630-517-7756
www.ftportfolios.com

First Trust

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Monday Morning Outlook

Brian S. Wesbury - Chief Economist
Robert Stein, CFA - Senior Economist

Congress is the Clunker

Auto sales spiked 16% in July and likely rose again in August. Much of the increase is due to the "cash for clunkers" program, where the federal government gives car buyers up to $4,500 to trade in older, lower miles per gallon, vehicles for brand new autos with better fuel efficiency.

Given the increase in sales, it's not hard to see why so many people like the program. Everyone who had a clunker that they knew they would be replacing in the next couple of years is happy that the government is now subsidizing them for a purchase they would have been making anyhow. And of course, the car dealers like the sales volume, while auto makers and their workers enjoy the ramp-up in production to maintain, or even replenish, inventories.

Trouble is, almost all the gain in sales simply transfers sales across time. Some car buyers who were walking showrooms in May and June decided to postpone their purchases so they could get a government check. In addition, some sales that would have been spread out over the rest of this year and 2010, were brought forward in time.

Meanwhile, other workers and businesses that make a living maintaining older cars and trucks are suffering. Take a news story in this week's Fairfax County Times, a weekly local paper in northern Virginia. Just before the clunkers program was announced, Bill Wiygul put $1 million into expanding his family's four-shop car repair operation. Business had been booming as more frugal car owners were squeezing their vehicles for every last drop of value. Now Mr. Wiygul is losing customers. Another nearby repair shop claims business is down 25%.

The basic problem with cash for clunkers is that it uses the old "broken windows" theory of economic activity. Everyone who lives in a hurricane zone knows that typically people are never busier than right after a major storm. Roofs need to be replaced, while damage to vegetation, glass, power lines, boats, etc., all require overtime to repair. All that activity gets counted in GDP.

But everyone also knows the storm was a bad thing, destroying property that was built at a cost in the first place. Sure, everyone is as busy as a beaver, but they're just busy replacing what they had, not actually improving their standard of living.

Every clunker that gets traded in has to be wrecked: its engine has to be destroyed with chemicals and then the car gets crushed. In a way, it's no different than if a storm came along and ruined each of these cars and then the government gave the owner a check to go out and buy a new one, as long as the new one is more fuel efficient.

Sure, the auto industry is busier for the time being, but every extra dollar getting spent has to be paid for, through a combination of higher taxes on the more productive segments of our economy as well as less spending on other businesses that provide worthwhile services without asking for a handout.

Ironically, the auto industry was primed for a revival over the next two years with or without government help. Cars and trucks were selling below the pace of scrappage earlier this year. This was unsustainable. Now, with the economy bouncing back, and unemployment at or near a peak, we suspect that car sales will begin to build. Look for auto sales to slump slightly (and temporarily), once the clunkers law lapses, but then start to move up substantially, and without government help, later this year.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-25 / 9:00 am	Consumer Confidence - Aug	47.9	**48.0**		46.6
8-26 / 7:30 am	Durable Goods - Jul	+3.0%	**+8.0%**		-2.2%
7:30 am	Durable Goods (Ex-Trans) - Jul	+0.9%	**+0.1%**		+1.6%
9:00 am	New Home Sales - Jul	0.390 Mil	**0.389 Mil**		0.384 Mil
8-27 / 7:30 am	Q2 GDP Second Report	-1.0%	**-1.4%**		-1.0%
7:30 am	Q2 GDP Chain Price Index	+0.2%	**+0.2%**		+0.2%
7:30 am	Initial Claims - Aug 22	565K	**570K**		576K
8-28 / 7:30 am	Personal Income - Jul	+0.1%	**+0.1%**		-1.3%
7:30 am	Personal Spending - Jul	+0.2%	**+0.4%**		+0.4%
8:45 am	U. Mich. Consumer Sentiment	64.0	**66.0**		63.2