US Daily: Downgrading Our US GDP Forecasts

- We expect US economic activity to contract sharply in the remainder of March and throughout April as virus fears lead consumers and businesses to continue to cut back on spending such as travel, entertainment, and restaurant meals. Emerging supply chain disruptions and the recent tightening in financial conditions will likely add to the growth hit.
- Our baseline assumption is that activity will start to recover after April and that H2 will see strong sequential growth, but the specifics depend on a number of important questions. Some are medical, including the extent to which social distancing and seasonally higher temperatures will reduce infections as well as whether good treatments will emerge. Others are behavioral and economic, including how quickly reduced infections will bring back everyday activities and how effective easier monetary and fiscal policy will be in providing support.
- All told, we now expect real GDP growth of 0% in Q1 (from +0.7%), -5% in Q2 (from 0%), +3% in Q3 (from +1%), and +4% in Q4 (from +2¼%), with further strong gains in early 2021. This takes our 2020 GDP forecast down to +0.4% (from 1.2%). The uncertainty around all of these numbers is much greater than normal.
- Would the NBER business cycle dating committee classify our new forecast as a recession, given that it involves only one quarter of strictly negative growth? It is not entirely clear, but we think the answer is probably yes. The committee has noted previously that even a contraction of just a few months can meet its recession definition if it is sufficiently deep.

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Downgrading Our US GDP Forecasts

Over the last week, the number of coronavirus cases in the US has risen rapidly. In response, business and government leaders have begun much stronger measures to combat the spread of the virus. Even with monetary and fiscal policy turning sharply further toward stimulus—we expect a 100bp rate cut on Wednesday and a fiscal impulse of 1-2% of GDP—these shutdowns and rising public anxiety about the virus are likely to lead to a sharp deterioration in economic activity in the rest of March and throughout April.

Virus fears have already begun to lead US consumers and businesses to reduce spending on activities such as travel, entertainment, and restaurant meals. Airlines have eliminated a significant share of flights, conferences have been called off, major cruise lines have canceled all cruises, theme parks have shut down, and hotel occupancy has fallen sharply in cities with early virus outbreaks. Among sports leagues, the professional and college basketball, hockey, and soccer seasons have been cancelled, as have major golf and tennis events, and the baseball season has been postponed. Data from online restaurant reservations also points to a large drop in restaurant visits, especially in the worst affected cities such as Seattle.

While we are not assuming an Italy-style national shutdown in the US, the experience of countries like Italy, Spain and France offers some indications of the impact that extreme local-level quarantines could have. In Italy, for example, all retail stores except drug stores and grocery stores are closed, all restaurants are closed, hotel occupancy is at a small fraction of capacity, and some factories have closed temporarily while many others are operating below normal levels because workers are resisting going to work out of fear of getting sick.

Exhibit 1 provides illustrative estimates of how large the GDP impact of these consumption cutbacks could be at their peak in the worst-affected areas. The bottom of the exhibit shows our assumptions about the peak magnitude of cutbacks—for example, we assume an 80% decline in spending on sports and entertainment and a 50% decline in hotel and restaurant spending. We have scaled up some of our earlier estimates based on preliminary signals from US cutbacks to date and from the experiences of other economies that went through large outbreaks earlier this year. The bars in the exhibit multiply these assumed cutbacks by the GDP share of each category to estimate the impact on the level of GDP.

In total, our assumptions about consumption cutbacks in these categories imply a peak hit to the *level* of GDP in the worst-affected areas of 6-7%. Reductions in home sales of the sort seen in other virus-hit economies and in business investment would add to the hit to GDP. The impact on US GDP growth depends on what share of the country is affected at a particular time, how close the affected areas come to the peak hit shown in Exhibit 1, and how long the retreat from normal economic life lasts. Our baseline scenario assumes the largest impact in April, with many areas of the US experiencing about two-thirds of the peak effect shown in the chart.

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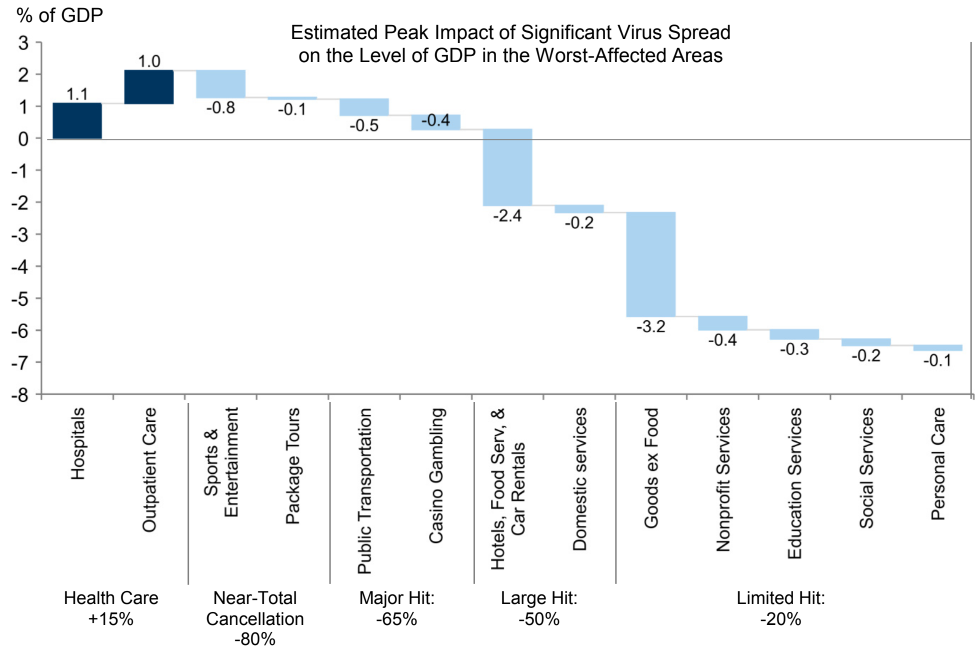
Exhibit 1: We Expect Major Cutbacks in US Consumer Activity Through April



Source: Goldman Sachs Global Investment Research

Beyond the hit to consumer spending, there are two other reasons for revising our growth forecast. First, the likelihood of significant supply chain disruptions has grown. Nearly 75% of companies responding to an ISM survey conducted in late February and early March reported that they have already experienced disruptions related to the coronavirus. This is a larger and earlier impact than we had expected. Second, we have significantly increased our assumptions for the boost from fiscal policy and now see an easing of 1-2% of GDP.

So what does all this mean for the growth outlook? Our baseline assumption is that after the near-term slump, activity will start to recover after April and that H2 will see rapid sequential growth. However, the specifics depend on how successful government actions will be in limiting the spread of the virus, how warmer and more humid weather will affect its spread, how quickly potential medical responses will progress, how strongly and for how long people will choose to cautiously avoid normal activities, and how effective monetary and fiscal policy will be in supporting the economy.

With all of these uncertainties noted, Exhibit 2 shows our new baseline growth estimates as well as its major drivers, especially the virus impact and fiscal policy. We now expect real GDP growth of 0% in Q1 (from +0.7%), -5% in Q2 (from 0%), +3% in Q3 (from +1%), and +4% in Q4 (from +2¼%), with further strong gains in 2021. This takes our 2020 GDP forecast down to +0.4% on an annual-average basis (from 1.2%). For the virus impact, we assume that some components of consumption—e.g. restaurant meals and goods consumption—normalize quickly after April while others—e.g. major sports events and international travel—are disrupted for longer. For the fiscal boost, we assume longer lags than normal because we think that the near-term disruptions and the hit to sentiment may keep households from spending their added after-tax income until later in the year. Finally, Exhibit 2 does not include an impact from

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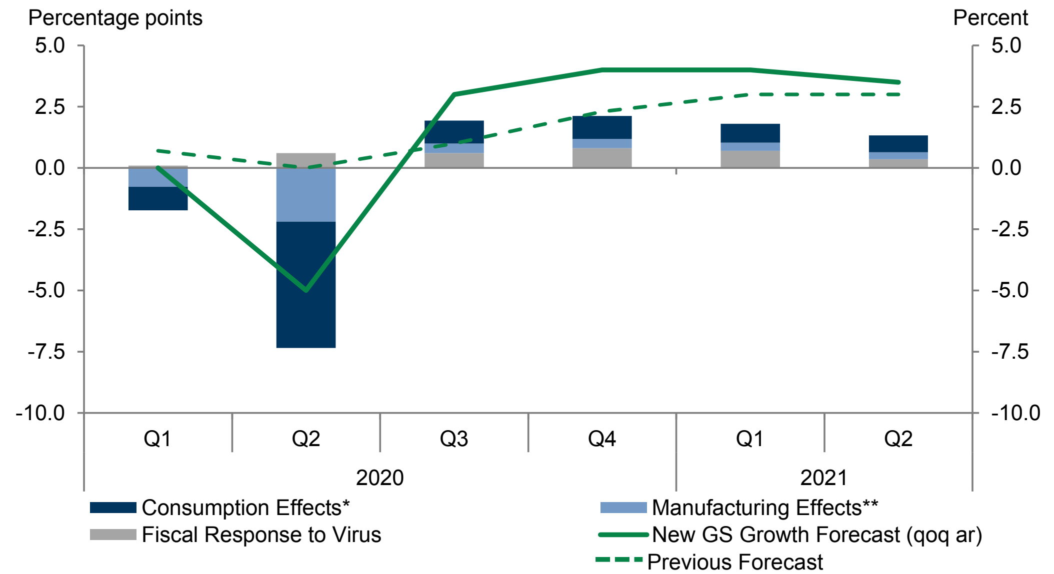
financial conditions because the path of our FCI is simply too uncertain under current circumstances; that said, if we built an added near-term hit from the recent tightening but assumed that financial conditions will start to ease sharply sometime in Q2 as the situation normalizes, this would imply an even deeper contraction in Q2 and an even stronger rebound thereafter.

Exhibit 2: A Deep Contraction in Q2, Followed by a Rebound



Source: Goldman Sachs Global Investment Research

If our revised forecast is broadly correct, it is not entirely clear whether the business cycle dating committee of the National Bureau of Economic Research (NBER) would classify the current episode as a recession, as it would involve just one quarter of strictly negative growth. But we think the answer is probably yes. During a recession, according to the official definition, "a significant decline in economic activity spreads across the economy and can last from *a few months* to more than a year" (emphasis added). The official definition emphasizes both the monthly chronology of diminishing activity and the depth of the decline and has usually but not always overlapped with the popular definition of two consecutive quarters of decline in real GDP. For example, in its comment on the brief recession from January to July 1980, the committee noted that although gross national product contracted for only one quarter, "the depth and breadth of the contraction in early 1980 clearly marked it as a recession, in spite of its unusual brevity."

US Economics Group

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