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TD Economics

Initial thoughts on Hurricane Sandy's impact on the US economy

- Now that Hurricane Sandy has come and gone, actuaries will be tallying up the damage for weeks to come. Of course, not all aspects carry a price tag, such as tragic welfare impacts related to the loss of human life, health consequences and the like.

- Some measurable impacts will be evident in the coming months within the economic indicators. In the next few months, it will be a greater challenge to get a handle of underlying economic momentum because the indicators will carry distortions related to Sandy. Those that will likely bear strong hurricane markings will be retail sales, construction (such as housing starts) and housing sales. If Florida's hurricane Andrew was any indication, housing related indicators should show significant weakness in the next two to three months. Retail sales could have a distorted pattern, with sales up for emergency supplies, food and construction materials, but weakness for many other discretionary items. Depending on how long labor disruptions persist, November's employment statistics may also be impacted via hours worked or temporary layoffs. However, there may be a shifting within or between industries, rather than a net drag in hours or employment. While some workers will be prevented from working due to damage, others will be required to work longer hours due to emergency and clean-up responses, as well as a potential shifting of production to other regions in the U.S. It will remain to be seen how long disruptions to electricity and infrastructure persist, as this could have a larger impact on small businesses, which are more sensitive to extended disruptions.

- Bigger picture, there is every reason to believe that the hurricane won't kick the legs out of an already-fragile US economy. For certain, disruptions to infrastructure, electricity and business operations will depress output in the near term. In fact, as noted by a World Bank report, past cases have shown that indirect consequences of impaired utility services can have larger consequences than the direct impact of asset losses. In September, we were originally estimating Q4 real GDP growth of roughly 1.7% (annualized), and the hurricane will cause us to downgrade this estimate once there is greater clarity on work and output disruptions. However, it's important to note that the accounting of GDP is not impacted negatively by damages to physical assets, like buildings and infrastructure except through the indirect effects related to loss of work hours and business production. In contrast, the rebuilding of these assets has a direct and positive impact on GDP. It is this impact, along with the pick-up in production, inventories, and hours worked that will follow in the months to come, offering some offset to the near-term economic drag.

- And, it matters when a natural disaster occurs in an economic cycle. Hurricane Andrew (1992) offers some guidance here. During that period, the Florida economy was depressed and reconstruction efforts that followed the hurricane had a stimulus effect on construction sectors, particularly employment. The situation today is similar, with the Northeastern economies having considerable slack in construction sectors. Construction employment is down 20-30% from peak levels in New York and New Jersey. Thus, reconstruction is more likely to utilize idle resources, rather than crowd out resources from one area of the economy to another, as would be the case in a more rigorous expansion that had less flexibility. Depending on the damage related to businesses and infrastructure, the reconstruction phase may create an opportunity to usher in new and updated technologies that would otherwise have been difficult to implement. Even households that must undertake repair may look to install improvements in electrical or heating that could promote energy savings down the road. Future calculations of economic growth will factor in the net effects of reconstruction and potential productivity gains.

- The extent and speed in which the local economies rebound depends on the severity of the damage and the response received via insurance and government support. Hurricane Katrina offers some guidance here. The region endured a long-term negative impact related to extensive infrastructure damage, an outflow of population, and relatively low insurance payouts. No doubt, this is the perfect storm for crippling production and businesses. The immediate impression from Hurricane Sandy is that the region will not suffer the same fate. Early figures on reported damage are coming in lower (potentially half or less than estimates of Katrina), and government responses thus far appear to be quick. Whatever the magnitude of the economic drag in the near-term, it should prove temporary and result in a rebound in activity in future months.

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