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Q2 GDP RELEASES:
THE SIZE OF THE COVID-19 CRATER

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The Covid-19-related trough has been reached. GDP figures for the second quarter confirmed the expected historic slump in economic activity in the Eurozone and the U.S. According to the Eurostat flash estimate, real GDP declined by -12.1% q/q in Q2 2020. All major Eurozone economies registered a hitherto unseen quarterly decline in real GDP: Germany -10.1% (after -2.0%), France -13.8% (after -5.9%) and Spain -18.5% (after -5.2%). The U.S. economy shrank at a quarterly rate of -9.5% (after -1.2%.), i.e. an annualized rate of -32.9%. The biggest surprise was Italy, where the GDP contraction was far less than expected at -12.4% (after -5.3%), even outperforming France.

The GDP figures confirm the different recovery speeds across advanced economies: Germany and the U.S. are in the pole position, France and Italy are the chasing group and Spain is the laggard. The main reason for both leaders is a massive fiscal response. In Germany, 35% of GDP was immediately mobilized in the form of public guarantees and public spending. In the U.S., the immediate fiscal stimulus package amounted to 10% of GDP.

After a historic slump, a historic rebound. For the next quarter, we expect economic activity in the Eurozone to increase by +12.8% q/q. However, it will be a largely mechanical rebound, stronger in those countries where economic activity previously slumped more sharply (Figure 1). Accordingly, we expect real GDP to grow by +9% in Q3 in Germany, +15% in Italy, +16% in France and +17% in Spain. In the U.S., on the other hand, the difficult sanitary situation will impact the strength of the recovery so we only expect a +3.2% q/q rebound in Q3.

The most important stage of the recovery is now ahead. The underlying rhythm will be moderate. No sustained impulse is to be expected from foreign trade because of the asynchronous opening of the global economy. Yet, the recovery of domestic demand is not happening at full speed either. Heightened economic uncertainty (insolvency risk) still weighs on investment, while some sectors are still affected by restrictions (major events). Consumers are likely to stay rather cautious, whether out of contagion fears or job insecurity. Indeed, unemployment remains elevated in the U.S. (11.1%) and the Eurozone (7.8%). Remember that 40 million European workers are still enrolled in short-term work schemes. In this context, the consumption of services with direct personal contact and big-ticket items are likely to suffer the most.

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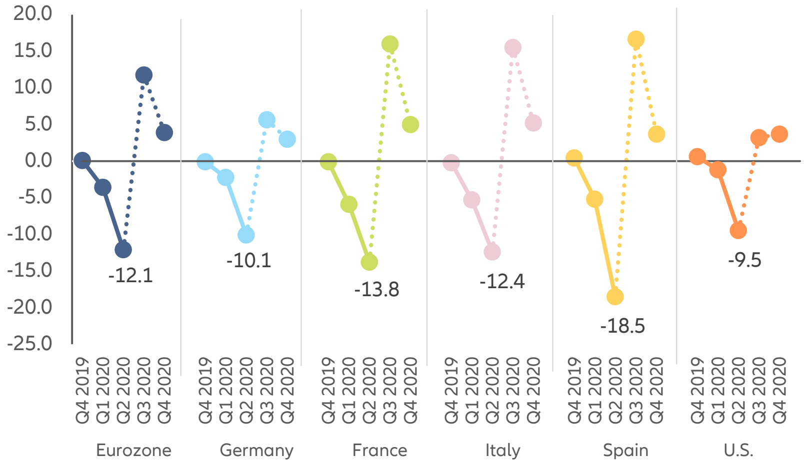
Figure 1 – Expected recovery profiles (q/q GDP growth in %)



Sources: National Statistical Offices, Allianz Research

GDP figures remain in line with our baseline scenario of a decline in real economic output of -9.0% in the Eurozone and -5.3% in the U.S. in 2020. We also stick to our national forecasts for Germany (-7,0%) and France (-10.8%). Following the surprisingly good results for Italy we now see upside potential to our forecast of -11.2% while our forecast for Spain (-11%) has some downside risks. Next year, we expect the Eurozone's GDP to grow at a rate of +6.0% and the U.S.'s at +3.7%. Pre-crisis levels are therefore unlikely to be reached before the end of 2022.

What to watch out for in the second half of the year?

- Renewed local lockdowns and selective and/or uncoordinated border closures are the most obvious risks.
- In this context, the consumer remains the weak spot. In Germany, consumer confidence continued to rebound in July, with buying propensity increasing despite weakening income expectations. This suggests a reduction of the saving rate. But it is too early to derive a trend from this as it could also be a short-term effect following the VAT reduction. In Italy, consumer confidence has already stalled in July. High household savings will remain a drag on private consumption in France as well. In the U.S., high-frequency data suggest that consumption by higher-income households in particular responds stronger to (perceived) contagion fears than official containment measures.
- We also see a risk that some governments will focus too much on the supply side in new fiscal packages, expecting that income-protection schemes in place will be sufficient to maintain consumption momentum. In Europe it currently looks like demand stimulus will overly rely on Germany.
- Moreover, one should not forget about the political uncertainty in the context of the U.S. elections but also in Southern Europe. In Italy, the notoriously fragile coalition has benefitted from the positive European policy momentum, but the potential for social tensions remains high (regional and intergenerational tensions). In Spain, political fragmentation and a weak coalition are creating downside risks in light of an already tense business sentiment and a hazardous reopening strategy.

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