Economic Analysis

1Q20 GDP: Remarkable transition from longest expansion in modern history to economic malaise

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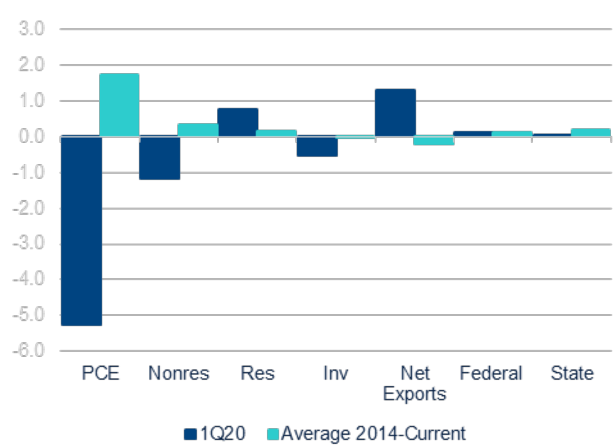
April 29, 2020

Today's advanced report showed that real quarterly GDP growth decreased by 4.8% in 1Q20 on an annualized basis; in line with our forecast of 4.7%. Unfortunately, the slowdown, which was the largest since 4Q08, will only mark the beginning of the economic deterioration associated with the COVID-19 pandemic, as the drop in 2Q20 will be several times larger. This also marks the end of the longest expansion in modern history.

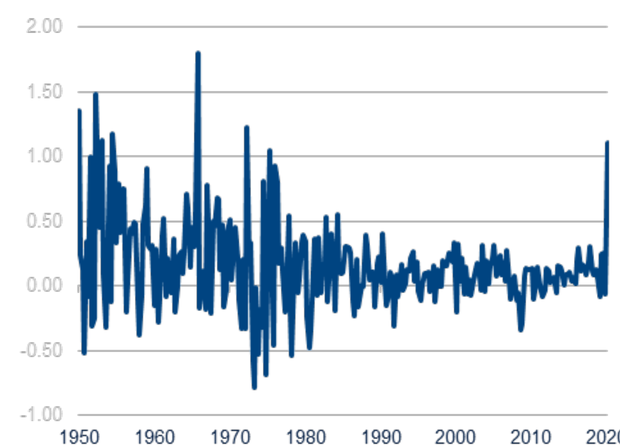
Given the nuances associated with stay-in-place orders, travel restrictions and shifts in both firms and individuals' behaviors and activities as a result of social distancing, the majority of the weakness in the first quarter was in the service sector. In fact, the over the quarter contributions from healthcare (-2.3pp), transportation (-0.7pp), recreation (-1.0pp) and food service and accommodation (-1.6pp) services were the lowest for which data is available. In addition, the contribution of motor vehicles and parts (-1.4pp) was the lowest since 4Q08. Nonessential items such as clothing and footwear also experienced the worst contribution to quarterly growth ever. That said, food and beverages purchased for off premise use contributed more than 1.1pp to growth in the first quarter, which was the largest since the 1970s, suggesting a return to a bygone era during the pandemic. Consumption of financial services also increased over the quarter, reflecting the important role that banks play during crises of this nature. In total, real PCE declined 7.6% on a quarterly annualized basis in 1Q20, the weakest performance in 40 years.

Figure 1. **Contributions to Growth,** (PP)



Source: BBVA Research, BEA & Haver Analytics

Figure 2. **Food & Bev for Off-Premise Use** (contribution PP)

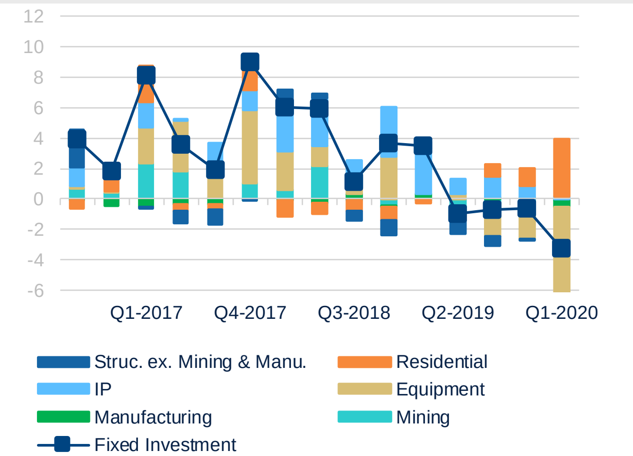


Source: BBVA Research, BEA & Haver Analytics

The slowdown in private investment was not as dire as consumption with firm's expectations coalescing around a "v-shaped" scenario in which growth slows down rapidly, but recovers quickly, and with the commitment by policy markets to provide stopgap support to firms and individuals. In fact, over-the-quarter residential construction grew 21.0% on an annualized basis. With respect to nonresidential private fixed investment in 1Q20, structures dropped -9.7% QoQa, equipment declined -15.2% while intellectual property grew 0.4% QoQa on account of solid investment in software.

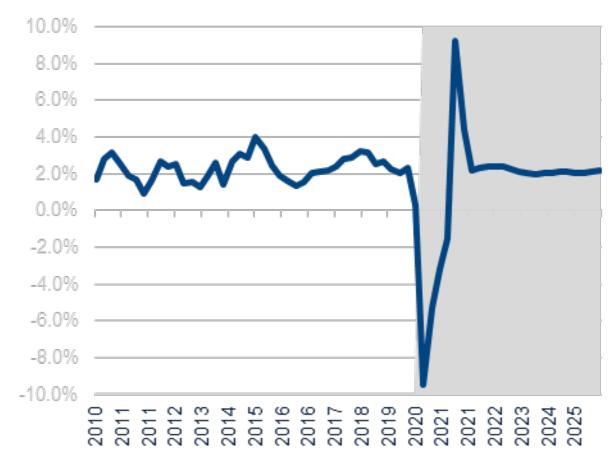
While private investment avoided a meltdown of the same magnitude as consumption, we expect investment conditions to deteriorate throughout the second and third quarter of this year, as low commodity prices weigh on the mining sector and as firms begin to adapt to the reality that the effects of pandemic could last throughout 2020 and that the demand-side of certain industries may never recover.

Figure 3. **Real Private Fixed Investment** (Contribution PP)



Source: BBVA Research, BEA & Haver Analytics

Figure 4 .**Real GDP** (YoY%)



Source: BBVA Research, BEA & Haver Analytics

The data on exports and imports of services also reflected the massive slowdown in global travel and transportation associated with the pandemic with respective annualized declines of 21.4% and 29.8%. Trade in goods was also tepid with annualized declines of -1.2% and -11.4% for exports and imports. Taken together, this led to a nontrivial positive contribution from net exports of 1.2pp, which is consistent with fluctuations in terms of trade during economic malaise.

In terms of public spending, contributions from federal, state and local governments were weaker than 4Q19, despite solid growth in federal consumption expenditures and state and local investment. With the massive fiscal packages implemented by the federal government and the need for a strong public health response at the state and local level, public contribution to GDP growth in 2Q20 will increase dramatically.

Meanwhile, the GDP price deflator increased 1.3%, the same rate as in 4Q19. This reflected a decline of 5.5% and 1.6% in the price index of goods exports and durable goods, respectively. As a result, nominal GDP declined 3.5%, marking the first drop since 2Q09, highlighting the downside risks to inflation and the Fed's price stability mandate.

With 1Q20 GDP growth falling in line with our baseline, and with ebbs and flows of social distancing falling in line with our previous expectations, we are maintaining our view that economic activity will contract 4.4% in 2020 before growing 3.4% in 2021. While there are some signs of hope that the curve is “flattening” given that the number of new cases is falling in many regions, there is a nontrivial risk that some of the relaxation of social distancing measures occurring today, may have to be temporarily reinstituted at some point in the future. As a result, without significant improvement in therapeutics, testing and monitoring, or without viable and scalable vaccines, risks will remain skewed to the downside.