ECONOMIC UPDATE
REGIONS
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Q2 2020 GDP: The Worst May Be Over, But The Path Ahead Is Anything But Clear

- The BEA's initial estimate shows real GDP contracted at an annualized rate of 32.9 percent in Q2 2020
- Consumer spending and business investment contracted sharply, while government spending rose and the trade deficit narrowed

The BEA's initial estimate shows real GDP contracted at an annualized rate of 32.9 percent in Q2 2020, easily the largest quarterly contraction on record. To some extent, the BEA's report on Q2 GDP is anticlimactic, in the sense that it was clear by the end of March that there would be an epic contraction in real GDP in Q2. So, today's report quantifies that decline but changes nothing – as we wrote back in late-March, when all is said, done, and revised, we'll know what the numbers tell us happened, but in the interim, as we live through this, what we see around us and how we feel about it will likely be of as much, if not more, relevance than what the data are telling us. And, no matter how many data series we write about and no matter how much we write about them, the inescapable fact is that, even to the extent we can measure the economic costs, the human costs of the pandemic are beyond measurement.

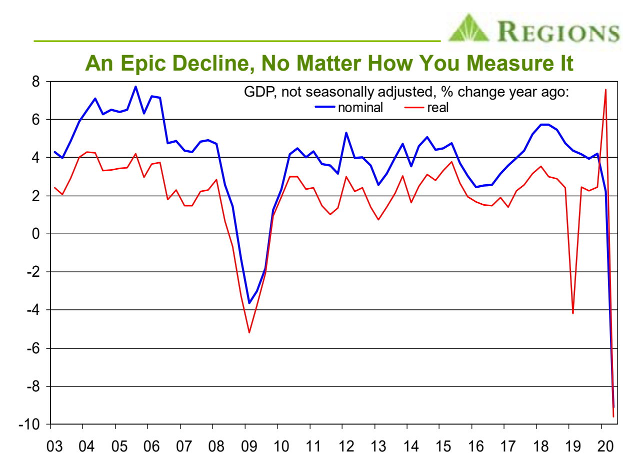
As to the data, a couple of housekeeping points are in order. First, in any given quarter, the BEA's initial estimate of GDP is based on highly incomplete source data and, as such, is prone to sizable revision. It is reasonable to think the revisions to the initial estimate of Q2 GDP will be much larger than normal; the first test will come on August 27 with the release of the second estimate of Q2 GDP. Also, while by no means trying to minimize the damage done to the economy, we do think it worth noting that the year-on-year percentage change in not seasonally adjusted GDP, which we show in our first chart below, is a more meaningful way to assess the hit to GDP in Q2.

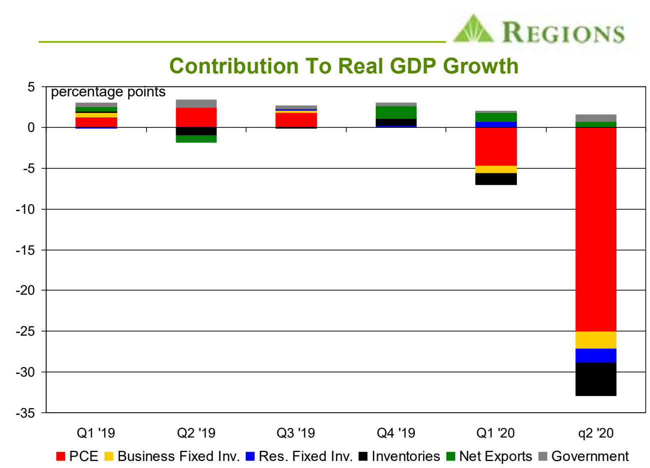
Real consumer spending contracted at an annualized rate of 34.6 percent in Q2, with spending on goods dropping at an 11.3 percent rate and spending on services dropping at a 43.5 percent rate. Recall that when the economy began to shut down in March and April, spending on services, such as travel, tourism, dining out, recreational activities, sporting events, and health care largely shut down. While some of these components had begun to rebound by the end of Q2, overall services spending remains significantly below pre-pandemic levels even as spending on goods has largely recaptured the initial declines. To some extent, foregone services spending has supported higher spending on goods, though at this point it is too soon to know how long and to what extent these patterns will be sustained, just as it is too soon to assess where the personal saving rate, which jumped to 25.7 percent in Q2, will ultimately settle.

Real business fixed investment contracted at an annualized rate of 27.0 percent in Q2, which is a much smaller contraction than our forecast anticipated. Outlays on structures and equipment fell at better than 30 percent rates and spending on intellectual property products fell at a 7.2 percent rate. While always a critical, as it lays the foundation for faster productivity growth, investment in intellectual property products will take on added importance in coming quarters as firms adjust head counts and working arrangements to adapt to the lasting effects of the pandemic.

Somewhat surprisingly, the trade deficit narrowed in Q2; real exports contracted at a 64.1 percent rate while real imports contracted at a 53.4 percent rate, the extent of these declines reflecting the extent to which trade flows dried up as the pandemic impacted the global economy. Real government spending rose at an annualized rate of 2.7 percent in Q2, with a sharp increase in federal government spending more than offsetting a decline in state/local government spending. Transfer payments are not included here but are included in personal income, with real disposable (or, after-tax) personal income rising at a 44.9 percent rate in Q2. How disposable personal income fares in Q3 is very much an open question as Congress negotiates another aid package. It seems likely there will be another round of Economic Impact Payments, which would mitigate the impact of any cut in supplemental UI benefits.

Whether or not the report on Q2 GDP sheds any new light on the economic toll of the pandemic, it provides no guidance on where we go from here. When we and others began forecasting a major contraction in real GDP in Q2 back in March, there was considerable disagreement over what the subsequent recovery would look like, but most of us at least thought that recovery would be on firmer footing at this point than has proven to be the case. With the COVID-19 virus still in the driver's seat, it is clear that while the worst of the damage to the economy may be behind us, the path ahead is anything but clear.





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