Rodney’s Take

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Second-Quarter GDP Puked 32.9%... What’s Next?

The first quarter ended on a sour note, with businesses shutting down during the month of March, which sank GDP by 5%. That was just the warmup, as we all know what happened next. During the second quarter, GDP dropped an eye-watering 32.9%.

Luckily, if we can call it that, these numbers are annualized, so the actual declines were 1.3 % in the first quarter, followed by 9.5% in the second quarter. The numbers aren’t one fourth of the annualized figure because of compounding growth rates. While that’s a lot better than -5% and -32.9%, it’s still horrible.

To get a sense of how much we lost, consider that GDP fell by 0.1% in 2008 and by 2.5% in 2009, for a total loss of 2.6% at the worst point in the Great Financial Crisis. We just lost more than four times that amount in roughly 120 days (starting with the pandemic on March 1 and going through the end of the second quarter).

Put another way, we just erased all of the economic activity gains we made in 2019, 2018, 2017, 2016, and half of 2015. We gave up 1,642 days of gains in just 120 days.

But now we're on our way back! Sort of.

There's no doubt economic activity began to pick up in late May and June, and a chunk of that carried over into July and now August. The Federal Reserve Bank of Atlanta maintains an economic forecasting model called GDPNow, which I've discussed before. The model updates after most important economic releases to provide a GDP forecast for the current quarter. The first estimate for the third quarter was 11.9%, which sounds great. The second estimate, or first update, pushed the number up to 19.6%, which is even better!

Again, these numbers are annualized. While dividing by four doesn't give us an exact estimate of quarter-over-quarter change, we can still get a general idea. The latest 19.6% GDP estimate would roughly equate to an increase of 5%. That's a great number, but it wouldn't even get us halfway back to where we were, and there are good reasons to question whether this high growth rate will hold.

With local and state officials reinstituting restrictions on businesses, we're likely to see the recovery stall. Note that this isn't the same as rolling over again and diving lower, it's just stalling near the current rate of activity. If this happens, then the 19.6% GDPNow forecast should decline in the months ahead, as we get new information on durable goods orders, retail sales, etc.

And then there's the mortality issue, not of people but of businesses.

We don’t know how many businesses will fail because of the pandemic. We do know that more than 100,000 have already closed and more close every day. If you can’t bring in sufficient revenue, you can’t pay your bills, it’s that simple.

I recently wrote that now is a great time to open a restaurant if you have the cash to wait out the pandemic and the desire to be in the business. While several of you called me out for suggesting people get into an industry in which it is so hard to succeed, my point remains. Consumers are being artificially held back from spending as they wish. When the restrictions are lifted, we’ll be seeking out ways to spend and will have fewer choices.

This makes it a great time to get into the industries that will benefit from renewed demand, but it also means that, at least at first, we can’t possibly spend as much in those areas, because many businesses no longer exist.

And we can’t change the calendar.

Some of our potential spending is gone forever. We can’t get back the summer vacation we didn’t take. We’re not going to eat twice as many restaurant meals to make up for the ones we missed or see twice as many movies to make up for missed trips to the cinema.

One more thing to consider is that our savings rate sits just above 25%. We might not be able to make up for lost spending in some areas, but we can certainly redirect the cash. If we get another relief package, which is likely, then the unemployed will stay afloat and evictions will remain at bay probably through the end of the year. This could drive holiday spending significantly higher, especially for gadgets and electronics as more people spend time online.

As for GDP growth, I expect it will fade from the 19.6% currently forecast by GDPNow, and then come back with a vengeance in the fourth quarter, but with economic activity well below the level of 2019.

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Got a question or comment? You can reach us at info@hsdent.com.