October 29, 2020

ECONOMIC COMMENTARY *from the Investment Advisory Group*

Massive Third Quarter Rebound, But US Economy Still Has Further to Go

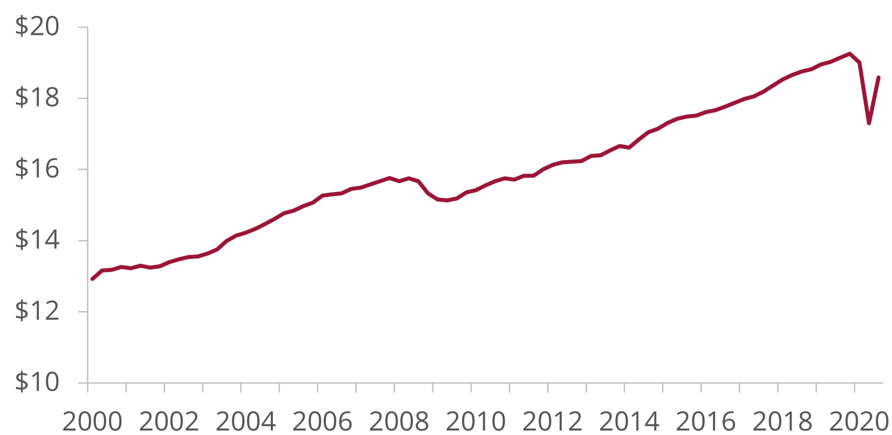
Michael Skordeles, AIF®
Director, US Macro Strategist
SunTrust Advisory Services, Inc.

Executive Summary: The US economy rebounded sharply in the third quarter, up 33.1% on an annualized basis and besting the consensus expectation of 32%. This is an excellent first step in the recovery from the 31.4% contraction in the second quarter. However, the US economy has a steep path to climb over the coming quarters to fully recover to pre-pandemic levels of gross domestic product (GDP).

Still Further to Go for Full Recovery

Despite the massive third quarter rebound, the US economy remains $670 billion (annualized) below pre-pandemic levels, as the chart below shows, and it will likely take until late 2021 to fully recover the lost ground.

Gross Domestic Product (Dollars in Trillions)

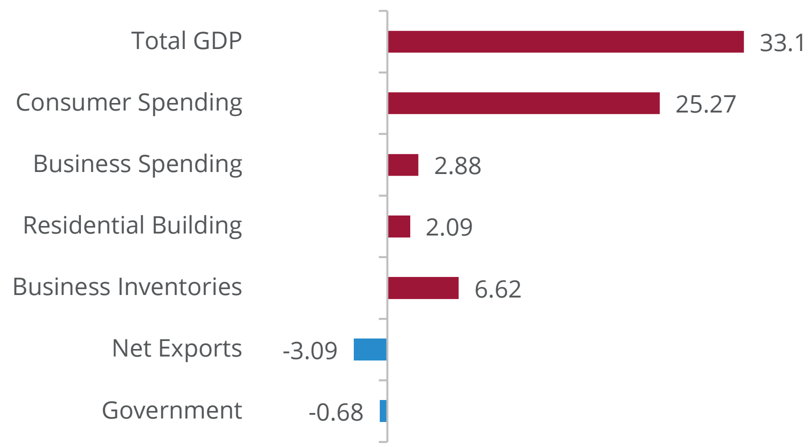


Data Source: SunTrust IAG, Bureau of Economic Analysis;
Figures shown are chained (2009) dollars on a seasonally adjusted annual rate.

A Review of the Major Categories

In a mirror image of the second quarter GDP data points, most of which were the worst since quarterly data collection began in 1947, the third quarter data are the best figures ever recorded. Accordingly, with no comparison to prior periods, we will not repeatedly note each data point as being the best on record throughout this report and will only note the exceptions.

Contributions to Percent Change in the Third Quarter 2020
US Gross Domestic Product



Data Source: SunTrust IAG, Bureau of Economic Analysis

Consumer services accounted for roughly half of total GDP, with healthcare services contributing almost a quarter of the rebound in third quarter headline GDP.

Consumer spending rebounded sharply, increasing 40.7% in the third quarter on an annualized basis. Total consumer spending surged to $12.9 trillion, a massive increase of nearly $1.1 trillion quarter over quarter, and added 25.27 percentage points to overall GDP.

The rebound in consumer services accounted for roughly half of total GDP. Healthcare services were the largest contributor, adding 7.61 percentage points to overall GDP, or nearly a quarter of the total. This includes healthcare of all stripes, from wellness and routine visits to primary care physicians along with non-emergency surgeries, which have largely reopened. Restaurants and hotels added another 4.33 percentage points to GDP. Recreation services—from health clubs and pools to spectator sports, concerts and amusement parks—chipped in another 2.44 percentage points to GDP.

Spending on big-ticket items (durable goods) spiked 82.2% on an annualized basis, while overall goods spending increased 45.4% and added 9.24 percentage points to GDP. We believe the improvement was the result of the CARES Act checks and other government support programs, along with payment and rent forbearance on the private side.

Residential construction also spiked, increasing 59.3% on an annualized basis and added 2.09 percentage points to overall GDP. We anticipate this strong trend will continue based on multiple private reports indicating that housing demand remains robust, aided by historically low mortgage rates and tight supply.

Business inventories jumped by $286.1 billion from the prior quarter, adding 6.62 percentage points to overall GDP. All but $7.4 billion were nonfarm inventories. Meanwhile, farm inventories rose modestly as production continued, though exports remain hampered.

Outside of inventories, overall business spending declined for the third straight quarter. It rose 20.3% in the third quarter and added 2.88 percentage points to overall GDP. Spending on equipment soared 70.1% on an annualized basis, but commercial construction fell -14.6%, the fourth straight quarterly decline.

On the downside, net exports carved off 3.09 percentage points from overall GDP, as goods imports soared 107.9% on an annualized basis, while exports of goods and services increased 59.7%. We regularly note that the net export figures are based on incomplete data at this stage of the quarterly process and are frequently revised.

Government spending fell 4.5%, slicing off 0.68 percentage points from overall GDP. Federal spending fell 6.2%, but non-military spending declined 18.1%. State and local spending decreased 3.3% during the quarter. Looking ahead, we are concerned about constrained state and local budgets, which cannot run deficits and comprise roughly two-thirds of total government spending.

Bottom Line

The US is in the early innings of a self-sustaining recovery. While we are delighted by the massive jump in economic activity during the third quarter, we recognize that the easy part of the recovery (in relative terms) is behind us. The recovery pace is transitioning from the V-shaped initial phase to a much slower pace in the coming quarters, likely to be less than a 5% annualized pace in the fourth quarter 2020.

As such, the recovery path should resemble Nike's iconic swoosh logo as the recovery process slows. Indeed, the pandemic—the path of the virus, the rate of new infections, the availability of therapeutics and a possible vaccine—will have the most impact on the pace of the recovery going forward. Many activities remain restricted, which will likely continue to drag on activity until therapeutics improve further or effective vaccines are widely available. Moreover, the unevenness in the recovery by industry and region will persist for several more quarters. Alternatively, the government support programs, with a large income replacement component for individuals and businesses, along with the Federal Reserve's efforts, have clearly blunted some of the downside and hastened the recovery. That was evident in the strength of this report's consumer spending data. While additional government support would smooth the transition to a slower recovery pace, we believe the US recovery will continue with or without additional support, though it would obviously help individuals avoid needless hardships during the transition.

Revisions to third quarter 2020 GDP will be released at 8:30 AM ET on November 25, 2020.

*Editor's Note: Any discussion of the subsequent revisions to third quarter 2020 GDP—**if needed**—will be published in the Quick Hit format.*

Disclosures

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CN2020- 2313 EXP12-2020

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