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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

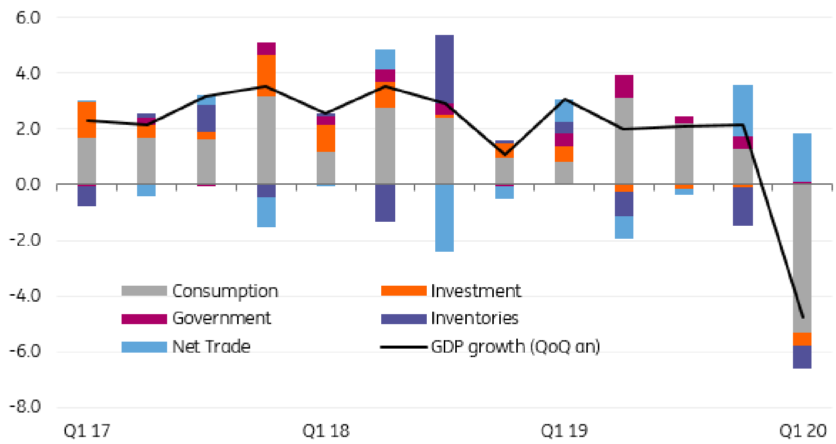
At the start of the year the US economy was in great shape. The uncertainty from US-China trade tensions was lifted by the deal signed between Presidents Trump and Xi while the lowest unemployment rate for over 50 years looked set to propel consumer spending ahead strongly. In fact, the Atlanta Federal 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

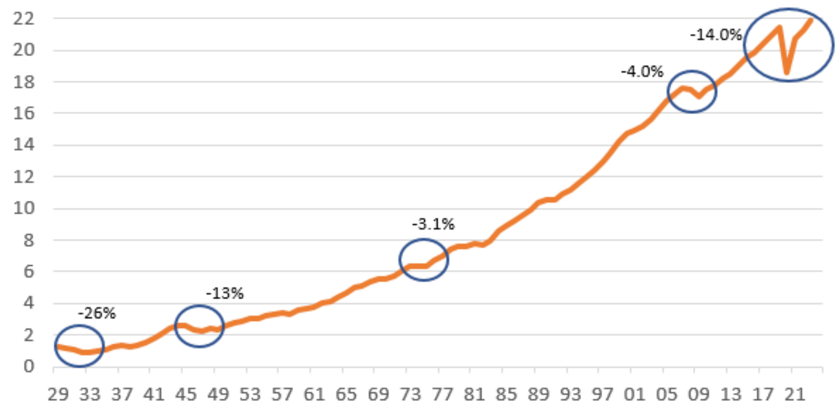
While today's reading is bad, the 2Q report is going to be far worse. We have pencilled in a 40% annualised contraction (-10% quarter-on-quarter) which, following the 1Q fall (4.8% annualised is roughly 1.2% QoQ), means that US economic output will be down 13% peak to trough. This is on a par with the 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.

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