Article | 12 September 2017

Why Hurricane Harvey won't derail the US economy

The hurricanes will distort GDP, inflation and jobless claims temporarily but the storm is unlikely to knock the US economy off course

$ 200bn

Early estimates of property damage and economic dislocation

Assessing the scale of the damage

With relief operations underway, the focus remains on the personal loss the hurricanes have inflicted on the people of the Caribbean and the southern United States. Millions remain without power, thousands of homes and offices are uninhabitable, and transport infrastructure is in need of repair. The clean-up operation will take weeks, probably months, exacerbating the sense of loss for those affected.

There are also going to be huge economic implications, particularly for the Caribbean islands that don't have the resources to deal with the disaster themselves. For example, Hurricane Ivan, a relatively modest category three storm, which hit Grenada in 2004 left 90% of houses sustaining damage with 30% destroyed. The financial cost more than USD 1 billion – twice the size of the country's GDP. It is too early to say how the islands feeling the full force of Hurricane Irma have fared, but news reports indicate it is of at least a similar scale, which will necessitate massive international relief efforts.

Quantifying the impact is incredibly difficult, but we suspect it could knock anywhere between three-tenths of a percentage point and a full percentage point off the national GDP

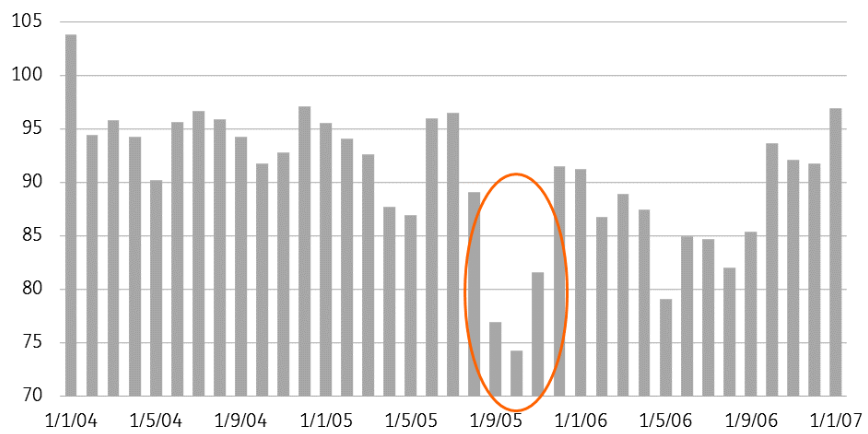
Hurricanes Harvey and Irma have also inflicted tremendous damage in the US with early estimates suggesting the combined costs could exceed USD 200bn regarding property damage (both insured and uninsured) and economic dislocation. In 2015 (2016 data will be released later this month), the Houston region had a GDP of $503bn or 3% of the national output. Miami/Ft Lauderdale and West Palm Beach accounted for $318bn, and Tampa/ St Petersburg/Clearwater had a GDP of $134bn.

In total, around 10% of the US economy is likely to have experienced some form of economic disruption because of the Hurricanes, which will have hurt economic growth in the third quarter.

Quantifying the impact is incredibly difficult, but we suspect it could knock anywhere between three-tenths of a percentage point and a full percentage point off the national GDP growth figure versus what might have been possible.

However, when Hurricanes Katrina and Rita hit the US in August and September 2005, the national economy experienced an acceleration in growth. GDP in 2Q05 expanded 2.1%, with growth pushing up to 3.4% in 3Q05 before slowing to 2.3% in 4Q05 so we have to remember that there are other stories in play that could offset the impact of the hurricanes. We still think the US will expand by around 3% in 3Q17, boosted by a rebuild in inventories and strong consumer spending elsewhere in the US.

Hurricanes Katrina and Rita had a temporary effect on confidence



Near-term impact on the US

The effects of the hurricanes will come through in some indicators, starting with figures this week. Friday sees the release of August industrial production numbers and while manufacturing should be good, helped by strong readings for employment in the sector, a robust ISM index and a weak dollar there will be softer utility and mining components. Harvey led to a shutdown on many oil platforms while refineries also closed as a result of the storm. Repairs are ongoing, which could mean industrial production underperforms manufacturing again in September and October.

Consumer spending patterns will also be heavily impacted. We tend to see hoarding behaviour ahead of such events as people ensure they have adequate supplies of food, water and fuel, but this stops as the storm hits, with spending severely limited several days after a storm. We then tend to see spending recover. However, there will be some permanent loss of spending, most notably on services such as restaurant meals, which are typically forgone given the pressing need to get lives back on track. Additionally, many people won't be getting paid as they can't get to their place of work - note the spike in jobless claims last week, which will continue into this week. This will add to the downside risk for growth in the near-term. Consumer confidence on Friday could be severely impacted as it was following Hurricanes Katrina and Rita, but this is likely to be temporary.

There are broader national effects –gasoline prices have jumped from around $2.20/gallon in mid-July to $2.65/gallon because of supply concerns relating to refinery outages. This is likely to show up in this week's August PPI and CPI readings. Headline PPI is set to jump from 1.9%YoY to 2.5%YoY while headline CPI is likely to rise to 1.8% from 1.7% with further rises possible in the September reports. This suggests some squeeze on household spending power, which could at the margin result in some weaker consumer spending nationally.

There will also be an impact on trade given the importance of sea ports and airports in the Texas and Florida regions as there will have had to be some re-routing and some spoilage of goods, leading to more economic losses.

Employee engagement may also, understandably, be impaired in the near-term. While workers may physically be in their place of work their minds are likely to be elsewhere having to deal with issues at home such as contacting insurers, helping friends and family make repairs to their homes which will mean some loss of productivity for a while.

Daily national gasoline price($/gallon)

Longer term impacts

As Federal funding is released, facilitated by the recent agreement to raise the debt ceiling and clean-up operations start to gain momentum, there is likely to be some boost to economic activity. These sorts of disasters result in significant damage to the capital stock of the economy, which now needs replacing. With insurance payouts also set to start being made in the months ahead we are likely to see a pickup in spending as households and businesses repair property and replace equipment, damaged vehicles, furniture and other belongings. Consequently, GDP should get a short-term boost.

However, we have to remember not everyone is insured and there will be many people and businesses that suffer permanent economic damage that can have prolonged impacts. Public infrastructure will get more investment, and so while third quarter GDP is likely to be weaker than it would otherwise have been, there should be subsequent offsets in coming quarters, which lead to higher rates of growth.

Other issues

A recent article by Tatyana Deryugina in the American Economic Journal: Economic Policy suggested that US counties impacted by Hurricanes see persistent increases in transfer benefits that on average over the subsequent ten years amount to five times the cost of disaster-specific aid. The research indicated unemployment insurance, income maintenance and Medicare benefits increased significantly following such events. This may well be because businesses are lost because of catastrophic events and others move away from the affected area, taking jobs with them.

Given such academic literature, there may well be a greater examination of what happens longer term. If hurricanes are indeed found to be more costly than previously thought this may incentivise planners to focus more seriously on defences and deter construction in areas that are more susceptible to damage.

Bottom line

At the margin, recent events may dampen the prospect of near-term action from the Federal Reserve. But should the economy prove to be resilient and inflation, as we suspect, return to the Fed's 2% target by the end of the year, we see little reason to change our forecast of a 25bp rate hike at the December FOMC meeting, followed by two further rate hikes in 2018.

Author

James Knightley
Chief International Economist, US
james.knightley@ing.com

Disclaimer