Economic Analysis

Economy Poised for Stronger Growth after 4Q20 Slowdown

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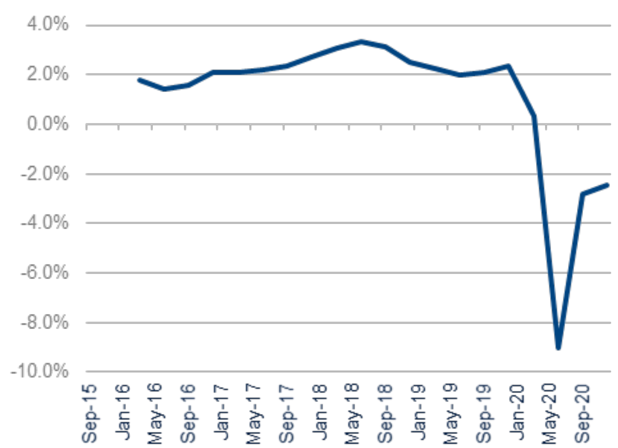
As we expected, economic activity continued to expand in the fourth quarter of 2020, albeit at a much slower pace than in the previous period. This reflected both solid ongoing momentum and the negative consequences of lower fiscal support and new restrictions after the spike in the number of cases across several parts of the country.

According to preliminary estimates from the BEA, real GDP increased 4.0% (SAAR) in 4Q20, which was slightly higher than our forecast of 3.2% but significantly lower than the third quarter (33.4%). On a year-over-year basis, economic activity contracted -2.5%. In 2020, growth contracted -3.5%, which was in line with our forecast of -3.6%.

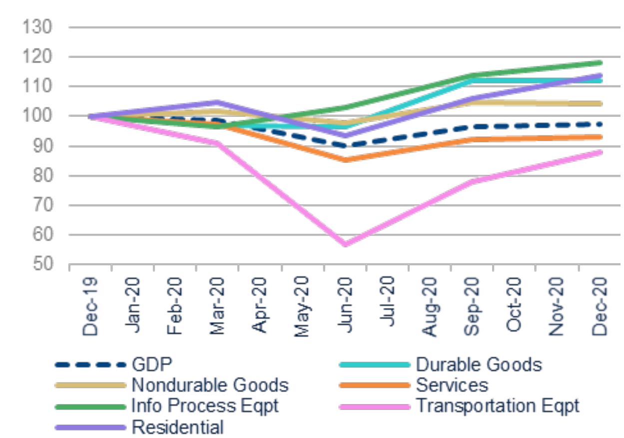
The stable economic performance in 4Q20 reflected a strong contribution from private investment, particularly residential, equipment, intellectual property and inventories. This reflected the uptick in business expectations after the strong recovery during 3Q20 and the need for inventory build-up.

Figure 1. **REAL GROSS DOMESTIC PRODUCT** (2012$, YoY%)



Source: BBVA Research & BEA

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



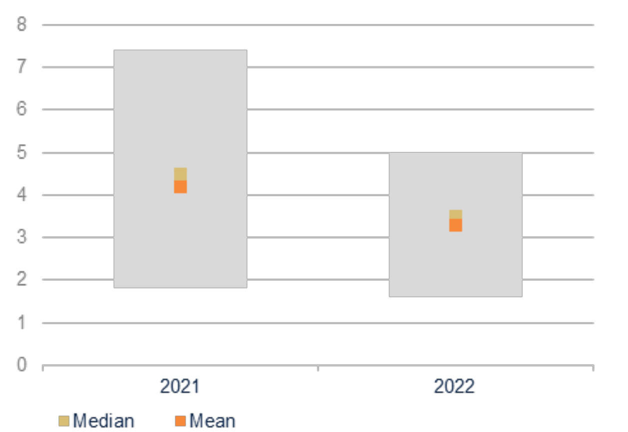
Source: BBVA Research & BEA

Structures posted their first positive gain in five quarters on the back of the strongest historical increase in mining activity despite the other four components contracting due to the pandemic and structural pressures. In fact, structures remain 14.1% below the 4Q19 level due to the sharp dislocation in manufacturing, retail, amusement and recreation, education, and lodging. In contrast, information processing equipment stands 18.1% above pre-pandemic levels, making it the component that has recovered the most during the pandemic, benefiting from the accelerated transition to the digital economy.

Although exports increased at a solid pace, the growth in imports resulted in a negative contribution from net exports. In fact, the trade deficit -adjusted for inflation- reached its highest historical level at $1.1tn. As a share of GDP, the trade deficit was 3.7%, its highest share in almost nine years. While the global recession induced by the pandemic impacted trade flows, these trends also are related to the trade war embarked on by the previous administration that did not help reduce the trade deficit.

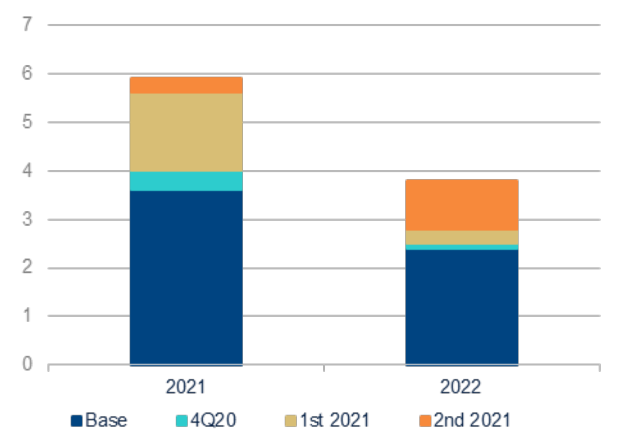
Meanwhile, government consumption and investment declined for the second consecutive quarter, as both nondefense and state & local spending continued contracting. In contrast, defense spending, which has only contracted in one of the last 11 quarters, posted its strongest growth rate since 4Q19.

Figure 3. **CONSENSUS GDP GROWTH EXPECTATIONS** (%)



Source: BBVA Research & Bloomberg

Figure 4. **REAL GDP GROWTH SCENARIOS** (%)



Source: BBVA Research

Although personal consumption increased 2.5% during 4Q20, the monthly estimates suggest that it slid down quickly towards the end of 2020, entering recession-like territory. In fact, after a 1.1% monthly gain in September, consumption slowed to 0.3% in October and declined -0.4% and -1.3% in November and December, respectively. This reflected a sharp decline in recreational and household equipment, groceries, gasoline, transportation services and restaurants. This was due to both the base-effects after the strong recovery in 3Q20 and the new restrictions that went into effect following the spike in infections during 4Q20. Nonetheless, solid gains in healthcare and recreation services, autos and other durable goods such as mobile phones, helped overall consumption to remain in positive territory.

While personal consumption could have been stronger had policymakers not waited until the end of the year to pass the additional stimulus, the latest relief package has nearly eliminated the probability of negative GDP growth in 1Q21. In fact, the combination of the year-end relief, which is already being distributed, and the high likelihood of additional support in 1Q21 creates a significant upward bias to our GDP outlook for 2021 and 2022.

A conservative estimate would assume that only a modest share of Biden's $1.9tn proposal would get Congressional approval. A more pessimistic scenario with increased mobility restrictions, an ineffective rollout of the vaccine and political gridlock would mean that the new administration would have to manage additional fiscal stimulus through budget reconciliation, limiting the upside to growth. A more optimistic perspective with control of contagions and successful vaccination efforts, coupled with the assumption that a larger share of the relief gets implemented now and later in the year with another sizeable round of fiscal support, would imply much higher growth. Due to the abnormally high uncertainty, consensus GDP growth expectations range between 1.8% and 7.4% for 2021 and between 1.6% and 5% for 2022. In any case, median forecasts imply that GDP growth in 2021 would be the highest since 1999.

In the pessimistic scenario, GDP would not return to pre-pandemic levels until 2024 or later, and it would remain below that which would have existed in the absence of the pandemic, thereby cementing the level-effects of the pandemic. In the optimistic scenario, GDP could return to the pre-pandemic level by mid-year and shortly after surpass that which would have prevailed if the pandemic had not taken place, thereby eliminating the level-effects of the pandemic. Regardless, the fiscal response during the pandemic, unlike the Global Financial Crisis, has been timely, forceful and effective. This has put the U.S. economy in an enviable position, one that if managed correctly could cement U.S. hegemony and ensure long-term sustainability.