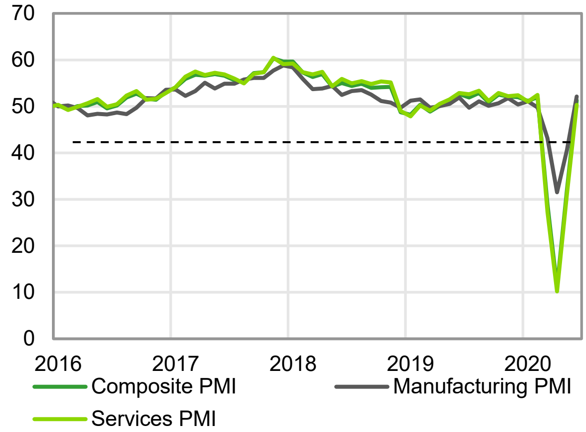
Sources: Insee, Crédit Agricole SA ECO.

However, this make-up effect might only be temporary. Despite the support measures, the uncertainty and the foreseeable rise in unemployment could harm household confidence and risk hindering a total, lasting recovery of major purchases.

The resumption of construction work is also expected to help investment rebound in the third quarter. Construction halted by the lockdown partially resumed beginning in late April and in May. According to the *CERC* (Regional Economic Unit for Construction) network, 95% of sites reopened by late June, while construction work was about 80% below normal in April according to INSEE estimates. Once again, despite this automatic effect, investment will only gradually return to its pre-crisis level. Given this uncertainty, businesses may be tempted to postpone their decisions to invest in production or construction. Households might also act cautiously and hold back from purchasing real estate. Additionally, the resumption of housing construction will be slowed by the sharp decline in building permits in Q2 (due to the lockdown and the postponement of municipal elections). However, investment could be encouraged to resume by national or European stimulus plans.

Other indicators have confirmed that economic activity is quickly resuming. Commuting has largely bounced back, returning to levels close to pre-lockdown levels. The business climate is also looking up, and the PMI index from IHS Markit's purchasing managers survey has returned to the economic expansion area, after hitting historic lows in April.

Business Climate

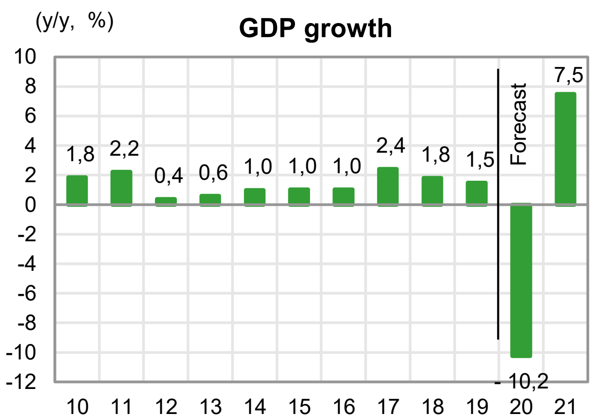


Sources: IHS Markit, Crédit Agricole SA ECO.

Nonetheless, given the scale and unprecedented nature of the shock, it is not easy to interpret surveys. PMIs are generally correlated with growth rates that automatically rebound in line with the resumption of activity. The surveys' high levels therefore do not necessarily mean that activity has returned to pre-crisis levels.

To sum-up, given the two months of lockdown, a gradual resumption of activity beginning in May and an automatic bounce in demand (consumption and investment), **we project that GDP will contract by more than 10% in 2020, followed by a strong rebound in 2021.**

GDP growth



Sources: Insee, Crédit Agricole S.A.

Despite this rebound, it will take time before GDP returns to pre-crisis levels. With GDP contracting 5.3% in the first quarter and about 17% in the second quarter, quarterly GDP might have fallen to a level similar to that of the year 2000, a 20-year step backward. By the end of 2020, GDP is likely to still be about 6% below its "normal" level. This crisis will have lasting consequences, and we estimate that GDP will only recover to Q4 2019 levels by late 2022.

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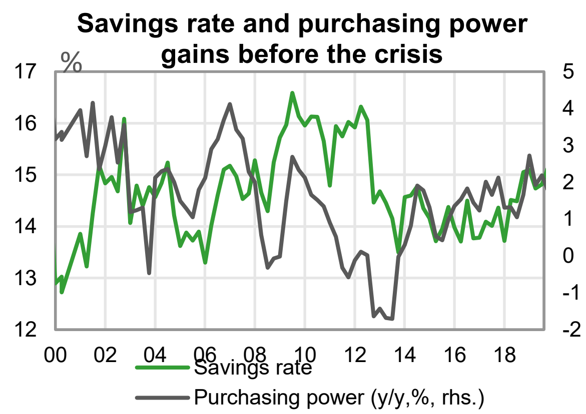
Sources: Insee, Crédit Agricole S.A.

The importance of using "forced" surplus savings

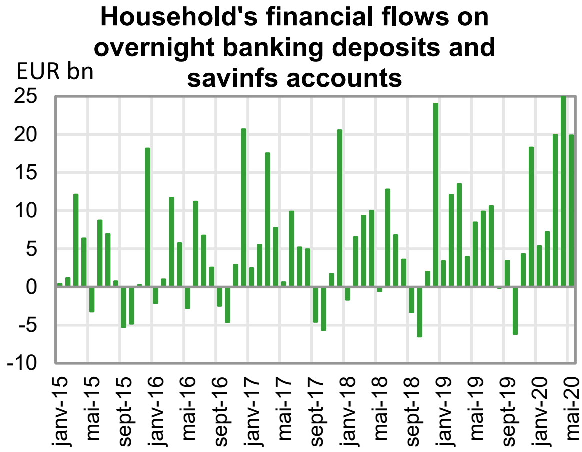
With consumption far below normal, households accumulated "forced" surplus savings in March and April. Although some households will see lower incomes (short-time work benefits or job loss), this savings glut will be much more important than those losses at the macroeconomic level. Relatively steady incomes as consumption fell due to the lockdown enabled households to "passively" accumulate a large savings cushion. Furthermore, French household savings were already high before the crisis. The purchasing power increases that resulted from measures taken by the government in response to the yellow vests movement were mostly saved. The household savings rate has therefore gone up more than 4 points, reaching 19.6% in the first quarter of 2020.



Sources: Insee, Crédit Agricole S.A.

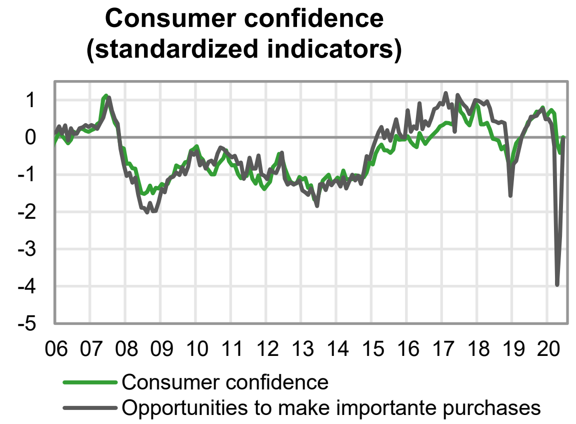
Bank deposit inflow data confirms that savings have been accumulating. Bank deposits grew more than €20 billion a month on average between March and May 2020, a figure much greater than the monthly average in recent years (about €5 billion per month since 2015). Additionally, these large flows do not match the usual seasonality of bank deposit inflows, which can reach that high in December with the payment of end-of-year or "13th month" bonuses.

Overall, the OFCE (French Economic Observatory) estimated forced accumulated savings during the lockdown to amount to €75 billion.



Sources: Banque de France, Crédit Agricole S.A.

The scale of the rebound in consumption will largely depend on the use of this savings glut, which itself will depend on the return of consumer confidence. This is because household confidence deteriorated during the lockdown. In particular, uncertainty is keeping households from having a clear picture of their financial future. Combined with a lockdown that put a strain on consumption, intentions to make major purchases were in freefall in March and April. There has been a rebound since then.



Sources: Insee, Crédit Agricole S.A.

On one hand, epidemic-related worries or fear of unemployment could encourage households to be cautious and keep a savings cushion for precautionary reasons.

On the other, a faster return of confidence, which will largely depend on changes in the health situation, could stimulate such major purchases as accumulated forced savings are withdrawn. Such catch-up effects could alter the consumption trajectory and therefore the profile of the post-crisis recovery.

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Summary table of economic support measures

Main Measures	Cost (estimates)
Direct support from Bpifrance to companies	€ 3 bn
Targeted measures for mosts affected sectors	€ 43,5 bn
Short time employment scheme	At least € 31 bn
Delay of tax and social contributions, cancellation of taxes and social contributions for the most affected companies	Around € 40 bn
Bill and rents are on hold for SMEs and self-employed workers	NC
Solidarity fund in order to support self-employed workers who lose more than 50% of their turnover	€ 8 bn
Emergency aid for low income families	€ 1 bn
Compensation for parents who need to stay at home caring for their children	€ 2 bn
Increase in health expenditures	€ 8bn
Equity holding or nationalisation of strategic companies	€ 20bn
Conservation of exporting companies through €2 bn of credit insurance and reinforcement of Bpifrance export insurance garanties	NC
€ 300 bn of state backed credit guarantees	€ 100 bn already granted
Increase of Bpifrance credit guarantees to 90% from 40%	NC
€ 10bn public guarantee for intercompany credits	NC
Total	Around €134 bn

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