Written by Thomas R. Eddlem on October 29, 2009

GDP Increases 3.5% in Third Quarter, Fueled by "Cash for Clunkers"

The U.S. economy grew at a better-than-expected 3.5 percent annualized rate in the third quarter, according to an "advance estimate" released by the Bureau of Economic Analysis (BEA) October 29.

While mostly good news, the BEA estimate of the growth in Gross Domestic Product (GDP) stressed that nearly half of the growth was due to Washington's "Cash for Clunkers" program, a program no longer in existence. "The third-quarter increase largely reflected motor vehicle purchases under the Consumer Assistance to Recycle and Save Act of 2009 (popularly called, "Cash for Clunkers" Program)," the BEA said. The BEA estimates that "Motor vehicle output added 1.66 percentage points to the third-quarter change in real GDP after adding 0.19 percentage point to the second-quarter change."

The Cash for Clunkers program paid consumers as much as $4,500 to trade in a less fuel efficient car for a new, more fuel efficient car. As a result of the offer, Americans swarmed to dealerships to take advantage of the government subsidy. The program ran out of it's $1 billion funding within a week, and Congress quickly authorized $2 billion more. With the binge in automobile purchases in the third quarter, if could be that most people considering buying a new car this year have already done so. That would mean a coming slump in auto sales, with the resulting drag on GDP. And this has caused many observers to predict the post-clunkers fourth quarter will contain the bust after the third quarter boom.

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The BEA analysis of growth in the third quarter explained: "The increase in real GDP in the third quarter primarily reflected positive contributions from personal consumption expenditures (PCE), exports, private inventory investment, federal government spending, and residential fixed investment. Imports, which are a subtraction in the calculation of GDP, increased."

Because the BEA analysis says that much of the rest of the growth is attributable to an increase in American consumer spending and federal government spending, the question is: Was the third quarter another bubble that will eventually burst when checkbooks and the federal budget are eventually balanced? "A lot of this is thanks to government support," Kathleen Stephansen, chief economist at Aladdin Capital Holdings told Bloomberg Television. "We still have major headwinds for the consumer. That worries me. The consumer, in fact private demand in general, is not ready yet to pick up the growth baton from the government."

The increase in the value of homes is another cause of the GDP growth and it too has been stimulated by government subsidies, many of which will expire when the “stimulus” spending runs out.

One indication that the economy may have further to fall is that BEA statistics indicate that Americans continue to consume more than they produce. “Trade subtracted from GDP as imports grew faster than exports,” Bloomberg.com observed of the BEA release, “while government spending expanded at a 2.3 percent pace after jumping 6.7 percent in the prior quarter. A decline in state and local government outlays limited the overall increase.” Viewed from the standpoint of increased consumer sales spurring growth in the third quarter, the widening trade deficit means that consumers (not to mention the federal government) are living on credit and biding time until the bills come due. Both will eventually be forced to tighten their belts by their creditors.

The BEA called their October 29 release their “first estimate” of three for the third quarter; revised estimates will be published in the last week of November and in December.

Photo: AP Images