

France: Coronavirus leads us to cut our 2020 growth forecasts

With four deaths and more than 200 cases of the coronavirus, the French economy will not be spared from the current health crisis. The last positive economic indicators already seem like yesterday's story. The first estimates of the impact on growth point to a 0.3 percentage point downward revision to our 2020 GDP number



The latest economic indicators show upbeat business sentiment in February

The Economic Sentiment Indicator, an aggregate of confidence indicators computed each month by the European Commission, suggested last week that sentiment in France is at its highest since the summer of 2018, before the 'yellow vest' crisis erupted. Increasing from 103.9 to 105.8, sentiment in France is well above its long-term average (100.0) and the eurozone average (103.5). Positive signs have been everywhere in recent weeks. The manufacturing sector has registered more orders while inventories were slashed in the fourth quarter, which bodes well for growth in the first half of the year. Sentiment in the services sector increased in both January and February, showing a jump in hiring intentions, which have not been this high since June 2018. Unemployment should therefore continue to decline in the coming months. Consumer confidence

also improved in February as a consequence of these better labour market prospects: households' opinions of future employment have not been this optimistic for 10 years.

Is it already yesterday's story?

The growth trend at the end of 2019 and signs of a stronger first half for the French economy have therefore been confirmed by the latest confidence figures and we still believe the first quarter of the year will show some recovery compared to the -0.1% quarter-on-quarter GDP growth in the fourth quarter.

February's figures look upbeat so far. But as [a recent ING note underlined](#), "before getting too excited about the positive figures, we must remember the (ESI) survey is conducted within the first two to three weeks of the month. The number of Covid-19 cases outside of China only started to increase significantly after 21 February. In other words, the survey was done at a time when Europe considered Covid-19 largely a Chinese problem with some minor negative effects on the rest of the world. But since then the situation has changed considerably".

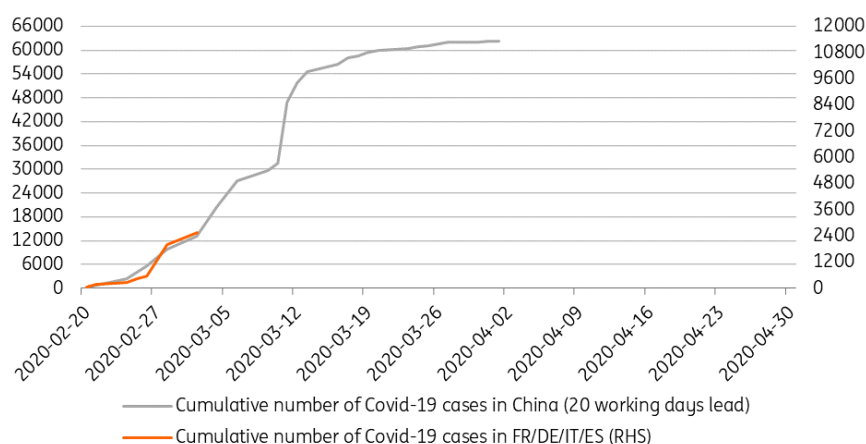
Recent news from France's neighbours is not that positive

The eurozone economy was not growing strongly at the beginning of the year. The good news is that the manufacturing sector is bottoming out and with the inventory correction coming to an end, the sector is set for a recovery. The bad news is that with the distortion of supply chains and trade flows caused by Covid-19, the upturn will now be delayed by a few months. On top of that, things now look a bit uglier in the services sector, which was up until now the stronghold of the eurozone economy, preventing a more severe slowdown in 2019. Leisure, tourism and transport, especially, are inevitably going to suffer from coronavirus fears.

Looking at the Chinese experience, peak Covid-19 should be behind us in the second quarter, but that still makes a rather weak first half of the year. We now expect 0.5% GDP growth for the eurozone this year.

If the China pattern is repeated, the epidemic could peak in the eurozone in four or five weeks

Note: the right-hand axis is six times smaller than the left-hand axis to take into account the fact that the Chinese population (1400 million inhabitants) is approximately six times larger than the population of the four main eurozone countries (257 million). The choice of scale is of course not neutral and must be seen as provisional, it will have to be adapted according to the development of the epidemic in Europe.



Source: Refinitiv Datastream, World Health Organization

What are the economic contagion channels?

The Covid-19 crisis has been referred to primarily as a supply shock. As workers cannot go to work (because schools are closed and their children are at home or they are quarantined) or essential parts are not delivered, factories cannot run as they otherwise would. Monetary policy can only help by alleviating the financial cost of this, either directly (the Bank of China encouraging banks to buy “corona bonds” issued by companies short of cash during the crisis and unable to repay their debt) or indirectly (by alleviating the cost for banks of increasing default rates by these companies). In the eurozone, that is one path the European Central Bank could take, by increasing the current tiering system of negative interest rates.

Lower interest rates are not very efficient in times of a supply shock. Of course, there will also be a demand shock at play in the eurozone. As long as the number of Covid-19 cases increases, restrictions on travelling and gathering will have a direct impact on some private consumption components such as travel, culture, restaurants and transport, etc. Moreover, some important purchases could also be postponed because of the uncertainty. While lower interest rates may be a good tool to push up consumption in normal times, these are not normal times. Therefore, we do not think the ECB will lower interest rates this time around, [preferring to steer markets through words rather than action](#), despite a globally coordinated central bank effort initiated yesterday by the Fed.

What does it imply for the French economy ?

Looking at these contagion channels in France, it seems that some difficult months could be in the offing if the epidemic turns into a pandemic. The first quarter should remain positive as January and February were unaffected and a rebound was expected after the small GDP contraction

registered in the fourth quarter. However, the supply shock should impact investments by French companies in the second quarter as some industrial activities will have their supply chains disrupted. In turn, this could create cash flow and debt service problems. The current trend of lower inventories and higher order books should have encouraged an investment rebound but this will probably be postponed.

The demand shock should affect private consumption growth in both the first and second quarters, especially in travel services and hospitality, with a stronger impact across other retail services in the second quarter. As a consequence, the rebound in private consumption growth that was expected for 2020 is unlikely to happen. Our current estimate of 2020 private consumption growth is only 1.1%. This adds to the already difficult international context coming from the slowdown of international trade, which might not grow at all in 2020. French net exports should therefore have a more negative contribution to growth than previously expected. We think that a 0.3 percentage point drag is likely in 2020.

As a result of all this, we have revised downwards our growth outlook from 1.0% to 0.7% for the French economy in 2020, under the hypothesis that the Covid-19 epidemic tops out in the second quarter.

We lower our growth outlook from 1.0% to 0.7% for 2020.

Should this be quicker or slower, we will have to revise this forecast. It also has to be underlined that there is a high level of uncertainty about the size of the supply shock so far (while the demand shock should account for around 0.1 percentage point of GDP). What is certain is that some of the recent positive domestic indicators will be gloomier in the coming months.