

US GDP: The descent begins

After a strong January and February, a combination of Covid-19 containment measures and consumer fear meant activity collapsed in March. With lockdowns likely to remain largely in place until mid-May and social distancing set to continue well beyond that, we forecast that the economy will contract at a 40% annualised rate in 2Q



New York

Source: Shutterstock

-4.8% 1Q annualised GDP growth

Slamming on the brakes

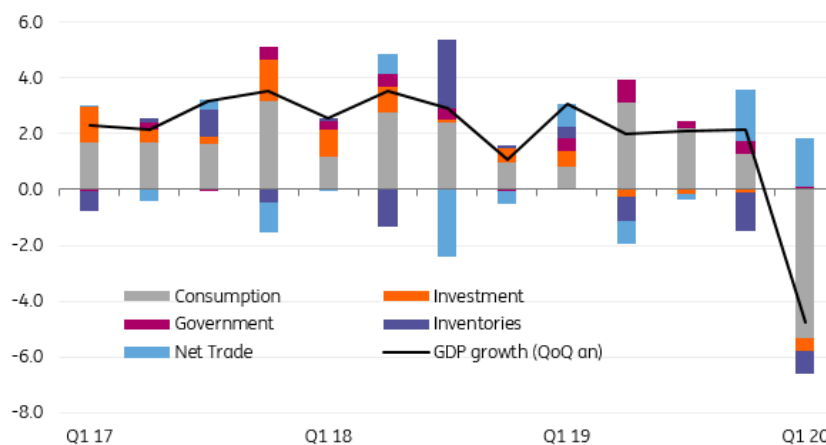
At the start of the year the US economy was in great shape. The uncertainty from US-China trade tensions was lifted by the deal signed between Presidents Trump and Xi while the lowest unemployment rate for over 50 years looked set to propel consumer spending ahead strongly. In fact, the Atlanta Federal Reserve Bank's GDPNow model, based on data released for January and February, suggested the US was on course for 4% annualised growth in the first quarter.

Instead, today's GDP report confirms that the mid-March lockdowns that shut businesses and to date have seen 26.5 million Americans lose their jobs, crushed economic activity in the final few weeks of March. Today's 4.8% annualised GDP contraction is the worst reading since 4Q 2008 and the depths of the financial crisis (-8.4% annualised).

The details show that household consumption was the weakest area, falling 7.6% annualised. We had already seen retail sales fall 8.7% month-on-month in March, with expenditure on hotels and travel falling even more. Business investment also fell (non-residential fixed investment dropped 8.4%), despite typically long lead times between making a decision and the money actually hitting the ground. Inventories were run down and subtracted half a percentage point from headline GDP.

There were some positives though. Residential investment surged 21% while net foreign trade actually added a full 1.3 percentage points to headline growth as imports plunged more than exports. These strong positive contributions won't be repeated in 2Q. Rounding out the numbers, government spending rose at a 0.7% annualised rate.

Contributions to US GDP growth



Source: Bloomberg, ING

2Q GDP to fall at a 40% annualised rate

While today's reading is bad, the 2Q report is going to be far worse. We have pencilled in a 40% annualised contraction (-10% quarter-on-quarter) which, following the 1Q fall (4.8% annualised is roughly 1.2% QoQ), means that US economic output will be down 13% peak to trough. This is on a par with the downturn experienced as World War II concluded, but that occurred over three years, not two quarters as is happening today.

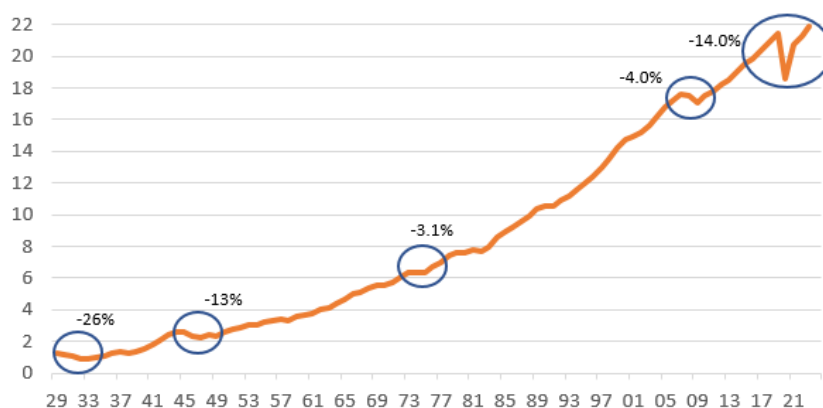
We must remember the lockdowns only really came into effect in mid-March, so total consumer spending through April will be well down on March. Even if we assume the bulk of the lockdowns start to ease from mid-May, ongoing social distancing, consumer caution and the legacy of 30 million unemployed Americans will ensure spending through June remains well down on the levels of January and February.

Travel restrictions will remain in place, limiting the scope for a recovery in the airline, hotel and hospitality industries while social distancing measures may make many restaurants and bars unprofitable and force their closure. With many businesses in different industries warning they will

need to restructure, millions of people who have lost their jobs will struggle to find work quickly.

Investment, particularly in the oil and gas sector, will plunge in 2Q. Moreover, with manufacturing output falling substantially, there is little need to invest in expanding production facilities. Export growth will be constrained by the gradual re-opening processes expected elsewhere.

GDP levels since 1929 with major recessions & ING's forecast



Source: Macrobond, ING

The long road back

Unfortunately, we doubt that the US will experience a V-shaped recovery. The legacy of the crisis and the potential for long term structural changes mean at best we currently think the lost output in 1Q and 2Q won't be fully regained until late 2022.

This is all quite gloomy, but with the Federal Reserve and the government continuing to offer support and with Covid-19 containment measures likely to ease further in the second half of the year – particularly if work on a vaccine makes substantial progress – the news flow for the economy should be much improved for 3Q and 4Q. To ensure we do regain the lost output by late 2022, an additional fiscal stimulus will be required and looks very likely. How that will be constructed (mix between spending and tax cuts) will be a key theme of the election battle between President Trump and his Democrat rival Joe Biden.

Author

James Knightley

Chief International Economist, US

james.knightley@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING

does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.