Prospects

N°20/240 – 6 October 2020

EUROZONE – 2020-2021 Macroeconomic Outlook

Resilience mapping to prevent the worst-case scenario

- **During the summer, the economy moved in two directions: one very positive, the other less so. Economic data confirm that the end of the second quarter did feature a very strong rebound in activity and confidence. On the other hand, the epidemic's global trend dispelled any scenario of the virus quickly abating. The risk of a second wave of the virus, which we predict will be controlled by targeted, localised restrictions, as well as the risk of an uneven recovery are also casting a high degree of uncertainty over our growth scenario.**
- **On the economic policy front, some reassuring certainties are emerging. With the European Recovery Plan, the zone's most indebted countries can count on large, highly concessional transfers and loans guaranteeing positive fiscal stimulus beyond the forecast horizon. With the Fed's change in strategy, any premature reversal of the monetary policy stance in advanced economies is off the table.**
- **Yet underneath the authorities' 'Band-Aids', the wounds from the crisis are becoming visible, and they are only the first. With profits eroding and activity still much reduced in certain sectors, we will inevitably see more and more companies go bankrupt, with higher unemployment as temporary support measures (tax relief and deferrals and short-time work) are removed.**
- **Together, these factors back up our scenario of an incomplete recovery: end-2021 GDP will be 1% lower than its pre-crisis level. The pace of growth in 2021 (+5.5% after -7.4% in 2020) will be slower than required to close the negative output gap that has developed during the crisis. Still, the recovery is brisker than our June scenario predicted, as it was based on GDP sinking 2% from its pre-crisis level. Thanks to better performance in Q2, the recovery looks to be moving faster in Germany, France and Italy, however it is quite a bit slower in Spain.**

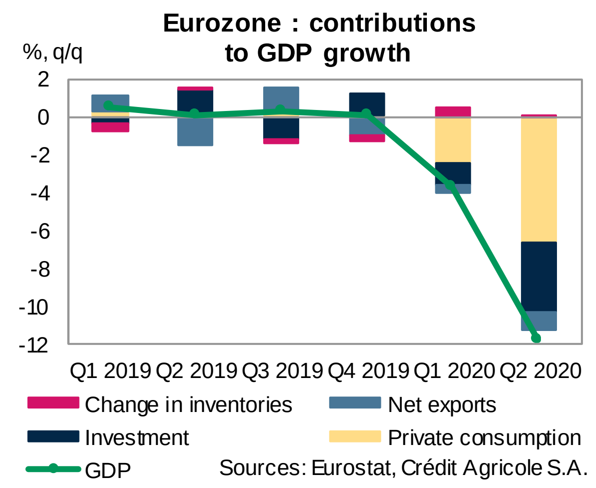
Anatomy of an imperfect "V"

The Eurozone's downturn in Q2 was the largest in the post-war period, at nearly three times the initial shock of the 2008-09 crisis.

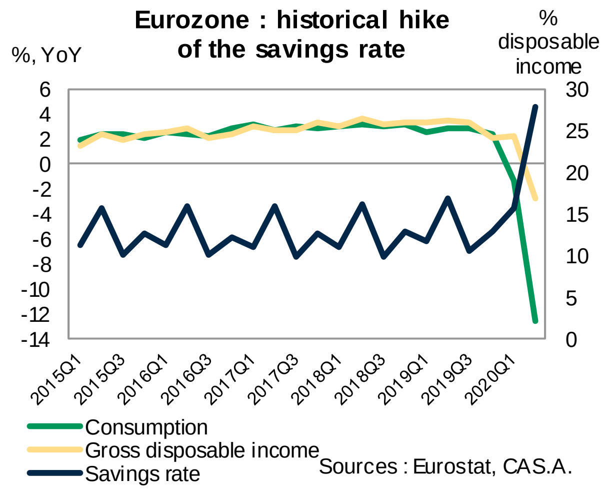
GDP fell by 11.8% from the previous quarter, just shy of projections (-12.7%). **The shocks that buffeted each of the zone's major countries indicated significant scatter:** Spain (-18.5%), France (-13.8%) Italy (-12.8%), Portugal (-13.9%), Belgium (-12.1%) and Greece (-14%) were hit hard. Meanwhile, Germany (-9.7%), the Netherlands (-8.5%), and Austria (-10.4%) showed less GDP erosion than the Eurozone average.

The slump in GDP in Q220 was primarily the result of **a drop in domestic demand**, which added 10.9ppt to the downturn. The contribution of changes in inventory was just barely positive (+0.1%), signalling that inventory reduction was ongoing after substantial build-up over the March-April period. Foreign trade subtracted just 1ppt from growth. Export (-18.8%) and import (-18%) flows had identical sharp downturns over the quarter.

Paola MONPERRUS-VERONI
paola.monperrus-veroni@credit-agricole-sa.fr

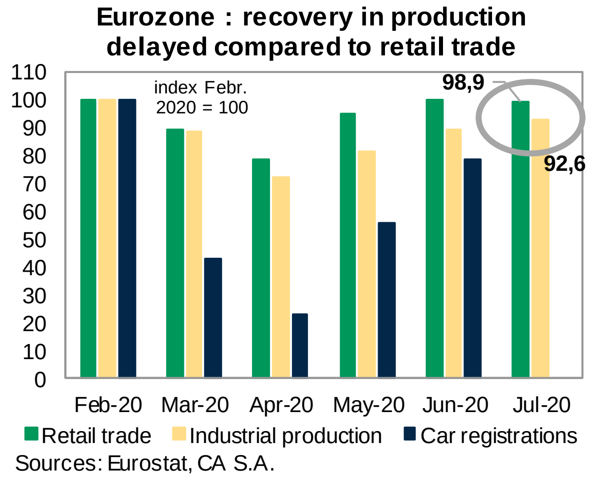


Consumer spending sank by 12.4% over the quarter (in line with our projections). In most of the Eurozone's large economies, the downturn in consumer spending was similar in scope from country to country, except Spain, which suffered a steeper fall (-20.8%). The decline in household spending was much sharper than the decline in gross disposable income (-3.3% in value terms, over the quarter), as the latter was supported both by the maintenance of employment and wages through short-time working and other new temporary benefits. After a strong rebound in Q1 (to 16.6% of disposable income), the households savings rate recorded its largest ever increase in Q2, reaching 24.6%. These savings were mainly used to fund household deposits, which increased by 6.4% from a year earlier. The flow of credit to households slowed (2.9% year-on-year after 3.3% in Q1), but their debt ratio continued to rise to 94.8% of their income. Their net wealth is still on the rise as the decline in the valuation of financial assets has been more than offset by the better valuation of real estate.



Investment sank deeper (-17% for the quarter). Household investment fell by 13.4%, bringing the Eurozone households' investment rate to its lowest level (7.9%) since the creation of the monetary union. The fall in construction investment (-12.5%) was more contained than that of productive investment (-19.6%), which was strongly affected by the turnaround in investment in transport goods (-32.6%). This reduction in capital accumulation was more contained in Germany and more pronounced in France and Italy; once again, Spain stood out in an unfortunate way. The same was true of the decline in exports, which was most extreme in Spain (-33.5%), then Italy (-26.7%) and France (-25.5%), but less substantial in Germany (-20.3%). In Q220, Eurozone GDP came in 15% below its Q419 level**.** The trend in activity in Q2 was marked by a dip in April and a better-than-expected rebound in May and June. **The pace of growth was rock-solid as the second quarter wrapped.**

Monthly indicators confirmed that consumers drove the initial phase of the rebound. During the lockdown phase, consumers lost less confidence than businesses, and sales of consumer goods picked up again quickly. After 20.3% in May, retail sales by volume picked up by 5.7% in June. Despite a July slump (-1.3%), they returned to February levels. Consumer goods suffered less than other goods: production was less undermined by the crisis, so producer confidence was less affected and more quickly restored.



Consumer confidence bumped back up after May, but did not quite return to pre-crisis levels, due to expectations of a jump in unemployment. **Starting in July, household spending indicators gradually lost momentum.** The jump-start in vehicle registrations could provide a key driver to maintain household spending. Low spending levels over the 2018-19 period, tax incentives and persistently tight spending in certain services, coupled with the relative financial strength of low-debt households, are positive levers for auto sales. In spite of a bumpy restart, registrations (+1.7% in August after +31.5% in July) are now edging up to their pre-crisis level (-0.8%). This reboot could be a

Paola MONPERRUS-VERONI
paola.monperrus-veroni@credit-agricole-sa.fr

cornerstone of a rebound in industry, which has been hard hit by declining auto production.

Clearly, business confidence has been shaken during the lockdown. However, the view that the economic backdrop would quickly return to normal has matured over time, except for those sectors most affected by social distancing and behavioural changes. Although there was substantial catch-up, industrial output was slower to return to its pre-crisis level than demand. And while there have been major gains (12.3% in May, 9.1% in June, 4.1% in July), it has not recovered its pre-Covid level (-0.7% compared to February) and is still hampered by auto production that itself is still 7% lower than pre-crisis levels.

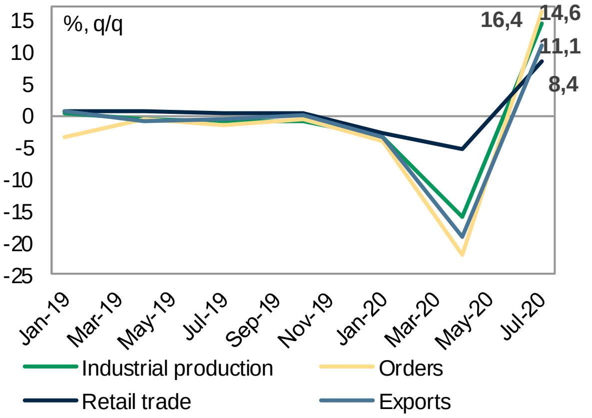
The recovery in demand was met by substantial inventory reduction in May and June, which offset the inventories stockpiled in April. In fact, unsold production has fallen, and surveys show orders rising faster than inventories can build up. **So an inventory cycle could mark the next two quarters and take up where consumer spending leaves off, supporting production.**

Sketching out a recovery, beyond the mechanical rebound

Though mobility indicators show shopping and recreation has been climbing back toward pre-crisis levels since August, **the potential rebound in spending now seems limited by both the advanced recovery in the consumption of goods and the restrictions still in place on consumption of services**. And this is precisely why survey indicators are flagging as Q3 gets underway. The business climate in the European Commission surveys has recovered, but still sits well below where it was before the pandemic. Survey data from purchasing managers confirm that growth in private-sector business in the Eurozone, after peaking in July, has lost its grip and now appears moderate, especially in services.

With high growth carrying over at the end of July, the 'hard' quantitative data still point to brisk business in the third quarter. In light of steadily less-enthusiastic survey results, this summer's growth came more from the rebound in activity in the spring and less from any sustained momentum in the third quarter.

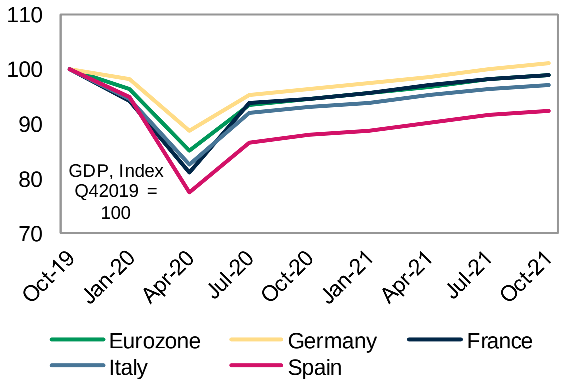
Eurozone : carry-over effect for Q3



Sources: Datastream, Crédit Agricole S.A.

Our GDP growth outlook for Q3 (10.1%) calls for Eurozone GDP to stay 6.5% below its end-2019 level. Surveys, deflating somewhat, suggest modest growth in Q3.

Eurozone : an incomplete and heterogeneous recovery



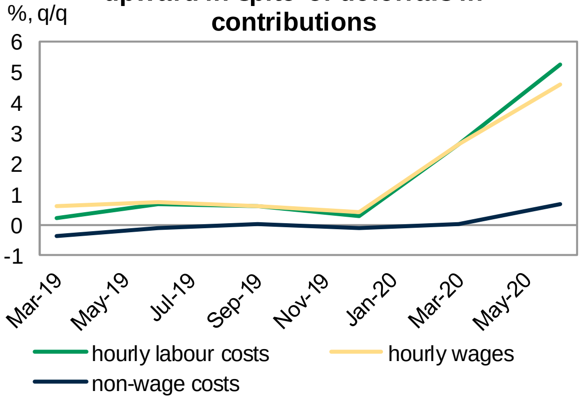
Sources: Eurostat, Crédit Agricole S.A.

Paola MONPERRUS-VERONI
paola.monperrus-veroni@credit-agricole-sa.fr

The true cost of the crisis is not yet visible

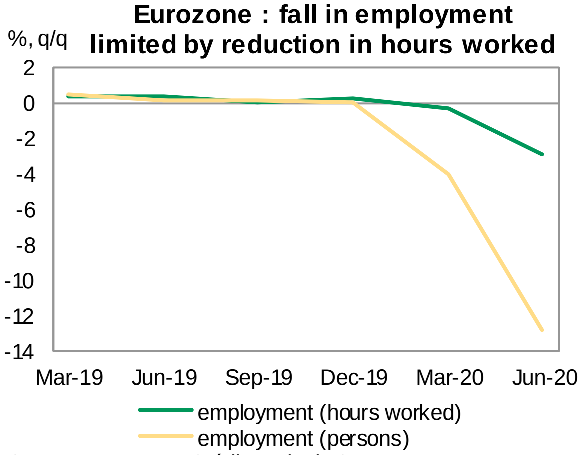
Short-time work arrangements as well as tax relief and deferrals have stemmed wage cuts, with the bulk of the adjustment impacting profits during Q220.

Eurozone : hourly labour costs upward in spite of deferrals in contributions



Sources: Eurostat, Crédit Agricole S.A.

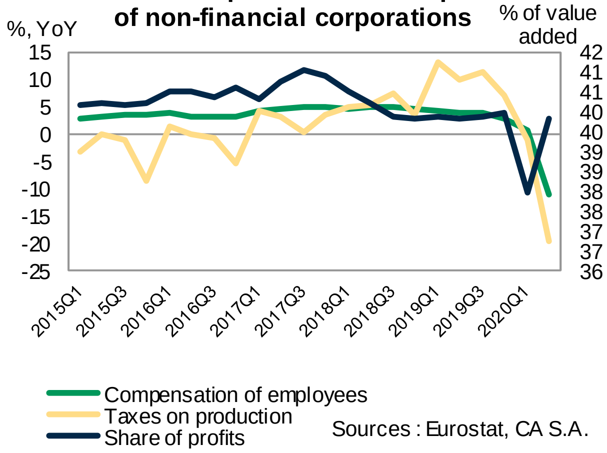
Eurozone : fall in employment limited by reduction in hours worked



Sources: Eurostat, Crédit Agricole S.A.

In Q220, the decline in unemployment (-2.9% QoQ) was out of all proportion to the downturn in activity (-11.8%), since the shock was absorbed by the reduction in hours worked (-12.8%). This reduction did not bring with it a commensurate drop in wages. Hourly labour costs (+5.2%) were driven upward in spite of the more moderate increase in non-wage hourly costs (+0.6%) tied to tax relief and deferrals. The fall in compensations per employee (-4.7%) did not make up for falling productivity, with a highly negative impact on gross operating surplus However, the significant reduction in production taxes has mitigated the negative impact on profits and allowed the margin rate of non-financial companies to return to its pre-crisis level.

Eurozone: optical illusion on profits of non-financial corporations



Sources : Eurostat, CA S.A.

Non-financial companies continued to use bank financing in Q2 (+3.3% year-on-year) and their debt ratio increased to 83.6% of value added (after 78.7% in Q1). However, most of this new indebtedness went into deposits, whose share in value added doubled from 9.6% in Q1 to 18.2% in Q2.

Short-time working schemes were applied in different ways: to respond to demand drying up temporarily and to underpin the transition forced by the crisis, but also as a windfall effect in some sectors to contend with transformations that were already in the works before the crisis. So it is difficult to state with any certainty, at this stage, that these systems will be temporary, especially since the European funds (SURE and NGEU) are available to refinance them with a more limited impact on national budgets. However, assuming that tax-deferral mechanisms are phased out, there will be upward pressure on wage costs. This upward pressure – which is bad for profits – will be only partially offset by the resumption of activity and the turnaround in productivity in the second half.

This improvement in profitability and liquidity conditions in Q2 is artificial. The gradual lifting of the temporary support measures will make visible the first injuries inflicted by the crisis, first bringing a deterioration in profitability before the appearance of the first defaults and the rise in unemployment. These are the key factors in the slowdown of our quarterly growth profile in 2021 (+1.1% average per quarter). Still, we are aware that the availability of the first vaccines and the European Recovery Funds will buoy confidence and public investment beginning in Q221, pushing growth up a notch. The confidence scenario is critical: the use of the considerable surplus savings built up during the lockdown depends on it. There is a high risk that the spike in the unemployment rate will transform it into precautionary savings, limiting the potential increase in private consumption. As to the investment cycle resuming, a question mark

Paola MONPERRUS-VERONI
paola.monperrus-veroni@credit-agricole-sa.fr

persists. Capacity utilisation rates are still very low, and it is hard to imagine any expansion in capacity, given the stubborn uncertainties over demand and the expected pace of growth. Although replacement investments are possible to support the required transformation of several activities, it is public investment that is expected to make the biggest contribution to a turnaround in capital accumulation, supported, in the Eurozone periphery, by the European Recovery Fund.

Why this time may be different

Faced with the exceptional scope of the Covid crisis, European national, community and monetary policy authorities seem to have drawn the right lessons from the great financial crisis.

The risk of a premature withdrawal of fiscal and monetary support seems to have been dispelled over the forecast horizon, even though the negative output gap is far from closed. By easing the regulatory and supervisory framework, the unusual nature of the crisis can be managed while rejecting any consideration of moral hazard – unwarranted as it is in these circumstances. And because this is not an excessive debt-induced crisis, the disinflationary mechanisms of debt reduction should also not be encouraged, as they were in the past decade. Also, the banking sector is playing the role of shock absorber, by preventing liquidity crises from turning into solvency crises. From our viewpoint, transitioning from the principle of efficiency to the principle of resilience is a key argument for a forecast that may appear, but is not, optimistic, and for asserting that the course of the 2009 and 2012 crises is not the only route.

In spite of efforts to engineer a more autonomous and uniform recovery, a high risk of fragmentation persists. At the end of 2021, Germany is projected to achieve a higher GDP (+1.1%) than at end-2019; meanwhile, GDP could still be 1.4% lower in France, 3.1% lower in Italy, and 7.9% lower in Spain. ■

Forecasts

EMU	Quarterly rate (QoQ, %) 2019				2020				2021				Annual rate (YoY, %)			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2018	2019	2020	2021
GDP	**0,5**	**0,1**	**0,3**	**0,1**	**-3,7**	**-11,8**	**10,0**	**1,2**	**1,0**	**1,3**	**1,3**	**0,9**	**1,8**	**1,3**	**-7,5**	**5,4**
Households consumption	0,5	0,2	0,4	0,1	-4,5	-12,4	11,1	1,3	0,9	1,0	1,0	0,7	1,4	1,3	-8,1	5,3
Public consumption	0,6	0,4	0,6	0,3	-0,7	-2,6	5,1	1,1	0,7	0,6	0,6	0,6	1,1	1,8	0,7	4,3
Total GFCF	-1,7	6,4	-5,1	5,7	-5,2	-17,0	9,3	2,2	1,6	1,8	1,5	1,1	3,1	5,6	-10,5	5,3
G&S exports	1,0	0,2	0,6	0,0	-3,9	-18,8	12,4	2,8	1,8	2,1	1,6	1,2	3,6	2,5	-11,7	7,1
G&S imports	-0,8	3,6	-2,3	2,2	-3,2	-18,0	10,3	3,3	1,7	1,7	1,1	0,9	3,5	4,0	-10,2	6,1
Inventory changes (% of GDP)	0,3	0,4	0,2	-0,1	0,4	0,5	0,3	0,2	0,1	0,2	0,2	0,2	0,6	0,2	0,4	0,2
Contributions to GDP growth																
Domestic demand excluding inventories	0,1	1,5	-0,8	1,3	-3,7	-10,9	9,0	1,4	1,0	1,1	1,0	0,7	1,6	2,3	-6,5	4,9
Inventories	-0,4	0,1	-0,2	-0,3	0,5	0,1	-0,2	-0,1	-0,1	0,0	0,0	0,0	0,0	-0,5	0,1	-0,2
Net exports	0,8	-1,5	1,4	-1,0	-0,5	-1,0	1,2	-0,1	0,1	0,2	0,3	0,2	0,2	-0,5	-1,1	0,7

Eurozone	Quarterly rate (QoQ, %) 2019				2020				2021				Annual rate (YoY, %) 2018	2019	2020	2021
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
Eurozone	**0,5**	**0,1**	**0,3**	**0,1**	**-3,7**	**-11,8**	**10,0**	**1,2**	**1,0**	**1,3**	**1,3**	**0,9**	**1,8**	**1,3**	**-7,5**	**5,4**
Germany	0,6	-0,5	0,3	0,0	-2,0	-9,7	7,7	1,1	1,1	1,2	1,3	1,3	1,3	0,6	-5,4	5,0
France	0,5	0,2	0,2	-0,2	-5,9	-13,8	15,6	0,9	1,1	1,4	1,1	0,6	1,8	1,5	-9,1	7,1
Italy	0,2	0,1	0,0	-0,2	-5,5	-12,8	11,3	1,3	0,9	1,5	1,2	0,6	0,7	0,3	-9,7	5,6
Spain	0,6	0,4	0,4	0,4	-5,2	-18,5	12,0	1,7	0,7	1,6	1,6	0,8	2,4	2,0	-12,8	4,5
Netherlands	0,5	0,4	0,3	0,5	-1,5	-8,5	5,2	1,2	1,2	1,2	1,2	1,2	2,3	1,6	-4,6	4,2
Belgium	0,1	0,3	0,4	0,5	-3,5	-12,1	12,6	1,3	0,8	0,6	0,6	0,5	1,5	1,4	-6,0	5,4
Ireland	1,0	1,9	3,3	1,3	-2,1	-6,1	3,1	2,9	0,4	1,4	1,1	1,1	9,3	5,9	-1,5	4,5
Portugal	0,7	0,5	0,3	0,7	-3,8	-13,9	7,0	1,7	1,2	2,2	2,5	1,2	2,6	2,2	-9,8	5,3
Greece	0,6	0,9	0,2	-0,9	-0,7	-14,0	6,6	1,2	1,3	1,6	1,9	0,8	1,9	1,9	-8,4	3,9
Finland	0,1	0,8	0,3	-0,3	-1,9	-4,5	2,7	1,1	0,6	0,6	0,6	0,6	1,5	1,1	-3,6	2,4
Luxembourg	0,1	2,1	0,4	0,4	-2,9	-13,2	12,0	2,6	0,9	0,9	0,7	0,7	3,1	2,3	-5,9	6,2
Austria	0,9	0,1	-0,2	-0,2	-2,4	-10,4	6,3	0,9	1,4	1,5	1,5	1,5	2,3	1,5	-7,3	4,7
Slovenia	0,5	0,0	0,8	0,4	-4,8	-9,6	3,1	1,8	2,8	2,2	2,0	1,7	4,2	2,4	-9,3	6,2
Malta	0,9	4,9	-2,0	0,5	-2,6	-11,6	4,4	-3,1	4,3	3,8	3,9	2,0	5,1	5,0	-9,4	6,1

Paola MONPERRUS-VERONI
paola.monperrus-veroni@credit-agricole-sa.fr

Consult our last publications:

Date	Title	Theme
02/10/2020	World – Macroeconomic Scenario for 2020-2021: All are equal, but some are more equal than others…	World
02/10/2020	World – 2020-2021 Macroeconomic Scenario: economic and financial forecasts	World
30/09/2020	Asia: which countries have come through the crisis best?	Asia
23/09/2020	Urban farming: fact or fiction?	Agri-Agro
16/09/2020	A strategic moment for the United States	Geopolitics
09/09/2020	As France's recovery falters slightly, its stimulus package takes shape	France
31/07/2020	Spain – 2020-2021 Scenario: Severe economic contraction	Spain
27/07/2020	Germany – 2020-2021 Scenario: coronavirus brings growth to a sudden halt	Germany
24/07/2020	Italy – Monthly News Digest	Italy
22/07/2020	Retrofitting buildings for energy efficiency: the imperative and the challenge	France, real estate
16/07/2020	Generation COVID: a sacrificed generation?	Geopolitics
15/07/2020	France – Impact of Covid-19 : what prospects does the French economy have for recovery?	France
08/07/2020	What can bankers learn from Nikolai Gogol?	Geopolitics

Crédit Agricole S.A. — Group Economic Research
12 place des États-Unis – 92127 Montrouge Cedex

Publication manager: Isabelle Job-Bazille
Chief Editor: Armelle Sarda
Information centre: Dominique Petit - **Statistics:** Robin Mourier
Editor: Fabienne Pesty

Contact: *publication.eco@credit-agricole-sa.fr*

Consult Economic Research website and subscribe to our free online publications:
Website: https://etudes-economiques.credit-agricole.com/en
iPad : Etudes ECO application available on App store platform
Android : Etudes ECO application available on Google Play platform