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Amundi ASSET MANAGEMENT

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France outlook

INVESTMENT TALKS

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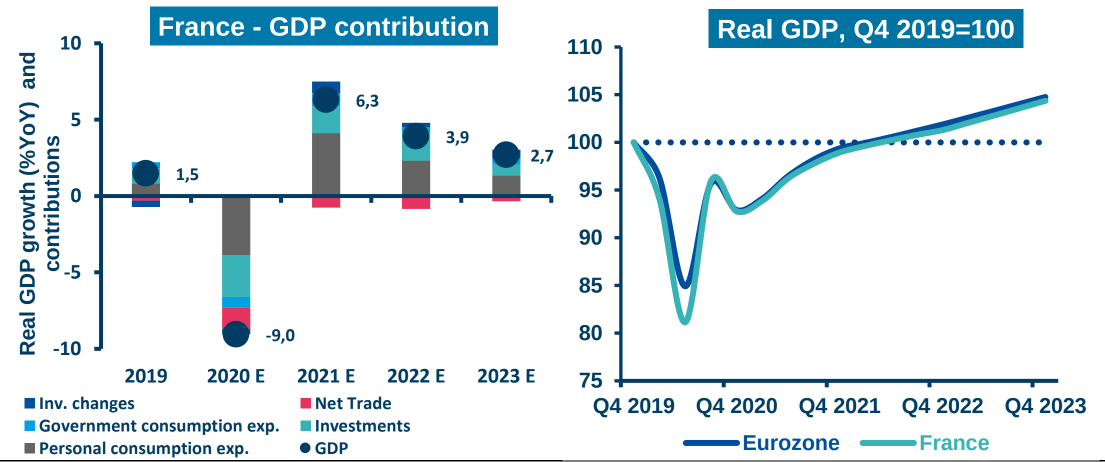
- **In Q3 France posted a major surprise**, with its 18.2% QoQ rise in GDP beating both consensus and our expectations, and leaving the French economy only about 4.0% below pre-Covid levels. But with the second wave and the new lockdown taking a toll on activity and sentiment, we now expect a new contraction of 3.3% QoQ in Q4. This will be followed by a slow and uneven recovery, which will reach full traction only from Q2 2021, when we assume restrictions will be fully lifted. In the meantime, a 'stop and go' process may take place, making the recovery path bumpier and more uncertain.
- **As the virus is successfully contained and a vaccine becomes widely available from mid-year 2021**, which is our working assumption, France's economic performance will improve and continue above potential, helped by the coordinated recovery of the rest of the Eurozone and the policy backing and domestic investment 'relaunch' plan. Therefore we expect the French economy to contract by about 9.0% YoY on average in 2020 and to grow by about 6% YoY in 2021. The recovery path we expect will bring GDP to pre-Covid levels by mid-2022. The risks remain tilted to the downside, given the lockdown measures implemented could become more stringent, either domestically and/or at the European level. We therefore expect to reassess our outlook in a few weeks, as the evolution of the virus shapes governments' decisions.

France: an uneven recovery



Source: Amundi Global Research, Bloomberg. Data as of 2 November 2020.

"We expect the French economy to contract by about 9% YoY on average in 2020 and to grow by approximately 6% YoY in 2021."

Analysis

A record Q3 rebound: Q3 GDP came in at a record 18.2% QoQ, driven by strong policy support, the release of pent-up demand and a pickup in external demand as major economic partners reopened post lockdown and rebounded strongly. Domestic household spending was particularly strong, as is also reflected by the strong recovery in retail sales, driving the recovery and ending Q3 only 2.2% below 4Q19 levels. Indeed, the French economy benefited from a 'coordinated' recovery at the European level, as even the most impacted economies rebounded strongly: across the Eurozone, Q3 activity was down just 5.0% on pre-Covid levels.

A new lockdown arrives: France, in line with other European countries, was driven by the second wave of the virus to implement a new lockdown, shutting down several non-essential activities. Under our current scenario**, we expect the economic impact to be less dire than the spring lockdown,**

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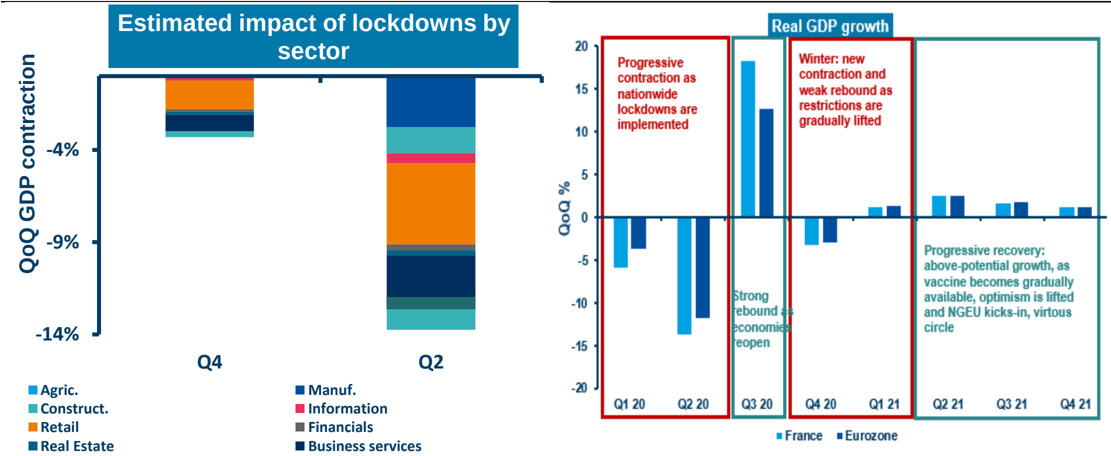
although it is difficult to estimate the final effect and it is likely the outlook will need to be reassessed in a couple of weeks. In addition to the reduction in French domestic demand, an increasing number of countries across Europe are implementing some form of lockdown and the resulting impact on external demand could further detract from growth, building downside risks to our base case.

Currently, we expect the French economy to contract by about 3.3% in Q4 – about a quarter of the contraction seen during the spring lockdown -- after combining multiple sources of information and an analysis at sector level:

- **October:** our high frequency indicators show that the French recovery curve was already flattening by mid-September and this deceleration trend continued into October, resulting in an average monthly output of about 4-5% below the average pre-Covid monthly output.
- **November:** we assume that the lockdown is imposed at full stringency – for this month, we begin with the assumption that each sector will be impacted similarly to the spring lockdown and we will rebase this impact on a monthly basis. By doing this exercise, we also take into consideration some mitigating factors: a) the economy was already operating below potential in October, thus the relative loss could be less than in Q2; b) factories, construction sites and public sector activities should remain open, thus, barring further restrictions, their activities could be much less impacted and their growth supported; c) consumers and businesses may adapt more quickly to the 'lockdown' state, thus limiting the downside (i.e., online shopping for consumers, while some businesses may also have adapted to new forms of service, e.g., restaurants working more on takeaway or home delivery); and d) on the policy front, a fourth supplementary budget is likely to be presented shortly, with additional measures to support workers and companies impacted by the new lockdown, which could help limit the economic damage.
- **December:** following the most stringent lockdown, we assume four weeks of reduced restrictions over December, with monthly economic performance returning to a level in line with October. However, on this we also see risks to the downside, as the possibility of a 'stop and go' process of closing and reopening is material and may even continue throughout the entire winter season.

France: estimated sector impact and quarterly GDP pattern



Source: Amundi Global Research, Bloomberg. Data as of 2 November 2020.

"2021 will start on a low gear, then growth will pick up."

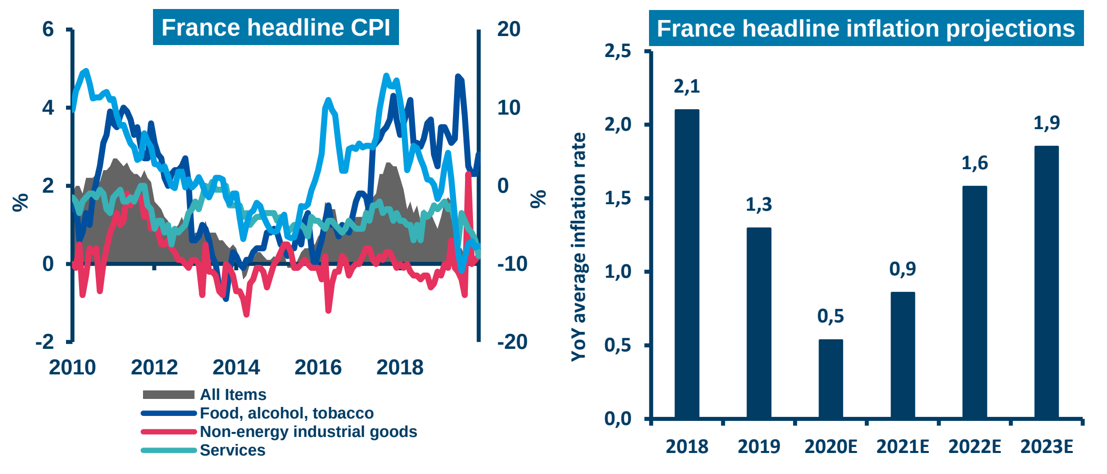
2021 will start on a low gear, then growth will pick up: we assume that restrictions will be gradually lifted over Q1, delaying a strong rebound until the spring. It is only from Q2 2021, when restrictions are fully lifted, that we expect a stronger rebound is more likely to materialise. As the virus is contained and a vaccine becomes widely available from mid-year, sentiment will lift and economic performance will improve and continue to be above the potential growth rate. France's recovery will be helped by the coordinated recovery of the rest of the Eurozone and will be backed by monetary policy support and the investment-supportive 'relaunch' plan. The recovery will bring GDP to pre-Covid levels by mid-2022.

Inflation

France's October inflation came in at 0% YoY after declining for a third consecutive month. While part of the weakness is currently being driven by temporary factors such as the negative base effect from energy prices, which are expected to fade by mid-2021, we are concerned about signs of weaker domestic demand, in particular on the inflation services component, which have been following a progressively weakening trend for a few months. Overall, **we project headline inflation of 0.5% YoY in 2020 and 0.9%YoY in 2021,** followed by a gradual uptrend in the following years. However, weaker-than expected domestic demand due to the impact of new lockdowns, a stronger euro or lower-than-expected energy prices pose downside risks to our projections.

"We expect the ECB to use PEPP flexibility before the next meeting in December, when we expect an increase of €500bn in PEPP."

France inflation dynamics and projections



Source: Amundi Global Research, Bloomberg. Data as of 2 November 2020.

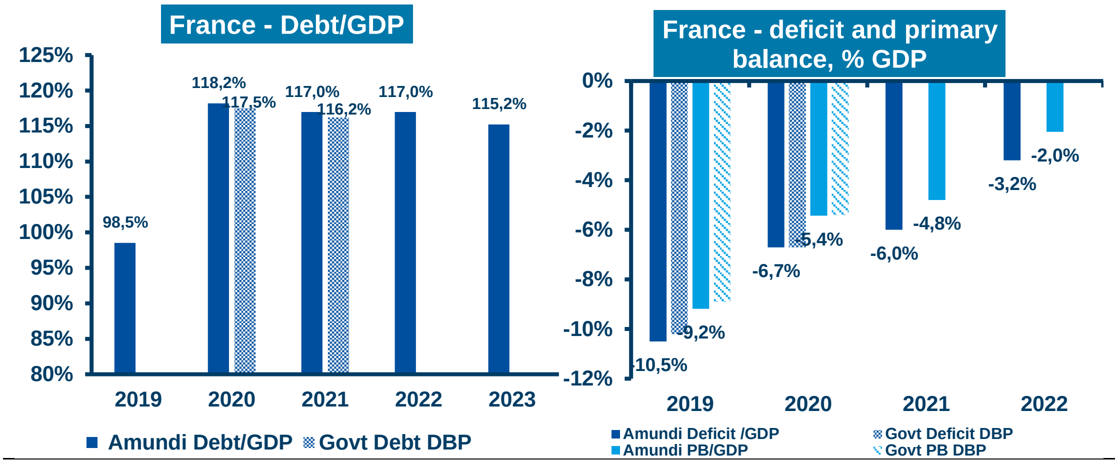
Policy

The weak inflation and low inflation expectations context, combined with renewed fragility on the recovery process following the expected contraction in Q4, will lead the ECB to recalibrate its policy tools in December. **We expect the ECB to use PEPP flexibility before the next meeting in December, when we expect an increase of €500bn in PEPP** (or in a combination of APP/PEPP), with an extension of the actual TLTRO conditions until the end of 2021. In addition, we see a possible further cheapening of TLTRO. On the fiscal side, we see upside risks to the 2021 fiscal policy response, at least at the national level, as a fourth supplementary budget is likely to be presented shortly, with additional measures to support workers and companies impacted by the new lockdown to help limit the economic damage.

Public finances

Under the current scenario, our public finance projections, based on the expected growth and inflation patterns, are subject to upside risks, both in terms of the deficit and debt-to-GDP projections for 2020 and 2021. However, these are subject to a possible reassessment depending on the revenue and expenditure path of Q4 2020 and the revised budget law. Currently, we expect the debt-to-GDP ratio to jump to 118% in 2020, before declining gradually over the forecast horizon as the deficit and primary balance deficit will be only slowly reduced over time to avoid untimely fiscal tightening.

France public finance projections



Source: Amundi Global Research, Bloomberg. Data as of 2 November 2020.

NB: On 4 November, the French government added an extra €20b of public spending to support the economy during the new Q4 expected contraction, amending the draft budget and revising up once more its 2020 budget balance and public debt projections, to -11.3% of GDP and 119.8% of GDP, respectively.

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Definitions

- **Asset purchase programme:** A type of monetary policy wherein central banks purchase securities from the market to increase the money supply and encourage lending and investment.
- **DBP:** Draft budgetary plan.
- **PEPP:** Pandemic emergency purchase programme.
- **PSPP**: Public sector corporate programme.
- **Quantitative easing (QE):** QE is a monetary policy instrument used by central banks to stimulate the economy by buying financial assets from commercial banks and other financial institutions.

Important Information

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