Economy Turned In Its Best Growth Rate In Nearly Two Decades

GDP Surged 7.2% in Quarter, On Broad-Based Gains; Bush Team Trumpets Data

By JACOB M. SCHLESINGER and JON E. HILSENRATH
Staff Reporters of THE WALL STREET JOURNAL

The U.S. economy shot out of the doldrums to its best quarterly growth rate in nearly two decades, giving a potentially powerful political lift to President Bush despite chronic weakness in the job market.

The 7.2% annualized rise in gross domestic product in the third quarter was the strongest pace of growth since the first quarter of 1984 and the broadest-based gain in the economy in the three years since the stock-market-fueled boom years of the 1990s.

Spending by consumers, exports and residential construction all registered sharp gains. But the news economists found most significant was that investment by businesses grew at an 11% annual clip, the fastest rate since early 2000.

The burst of growth was in different measures both an economic and a political achievement for President Bush. As the economy sputtered after the stock market tanked in 2000 and the terrorist attacks of 2001, he pushed through the biggest tax cuts in history, adding fiscal fuel to the monetary stimulus of lower interest rates set by the Federal Reserve.

While the economy certainly won't keep up the third quarter's blistering pace in the months ahead, most economists believe the quarter marks a distinctive shift into a more-robust expansion that could stretch to next year's presidential election. "We're not going to see 7% growth again, but we could well see over 4% over the course of the next year," said Richard Berner, an economist with Morgan Stanley in New York.

The darkest shadow over the economy now is unemployment, which remains above 6% of the labor force. Thursday's GDP number was also just a preliminary estimate by the Commerce Department and could be revised in a few months. Some economists questioned whether steady growth could continue once the short-term effects of pump-priming from tax cuts and low interest rates wear off. Moreover, critics of the tax cuts argue that their contribution to the latest burst of growth comes at a steep cost: mounting federal budget deficits.
But Thursday's report will take some sting out of the most potent attack Democrats have been honing for the 2004 campaign: that Mr. Bush, like his father, is presiding over a weak economy and doesn't deserve another term. By early afternoon, Mr. Bush's campaign aimed to take advantage, e-mailing a giddy report with the subject line, "Breaking News: Largest economic growth in 19 years."

"There is no precedent in the last generation and a half of an American president losing an election when the economy is booming," says Republican pollster William McInturff. The last president to enjoy such a strong quarter was Ronald Reagan, who successfully managed the shift from economic gloom to optimism to win a second term after a deep recession.

Strong growth, if sustained, helps Mr. Bush in his running argument with Democrats about the wisdom of his aggressive tax-cutting, the centerpiece of his economic policy. As retired Gen. Wesley Clark, one of the nine Democrats competing to challenge Mr. Bush, said in a debate in Detroit earlier this week: "They said tax cuts would help us.... They didn't." Mr. Bush was quick to offer a rebuttal in a speech Thursday afternoon before an aluminum company in Columbus, Ohio, where he trumpeted the growth report and asserted it was because "we left more money in the hands of the American people."

Independent economists say the tax cuts deserve some credit for the good quarter -- but not the bulk of it. Chris Varvares of Macroeconomic Advisers in St. Louis estimates about 1.5 percentage points of the quarter's growth, or just about a fifth, came directly from the cuts. The 7.2% rise in GDP measures the increase in the nation's total output of goods and services; it is an annualized rate adjusted for inflation and seasonal factors.

Mr. Bush isn't out of the economic woods yet. For voters, jobs and income matter far more than GDP statistics -- and by those measures, the president's record is still weak. The unemployment rate remains near a nine-year high, and even during the third-quarter boom, the economy shed 41,000 jobs.

Since Mr. Bush took office, businesses have slashed a whopping 2.7 million jobs, a record that -- Democrats never tire of pointing out -- is the worst for any president since Herbert Hoover presided over the Great Depression. Even under the most optimistic forecasts for the next year, the economy will likely end up having lost jobs during all of Mr. Bush's first term. "A jobless economic recovery is a little bit like going on a diet and gaining weight -- what's the point?" says Clark aide Chris Lehane.

There are reasons for some caution about the growth outlook in the months ahead. Economists say much of the third quarter's increase came from the peak of the mortgage refinancing boom and the implementation of tax cuts -- factors that won't be repeated in coming quarters. Consumer spending has already begun to show signs of slowing after surging over the summer. Sales of cars and light trucks, for instance, slowed to an annual rate of 16.7 million units in September from 19 million units in August. J.D. Power & Associates, which tracks sales at more than 6,000 dealer franchises around the country, says the slowdown continued into October.

Because businesses are operating more efficiently and getting more output out of each worker, rapid economic growth may not guarantee a better job market soon. "Any good news on the economy is welcome, but it would be premature for President Bush to declare 'mission accomplished' on the economic front while we still have a jobless recovery and a huge jobs deficit to erase," said Rep. Pete Stark of California, ranking Democrat on the Joint Economic Committee.
While the economic news may roil the political world, it made barely a ripple on Wall Street, which has already been rallying for months in anticipation of an improving economy and corporate profits. The Dow Jones Industrial Average rose 12.08 points for the day to close at 9786.61.

The booming third quarter is likely to bring comfort -- but no policy change anytime soon -- at the Federal Reserve, whose aggressive interest-rate cutting over the past couple years has been a major factor behind the current rebound. The Fed has suggested it will take several more quarters of strong growth to use up the slack in the economy and prompt the Fed to consider raising rates -- though minutes of its Sept. 16 meeting released Thursday indicated it was struggling with when and how to drop its reference to a "considerable period" for low rates. (See related article.)

For months, economists have argued that a real recovery would not take hold until business executives had confidence to start investing again. That now appears to be happening. The Business Roundtable, an association of CEOs from large companies, said earlier this month that 23% of its executives expected to increase capital spending in the months ahead, while only 12% were cutting. Just three months earlier, the percentage of those planning additional spending was roughly equal to the percentage that planned to cut.

"Almost everybody you talk to will say, 'I see very definite positives in the economy,'" said Philip Condit, chief executive of Boeing Co. and chairman of the Business Roundtable. "But they will follow that by recognizing that they are going to be careful in terms of making sure that their business spending is where it produces results."

Executives are clearly seeing the benefits of growth in their bottom lines. Profits grew by 14% in the second quarter, compared with a year earlier, and Mr. Berner of Morgan Stanley estimates third-quarter profits jumped by more than 30% from a year earlier. That is based on the Commerce Department's broadest based measure of corporate profitability.

What's unclear -- and what matters most for Mr. Bush and his would-be Democratic challengers -- is just how much households are benefiting from the economic spurt. Individuals are certainly spending as if they are better off. Purchases of durable goods, such as automobiles and furniture, grew at a blistering 27% annual rate in the third quarter.

The tax cuts helped encourage families to spend: Inflation-adjusted personal after-tax income rose at a 7.2% clip during the quarter, lifted by the child tax credits and lower tax rates that were written into law in the spring. That was far faster than an average of 3.2% growth during the previous five years.

But the third-quarter boom came even as businesses continued to lay off workers -- or at least refused to expand their payrolls. In a separate report, the Labor Department said Thursday that first-time claims for unemployment insurance fell slightly last week, by 5,000, to 386,000 -- a level that suggests the unemployment rate might have stabilized, but isn't falling by much yet. According to an October poll of economists by The Wall Street Journal Online, the unemployment rate is expected to drop only to 5.9% by next May from 6.1% in September.

Wage gains, too, remain under some pressure. The Labor Department's Employment Cost Index report for the third quarter, also released Thursday, showed that wages and salaries were up just 2.9% over the previous year, well below the 4% pace registered at times during the late 1990s boom.

"We have yet to see if any of this will hit Main Street instead of just Wall Street," says Mandy Grunwald.
an adviser to presidential candidate Joseph Lieberman, senator from Connecticut.

The Labor Department compensation report also showed that benefit costs to companies, largely health insurance, soared by 6.5%, the fastest rate in more than a decade. That has put a damper on company hiring plans and led companies to impose more health costs on workers.

Indeed, if the economy and the labor market do improve through next year, Democrats will try to steer the debate away from general conditions and more toward specific weaknesses in the economy, such as health care.

"Soaring health-care costs and education costs and higher local taxes are still putting enormous stress on middle class families," says Sarah Bianchi, policy director for Massachusetts Sen. John Kerry, another presidential aspirant, foreshadowing the likely turn in rhetoric.

Anticipating the whopping growth number -- and the impact it would have on the political debate -- candidate John Edwards, senator from North Carolina issued a "prebuttal" on the news even before it came out, asserting that "3.8 million Americans have lost health insurance" since Mr. Bush took office while "the cost of health insurance for the average family has risen by almost 50%." He also noted rising household debt and bankruptcies, and a 14% increase in college tuition this year.

Democrats will also ratchet up their attacks on the record budget deficits ushered in by Mr. Bush's tax cuts, arguing the long-term costs exceeded any short-term gains. Most economists believe that, over time, interest rates will be higher -- and growth lower -- because of the sharp increase in expected government borrowing under Mr. Bush.

"The Democratic nominee is going to have to make the case that President Bush has made very unwise tradeoffs for our future," says former Clinton economic aide Gene Sperling, who is advising many of the campaigns.

The economic debate will also focus more on time horizons. While Republicans will try to trumpet the good news over the next year, Democrats will continue to try to hold Mr. Bush accountable for how Americans have fared throughout his whole term. And growth, jobs and income were so weak at the start he isn't likely to come out ahead by that measure.

"It's the old Ronald Reagan question -- are you better or worse off than when George Bush took office," says Mark Penn, Mr. Lieberman's pollster. "That is still going to work against him."

--Greg Hitt contributed to this article.

Write to Jacob M. Schlesinger at jacob.schlesinger@wsj.com and Jon E. Hilsenrath at jon.hilsenrath@wsj.com

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