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FRANCE VS GERMANY: NO #EURO2020 FINAL BUT A TIE AGAINST COVID-19

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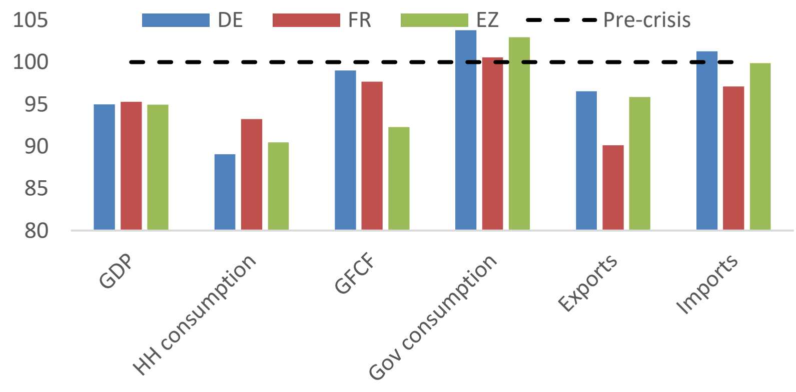
During the UEFA EURO 2020 opening game, France arguably dominated its archrival Germany. While both teams have since exited the tournament, we find a welcome tie between the EU's two largest economies when it comes to weathering the Covid-19 crisis, judging by GDP developments, labor market performance, debt toll and policy support. While this is only a halftime assessment as the Covid-19 crisis still far from resolved, and economic activity remains subdued, it suggests that the Eurozone policymaking won't have to face a penalty for economic divergence.

Headline GDP performance: France 0 – 0 Germany. Judging by the latest headline GDP figures, the French and German economies show no meaningful divergence, with both registering roughly 5% below pre-crisis GDP levels in Q1 2021. However, Q1 acted as the great equalizer in this regard, with the French economy proving relatively resilient (-0.1% q/q) at the start of 2021, whereas German GDP contracted by close to -2% q/q. However, looking beneath the surface, we find some quite notable divergence

Figure 1 – Real GDP & components, Index: 100 = Q4 2019



Sources: Refinitv, Euler Hermes, Allianz Research

Investment and Exports: France 0–1 Germany. Given its more favorable position to profit from the industrial upswing, thanks to its product palette and geographical focus (US and China absorb 17% of German exports compared to 12% for France), Germany leads on investment and exports – both of which are within reach of pre-crisis levels. In contrast, in France, the Covid-19 gaps remain larger (10pp for exports). Particularly during the long Covid-19-induced economic hibernation of domestic demand, it was German industry – the country's Achilles heel in 2018-19 – that helped prop

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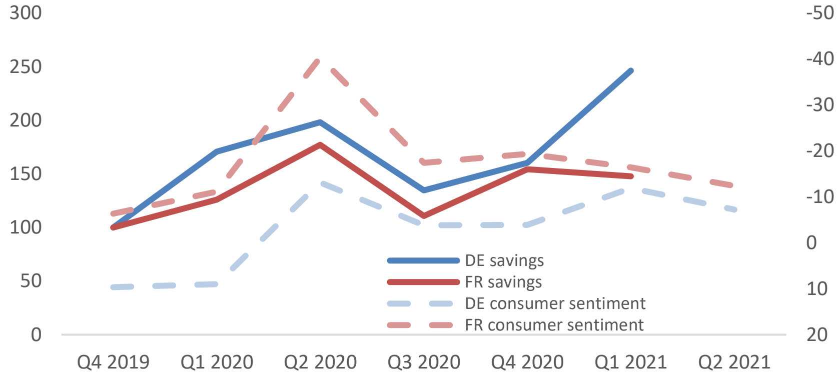
up economic activity.

Consumption: France 1-1 Germany. When it comes to private consumption, Germany is lagging behind developments in France. A key reason is the extension and tightening of Covid-19 restrictions in Germany in Q1. As a result, German consumers stumbled into the new year, resulting in a marked contraction of -5% q/q in private consumption in contrast to a mild expansion in France (+0.2% q/q). Germans also nursed a consumption hangover following the temporary VAT reduction between July and December 2020.

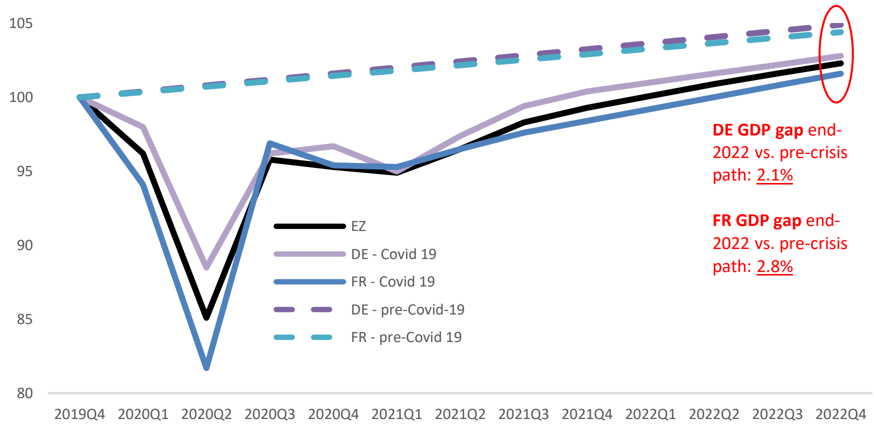
Figure 2: Household savings (Index: 100=Q4 2019) vs. consumer confidence (rhs, inverted axis)



Sources: Refinitv, Euler Hermes, Allianz Research

Economic recovery prospects: France 1-2 Germany. France will be lagging the German economic recovery by around six months, given a projected return to pre-crisis GDP levels only by mid-2022. Europe's largest economy is on track to already hit that milestone by the end of this year. The key driver of the German lead will be a stronger rebound in consumer spending as German consumers are better positioned to fuel the recovery momentum in the coming quarters. For one, there will be more pent-up demand that can be unleashed. After all, in Germany, the savings rate shot up to 21% – its sharpest move since the start of the pandemic – whereas it declined in France. Nevertheless, with consumer sentiment in France returning close to pre-crisis levels, a consumption boom driven by pent-up demand still remains firmly on the cards (in contrast German households remain somewhat more cautious). However, even by end-2022, a GDP gap will remain with regards to the economies' pre-Covid-19 growth path. The gap will be slightly larger in France (2.8%) compared to Germany (2.1%). Unlike the US, which will be catapulted above its pre-crisis GDP growth path, thanks to a turbo-charged fiscal stimulus, Europe's heavyweights will not close the Covid-19 GDP gap in the medium-term.

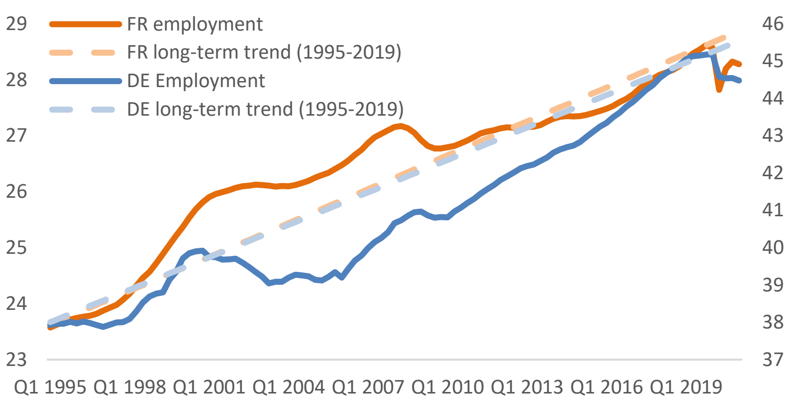
Figure 3 – Real GDP, Index: 100 = Q4 2019



Sources: Refinitv, Euler Hermes, Allianz Research

Labor market performance: France 2-2 Germany. Generous furlough schemes helped cushion the blow to labor markets in both countries. But for now France appears to have a leg up, with around 250,000 fewer unemployed workers compared to December 2019, whereas Germany has registered an increase of more than 500,000. Clearly headline figures remain to some extent distorted, particularly in France, as a result of discouraged workers becoming inactive and dropping out of the workforce altogether. However, even when looking at employment figures – which of course remain propped up by furlough schemes – the Covid-19 shock appears somewhat milder in France, with the total number of employed down -1.2% relative to December 2019 compared to -1.5% in Germany. Similarly, when looking at the long-term trend of employment growth, Germany is lagging slightly behind France, with employment -2.4% (1,100,000) below the pre-crisis trend as of Q1 2021 compared to -2.1% (590,000) in France.

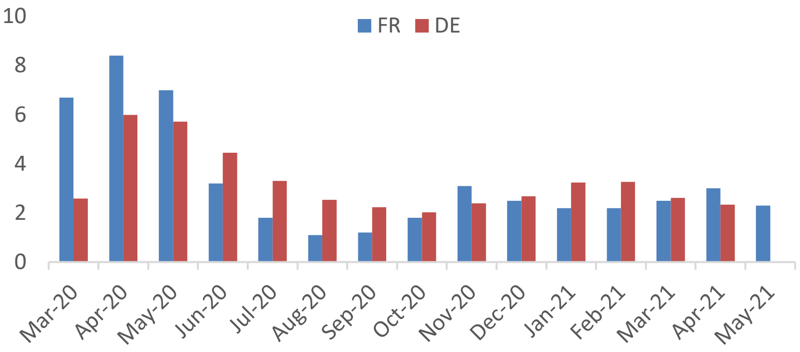
Figure 4 – Employment (million) in Germany (rhs) vs. France (lhs)



Sources: Refinitv, Euler Hermes, Allianz Research

Clearly the moment of truth still lies ahead as support is phased out in the coming months: around 2 million workers are still enrolled in furlough schemes in each country.

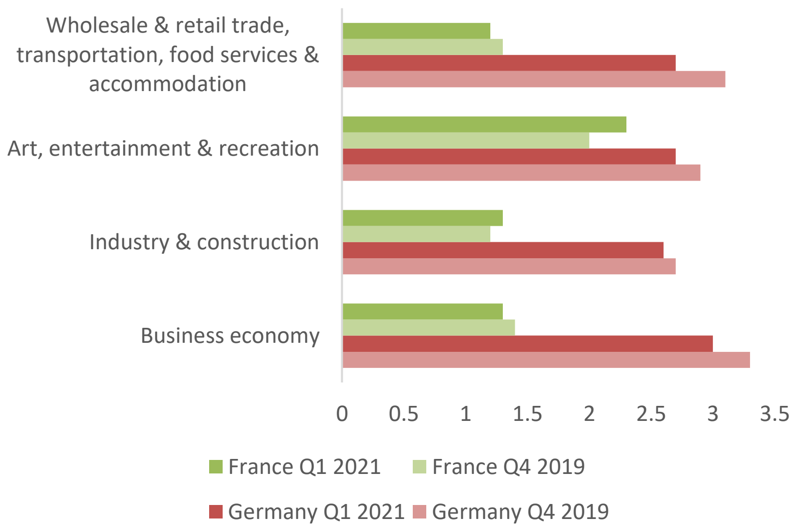
Figure 5: Furlough schemes (million workers enrolled)



Sources: Refinitiv, French Ministry of Labour, Employment and Economic Inclusion

Labor market outlook: France 2-3 Germany. Early signs of rising vacancy rates bode well for a swift labor market recovery in France, particularly in the hardest hit sectors, whereas Germany for now is lagging a bit behind as the exit from lockdown kicked-off slightly later. However, weaker initial conditions in France (in 2019 French unemployment stood at 8.4% compared to 3.1% in Germany) together with a swifter furlough phase-out put the French labor market at a disadvantage. According to the most recent policy announcements, France will be first to face the music, with tighter furlough rules already in place for "ordinary" firms since 01 June. Going forward, the share the government covers as well as the amount of compensation received by workers will be gradually reduced. To firms in "protected sectors" as well as those closed for administrative reasons somewhat more generous rules – higher compensation rates and a slightly delayed phase-out schedule – apply. The cliff-edge effect is to some degree mitigated as a result of France installing a more long-term furlough scheme with less generous conditions.

Figure 6: Vacancy rates in selected sectors (%)

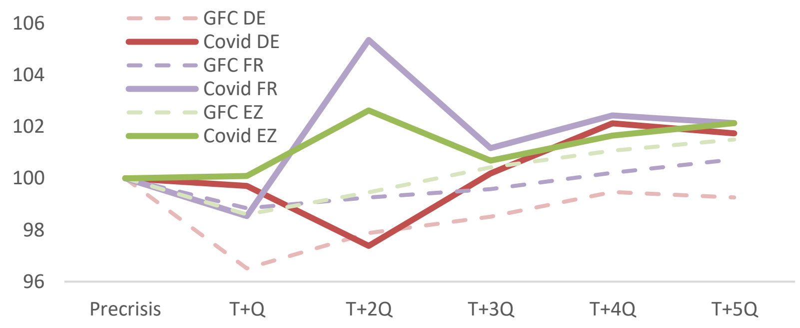


Sources: Refinitv, Euler Hermes, Allianz Research

Meanwhile in Germany the *Kurzarbeit* moment of truth has been pushed out until after the 26 September election. From 01 October onwards, the German government is planning to pay only 50% of employers' social security contributions (down from the current 100%) and as of 2022 the less generous "regular" *Kurzarbeit* rules will once again apply (including lower wage compensation, no social security contribution subsidy, maximum of 12-month duration etc.).

Labor productivity: France 3-3 Germany. A key debate centers on the medium-term impact of the Covid-19 shock on economies. A very preliminary analysis of labor productivity per hour provides some evidence that it may have been boosted by the Covid-19 shock, with France likely to be enjoying larger labor productivity gains compared to Germany. Productivity per hour worked rose above pre-crisis levels as soon as Q2 2020 in France and Q3 2020 in Germany. This is in sharp contrast to the productivity per hour worked trend observed during the Great Financial Crisis (Figure 7). While it is still early days, one interpretation could be that the pandemic forced digitalization upon Europe, with widespread remote working and an increased degree of automation in production being potential drivers of the productivity boost.

Figure 7 – Real productivity per hour worked, Index: 100 = Pre-crisis level

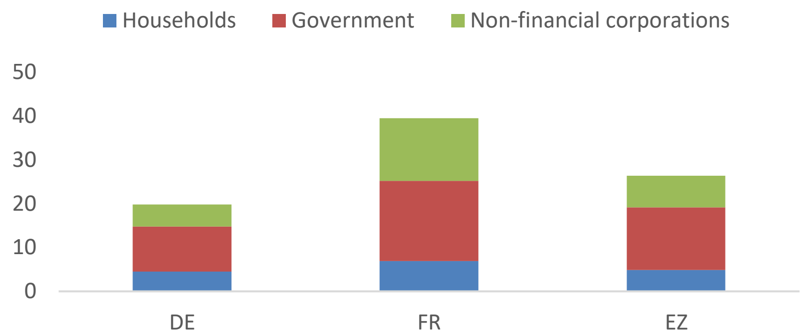


Sources: Refinitiv, Euler Hermes, Allianz Research.

Debt: France 3-4 Germany. The crisis has left more of a footprint on French debt burdens across all key sectors. At close to 40pp of GDP for all sectors combined, the increase in French indebtedness has been twice as large Germany's (20pp). In particular, as far as non-financial corporations are concerned, France stands out with the most notable debt increase (14pp vs. 5pp in Germany and 7pp for the Eurozone as a whole). Differences in starting conditions do explain the divergent trends to some extent, with German companies boasting much higher liquidity levels going into the crisis.

Starkly heterogeneous outcomes on the debt front will lead to divergent policy recipes in France and Germany. On the one hand, this includes ideas on how to tackle ballooning private sector debt: one example is France's recent announcement of a EUR3bn fund to help troubled companies via loans or equity investments. A bigger sticking point may prove to be finding a common approach to tackling public debt. Moreover, finding agreement on how to reform EU fiscal rules will likely prove more challenging in this context.

Figure 8: Change in sectoral indebtedness (% of GDP)



Sources: BIS, INSEE, Euler Hermes, Allianz Research

Fiscal outlook: France 4-4 Germany. While both countries went on a "whatever it takes" fiscal splurge to limit the impact of the Covid-19 shock on their respective economies (with discretionary fiscal spending to the tune of 4-5% in 2020-21), France focused on the supply side whereas Germany aimed at stimulating short-term demand[1]. What is the outlook for preserving these achievements? Faced with the third wave in early 2021, both countries opted to extend key flagship policy support measures. But as the economic rebound is unfolding, the focus will increasingly shift towards phasing out support, for which the timetable is more ambitious in France (see Appendix for an overview). This hints at more stressful times ahead for French firms relative to their German counterparts, particularly when factoring in a less dynamic recovery.

In contrast, we see the risk of a fiscal cliff-edge looming in Germany from 2023 onwards. After all, the outcome of the September election will most likely see a CDU/CSU win, parties that have campaigned on reinstalling the debt brake as soon as possible with a view on pushing government debt below 60%. Moreover, from 2023, the federal government will have to pay off the Covid-19 debt that it was allowed to take on during the pandemic beyond the requirements of the debt brake. This starts off manageably, with EUR2bn in the year after next. But from 2026 onwards, it's going to be a big deal: around EUR20bn in repayments will then be due over a number of years. Future governments will therefore have to generate real surpluses again in order to repay the Covid-19 loans. Should the economic recovery disappoint – and revenues lag expectations - then we see the risk of a hard landing of fiscal policy in Germany. In contrast, in France, any fiscal consolidation efforts should prove much more contained, not least with a national election on the horizon in Spring 2022.

Mind the second halftime: As the Covid-19 crisis is far from resolved on many issues, the verdict still remains out. Any diverging impact that Covid-19 may have on Germany and France could complicate policy setting and reform ambitions within the Eurozone. Once the policy support plug has been pulled, we will get more visibility on topics ranging from the health of the banking sector to insolvencies and unemployment, and in turn medium-term growth prospects.

[1] See our report *German 'Wumms' vs. French 'Relance' - who does it better?*

APPENDIX: Timeline for pulling the policy plug

	Germany	France
State guaranteed loans	The "rescue umbrella" (incl. the EUR600bn Economic Stabilization Fund (guarantees & recapitalizations for larger firms) and the KfW loan program) expires end-2021. Maturities on KfW loans range up to 10 years while typically a two-year redemption free grace period applies.	Loan program runs until end-2021 with loan maturities conditional on their usage stretch from 1-5 years. The quasi-equity loans to SME announced in fall 2020 will run until summer 2022.
Tax relief	Until July 1 2021 tax authorities will refrain from tax enforcement measures and late payment charges provided that the tax debtor is directly & significantly affected by Covid-19 crisis. As of October 2021 tax deferrals and relief measures expire, follow-up deferrals in connection with installment payment agreements are possible until December 31. Deferred interest is not charged. End-2021 ends the extension of the tax loss carryback for 2020 and 2021 to €5 million and €10 million respectively (in the case of joint tax assessment). End-2021 is also the deadline to adjust/suspend advance tax payments on income and corporate tax in 2021.	For 2021 the accelerated refund mechanism for corporate income tax credits continues to apply. The quarterly corporate income tax installment due on 15 March and 15 June 2021 exceptionally may be adjusted to a combined minimum of 50% of the estimated corporate income tax for 2020 (instead of 2019) with a 10% margin of error. For firms affected by the Covid-19 crisis the option exists to reschedule payments for up to three years.
Grants	*As of end-September the temporary aid program III plus* i.e. bridge *grants* for firms and self-employed, Neustarthilfe & restart premium (labor costs) as well as the reimbursement of legal costs (up to EUR20k/month for firms that opt for restructuring and not insolvency procedure) are scheduled to end.	As of June the compensation will decrease until August. The government will decide if the Fund will be totally stopped after August.
Furlough	The more generous Covid-19 furlough conditions will remain in place until end-September including a higher wage compensation, 100% of social security contributions paid by the government and extended maximum duration before being phased out until end-2021.	Furlough will be gradually phased out: from June 1 onwards for the standard firm, Sept 1 for protected sectors, and November 1 for firms that have closed for administrative decisions.

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

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