August 27, 2020

Economics Group

Jay H. Bryson, Chief Economist
jay.bryson@wellsfargo.com • (704) 410-3274
Shannon Seery, Economist
shannon.seery@wellsfargo.com • (704) 410-1681

Minor Revisions to Second Quarter GDP

According to the second estimate, real GDP declined at a 31.7% annualized rate in the second quarter. Revisions were minor in terms of the underlying components. As expected, corporate profits plunged in the quarter.

Minor Revisions in the Context of Steep Decline in GDP

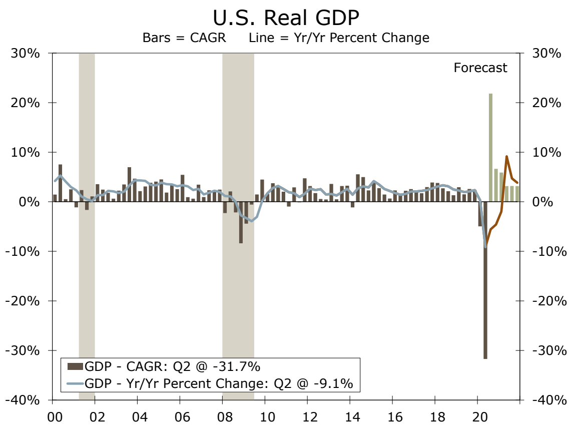
Data released this morning showed that real GDP in Q2-2020, which was originally reported to have nosedived at an annualized rate of 32.9%, was revised to a decline of 31.7% (top chart). Still, the revised swoon in second quarter real GDP remains by far the steepest rate of decline on record. The next steepest drop of 10.0% occurred in 1958. However, recent monthly indicators suggest real GDP will bounce markedly in the third quarter (top chart).

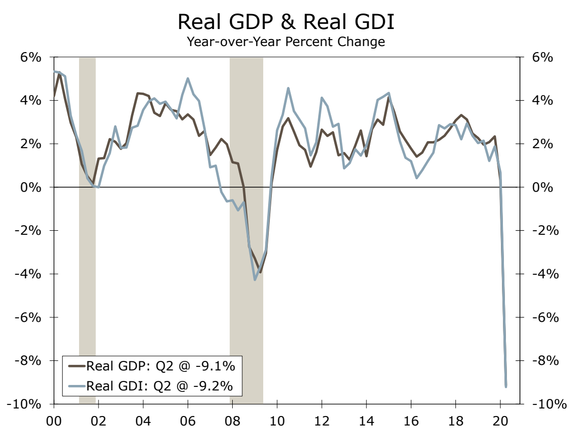
The revisions to the spending components were miniscule in the context of the unprecedented contraction in the economy. Real personal consumption expenditures (PCE), which accounts for two-thirds of spending in the economy, led the way with a decline of 34%. But growth in most other spending components remained deeply in negative territory. Specifically, fixed investment spending plunged 29% and real exports of goods & services tanked by 63%. The only major component to record positive growth was spending by the federal government, which jumped about 18%. As we noted a month ago when the first estimate of Q2 GDP was reported, the increase in federal spending largely reflect the administrative costs of the PPP loans that were extended in the second quarter.

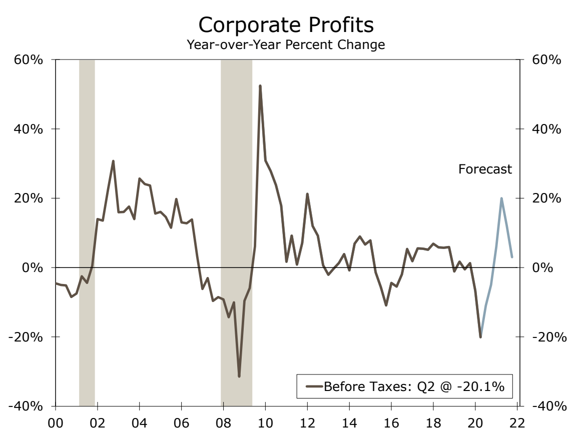
Turning to the income side of the National Income and Product Accounts, real Gross Domestic Income (GDI) fell at an annualized rate of 33.1% in Q2 (middle chart). Although government transfer payments helped prop up income to households (up 34.3%), the 39.0% drop in proprietors' income and 37.7% decline in profits (all annualized) more than offset that gain and led to the overall decline in GDI.

Compared to a year-earlier, pre-tax profits fell 20.1% in Q2 as profitability was hammered by lockdowns, which led many businesses to either temporarily cease operation or continue under minimized capacity. The decline in domestic profits was entirely due to non-financial industries, where profits slid 15% in Q2 compared to Q1. Profits in the financial sector *rose* 9%. But, with nonfinancial profits accounting for roughly 70% of domestic profits, it more than offset any gain coming from financials. Further, foreign profits, or remittances from foreign subsidiaries less remittances of American subsidiaries to foreign parents, fell about 20%, also weighing on overall profit growth in the quarter.

Our forecast for profits follows a similar trajectory as GDP—after bottoming in Q2, we expect profits to bounce in Q3. But, as the virus drags on a full-rebound in profits likely remains a ways off. Businesses remain under pressure amid a lower level of activity, and with lawmakers at a stalemate regarding additional stimulus, the economic trajectory posits a slow rebound in activity. Thus, on a year-over-year basis, profits will likely remain negative through the end of 2020 (bottom chart). Our latest forecast has profits declining by about 10% for 2020 as a whole. With the Q2 decline having come in as we expected, this forecast remains largely intact.







Source: U.S. Department of Commerce and Wells Fargo Securities

Wells Fargo Securities Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	International Economist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	(212) 214-2029	azhar.iqbal@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	International Economist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economist	(704) 410-1681	shannon.seery@wellsfargo.com
Jen Licis	Economic Analyst	(704) 410-1309	jennifer.licis@wellsfargo.com
Hop Mathews	Economic Analyst	(704) 383-5312	hop.mathews@wellsfargo.com
Coren Burton	Administrative Assistant	(704) 410-6010	coren.burton@wellsfargo.com

WELLS FARGO SECURITIES