

## Cash-for-Clunkers Boost to Q3 Auto Sales Likely Unsustainable

*The cash-for-clunkers program, which encourages consumers to trade-in gas guzzlers for more fuel efficient cars, will likely provide a slight boost to vehicle sales in the third quarter. In turn, we expect the spike in auto production will put GDP in positive territory in the third quarter, but the gain from the program will likely be unsustainable.*

### Auto Production will Likely Help Boost GDP in the Third Quarter

The cash-for-clunkers program, which will provide consumers with a voucher ranging from \$3,500 to \$4,500 to encourage trade-ins for more fuel efficient new vehicles, should provide a slight boost to motor vehicle sales during the third quarter. Vouchers would be limited to vehicles costing under \$45,000. Rising unemployment and a whole host of restrictions in the program will limit its success, but sales should rise.

Even a small boost in sales could prove to be a crucial piece of the recovery puzzle. Auto production was already slated to increase in the third quarter, reflecting sharp cutbacks in output earlier this year and a decline in dealer inventories. Even a slight pick up in sales would build on this momentum and help keep assembly lines running further into the year.

A bounce-back in motor vehicle production will nearly ensure third quarter real GDP moves back into positive territory. The swing in production from severely depressed levels during the second quarter will greatly reduce the pace of inventory liquidation and provide the thrust for an economic rebound. Moreover, consumer spending, which was already poised to rise modestly in the third quarter, will now likely rise solidly. We currently expect third quarter GDP to bounce back at close to a 3 percent pace in the third quarter, but the gain from the cash-for-clunkers program is likely unsustainable.

### Trade-ins Expected to Provide Little Long-Term Bang for the Buck

The bill, which appropriated \$1 billion for the program, will likely boost auto sales in the third quarter by a much smaller-than-expected 250,000 units versus the originally proposed 1 million units. With the program running for three months, the difference in the closely watched annual sales rate is a 1 million unit boost versus 4 million units. In order to get a more sustained boost to auto sales, the program would need to run for a full calendar year. The program's short duration means that sales will likely give back a good part of their gains in the fourth quarter.

Similar programs with less restrictive features have worked successfully in Germany, China, India, and Brazil. German auto sales rose from a 2 million unit pace early this year to 4.2 million-unit pace in April. Chinese auto sales rose from a 6 million unit pace to a 9.4 million unit pace. Brazilian auto sales also rose sharply, climbing from 1.7 million units to 2.8 million units.

We do not want to be overly critical about the cash-for-clunkers program, because it will boost sales. The program, however, would be even more successful if it started a little earlier, ran a little longer and had fewer restrictions.

