Brace Yourself For A Negative GDP Report On Thursday

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Overview

The Commerce Department will release its first estimate of second quarter Gross Domestic Product on Thursday of this week, and it is widely expected to be really bad due to the economic lockdown earlier this year. Most forecasters expect 2Q GDP to be down 30-50%, making it the worst quarterly downturn since the Great Depression.

Following that discussion, we'll turn our attention to a crisis brewing in our nation's bankruptcy courts, which are widely expected to get overwhelmed in the month ahead. The number of bankruptcies by small and large companies will easily break all records this year.

2Q GDP Expected to Be Down 30%-50%, Maybe More

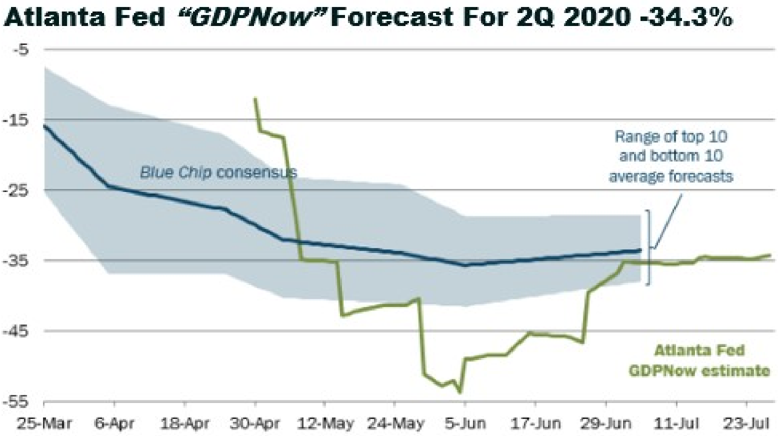
Today I want to focus our attention on this Thursday's Gross Domestic Product report for the 2Q. This will be the Commerce Department's first estimate of 2Q GDP, and it is widely expected to be really bad.

The fact that this report will be really bad should not surprise anyone because we all know a wide swath of the US economy was shut down in much of the 2Q. More than 50 million Americans were furloughed or lost their jobs permanently in recent months, although some were able to go back to work in late May, June and so far this month.

I have warned in recent weeks that forecasters were predicting a GDP decline of 25%-40% (annual rate) in the 2Q. Now, as the report has drawn closer, the predictions have only gotten worse. As of today, many of the pre-report forecasts are suggesting a decline of 30%-50% or even more for the 2Q. If so, it will be the worst quarterly GDP plunge in US history.

The non-partisan Congressional Budget Office, which tends to be fairly conservative in its forecasts predicts that 2Q GDP contracted by nearly 40%. The Atlanta Fed now forecasts 2Q GDP tanked by a whopping 46.6%. The independent Conference Board predicts the economy plunged by 40% in the 2Q after falling by 5% in the 1Q. Deutsche Bank revised its estimate of 2Q GDP from its previous forecast of down 13% to a nearly 40% decline.

The Atlanta Fed's widely-followed *GDPNow* indicator is not quite as bad with a reading of -34.3% as of July 27. However, you will also notice below that this reading was more than 50% negative in early June.



The bottom line is, barring a really big surprise, we are going to see a devastating 2Q GDP report on Thursday morning at 8:30 Eastern time.

The Question Is, How Will the Financial Markets React?

The GDP numbers I described for you above have been developing for some time now. Really, ever since the economic lockdown in April and May, forecasters and investors alike have known that Thursday's GDP report was going to be really bad – perhaps the worst quarterly GDP report we've ever seen in this country.

The question is, of course, how will the financial markets react? Stock market analysts have long maintained that stock prices we see on any given day are a reflection of all known market information. I generally agree but we must not forget there are *SURPRISES* from time to time – some small and some big. These can make markets react in ways no one expected.

The major stock market indexes have been rallying recently ahead of what everyone knows is going to be some really bad news on Thursday morning, just two days from now. Take a look.

The Dow has been trending steadily higher since the end of the Great Recession in 2009. That is, until the COVID-19 pandemic hit and stocks nosedived 35% in March. Despite that record fast plunge, the Dow has managed to climb back above 26,000 as this is written.

Most stock market analysts would argue that Thursday's GDP report is already *"priced-in"* and unless the report is significantly worse than expected, it shouldn't have too much of an effect on the equity markets. And if the report is not as bad as expected, stocks could be knocking on the door of new recent highs. That remains to be seen, of course.

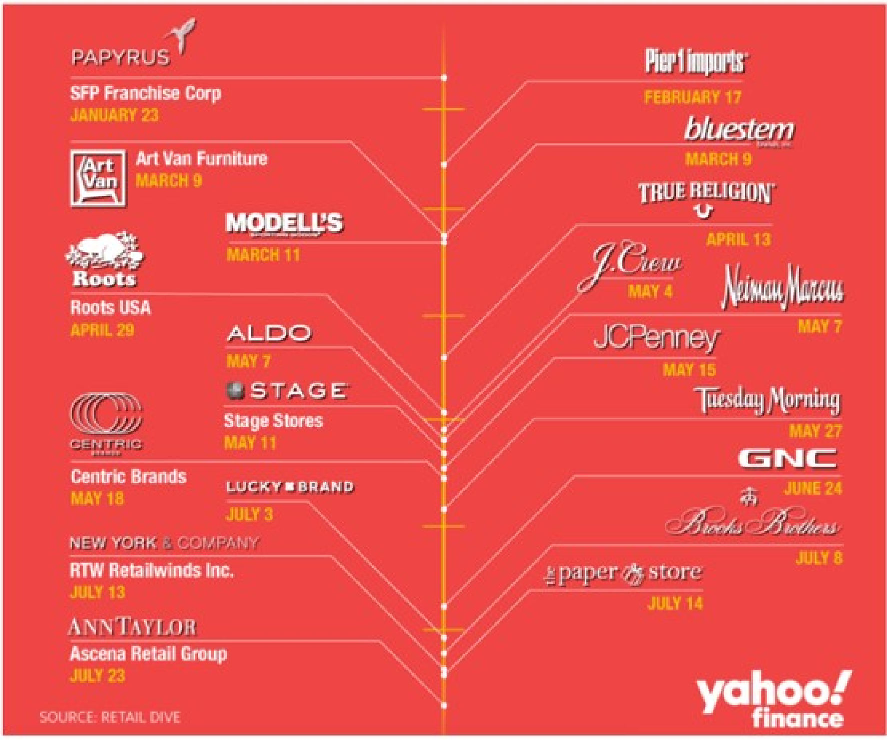
Record Wave of Bankruptcies to Come in Months Ahead

While a very bad 2Q GDP report may be priced-in, I do not believe the equity markets reflect the wave of bankruptcies which is already under way. Thousands of small and medium-sized businesses have already been driven to bankruptcy or permanent closure by the coronavirus this year, and you've likely never heard of most of them.

In the first half of 2020, more than 3,600 companies filed for bankruptcy, according to EpiqGlobal, a leading bankruptcy consultant. Just over 600 filed in June alone, up 43% from June of last year. And experts predict things are only going to get worse, probably much worse, in the second half of this year.

In addition to the thousands of small and medium-sized businesses, more and more large name-brand companies we all recognize are also filing for bankruptcy. Names include JC Penny, Neiman Marcus, J. Crew, Gold's Gym, Tuesday Morning, Hertz, Chuck E. Cheese, GNC, Brooks Brothers, Ann Taylor and others. Unfortunately, the list is growing.

RETAIL BANKRUPTCIES RAGE ON IN 2020



Edward I. Altman, the creator of the *"Z Score,"* a widely used method of predicting business failures, estimates that this year will easily set a record for so-called mega bankruptcies — filings by companies with $1 billion or more in debt. And he expects the number of merely large bankruptcies – at least $100 million in debt – to challenge the record set the year after the 2008/2009 economic crisis.

Even a meaningful rebound in economic activity over the coming months won't stop it, said Professor Altman, who teaches finance at New York University's Stern School of Business. *"The really hurting companies are too far gone to be saved,"* he said.

Many are teetering on the edge. Chesapeake Energy, once the second largest natural gas company in the country, is wrestling with about $9 billion in debt. Tailored Brands – the parent of Men's Wearhouse, Jos. A. Bank and K&G – recently disclosed that it, too, might have to file for bankruptcy protection. So did Weatherford International, a large oil field services company that emerged from a previous bankruptcy only in December.

More than 6,800 companies filed for Chapter 11 bankruptcy protection last year, and this year experts predict the number could approach 10,000 with filings expected to accelerate significantly in the months just ahead.

Most good-size companies that go into bankruptcy try to restructure themselves, working out new payment agreements for their debts so they can stay open. This often means closing some of their outlets. But if a plan can't be worked out – or isn't successful – they are usually liquidated instead. Equipment and property are sold off to pay debts, and the company disappears.

Bankruptcy Courts Are Jammed & Likely to be Overwhelmed

The flood of bankruptcy petitions from the worst economic downturn since the Great Depression could swamp the court system, making it harder to save the companies that can be rescued, bankruptcy experts warned. Fitch Ratings predicts that the debt default rate among America's largest companies, normally around 3-4%, could easily rise to 15% in 2020-2021. Wow!

A number of distinguished bankruptcy scholars who are analyzing the impact of the COVID-19 pandemic on large American businesses recently urged leaders of Congress to immediately authorize the appointment of temporary bankruptcy judges and significantly increase the budgets for existing bankruptcy courts.

A similar sentiment was expressed in a recent op-ed, *"Planning for an American Bankruptcy Epidemic"*, which warned that the *"trifecta"* of millions of insolvent consumers, thousands of small business failures and many bankruptcies of large firms could overwhelm the bankruptcy court system.

The authors of the op-ed pointed out that if only 0.9% of the 30 million of the currently unemployed filed for bankruptcy, the bankruptcy caseload would exceed the level experienced as a result of the Great Financial Recession of 2008/2009 and didn't peak until 2010.

They note, too, that research has demonstrated when bankruptcy courts become overcrowded, cases take longer to resolve, more small and large businesses are liquidated and creditors recover less. Unfortunately, I don't hear talk that our lawmakers in Washington are taking any action to head-off this looming bankruptcy court crisis.

For reasons I do not fully understand, this issue of the bankruptcy courts getting overwhelmed just ahead is not getting a lot of play in the media. If bankruptcies are remotely as large as the experts predict, it will have a very negative effect on the economy. And the worst of it may well be happening right around election time in early November.

If so, that will certainly be bad news for President Trump, who is already not doing so well.

Best regards,
Gary D. Halbert