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Car Makers Help Drive Economic Recovery

Stepped-Up Production in 3rd Quarter Follows a Spring Hobbled by Shortages

By JUSTIN LAHART

A resurgent auto industry has weathered the supply-chain hitches that stifled production during the spring and is poised to double the pace of U.S. growth in the third quarter, according to some estimates. But that may not be enough to help beleaguered consumers and businesses get a flagging recovery back on track.

Bloomberg News

General Motors employees at work this month on an assembly line in Flint, Mich. GM plans to prepare the plant to build full-size pickup trucks.

The gross domestic product report due Friday from the Commerce Department is expected to show the economy grew at a 1.8% annual rate in the second quarter, down from 1.9% in the first quarter and the slowest pace in a year, according to economists polled by Dow Jones Newswires.

The pace of the economy in the spring was a disappointment, caused largely by shortages of key automobile parts following Japan's earthquake and tsunami. Federal Reserve figures show that U.S. auto plants cut back motor vehicle production 5.9% in the second quarter from the first quarter—enough to significantly slow the economy.

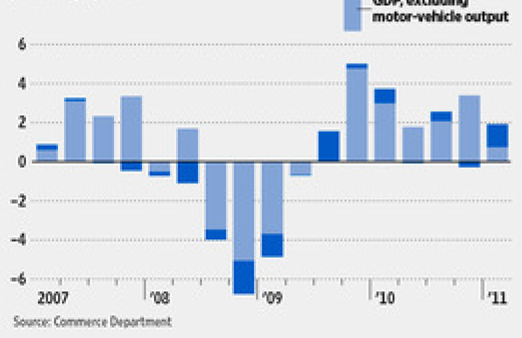
With supply chains in better order, auto production is bouncing back. Toyota Motor Corp. has said it expects its North American production to return to normal this month. Volkswagen AG is ramping up production at a new plant in Chattanooga, Tenn. General Motors Co. is in the process of adding a third shift at an assembly plant in Flint, Mich.

The jump in car manufacturing should filter into employment and spending as well. As auto production picks up, then, so could jobs and wages—which in turn could help consumer spending. In an optimistic scenario, that might create a scenario where overall spending and hiring are feeding on one another, and putting the economy on the path to stronger growth.

But the economy may be too weak for such a virtuous circle to take hold. Auto sales were sluggish in May and June, in part because the disasters in Japan led to fewer cars on dealer lots, but also because higher gasoline prices and worries over the job market made consumers less willing to spend.

Indeed, the sluggish sales prompted some auto makers to rein in production plans a bit for the third quarter, noted J.P. Morgan economist Michael Feroli. He forecast that GDP will increase at a 2.5% rate in the third quarter, and that auto production will lift growth by between a half and full percentage point. "It's still certainly going to be a positive," he said.

The gain may be ephemeral, however, as fallout from the housing bust and the recession persists.



"I don't think the bounce back in auto production in and of itself is going to mean that much," said Goldman Sachs economist Jan Hatzius. "It's not going to be able to carry the third quarter."

During the third quarter, auto makers will produce 7.5% more cars and light trucks in the U.S. than they did a year earlier, estimates to industry tracker IHS Automotive. That will provide a boost to the overall economy.

On Tuesday, Ford Motor Co. forecast that in the third quarter, it would produce 630,000 cars and trucks in North America—a 7.5% increase over the year-ago period. (The tally also represents a decline from the second quarter's production of 710,000 vehicles. However, in calculating GDP, the Commerce Department allows for such quarter-to-quarter declines—due to summertime plant shutdowns—by seasonally adjusting the data.)

Motor vehicle production "is going to be a big swing factor," said Barclays economist Dean Maki. He is looking for gross domestic product to grow at a 3% annual rate in the third quarter, up from 2% in the second, as auto production reaccelerates.

According to the Labor Department, there are approximately 700,000 workers engaged in manufacturing vehicles and parts production, and an additional 900,000 who work at new car dealerships.

"There are also a lot of jobs we don't consider automotive jobs," said Kim Hill, a research director the Center for Automotive Research, an industry think tank in Ann Arbor, Mich. These include everyone from the truckers who haul cars to the bartenders who work near auto plants. All told, he estimated that the auto industry directly or indirectly supports roughly 8 million U.S. jobs—about 6% of the total 131 million U.S. positions.

Mr. Hatzius pointed out that data so far for July, including sharply lower consumer sentiment figures, suggest the quarter has gotten off to a poor start. His takeaway is that while temporary factors such as supply-chain disruptions have hurt the economy, they can't explain all of what's going on.

He suspects the underlying problem is that badly damaged balance sheets have made it more difficult for households to adjust to shocks that they used to absorb readily.

When gasoline prices go up, for example, people can't as easily tap into savings or borrow to cover the higher cost, so they quickly cut back on other items.

That lack of flexibility is damping consumer spending, which in turn is making businesses less willing to make new hires. The result is an economy that, despite the occasional glimmer of hope, can't grow very fast.

"The economy is just weaker and it's going to stay weaker," said Mr. Hatzius. "That's the unfortunate conclusion here."

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