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US Economic Report for September 2005

Some economic pundits are calling this stage in the American economic story the 'calm-before-the-storm'. They could be right, both figuratively and in reality – and not just because of Hurricane Katrina – although there are no real threats externally to the U.S. economy as a whole, internal political stability and economic realities are risk issues going into the next six months – the word recession has come to mind. Some issues may reverberate through until the mid-term elections next November, where there has been a significant realignment in political forces as a result of the Administrations response to Hurricane Katrina's destruction. For the Administration and the GOP, much will ride on the response to further hurricane activity, the states they impact, the war in Iraq, and jobs. The economy though has unlikely hit a "tipping point", but there are some cause for pause; effects that broadly may lead to a recession in the short to medium term.

Despite the impacts of Hurricane Katrina, and the now looming possibilities of Hurricane Rita, which has not seemed to have impacted the region as hard, the Fed raised the fund rate to 3.75%. This has raised the 30-year fixed term rates on mortgages significantly, despite lowering prices generally in a cooling market (the exception being some parts of the major capital cities). Of course the Fed's worry was inflation - maybe that was not as obvious to the financial sector, as the national average on the 30-year fixed term rates rose about 6% in the last week of September, and about 5.5% the week before - the second consecutive weekly increase and pushed the 30-year rate to its highest level in a month and a half.

While most analysts attributed the increase in part to the Fed's decision this month to boost a key short-term rate related to mortgages, the Fed believes Hurricane Katrina's impact on economic growth would only be temporary and here was more concern about the impact hurricane disruptions would have on energy prices and overall inflation. However, some predict that rising 30-year loan rates to be exactly where the Fed wants them - to further prevent a drastic housing collapse in the six largest cities in the U.S. - Katrina rebuilding efforts notwithstanding. It's a complex equation that only needs to be calculated incorrectly once to have a significant impact on future economic behaviour. Many economists were split as to whether the Fed should have raised interest rates so soon after the hurricane but regardless, most expected them to do it anyway.

While Hurricane Katrina has forced the addition of a further 200,000 to jobless figures, the airline industry are facing massive cuts in jobs in light of recent bankruptcies. ATA, Delta, and Northwest were added to the long list of U.S. carriers filing for Chapter 11 this month (the likes of United, and US Airways are already in bankruptcy). Northwest were not in a good position at the beginning of the month due to labour disputes since about May, coming to a head in August when mechanics went out on strike. The U.S. economy has lost the equivalent of a large major airline in the last year and a half through restructures and bankruptcies. Even airline manufacturer Boeing faced industrial disputes, while the automotive sector is still shedding mid-level jobs. On other airline news, US Airways and America West were approved for a merger. This should

strengthen US Airways' position relative to their bankruptcy filing.

The main concern for the U.S. is to get oil refineries and rigs, affected by the storms in the Gulf of Mexico, back on production track. Oil prices are still high by American standards and affecting inflation, although not impacting consumers as much as expected, except in areas of discretionary spending. Oil refineries shut down temporarily during Katrina, and nearly four weeks later had to close again, just as production was ramping up for Hurricane Rita. The Bush Administration is still mulling a release of a portion of the strategic petroleum reserve, which should force prices down, alleviating some of the supply pressures forcing prices higher than USD\$65 per barrel. Hurricane Rita has appeared to have left refining capability intact, and production should resume within the next week.

Deficits are again on the rise due to the effects of the twin hurricanes and the surge in gasoline prices. The trade deficit for both August and September rose sharply. Public and private debt also rose, as well as the US current account - deficits are not always bad - just so long as the percentage of the debt is less than the rate of income (GDP). GDP is set to be markedly slower for this quarter for the US economy, which will concern most analysts – most of whom are now predicting about 2% growth for the year – much lower than previously expected. The US budget deficit was showing signs of narrowing prior to Hurricane Katrina, and the military offensive in the western regions of Iraq. However, due to these developments, as well as other spending programs looming for the new session of Congress, this is likely to jump to figures that some economists are predicting could be higher than June, the last high point before the drop. The Congress passed a Katrina aid bill valued at USD\$52 billion.

A possible housing bubble is still concerning to some, but Alan Greenspan has softened his position somewhat in recent days as the construction and remodelling industry could pick up after the hurricanes in the Gulf of Mexico. Some markets, like Los Angeles, Chicago, Boston, New York and Atlanta could have the potential to see significant bubbles, which could have a recessionary result for the economy. How temporary this recession could be, is speculative, but as the economy is moving into the peak of a business cycle, may not significantly hamper the economy until part way through the 2006 New Year. This might then still stay fresh in voters' minds leading into the mid-term elections in November 2006.

What do all these numbers say? - it looks like inflation is the dire concern. Inflation is up for September. This may come as no surprise considering all the forces moving within the economy, but the current rate of 3.64% (using the Moore Inflation model) with only part of the affects of the hurricanes calculated, a portion of the housing figures predictable, and the Fed still raising interest rates, is giving us a clear indication as to the outcome of the next two quarters. CPI is set to rise and is currently at 195.4.

Consumer confidence fell nearly 20 points – the highest fall in 15 years – to 86.6 as reported by the Conference Board, compiled from a survey of U.S. households. The last largest fall was in October 1990 when after the recession, it fell to 62.6, and the last low was in October 2003, when during the recession confidence dipped to 81.7. Economists had expected a reading of about 98.0. Poor job outlook, Hurricanes Katrina and Rita, and high gasoline prices have been noted in the fall. Consumer confidence is critical to the U.S. economy as consumer spending accounts for two-thirds of U.S. economic activity.

Hurricane Katrina

The full extent of the damage from Hurricane Katrina may not be known for months - many months. There is still clean-up in New Orleans, whose levee broke again, flooding areas previously pumped free from water, during the Hurricane Rita deluge, as well as clean-up in Biloxi, Gulfport, Mobile and surrounding areas. It is probably, by estimates, the most costly natural disaster in U.S. history. The humanitarian crisis alone has been compared to the Great Depression in various news sources.

The Bush Administration, opponents have argued, have performed poorly to offset the damage caused by the hurricanes, especially Katrina. Competing interests and agencies, both from a jurisdiction perspective and a political one, were partly to blame for the response, to be sure. But the Administrations response through the Federal Emergency Management Agency (FEMA) and the Department of Homeland Security was considered by many to be late, lacklustre, and not very well co-ordinated. The Bush Administration lost a considerable amount of political capital as a result, with polls rating the performance of the President, FEMA and DHS, and the States governments poorly.

The criticism lies in how much was known prior to the hurricane, however, there was already some considerable risk of devastation from a direct hit, well documented. Further, post Katrina management was considered lacking in planning and direction – reports of trucks of water and other relief supplies being turned back, by FEMA and other Federal Departments, are numerous. Small businesses are also upset by the Administration backing no-bid contracts for large corporations like Kellogg-Brown-Root (KBR), a subsidiary of the large oil services company, Halliburton.

Over 1200 are dead or missing, but the number is set to rise as clean-up efforts continue. Stagnant water, containing possible toxins leaked from chemical storage facilities, has created a severe health risk. Enteric infection and mosquito infestation is of major concern to the Centers for Disease Control (CDC), as well as rotting corpses and animal carcasses.

Damage costs will likely exceed USD\$100 billion, and the personal insurance costs have been estimated at USD\$12 billion.

Since the storm hit an area with significant petroleum extraction and refining capability, the hurricane has weakened supply of gasoline.

The New Orleans area and the local ports, rail and roads, supply much of the transportation infrastructure to the industrial centres of the U.S. As well as disrupting Mississippi, Tennessee and Ohio River transportation, the hurricane has affected UPS and DHL deliveries, and the aviation gasoline pipeline that feeds into Atlanta, which serves as a hub for some of the U.S.'s major airlines. NASA shuttle fuel tank and booster rocket production has been set back and could delay the next launch of the space shuttle, and internet and other communications to financial institutions in the Southern States have been damaged. About a quarter of the country's chemical industry is located along the Gulf Coastal Region of Louisiana, Alabama, Eastern Texas, the Florida Panhandle and Mississippi, and the aftermath of both hurricanes, Katrina and Rita will have some longer lasting effects in the economy, especially in the area of chemical surface agents, lubricants, sanitation chemicals and chemicals for industrial processes like polymerisation and metal alloy production. It has already been mentioned that in excess of 200,000 jobs have been lost in New Orleans alone as a result of the hurricane. Further job losses are expected.

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