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FRANCE: IMPROVED CONFIDENCE WILL BOOST CONSUMER SPENDING BY EUR10BN IN 2021

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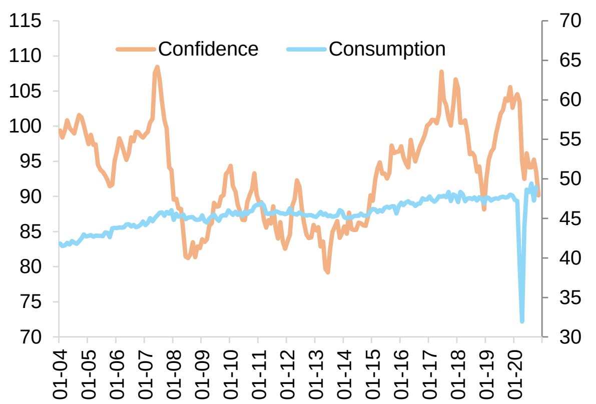
Household confidence will play a key role in France's economic recovery from the Covid-19 crisis[1]. But unlike consumption, confidence never recovered to its pre-crisis level even when the first lockdown was lifted. After a short-lived rebound in June, and with the implementation of a second lockdown in November, confidence has deteriorated severely to near the historically low level seen in December 2018 during the peak of the 'Yellow Vest' movement. The "confidence effect" usually explains around one third of the consumption gains in France but this relation seems to now be 'temporarily' broken (see Figure 1). During the first lockdown, the timely announcement of generous fiscal support measures reassured households, helping to prevent a major confidence shock despite the historical drop in consumption. However, while the gradual easing of sanitary restrictions from May led to a consumption euphoria during the summer, it was fueled by "other" factors than confidence, such as pent-up demand and the unleashing of forced savings accumulated during the lockdown (close to EUR100bn in Q2). In our view, household confidence in France has been held back by continued uncertainty over the sanitary and economic outlook, as well as growing fears of unemployment (after a potential phasing out of the government support). Indeed, after a short-lived recovery in August[2], the unemployment outlook sub-component of the headline confidence indicator has deteriorated continuously.

Figure 1 – Consumer confidence (lhs) and consumption (rhs) - EURbn



COVID-19 data m/m change

Date	Consumption (%)	Change/std dev.	Consumer confidence (100 basis points)	Change/std dev.
03-20	-16.7%	-17	-0.9	-1
04-20	-18.7%	-20	-8.5	-4
05-20	37.5%	30	-2.5	-1
06-20	10.7%	9	3.7	2
07-20	-0.6%	-1	-2.0	-1
08-20	2.2%	2	0.0	0
09-20	-4.4%	-5	1.1	1
10-20	3.7%	3	-1.7	-1
11-20	n.a.		-3.3	-2

Sources: INSEE, Eurostat, Allianz Research

1 See appendix for methodology of our empirical analysis.

2 The unemployment outlook (next 12 months) index declined from 76 to 71 between July and August. However, as of August the level of the index rose gradually to reach 78 in November.

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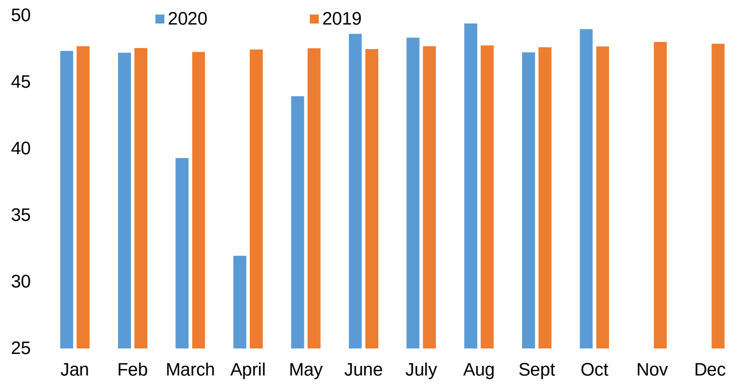
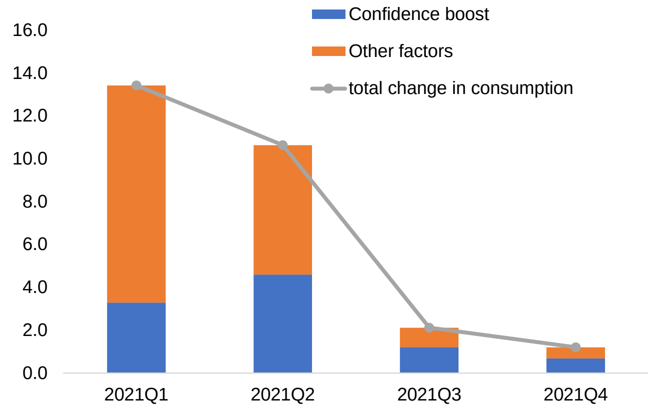
Figure 2 – Monthly household consumption, EURbn



Sources: INSEE, Allianz Research

In our baseline scenario[3], we expect the continued stringent sanitary measures[4] to prevent a strong confidence rebound in Q1 2021, even though the vaccination of the population at risk is likely to kick off successfully during this period. The confidence recovery could only gain traction as of Easter 2021, under the hypothesis of a larger scale vaccination campaign being implemented and continued fiscal support from the government. Overall, in 2021, we expect a strong consumption rebound of +7.2% in view of sizeable base effects (after a -8.1% consumption drop in 2020). **Applying model elasticities to our macroeconomic scenario, we find that returning to the pre-crisis confidence level (i.e. that seen in February 2020) by end 2021 could generate close to EUR10bn in additional consumption in 2021 itself, and explain above one third of total consumption gains in 2021 (EUR27.4bn,** see Figure 3). However, with deteriorating labor market conditions amid rising insolvencies, we expect consumption expenditure to recover to its pre-crisis levels only in 2022.

Figure 3 –Decomposition of quarter-on-quarter change of consumption in 2021 (EURbn)



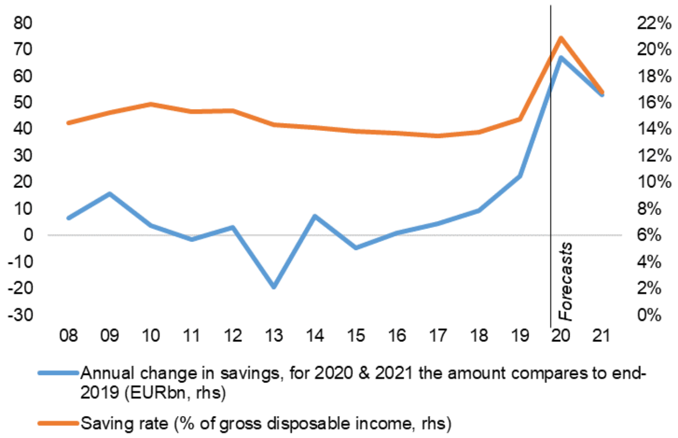
Sources: Euler Hermes, Allianz Research

[3] For more detail see our latest macroeconomic scenario : [Delayed but not derailed: The Eurozone recovery after 'lockdown light']

[4] In France, the second wave of the pandemic resulted in a return to a slightly lighter version of national lockdown as of November. In view of the saturated hospital capacity, the national lockdown has been extended for two more weeks in December and would be afterwards replaced by a curfew until mid-January. In 2021, stringent sanitary measures will remain in place in January and February, before being progressively relaxed as of March. Thus, we project a moderate rebound of activity (+3.4% q/q) in Q1 2021, driven by base effects. On the other hand, with the progressive re-opening of the economy and the recovery of domestic demand, we project the GDP to grow by (+3.6% q/q) in Q2 2021.

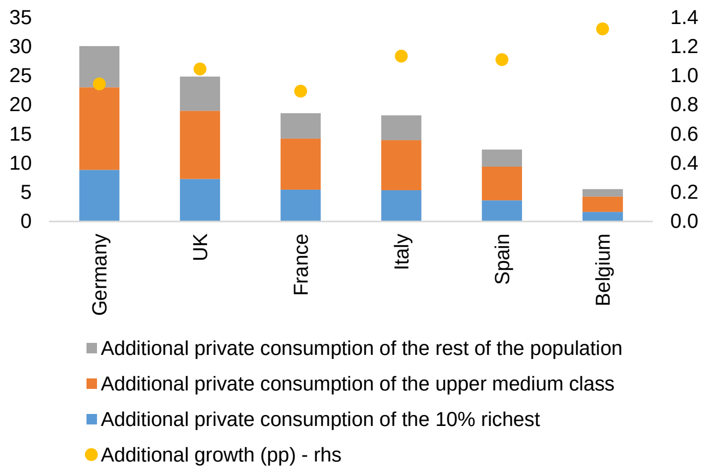
The confidence recovery as well as the reopening of the Covid-19 sectors throughout 2021 is also likely to unleash close to EUR20bn of excess savings. We expect the second (lighter) lockdown to push the household saving rate up to 21% at end-2020 from 16.5% in Q3. Under the hypothesis of a +2% y/y increase in gross disposable income[5] and a rebound of private consumption of 7.2% y/y, we calculate that the household saving rate will fall to 16.8% in 2021. This should translate into close to EUR20bn of unleashed private savings (see Figure 4) and in our view, most if it will be private consumption due to pent-up demand. Based on the split of savings[6] and propensity to spend these savings by revenue category (higher when revenues are lower), we estimate that improved confidence and pent-up demand would unleash a total of EUR19.5bn of household excess savings, with EUR5bn of excess savings from the 10% richest households and EUR9bn from the upper medium class (see Figure 5). Overall this unleashing of savings should bring around +1.0pp of additional GDP growth in 2021.

Figure 4 – Expected pattern of French households' savings



Sources: Insee, French Treasury, Eurostat, Allianz Research

Figure 5 – Potential for additional private consumption from excess savings in 2021, EURbn and pp of GDP growth



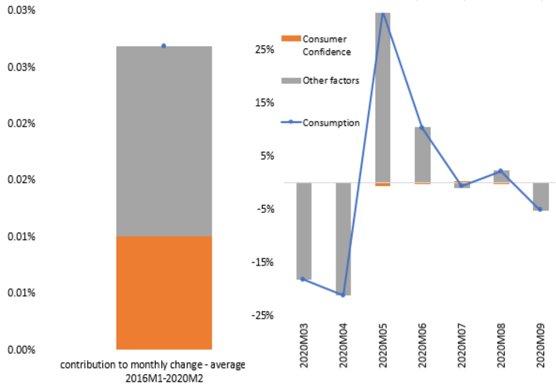
Sources: Eurostat, Allianz Research

[5] Given the lack of visibility on the extension of partial unemployment scheme and other labor market stabilization tools in 2021, we take the French Treasury forecast for gross disposable income growth in 2021

[6] Based on the distribution of financial assets in Europe from ECB's Household Finance and Consumption Survey

APPENDIX

Variation of consumption by factor before and after Covid-19 crisis



Sources: Euler Hermes, Allianz Research

Consumer confidence index: The consumer confidence synthetic index shows, through a single variable, the common component of the following selected balances of opinion: past and future general economic situation in France, past and future personal financial situation, future prospect of unemployment, opportunity to make major purchases and current and expected saving capacity. The indicator is calculated using the factor analysis technique that yields a summary of the concomitant change of several variables whose movements are highly correlated. The final index is standardized to have an average of 100 and a standard deviation of 10, excluding backdated period and current year. The weighting coefficients of the common factor are re-estimated each year in January.

Methodology: We use an econometric model to investigate the main drivers of consumption. The model is of an Error Correction type, whereby the long-term relationship assumes consumption expenditures to evolve in line with the business cycle. In the short term, changes in consumption are driven by both real economic developments and the change in confidence of the previous month. As expected, confidence appears to have leading properties to predict consumption. We estimated the model over the pre-Covid-19 period, from January 2000 to February 2020. All associated coefficients are statistically significant and have the expected sign. The contributions of confidence to changes in consumption over the forecasting horizon are computed as a conditional forecast based on our baseline macroeconomic scenario below. This forecast has been scaled up for accounting for the change in volatility of the residuals in the post Covid-19 period, following the method proposed by Lenza and Primiceri (2020), https://www.nber.org/papers/w27771.

Consumption and confidence baseline scenario in 2020

2021	Consumption expenditure (bn EUR)	Consumption growth (q/q)	Synthetic consumer confidence indicator
Q1	287.5	4.9%	93
Q2	298.1	3.7%	97
Q3	300.2	0.7%	101
Q4	301.4	0.4%	104

Sources: Euler Hermes, Allianz Research

These assessments are, as always, subject to the disclaimer provided below.

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