

GDP: Bad, And Getting Worse

Before the Coronavirus, the US economy was cruising for what looked like 3% annualized growth in real GDP in the first quarter. But the effects of both natural social distancing and government-mandated lockdowns crushed economic growth in March.

As a result, we now think real GDP contracted at a 3.7% annual rate in Q1, led by a massive drop in inventories as well as declines in consumer spending, business investment in equipment, and commercial construction. That 3.7% is not set in stone, however. We'll get some reports on inventories and international trade on Tuesday morning, and may refine our forecast then. Either way, it's going to be bad.

But the second quarter, which we're already in, is going to be worse. How much worse? Put it this way: Since 1947, the worst quarter in our history was a 10% annualized drop in the first quarter of 1958, on the heels of the Asian Flu. In the current quarter, real GDP is likely to drop at about a 30% annual rate, rivaling declines last seen during the late-1945 wind-down from World War II as well as the Great Depression.

We also expect an unemployment rate that flirts with 20%, compared to highs of 10.0% in the aftermath of the Great Recession in 2009 and 10.8% at the end of the brutal 1981-82 recession.

The key for investors to remember is that none of this is going to shock anyone; the markets already know it's going to be awful. Instead, investors need to focus on how quickly we are going to recover, which will depend on finding ways to carefully ease lockdowns, the virulence of the Coronavirus in the months ahead, the timeline for developing therapies, and, ultimately, the timeline for developing a vaccine.

In the meantime, the loss in output is going to be huge. Real GDP for all of 2020 will be about 5.0% lower than 2019, versus the roughly 2.5% higher it would have been in the absence of the Coronavirus. In turn, federal revenue will be down, and would have been lower even in the absence of recent policy

changes, like the IRS sending out checks for \$1,200 per adult and \$500 per child, as well as delays in employers paying their share of payroll taxes.

The Congressional Budget Office recently updated its forecast for the budget deficit for the current fiscal year (ending September 30) and expects it to be about \$3.7 trillion, or roughly 18% of what we estimate to be fiscal year GDP. To put that in perspective, the budget deficit hit 9.8% of the GDP in 2009 and the deficit peaked at 29.6% of GDP in 1943.

In the months ahead, investors should focus on two key pieces of macro-data. First unemployment claims. It looks like initial claims peaked at 6.9 million the week ending March 28 and have since declined three weeks in a row, to a still humongous 4.4 million the week ending April 18. However, continuing unemployment claims are still rising every week and will likely keep doing so for at least another month. Watch continuing claims carefully: we expect a peak in continuing claims, whenever it happens, to signal the bottom for the recession.

Second, we're following the federal government's receipts for withheld income and payroll taxes, which are reported daily. Those are down around 10% from a year ago, but are very volatile from day to day. We're waiting for that year-ago comparison to hit bottom and then start getting less bad, which would suggest an economic bottom, as well.

In addition, we'll be following reports on auto sales, hotel occupancy, passengers going through TSA checkpoints, gas purchases, railcar traffic, and steel production (we update this every Thursday on [our blog here](#)).

What investors need to keep in mind is that when they invest in stocks, they're not buying shares of GDP; they're buying shares of specific companies that offer an always changing flow of goods and services. We think the worst news is already factored in. Investors who can grit their teeth through the economic pain should be rewarded in the years ahead.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
4-29 / 7:30 am	Q1 GDP Advance Report	-3.9%	-3.7%		2.1%
7:30 am	Q1 GDP Chain Price Index	1.0%	1.3%		1.3%
4-30 / 7:30 am	Initial Claims – April 25	3.500 Mil	3.615 Mil		4.427 Mil
7:30 am	Personal Income – Mar	-1.6%	-1.7%		+0.6%
7:30 am	Personal Spending – Feb	-5.0%	-3.3%		+0.2%
8:45 am	Chicago PMI – Apr	38.2	30.0		47.8
5-1 / 9:00 am	ISM Index – Apr	36.1	35.0		49.1
9:00 am	Construction Spending – Mar	-3.5%	-3.0%		-1.3%
afternoon	Total Car/Truck Sales – Apr	7.0 Mil	7.7 Mil		11.4 Mil
afternoon	Domestic Car/Truck Sales – Apr	4.0 Mil	6.2 Mil		9.1 Mil