Economic Analysis

3Q20 GDP: Strong policy support drives historic rebound in GDP, but headwinds emerging

Nathaniel Karp / Boyd Nash-Stacey
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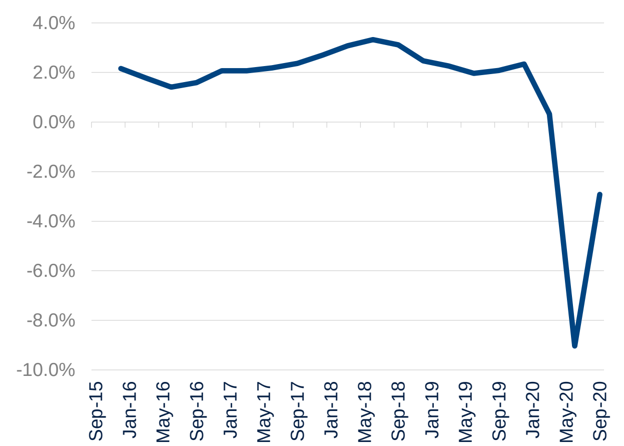
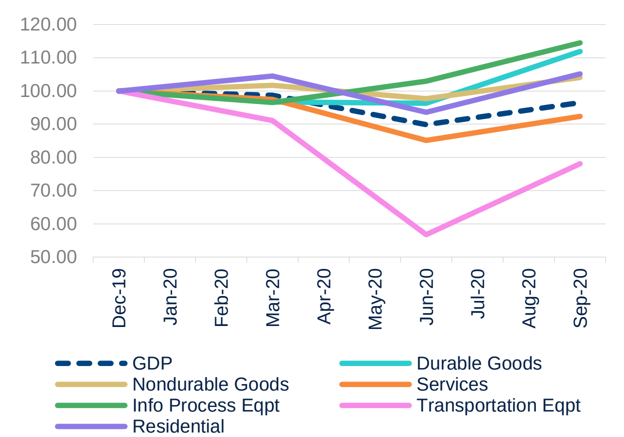
The U.S. economy showed astounding resiliency in the 3Q20, bouncing back from a 31.4% QoQa nosedive in 2Q20 with a 33.1%QoQa gain in 3Q20. Strong monetary, fiscal and administrative support from the federal government, less restrictive lockdown measures and stronger impetus to end distancing measures contributed to the rebound. That being said, GDP remains 2.2% below the pre-pandemic peak. Moreover, the positive data underpinning the report was strongly influenced by pandemic-related shocks to teleworking and the new normal, inventories and the surge in residential and auto demand, which are likely to wane in the coming quarters. In addition, the rising number of Covid-19 hotspots and likelihood of increased headwinds for the service sector suggests growth could slow considerably in 4Q20.

Figure 1. **REAL GDP (YEAR-OVER-YEAR %)**



Source: BBVA Research & BEA

Figure 2. **REAL GDP COMPONENTS (INDEX, 2019Q4=100)**



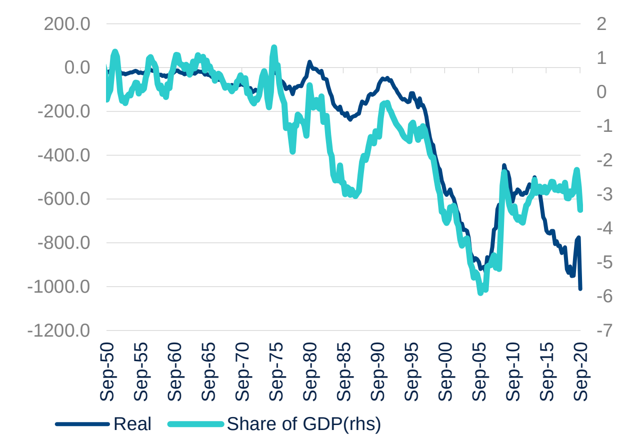
Source: BBVA Research & BEA

For consumption, the unprecedented fiscal stimulus and pent up demand pushed durable goods spending up $300bn on an annualized basis to 2.0Tn, nearly $215bn above the pre-pandemic peak. The 82% QoQa growth was driven by motor vehicles and parts (87.0%), furnishing and household equipment (60.9%) and recreational goods and vehicles (48%). Consumption of nondurable goods also surpassed its pre-pandemic peak on account of strong demand for clothing, gasoline and other energy products. For services, precautionary and compulsory distancing contributed to a muted recovery, which remains well below the pre-pandemic peak. In fact, food service and accommodation, recreation, transportation and medical care services stand between 7 and 32% below pre-pandemic levels in spite of respective increases of 210%, 277%, 173% and 93% on an annualized basis in 3Q20, signaling the service sector remains on the mend.

Despite the elevated policy, financial and pandemic related uncertainty, both domestically and internationally, investment rebounded strongly on account of the surge in pandemic-induced demand. For example, transportation equipment that includes fleet vehicles surged 257% QoQa, contributing 1.5PP to growth in 3Q20, which is the most since 1965. Similarly, in the push to adapt to remote working demands and increased teleworking, capital spending in information processing equipment surged past pre-pandemic levels exceeding them by 14%. Low interest rates and increased demand for residential housing pushed investment up 59.3% over the quarter on an annualized basis, a trend that should continue as individuals adapt to living, working and commuting in a world where Covid-19 remains a risk factor.

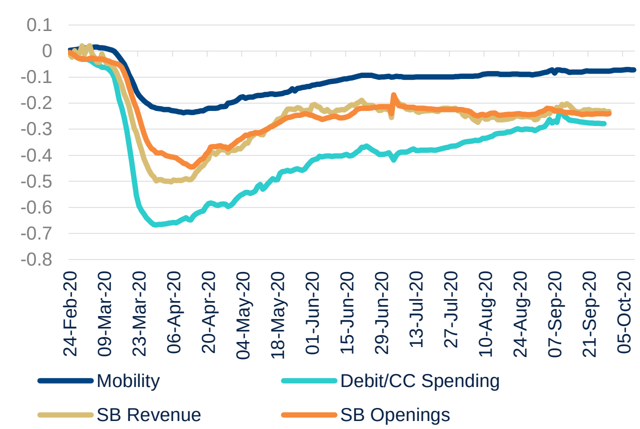
Trade-related frictions from the pandemic weighed heavily on net exports in 3Q20, pushing the deficit to the highest level ever at $1.0Tn in real terms. As a share of GDP, the trade deficit (-3.5%) was the highest in 8 years but significantly lower than the record of 5.9% back in 2005. Similarly, Federal state and local expenditures also declined due to the drop in fees paid to administer the Paycheck Protection Program loans at the Federal level and dire fiscal positions of most state and local governments that have led to nontrivial cutbacks.

Figure 3. **NET EXPORTS** (BN 2012$, %)



Source: BBVA Research & BEA

Figure 4 **HIGH FREQUENCY ECONOMIC INDICATORS** (JAN-2020=0)



Source: BBVA Research, Opportunity Insights, Google, Womply, Affinity & BEA

Although a potential fourth round of fiscal stimulus remains on the table, the positive income and savings shock from the previous stimulus has faded and real-time indicators suggest that economic activity is at a standstill. For example, while the impact that new Covid-19 cases are having on economic activity has diminished, mobility based GPS data has slowed down somewhat. Likewise, small business openings and revenue growth have stagnated, spending on credit and debit cards has fallen, and output of refineries and electricity have flattened. Moreover, new Covid-19 cases have surpassed the number registered during the summer surge with no signs of containment, suggesting that the upside to the service sector has diminished. Moreover, personal income is declining as the stimulus measures fade, creating headwinds unrelated to the health crisis that will impede growth in the fourth quarter.

Despite our expectation of a nontrivial slowdown in GDP growth in 4Q20, the strong rebound in 3Q20 adds an upside bias to our annual average forecast, implying growth between -3.5 and -4%. Nonetheless, the uncertainty around the outlook for 2021 remains elevated and conditional on how effective the next administration and Congress are at tackling the economic costs of the pandemic, and how quickly the economy can adapt to the post-Covid reality without protracted monetary and fiscal support. This implies that under a more optimistic scenario, GDP could return to pre-pandemic levels as early as 1Q22. However, under more pessimistic conditions, the full recovery could take much longer.