US ECONOMIC UPDATE JULY 2020

MASSIVE FALL IN Q2 GDP

NAB Group Economics

An unprecedented fall in GDP in Q2 but growth is set to bounce back in Q3. However, indicators are pointing to a pause in the recovery over recent weeks. This reflects a resurgence in COVID-19 in parts of the US and a partial re-introduction of containment restrictions. We are forecasting GDP to decline by 5.1% in 2020 before rising by 3.7% in 2021. The timing of the recovery will be highly dependent on the path the virus takes; we continue to expect a full recovery will take a long time.

Biggest GDP fall on record in Q2

As expected, in Q2 the impact of COVID-19, and the societal response to it including stay-at-home and other government restrictions, led to the largest recorded fall in quarterly GDP since at least 1947.

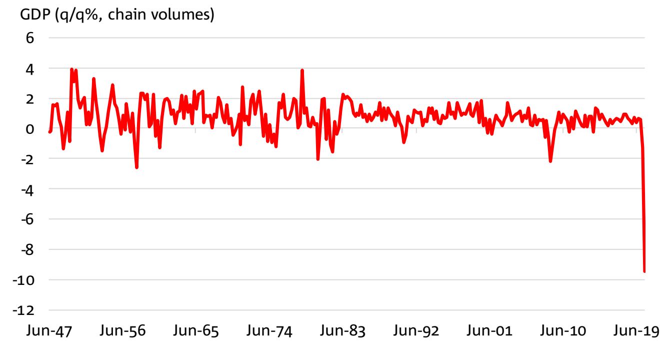
The 9.5% (32.9% annualised) fall in Q2 GDP was on top of a -1.3% decline in Q1. There were large falls across most of the major expenditure categories, although a large increase in Federal spending saw overall public demand increase.

Personal consumption fell by 10.1% q/q, with the largest declines occurring in services consumption. Recreation, food services/accommodation and transport services consumption collapsed, with falls of between 34 and 49%, and there was a large fall in health services consumption as 'non-essential' treatments were deferred. In terms of goods consumption, there were large falls in clothing & footwear and gasoline (over 15%), while food and beverages partly reversed the strong growth seen in Q1 when households stocked up on essentials. In contrast, motor vehicle and recreational goods consumption rose; the latter in part due to households buying IT equipment likely reflecting increased work from home.

There were also large falls in business fixed investment, with non-residential structures and equipment investment falling by over 10%. Residential investment also saw a large fall (-12% q/q) as both new home construction and property sales declined.

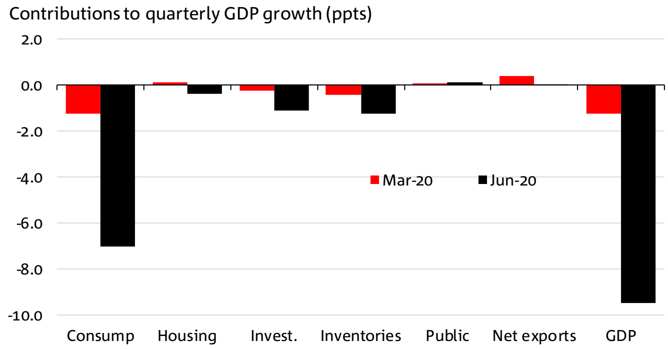
With the US economy well down, and similarly large declines occurring globally, trade flows also collapsed. Exports declined 23% and imports 17%.

Largest recorded fall in GDP



Source: BEA

Fall driven by consumption and investment



Sources: BEA, NAB. Data not annualised

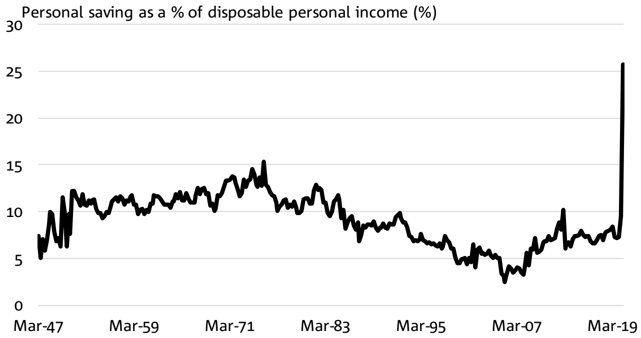
Travel and transport (including aircraft and motor vehicles) trade was particularly hard hit, consistent with widespread travel bans and factory closures.

The extent of the large fiscal support put in place by Congress was evident in the accounts. Despite the massive fall in GDP, household disposable income increased by over 9% q/q, despite falls in wage income (as employment fell), small business earnings and investment returns. COVID related fiscal programs made up over 10% of disposable income in

Date **July 2020** | Author Tony Kelly – Senior Economist

Q2. The rise in income, combined with the large fall in household spending, meant there was an unprecedent increase in household savings.

Savings rate spikes



Source: BEA

Outlook

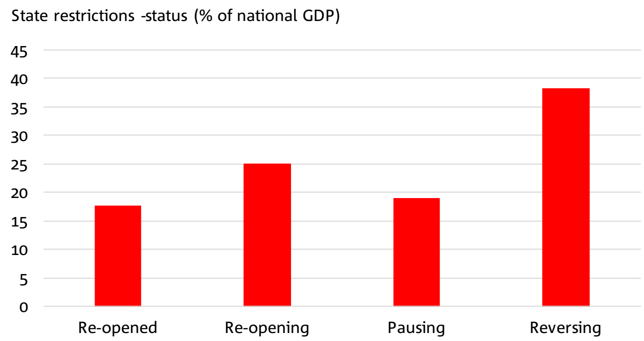
That GDP recorded a massive fall in Q2 was not a surprise. Huge declines in many activity indicators were recorded over March and April.

As COVID-19 containment restrictions began to be eased, to varying degrees across the US, activity picked up over May and June, with very strong growth rates recorded (although most indicators, except retail sales, were still well below their pre-COVID-19 level).

However, another significant upwards spike in the number of reported COVID-19 cases, starting in mid-June, has led to a pause in the economic recovery.

The rise in case numbers led to many states – principally in the south/west of the country either pausing their re-opening plans or even re-imposing some restrictions. At the same time, reflecting the uneven path of the virus through the US, some states have continued to re-open their economies. At this stage states re-imposing restrictions have generally not fully gone back to measures as severe as they were in March/April as they try to adopt a more targeted response.

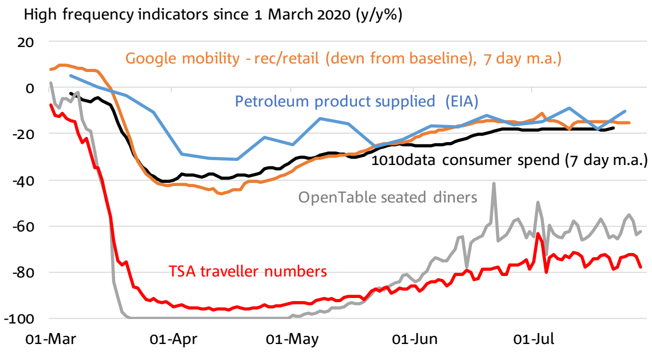
Some states pausing removal of restrictions or (somewhat) re-imposing them



Source: New York Times, BEA, NAB

Not surprisingly, the surge in case numbers looks to have affected the recovery that was underway in the economy. The high frequency indicators that we monitor have largely been tracking sideways in recent weeks, if not edging down, while jobless claims have moved higher.

High frequency indicators have flattened out

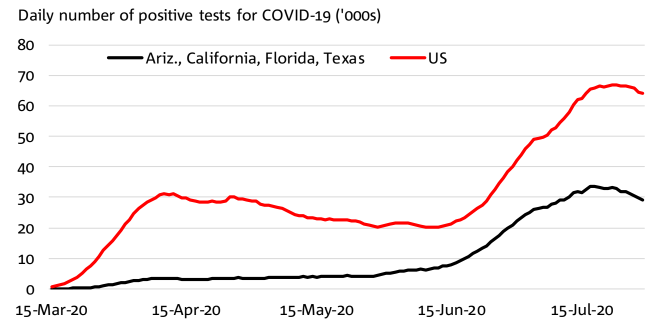


Sources: Google, US EIA, TSA, 1010data, OpenTable

Even with a pause, or even a small reduction in activity over July/August, a large increase in GDP in Q3 is likely. June retail sales were 10% higher than their Q2 average, while housing starts were up 15%, existing home sales 9%, non-defence capital goods shipments 5%, exports 7% and industrial production 4%. This means that even if activity held at its June level, there would be significant growth in Q3 relative to Q2.

How activity tracks from here is going to be heavily dependent on the path of the virus and how society and government react. Importantly, there are signs that the most recent surge in cases has come to an end, with some recent decline in case numbers. This is also true for Arizona, California, Florida and Texas – states which have been particularly under the microscope as they have accounted for a large part of the higher case numbers (and have a 30% share of the national economy).

Signs recent surge in cases showing signs of abating



Source: The Covid Tracking Project

For this reason, we assume that while activity may track sideways for a while longer we do not expect large falls and that towards the end of Q3 the recovery in the economy will resume (albeit at a slower pace than occurred over May/June).

However, there is a risk that the recent dip in cases is temporary, or that states which have not seen large case numbers to-date see a pick up or states particularly hard hit in March/April – and now seeing very low numbers such as New York – may experience a second wave. Changes in medical practices – either through treatment that reduces severity or the development of a safe and effective vaccine – is another important factor to watch. As a result, uncertainty around any forecast remains very high.

Adding to the uncertainty is the unclear direction of fiscal policy. Some measures to support the economy through the COVID-19 were one-off (cash grants to households) while others are coming to an end. Most notably this includes the extra $600 per week for unemployment benefit recipients (Federal Pandemic Unemployment Compensation) which has substantially added to household income.

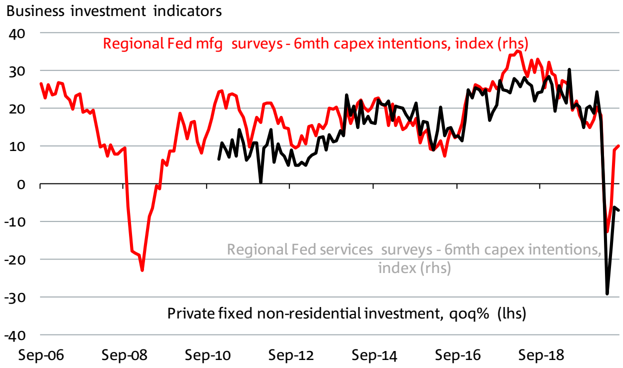
Both major parties in Congress have put forward proposals for significant further spending of between one to three trillion dollars (5-14% GDP). Apart from the amounts, the details of individual spending measures differ, so when (and if) agreement will be reached is unclear.

Too rapid a withdrawal of fiscal support could undermine the recovery but, given it is an election year, we expect a package to be agreed.

These forecasts continue to be based on the expectation that a full recovery will take a long time.

This is in part due to the only gradual removal of COVID-19 related activity restrictions as well as the possibility of further flare ups in the spread of the virus slowing the process down further. Faced with this outlook, businesses are likely to be cautious in putting in place significant investments. Lower levels of business investment could also result in lower productivity growth in the future.

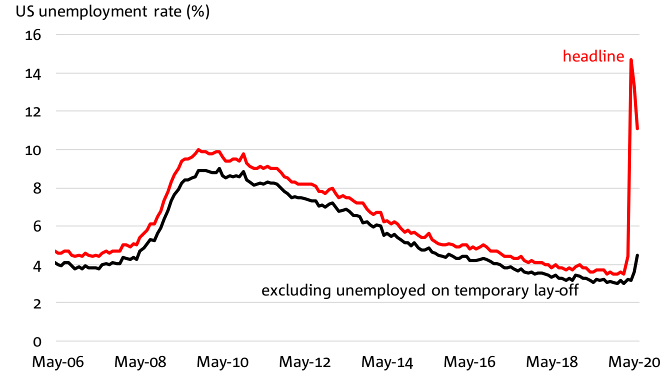
COVID scars likely to weigh on business investment



Source: BEA, Kansas City, New York, Richmond, Dallas, Philadelphia Fed. Reserves, NAB

The increasingly drawn out restrictions in place are also likely to mean a growing number of initially planned temporary business closures will become permanent. This dynamic is also reflected in the labour market; even as the unemployment rate has declined, the number of unemployed who are not on a temporary lay-off has been rising.

Falling unemployment rate, but rising long-lasting labour market damage



Parts of the economy will also need to adjust to significant structural change – less travel, more on-line activity and work from home). As the extent of business losses become more evident, lending standards may tighten further, particularly in the sectors most exposed to these forces. Damage to government finances is another factor, particularly for state governments, due to many having balanced budget requirements.

We expect GDP growth of -5.1% in 2020 (revised up from -5.9%) and 3.7% in 2021 (revised down from 4.2%). The upwards revision reflects the slightly better than expected Q2 outcome (-9.5% compared to our forecast of -10.3%). The downwards revision in 2021 reflects an expectation that the long-term damage from COVID-19 is increasing given the re-introduction of some containment measures and delayed re-opening in some states.

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U.S. ECONOMIC & FINANCIAL FORECASTS

	Year Average Chng %					Quarterly Chng %											
						2020				2021				2022			
	2018	2019	2020	2021	2022	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
US GDP and Components																	
Household consumption	2.7	2.4	-5.4	4.0	2.5	-1.8	-10.1	5.8	1.7	1.5	0.9	0.7	0.6	0.6	0.6	0.6	0.6
Private fixed investment	5.2	1.9	-7.0	2.8	5.2	-0.3	-8.5	-2.0	0.9	2.4	2.5	1.8	1.3	1.1	1.0	0.9	0.9
Government spending	1.8	2.3	2.1	1.9	2.0	0.3	0.7	0.2	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Inventories*	0.2	0.0	-0.8	0.8	0.0	-0.4	-1.2	1.6	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net exports*	-0.3	-0.2	0.5	-0.4	-0.1	0.4	0.0	-0.4	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real GDP	**3.0**	**2.2**	**-5.1**	**3.7**	**2.8**	**-1.3**	**-9.5**	**4.7**	**1.5**	**1.5**	**1.0**	**0.8**	**0.7**	**0.6**	**0.6**	**0.6**	**0.6**
Note: GDP (annualised rate)						*-5.0*	*-32.9*	*20.0*	*6.2*	*5.9*	*4.2*	*3.4*	*2.8*	*2.6*	*2.5*	*2.4*	*2.4*
US Other Key Indicators (end of period)																	
PCE deflator-headline																	
Headline	2.0	1.5	0.3	1.4	1.6	0.3	-0.5	0.2	0.3	0.3	0.4	0.4	0.4	0.3	0.4	0.4	0.4
Core	2.0	1.6	0.6	1.4	1.6	0.4	-0.3	0.2	0.3	0.3	0.4	0.3	0.3	0.3	0.4	0.4	0.4
Unemployment rate - qtly average (%)	3.8	3.5	9.2	7.5	7.0	3.8	13.0	10.5	9.2	8.8	8.0	7.6	7.5	7.3	7.3	7.2	7.0
US Key Interest Rates (end of period)																	
Fed funds rate (top of target range)	2.50	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25	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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