

US ECONOMIC UPDATE APRIL 2020

Q1 GDP FALLS AS US GOES INTO RECESSION



NAB Group Economics

The largest quarterly fall in GDP since 2008 occurred in Q1 GDP. As this mainly reflected the impact of COVID-19 containment measures that ramped up towards the end of March, there is almost certainly going to be a far larger decline in Q2. With many households and businesses severely impacted, the likelihood of ongoing caution and only a gradual easing in containment restrictions, it will be a long-time before the economy recovers to its pre-virus level. We are forecasting the US economy to contract by 7.4% in 2020 before growing by 6.8% in 2021.

Q1 GDP

US Q1 GDP fell by 1.2% q/q, its first decline in six years and its largest fall since the end of 2008. With the fall in GDP almost certainly concentrated in the second half of March due to a major ramping up of COVID-19 containment measures, there will almost certainly be a far larger decline in Q2.

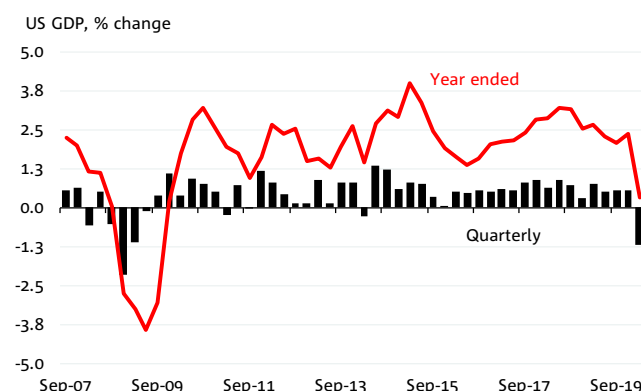
There were large falls in both household consumption (-1.9% q/q) and business fixed investment (-2.2%). The fall in consumption reflected large falls in durable goods purchases (particularly motor vehicles at almost -10% q/q), clothing & footwear (over -10% q/q), while food services & accommodation, transportation and recreation services all fell by 8% q/q or more.

Major purchases, such as cars, are often put off in the face of major uncertainty. Travels bans initially, and then social distancing and containment restrictions had immediate effects on many retailers and service sectors. Health care also recorded a large fall of -4.8% q/q as many states also imposed restrictions on 'non-emergency' treatments. In line with the experience in other countries, food & beverages (supermarkets) consumption was up 5.8% q/q reflecting households stocking up due to stay at home orders.

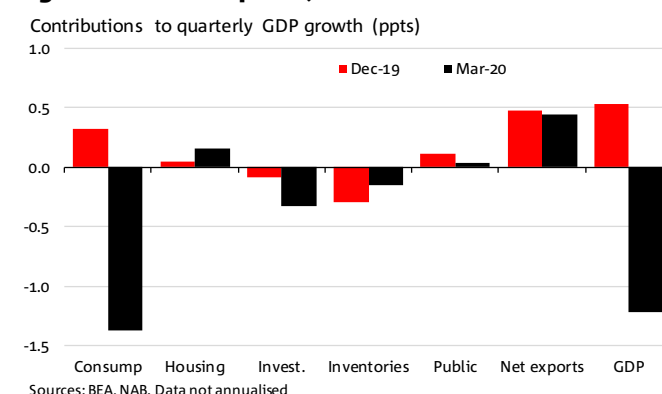
The decline in business fixed investment was pretty much across the board, although intellectual property investment eked out 0.1% q/q growth (its weakest result in almost three years).

While net exports again made a positive contribution to growth, the details provided no comfort. Both exports (-2.2% q/q) and imports (-4.1% q/q) fell, likely reflecting a combination of lower demand, supply

US GDP falls in Q1



Big fall in consumption; investment also well down



disruptions and in the case of services, travel bans and other restrictions. Reflecting this, the largest falls were in services trade with double digit falls in transportation and travel (including a 25% decline in spending by Americans abroad).

Inventories also declined again likely reflecting COVID-19 factors (including supply disruptions) but also the suspension by Boeing of 737 MAX production.

The one bright spot was residential investment which has been accelerating in recent quarters, supported by last year's Fed interest rate cuts. However, the impact of COVID-19 containment measures is likely to see this come to an end in Q2.

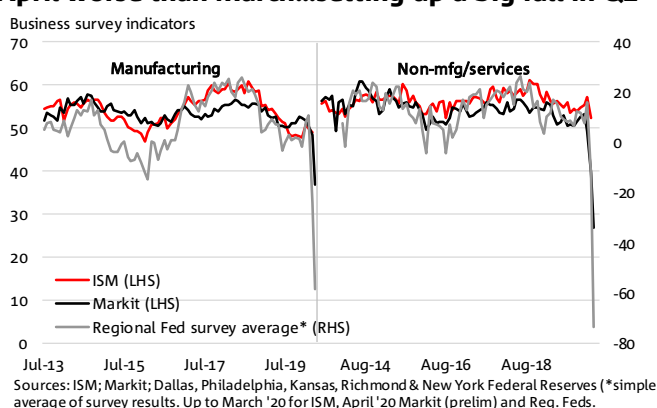
Outlook

The fall in activity in Q1 was no surprise given the ramping up in COVID-19 containment measures in the second half of March and the consequent shuttering of many businesses.

Q2 is likely to be worse. As the fall in activity mainly occurred towards the back end of March, the starting point for Q2 is well down on its Q1 average level.

Overall, containment measures became even more widespread across the US in early April. This is evident in business surveys which dropped notably in March and generally fell off the cliff in April.

April worse than March...setting up a big fall in Q2

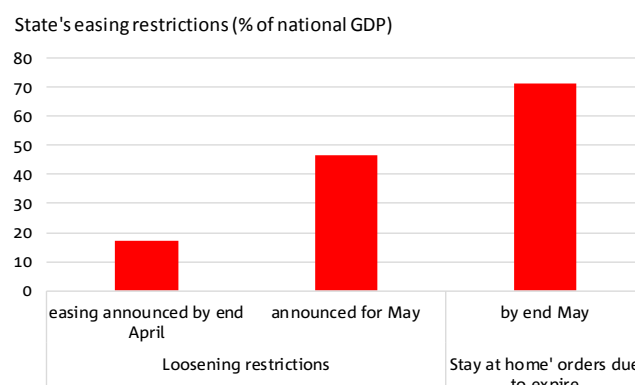


Towards the end of April some states started to, or announced a loosening in restrictions. It is by no means a near return to 'normal' even for these states – e.g. in Texas (the 2nd largest state in terms of share of GDP) the first phase in easing allows some businesses to operate at 25% of capacity. Many states have not yet made any material changes, including California and New York State, the 1st and 3rd largest states respectively. The overall proportion of states that have announced at least some non-trivial easing in containment restrictions (weighted by state share of GDP) is under 50%. Moreover, in almost a third of states 'stay at home' orders are set to last beyond May or have no end date (such as in California).

So, while April is likely to be the high-water mark in terms of containment restrictions, they are likely to be eased only gradually from here. Moreover, even as restrictions are eased, it doesn't automatically mean that people will flock back to the shops, as individuals are likely to remain cautious in the face of continuing health risk related to the virus and the need to

continue to practice social distancing. Similarly, some businesses that closed of their own volition due to health concerns or a lack of demand may stay closed for a while longer.

Easing of restrictions to be gradual across states and within



Source: compiled from various sources including CNN, www.finra.org, NAB

All this points to an exceptionally large fall in Q2 GDP. The Q1 outcome in the US – assuming the economy was growing in the first two months or so – suggests a fall in activity (from its pre-COVID level) of around 9% concentrated in the final few weeks of the quarter. A further, large, deterioration in activity has almost certainly occurred over April as well.

Estimates of the impact of widespread lockdowns in other countries generally appears to fall within the range of 25-35% (relative to their pre-COVID-19 level), although not all states in the US went into a severe lockdown. Assuming the trough in activity, from its pre-COVID level, is around 20% (possibly optimistic), a gradual easing in containment measures starting late April, and ongoing consumer/business caution, suggests a decline in Q2 GDP of around 15% q/q. Risks are still probably slanted towards an even weaker result.

In Q2 and beyond, there are a range of factors that are likely to hold back activity from quickly returning to its pre-COVID level, even assuming restrictions continue to be eased.

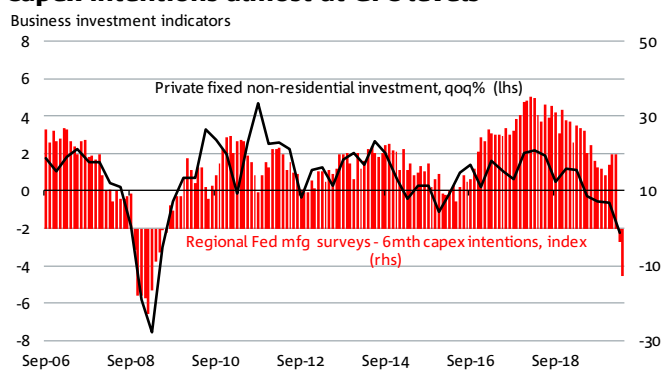
Even businesses which have remained open or are re-opened, outbreaks of COVID-19 may to see operations disrupted from time-to-time (as is currently the case for some US meat processors).

The widespread job losses, and the damage done to household and financial businesses incomes and balance sheets is also likely to act as a significant curb to the recovery. Some businesses will have closed permanently, and it will take time for new businesses to emerge to fill the slack. Similarly, there is likely to be permanent changes to some industries (e.g. more work from home, less use of offices) and moving resources from these industries to other sectors will take time.

Financial conditions remain tight, particularly for lower rated entities, although the Fed's extensive range of programs (see attachment) have managed to ease the degree of stress. Importantly credit also appears to be flowing to many businesses that need it to support them through the severe cashflow squeeze underway.

There is also a risk of a second wave of infection as the containment restrictions are eased. It is unclear what the policy response would be in this case.

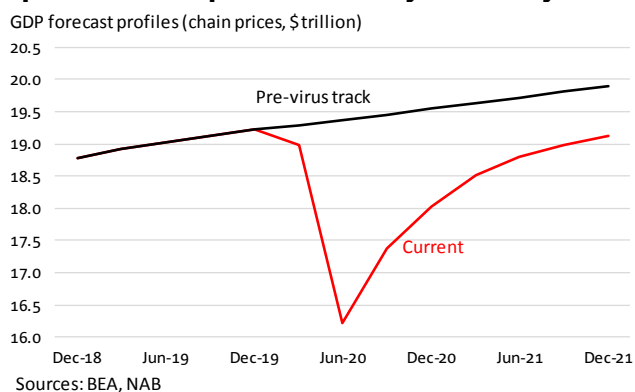
Capex intentions almost at GFC levels



The resulting high level of uncertainty about the future, as well as similar large falls in activity in other countries (a big negative for exporters), is likely to weigh on business investment. This is already evident in regional Fed surveys of manufacturing capex intentions. In the case of the oil industry, which has seen a significant drop in prices, investment is likely to be wound back significantly.

Reflecting these factors, the return to the pre-COVID-19 level of activity is going to take an extended time. We are projecting GDP to fall by 7.4% in 2020 and to grow by 6.8% in 2021. This includes projected growth in the second half of 2020 which, in the normal course of events would be exceptionally strong, but still leaves the level of activity below its end 2019 level at the end of 2021.

A quick return to pre-virus activity is unlikely



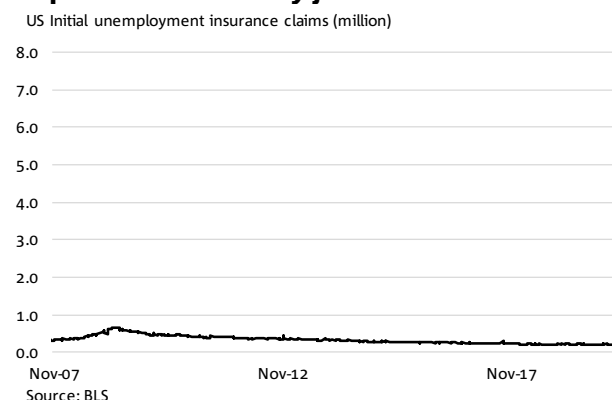
Labour market fall out

The fallout for the labour market has been massive.

The March employment survey was largely conducted before the ramp up in containment measures. Even so, non-farm employment fell 701,000 and the unemployment rate rose 0.9ppts to 4.4%.

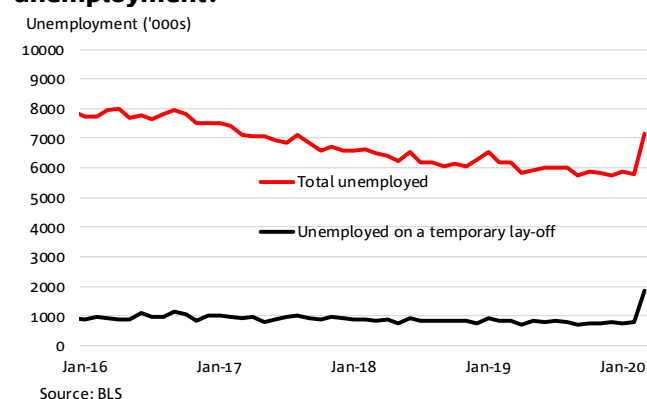
However, since mid-March there have been over 26m initial jobless claims filed – an astronomical amount which makes the GFC look insignificant in comparison. Not surprisingly the consensus analyst expectation for the April jobs reports looks for a fall in non-farm employment of 20m and a rise in the unemployment rate to 14%.

Unprecedented weekly jobless claims



The only possible silver lining is that, at least in March, most of the increase in unemployment was in workers who thought the lay-off would prove to be only temporary. The concern is that, with restrictions likely to be eased only slowly, a lot of the temporary job losses turn into permanent ones. Government financial support, such as through the Paycheck Protection Program, and credit from the financial system will be important in keeping businesses alive so that there are jobs to return to.

Looking for a silver lining...only a temporary spell in unemployment?



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US Economic Policy Response – principal measures

Measure	Summary	Date
Federal Reserve		
Fed funds rate	Reduced by 150bps over two meetings. Target range now 0 to 0.25%	3 March (50bp), 15 Mar (100bp)
Discount window	Reduced by 150bp (to 0.25%) – the ‘window’ is a source of lending to depository institutions (banks)	15 March
Reserve requirements	Bank reserve requirements reduced to zero.	15 March
Asset purchases & other liquidity measures	\$500 billion of Treasury securities and \$200b of agency mortgage-backed securities over coming months. Fed also active in Repo market with up to \$500b on offer on some days	15 March (securities) – security details superseded by 23 March announcement
Commercial paper funding facility (CPFF) & primary dealer credit facility	CP: Purchase from eligible issuers (based on credit ratings at 17 Mar) three-month U.S. dollar-denominated commercial paper Dealer facility: will offer overnight and term funding (up to 90 days) from 20 March 2020 (and in place for least six months). Stocks and investment grade securities can be used as collateral.	17 March
Money Market Mutual Fund Liquidity Facility (MMFLF)	MMLF will make loans available to eligible financial institutions secured by high-quality assets purchased by the financial institution from money market mutual funds	18 March
New or enhanced swap lines with other central banks	Temporary U.S. dollar liquidity arrangements (swap lines) established with a range of other central banks (including RBA), or where there was a standing arrangement, lowered the pricing and extended the maturity	15 & 19 March
FIMA repo facility	FIMA account holders can temporarily exchange their U.S. Treasury securities held with the Federal Reserve for U.S. dollars	31 March
Further ‘extensive’ measures	1) Treasury securities and agency mortgage-backed securities will be purchased in the amounts needed to support smooth market functioning and effective transmission of monetary policy. Expands 15 March operations in size and includes purchases of agency commercial mortgage-backed securities. 2) New programs that to provide up to \$300 billion in new financing. The Department of the Treasury, using the Exchange Stabilization Fund (ESF), will provide \$30 billion in equity to these facilities. □ credit to large employers – the Primary Market Corporate Credit Facility (PMCCF) for new bond and loan issuance and the Secondary Market Corporate Credit Facility (SMCCF) to provide liquidity for outstanding corporate bonds. Note: expanded 9 April. □ the Term Asset-Backed Securities Loan Facility (TALF), to support the flow of credit to consumers and businesses. The TALF will enable the issuance of asset-backed securities (ABS) backed by student loans, auto loans, credit card loans, loans guaranteed by the Small Business Administration & other assets. Expanding the MMLF to include a wider range of securities, including municipal variable rate demand notes (VRDNs) and bank certificates of deposit. Expanding the CPFF to include high-quality, tax-exempt CP as eligible securities. In addition, the pricing of the facility has been reduced	23 March
Actions to provide up to \$2.3 trillion loans		9 April
PPPLF	The Paycheck Protection Program Liquidity Facility (PPPLF) will extend credit to eligible financial institutions that originate PPP loans	
Mainstreet Lending Program (MSELF & MSNLF)	Purchase of up to \$600 billion in loans, with the Department of the Treasury providing \$75 billion in equity to the facility (loans of 4 years, P&I deferred on 1 st yr, loans provided through banks who retain a 5% share selling the rest to the facility)	

Expanded PMCCF and SMCCF, TALF facilities	Size and scope of the Primary and Secondary Market Corporate Credit Facilities (PMCCF and SMCCF) as well as the Term Asset expanded to now support up to \$850 billion in credit backed by \$85 billion in credit protection provided by the Treasury	
Municipal Liquidity Facility	To help state and local governments manage cash flow stresses the Municipal Liquidity Facility will offer up to \$500 billion in lending to states and municipalities (Treasury to provide \$35 billion of credit protection to the Federal Reserve).	Scope expanded 27 April
Government (fiscal)		
Initial package – stimulus “Phase 1”	\$8b package (< 0.1% of GDP) directed at medical preparedness	6 March
Administration decisions, announcements & emergency declaration	Low interest loans from SBA, in affected states and territories, to help small businesses overcome temporary economic disruptions caused by the virus. Will need Congress to increase program funding by an \$50 billion	11 March
	Emergency declaration – frees up to \$50b of funding for the states. At same time announced waiver on interest on student loans and oil purchases	13 March
	Tax deferral - April 15 deadline to pay taxes owed for many individuals and businesses pushed back 90 extra days. Individuals can defer up to \$1 million of tax liability and corporations get an extension on up to \$10 million. Frees up to \$300b of liquidity.	17 March (Tax deferral)
Stimulus – “Phase 2”	Virus testing, unemployment insurance and food assistance aid to states, paid family/sick leave at a cost of approx. \$100b.	18 March
Stimulus – “Phase 3”	\$2.2 trillion package – \$1200 per adult/\$500 per child, means tested. \$500b in loans to business (incl. \$25b for airlines and some ties is in with Fed lending facilities); unemployment benefits increased by \$600 a week for four months; \$150b of health care funding; Paycheck Protection Program (PPP) – loan to (mainly) small/medium businesses which is forgiven if used to cover employee and some fixed costs	27 March
Stimulus – “Phase 4”	\$484b package – extra funding for Paycheck Protection Program and other loans/grants for businesses, extra health care funding	24 April

U.S. ECONOMIC & FINANCIAL FORECASTS

	Year Average Chng %				Quarterly Chng %									
	2018	2019	2020	2021	2019 Q3	2019 Q4	2020 Q1	Q2	Q3	Q4	2021 Q1	Q2	Q3	Q4
US GDP and Components														
Household consumption	3.0	2.6	-9.5	7.8	0.8	0.5	-1.9	-18.4	10.2	4.8	2.8	1.4	0.9	0.8
Private fixed investment	4.6	1.3	-9.2	5.0	-0.2	-0.1	-0.6	-12.7	1.5	2.2	3.1	2.4	1.8	1.4
Government spending	1.7	2.3	2.6	4.3	0.4	0.6	0.2	0.4	1.5	1.3	1.3	1.0	0.7	0.4
Inventories*	0.1	0.1	-0.6	0.4	0.0	-0.3	-0.2	-0.4	0.4	0.1	0.2	0.0	0.0	0.0
Net exports*	-0.4	-0.2	0.7	-0.2	0.0	0.5	0.4	0.1	-0.2	-0.1	-0.1	0.0	0.0	0.0
Real GDP	2.9	2.3	-7.4	6.8	0.5	0.5	-1.2	-14.6	7.2	3.7	2.7	1.5	1.0	0.8
Note: GDP (annualised rate)					2.1	2.1	-4.8	-46.8	32.1	15.8	11.2	6.1	4.1	3.2
US Other Key Indicators (end of period)														
PCE deflator-headline														
Headline	1.9	1.4	0.4	1.9	0.4	0.3	0.3	-0.5	0.4	0.2	0.6	0.5	0.5	0.2
Core	1.9	1.6	1.2	1.3	0.5	0.3	0.4	0.4	0.2	0.2	0.3	0.3	0.4	0.3
Unemployment rate - qtly average (%)	3.8	3.5	10.2	6.8	3.6	3.5	3.8	18.2	12.5	10.2	9.8	8.0	7.1	6.8
US Key Interest Rates (end of period)														
Fed funds rate (top of target range)	2.50	1.75	0.25	0.25	2.50	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25

Source: NAB Group Economics

*Contribution to real GDP growth

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