ECONOMIC UPDATE

REGIONS

April 29, 2020

Q1 2020 GDP: Bad Is Here, Worse Is On The Way

- Real GDP contracted at an annualized rate of 4.8 percent in Q1 2020, according to the BEA's initial estimate
- Real private domestic demand, or, combined household and business spending, contracted at an annualized rate of 6.6 percent

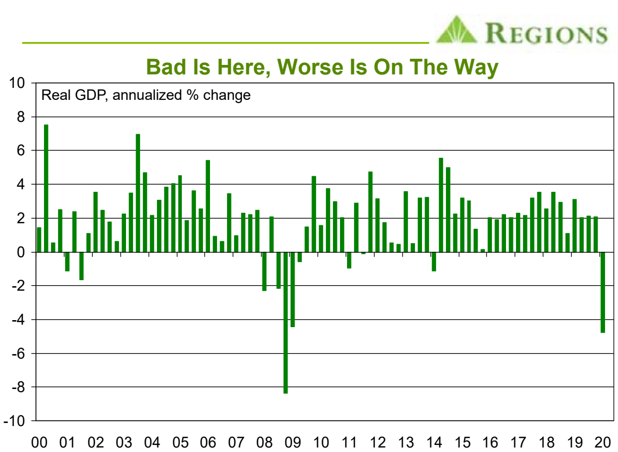
Real GDP contracted at an annualized rate of 4.8 percent in Q1 2020, less harsh than the 5.8 percent decline our forecast anticipated but a more severe contraction than the consensus estimate. While the effects of the sudden stop in economic activity over the back half of March due to the COVID-19 virus and the efforts to contain its spread are without a doubt front and center in the Q1 GDP data, BEA notes that "the full effects of the COVID-19 pandemic cannot be quantified . . . because the impacts are generally embedded in source data and cannot be separately identified." In any given quarter, the BEA's initial estimate of GDP is based on highly incomplete source data, leaving BEA to fill in the blanks with their own estimates/assumptions. BEA notes their assumptions were aided by several data sources to help capture the effects of the COVID-19 virus, such as high-frequency credit card transactions data (consumer spending), initial claims for Unemployment Insurance (business production and worker compensation), and the timing of government mandated school closings (state and local government spending). Still, given that much of the regular source data at BEA's disposal were impacted by data collection issues, including notably low response rates, the initial estimate of Q1 2020 GDP may be subject to a larger revision than would be seen in a typical quarter.

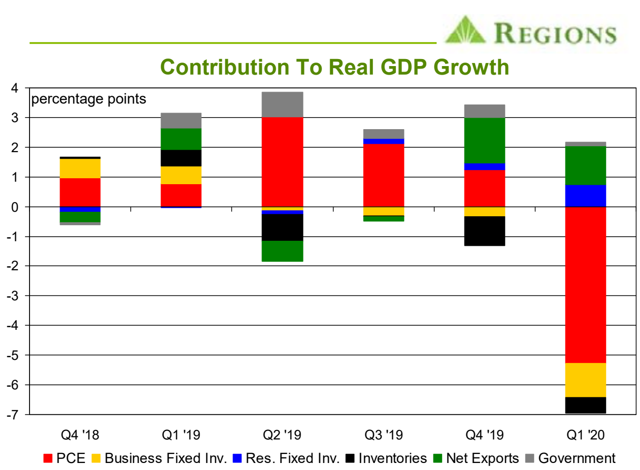
Real consumer spending contracted at an annualized rate of 7.6 percent in Q1, the largest quarterly contraction since Q2 1980, which deducted 5.26 percentage points from top-line real GDP growth. Mainly reflecting the collapse in motor vehicle sales over the second half of March, real spending on consumer durable goods contracted at an annualized rate of 16.1 percent in Q1. In contrast, real spending on nondurable consumer goods rose at an annualized rate of 6.9 percent, mainly reflecting the initial surge in sales at grocery stores, warehouse/club stores, and drug stores as consumers rushed to stock up on essentials. Still, this initial estimate seems on the high side, so we'll see what the revisions say. Real spending on services, which accounts for over two-thirds of consumer spending as reported in the GDP data, contracted at an annualized rate of 10.2 percent in Q1, the largest contraction on record for this category. Recall that it was spending on services, such as travel, lodging, restaurants, entertainment events, and sporting events, that dried up almost immediately in mid-March. The contraction in services spending alone took 4.99 percentage points from top-line real GDP growth.

Real business fixed investment contracted at an annualized rate of 8.6 percent in Q1, with spending on structures contracting at a rate of 9.7 percent and spending on equipment/machinery contracting at a rate of 15.2 percent, while spending on intellectual property products posted a modest advance. Overall, the decline in business fixed investment took 1.17 percentage points from top-line real GDP growth. A drawdown in inventories deducted an additional 0.53 percentage points from top-line real GDP growth in Q1.

Somewhat lost in the shuffle is that real residential fixed investment rose at an annualized rate of 21.0 percent in Q1, adding 0.74 percentage points to top-line real GDP growth. Single family residential construction was unseasonably strong in January and February before cooling off in March, and while construction activity has been allowed in most areas during the shutdown in economic activity, the rate of new residential construction will almost surely slow significantly in Q2. Thanks to imports having fallen off even more sharply than exports, the trade deficit narrowed in Q1, thus adding 1.30 percentage points to top-line real GDP growth. Government spending increased on all levels in Q1, but a relatively small share of the increase in federal government spending in response to the COVID-19 virus is reflected in the Q1 GDP data. In Q2, federal government spending will be materially higher, but state and local government spending will likely tumble.

As noted above, the pending revisions to the initial estimate of Q1 2020 may be even larger than is typical for a first estimate. Of more significance, however, is that no matter what the BEA's final estimate of Q1 GDP ultimately tells us, the contraction in real GDP in Q2 will be more severe, to a degree that would have been unthinkable prior to the COVID-19 virus. At the same time, however, the prospect of different segments of the economy being opened up in the weeks ahead suggests the contraction in GDP will not persist into the back half of 2020.





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