

## France: GDP falls less sharply than expected

French GDP, posting -1.3% QoQ, fell by less than expected in the fourth quarter, despite the lockdown. The big question now is whether France will manage to avoid a second recession in 15 months. Given the current health situation, another recession looks all but certain.



### A decrease, but not as much as expected

A big surprise for French GDP. According to INSEE, GDP fell by 1.3% QoQ in the fourth quarter of 2020, after the slightly revised increase of 18.5% in the third quarter. If the lockdown in November and the curfew implemented in October and December have weighed on economic activity, the decrease in GDP is much less than that expected by consensus (-4% QoQ), but also that estimated by the INSEE itself, the Bank of France and the government. The monthly activity indicators all seem to have overestimated the decline in activity caused by the restrictive measures in the fourth quarter. Compared to the fourth quarter of 2019, French GDP fell by 5%.

Over 2020 as a whole, the average fall in GDP therefore stands at 8.3%, compared with a previous estimate of 9%. This decline is dramatic, and France is probably below the average for the eurozone, but the loss of activity over the year was ultimately less than expected. This allows us to start 2021 with a less significant negative base effect, which will lead, paradoxically, to an upward

revision to the outlook for 2021, despite the deterioration in the health context.

In the fourth quarter, the decline in activity was, in the proportions expected, mainly caused by a drop in household consumption (-5.4% QoQ in Q4 compared with +18.2% in Q3). Household consumption is now much further away from its pre-crisis level (-6.8% compared with Q4 2019) than at the end of the third quarter (-1.1%).

The pleasant surprise comes from business investment, which held up very well, increasing by 2.4% over the quarter compared with 24% in the third quarter. Over one year, the fall in gross capital formation is only 3.2%, thus less than the fall in GDP. This data alone shows how different the current crisis is from all previous crises. Usually during a crisis, investment is the first variable of adjustment for companies and tends to fall much more than GDP. The crisis of 2020 did not lead to this phenomenon, probably because companies started the year in relatively good financial health and the credit channel did not dry up, unlike in 2008-2009.

Exports also contributed favorably to economic activity in Q4, increasing by 4.8% in one quarter, following a 21.9% increase in Q3. Over one year, exports remain down 11%, as the shock of the first half of 2020 has not yet been absorbed. This continued recovery in foreign trade can probably be partly attributed to Brexit and to the fact that many companies anticipated the end of the transition period by increasing their exports and imports in Q4. The positive contribution of inventories to GDP (+0.4) is probably also at least partly illustrative of this. Conversely, Brexit is likely to have a negative effect in Q1.

## Deteriorating short-term prospects

Looking beyond the figures for the fourth quarter, it is clear that the outlook for the beginning of 2021 is uncertain. The big question now is whether France will be able to avoid a further decline in its GDP in the first quarter of 2021, which would imply a second recession in 15 months. And, once again, the usual economic indicators are not much help in answering this important question. Everything will depend on the decisions taken by the government on the restrictive measures to be put in place to fight the pandemic. Announcements are expected this weekend.

What is clear at this stage is that the pandemic is far from being under control and that the current measures (mainly the 6 p.m. curfew) no longer seem to be sufficient to combat the spread of the disease. New restrictive measures are therefore expected. The form that these new measures will take will directly influence the short-term economic outlook for France :

- If the measures remain limited and targeted, a stagnation or a slight increase in GDP in the first quarter compared to the fourth quarter is possible.
- A new lockdown in February with shops closing as in November could lead economic activity in France to fall to 12% below its pre-crisis level, after an estimated 7% below pre-crisis levels in January. In view of the very slow progress of the vaccination campaign, a significant relaxation of restrictions cannot be expected for the month of March. At best, we expect a similar situation in March to that which prevailed in January. This implies that GDP growth could again be negative in the first quarter, which could be as low as -1.5% quarter-on-quarter.
- With the new Covid variants, school closures remain a possibility, although the French government continues to emphasize that this decision will only be taken as a last resort. From an economic point of view, such a closure would be very costly, probably causing a drop in activity of around 5% on its own (compared to the pre-crisis level), notably due to

the loss of productivity. Consequently, a closure of schools for one month, in addition to the closure of shops, would lead to a decrease in economic activity in France of almost 17% compared to the pre-crisis level in February. In such a scenario, GDP could collapse more than in the fourth quarter, probably by as much as -3% over the quarter. This would put France in a much more unfavorable position than the other eurozone countries that did not experience a shock of the same magnitude in the autumn.

## The best is yet to come

Beyond these bleak short-term prospects, the medium-term outlook is more optimistic. The vaccination campaign and the return of good weather should allow a gradual relaxation of health restrictions in the second quarter. We believe that this relaxation should lead to a strong rebound in consumption, as observed in the third quarter of 2020. The savings surplus of French households is estimated by the Banque de France at 130 billion euros in 2020 compared to a scenario without a pandemic. And this surplus continues to grow given the current restrictions that prevent a part of consumption. Once the restrictions are lifted, part of these savings should be able to help consumption rebound, although, of course, precautionary savings should remain important. An upturn in tourism in Europe should also boost activity this summer. It should also be noted that the industrial and construction sectors are only slightly affected by the restrictive measures put in place since November, allowing them to perform much better than the service sector. And these sectors could benefit from a synchronized recovery in the global economy as early as the spring. If we further underline the important support of fiscal and fiscal policy expected for 2021 as a whole, as well as that of monetary policy, the conditions are in place for a significant improvement in prospects once the pandemic is under control. Nevertheless, the solid rebound will not erase the catastrophic start to the year. And the longer it takes to bring the pandemic under control, the greater the economic consequences.

All in all, thanks to better than expected figures in 2020, the government's objective of reaching 6% growth in 2021 is still attainable, even if very difficult. We believe that a forecast of 4% to 5% for 2021 is more realistic. In this context, it is apparent that part of the economic recovery will take place in 2022. We will have to wait until 2023 to return to the level of activity that prevailed before the pandemic.

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