July 30, 2020

ECONOMIC REPORT

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LARGEST-EVER ONE QUARTER CONTRACTION IN GDP IN Q2; UI CLAIMS REMAIN STUBBORNLY HIGH

SUMMARY

- Real GDP plummeted 32.9 percent annualized in the second quarter, the biggest drop ever. The U.S. economy contracted 10.5 percent in the first half of 2020.
- Outside of the federal government, all components of GDP in the second quarter were extremely weak.
- Initial claims for unemployment insurance rose in the week ending July 25, and continuing claims rose for the week ending July 18. More than 30 million people are receiving UI benefits. The improvement in the labor market is slowing.
- Real GDP will increase in the second half of 2020, but the pace of the recovery will depend on the path of the coronavirus and the amount of fiscal stimulus Congress provides.

Real GDP plummeted 32.9 percent at an annualized rate in the second quarter of 2020, by far the biggest drop in the history of the series, going back to 1947. The previous largest decline was 10.0 percent in 1958. The U.S. economy did not contract by one-third in the second quarter; the annualized number means that the economy would have contracted by 33 percent if the pace of decline in the second quarter lasted for an entire year. The economy contracted 9.5 percent at an unannualized pace in the second quarter; that is, the economy was almost 10 percent smaller in the second quarter of 2020 than it was in the first quarter. Final sales of domestic product, which is GDP minus the change in inventories and measures total demand for goods and services produced in the United States, fell 29.3 percent annualized in the second quarter.

Real GDP fell 5.0 percent in the first quarter (annualized), unrevised from the previous estimate. In the first half of 2020 real GDP contracted 10.6 percent unannualized. By comparison, during the Great Recession a decade ago real GDP fell 4.0 percent over six quarters, so the Viral Recession was a much more severe downturn during a much shorter period of time. On a year-ago basis real GDP was down 9.5 percent in the second quarter. This was by far the biggest year-over-year contraction in the history of the series. The size of the U.S. economy, adjusted for inflation, is now back to where it was in 2014 (see Chart 1).

The coronavirus pandemic and restrictions on economic activity hit most components of the U.S. economy in the second quarter (see Chart 2). Consumer spending fell almost 35 percent annualized, subtracting 25 percentage points from annualized growth, as households cut back drastically on their purchases due to stay-at-home orders, a reluctance to venture out, and massive job losses. Business fixed investment dropped 27 percent, subtracting almost 4 percentage points from growth, as firms tried to weather the storm. Residential investment fell 39 percent, subtracting almost 2 percentage points, as homebuilding contracted with many construction sites closed.

Inventories subtracted 4 percentage points from growth in the quarter as businesses rushed to cut stocks amid weak demand and supplies from abroad were disrupted. Trade was a slight positive in the second quarter, adding a little less than 1 percentage point to growth. Exports fell 64 percent annualized as the pandemic caused supply chain disruptions and demand from overseas for U.S. goods and services dropped. Imports fell 53 percent as U.S. consumers bought less from abroad, due to both weak demand and limited supplies.

Government spending in GDP rose 2.7 percent annualized in the quarter, with a 17 percent increase in federal spending in response to the pandemic offsetting a 6 percent drop for state and local spending. Overall, with government purchases up the contraction in second quarter GDP was about one percentage point smaller than it otherwise would have been.

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The GDP price index fell 1.8 percent annualized in the second quarter as prices fell for most goods and services. This was the biggest one-quarter drop in economy-wide prices since 1948. The GDP price index was up 0.6 percent in the second quarter from one year earlier.

The personal consumption expenditures price index, the Federal Reserve's preferred inflation measure, fell 1.9 percent annualized in the second quarter, but was still up 1.5 percent from one year earlier. The core PCE price index, which excludes volatile food and energy prices, dropped 1.1 percent in the second quarter and was up 1.6 percent from a year earlier. Consumer prices are likely to increase in the third quarter as demand picks up.

As expected GDP contracted by the most on record in the second quarter; the only question was how bad it was going to be. The 33 percent annualized decline was close to most estimates of 30 to 35 percent. But that is backward looking—how the economy did in the second quarter. The question now is what the recovery is going to look like. Most measures of economic activity—employment, retail sales, housing starts, auto sales, etc.—have improved since April, indicating that economic growth has resumed and GDP will increase in the third quarter.

But the strength of the nascent recovery is highly uncertain. Much of it depends on the path of the virus. The pickup in coronavirus cases in many parts of the country is very concerning. Many states are reimposing restrictions on economic activity, although in a more targeted way than earlier in the crisis. But even without state mandates, continued spread of the virus is deterring consumers from spending and weighing heavily on industries such as travel and tourism, restaurants, and in-person entertainment. As long as people are reluctant to be in large groups, the recovery will be soft.

In addition, fiscal stimulus is at risk of fading. One-time stimulus payments and extended and expanded unemployment insurance benefits allowed consumers to boost their spending in the late spring as the economy started to reopen, even with job losses of 22 million in March and April. But the boost from the stimulus payments is fading, and an extra $600 per week in unemployment benefits is set to expire on July 31. If these payments do expire aggregate household income would fall by about $75 billion a month, which is likely to lead to a drop in consumer spending and weigh on the recovery.

Assuming the spread of the virus is contained and Congress passes additional fiscal stimulus, PNC's baseline forecast calls for economic growth that is well above its long-run trend in the second half of 2020 and throughout 2021. PNC expects annualized GDP growth of around 10 percent in the second half of 2020. Even so, real GDP is

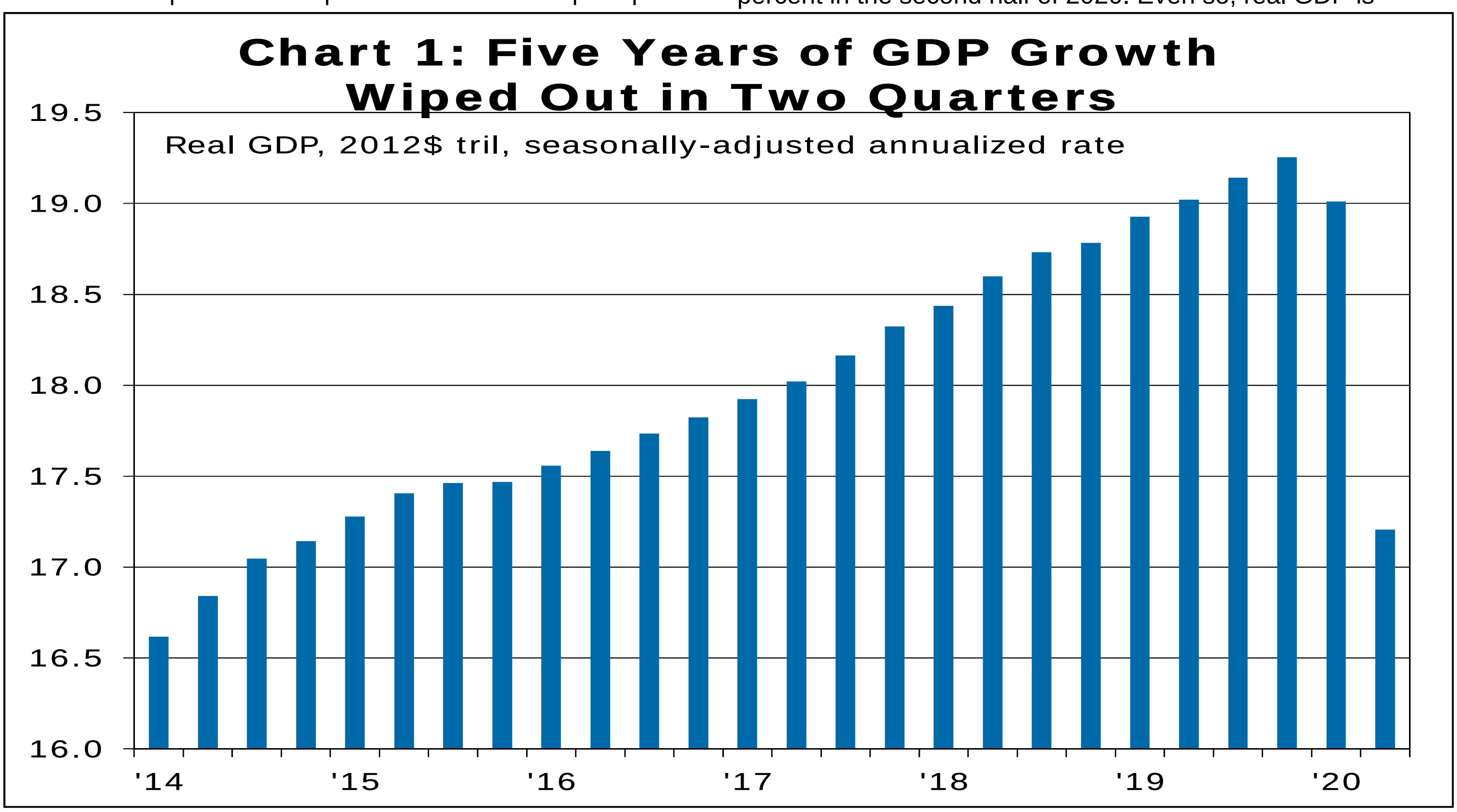

Chart source: Bureau of Economic Analysis

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not expected to return to its pre-recession level until the first half of 2022.

Initial claims for unemployment insurance rose for a second straight week in the week ending July 25 to 1.434 million, up 12,000 from the previous week (1.422 million, revised higher from 1.416 million). The increases of the past two weeks followed sixteen straight weeks of decline since the end of March, when initial claims peaked at an all-time high of almost 7 million. Although claims are down almost 80 percent from their record high, they are still far above their early 2020 level of around 200,000 per week.

Continuing claims, which measure the number of people receiving regular UI benefits, were up 867,000 in the week ending July 18, to 17.018 million. Claims for the week ending July 11 were revised slightly lower, to 16.151 million, from 16.197 million. This was the first increase in continuing claims in 8 weeks. Continuing claims peaked at almost 25 million in early May, and have slowly declined. Before the crisis in early 2020, continuing claims were about 1.7 million per week.

In addition, 830,000 people filed claims for the special Pandemic Unemployment Assistance program (PUA) in the week ending July 25, down 106,000 from the previous week (not seasonally adjusted). There were 12.4 million people receiving PUA in the week ending July 18, up from 13.2 million the previous week (again, not seasonally adjusted). Overall there were 30.2 million people receiving some form of unemployment benefits in the week ending July 18, down from 31.8 million the previous week.

The picture of the labor market from UI claims is mixed. After skyrocketing in March and April as the pandemic hit, the number of people filing for unemployment insurance benefits initially declined, but appears to have leveled off in recent weeks. Claims are volatile, and seasonal adjustment problems around the pandemic are making comparisons more difficult. But what is apparent is that layoffs remain far above their pre-pandemic level, that tens of millions of workers have lost their jobs over the past few months and remain unemployed, and that the pace of improvement in the labor market has slowed.

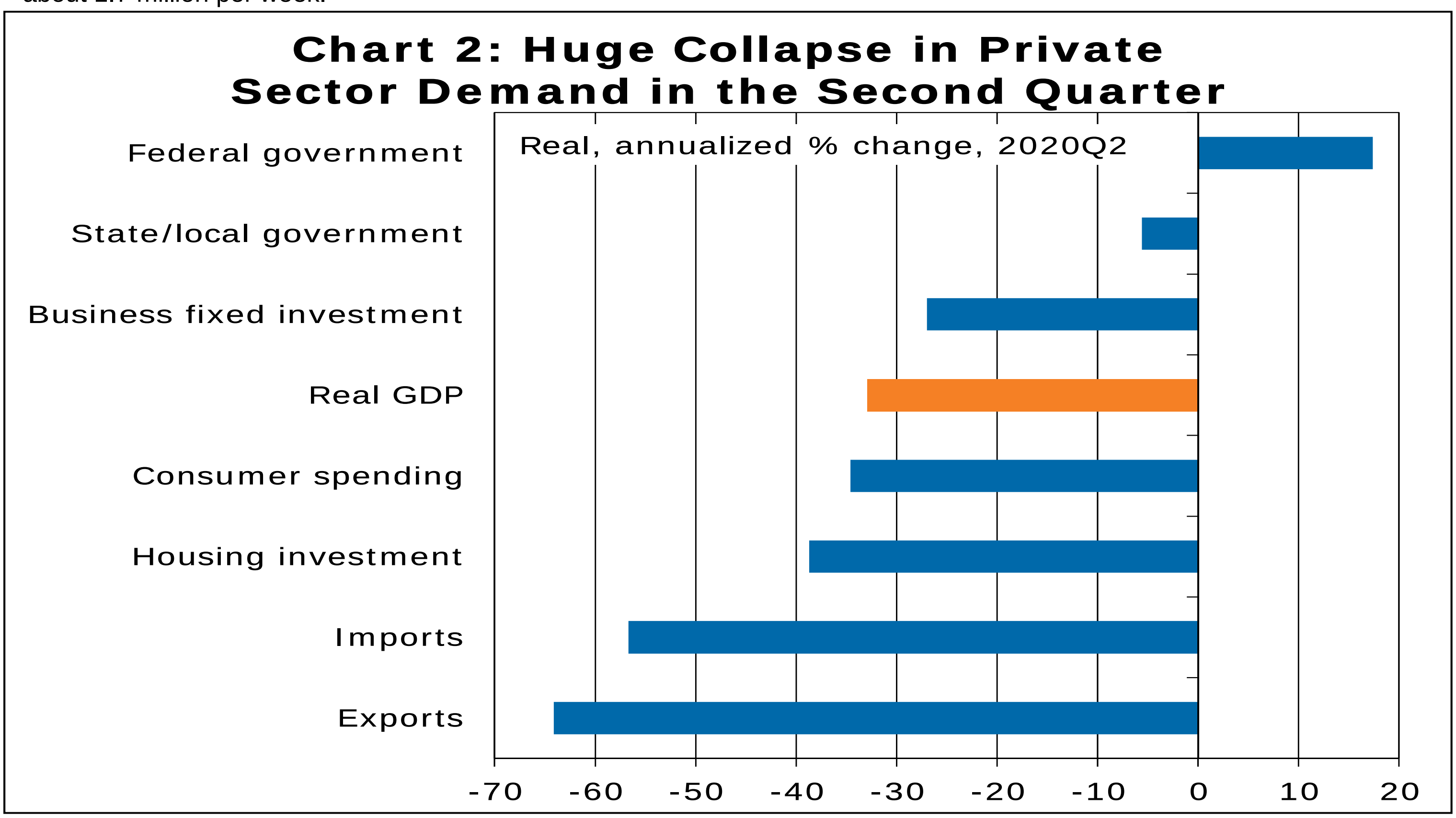

Chart source: Bureau of Economic Analysis

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