

## Hurricane Economics

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The hits keep coming. Hurricane Harvey left destruction in its wake, and now, Hurricane Irma has Florida in its sights.

It's been five years since Hurricane Sandy, nine years since Ike and twelve years since Katrina. As with all major weather events, personal tragedy, pain, suffering, and loss are left in their wake. We have prayed, and continue to pray, for those affected. But at the same time, in our job as economists we look toward rebuilding and economic restoration. This is where investors often make two different mistakes about how these massive weather events will affect the economy and markets.

Some might think that, as did Nouriel Roubini after Katrina, the damage itself will cause a recession. Others take the opposite tack and think rebuilding efforts might actually help the economy. Neither are correct. By themselves, the storms will not push the economy off its Plow Horse path.

In the face of disasters we should all be thankful for the (mostly) free markets that help the U.S. respond. These markets allow accumulated wealth and know-how to focus on recovery. The losses will never be fully replaced, but the sheer size and flexibility of the U.S.'s capitalist system allows resources to be shifted and directed toward recovery. The price system makes this happen. While some think no profit should be made from a disaster, it is those profits which allow overall "economic" recovery to occur in relatively quick order.

Some estimate that damage from Harvey could be close to the \$108 billion estimate for Katrina (2005), certainly above the \$75 billion cost of Hurricane Sandy (2012).

Neither of these previous storms caused a recession, and at the same time, the data show no real acceleration in growth either. Real GDP grew 4.9% at an annual rate in the first quarter of 2006 after Katrina, but never accelerated above 3% in the first two quarters after Sandy. For six and nine month periods before and after these storms, growth rates were similar. In other words, it's hard to separate the impact of Katrina or Sandy from normal statistical noise. The U.S. grew over 4% annualized in Q1 2005 and in Q3 2014, with no major weather impact.

But even if the bump in real GDP growth in the first quarter of 2006 was due to Katrina, that doesn't mean it was good news. It would be what Henry Hazlitt in his book "Economics in One Lesson" called the "fallacy of the broken window" – which we recommend all investors read.

Hazlitt told a story about a vandal who broke a shopkeeper's window, which caused a glassmaker to get an additional order. But the shopkeeper was planning on eventually using that same money to buy a new suit, so the tailor lost an order. In other words, even though rebuilding appears to create new economic activity, fixing things that have been destroyed actually robs an economy over time of the benefits of growth. Repairing physical capital does not generate new wealth, it only replaces old wealth.

Before Harvey, the market consensus was that automakers would sell cars and light trucks at a 16.6 million annual rate in August. Instead, automakers reported late on Friday that they only sold at a 16.1 million rate. Harvey hit an area that represents about 5% of US auto demand and it did so for about 20% of August. This suggests Harvey cut roughly 1% off of August sales nationwide, or that autos would have sold at a 16.3 million annual pace in the absence of the storm.

Automakers should make those sales back up in the next few months. In addition, reports suggest the storms destroyed about 500,000 autos, which will also generate additional sales in the months ahead.

These sales might help make the GDP numbers look better late this year or early next year, but it just represents demand that would have eventually appeared elsewhere in other sectors.

The lesson is that these disasters, while a tragedy in so many ways, do not shift the fundamental path of the U.S. economy. Some think socialist economies can respond better, but this is not true; markets are the most efficient system for guiding resources to areas in need. Free people that get hit with a disaster will overcome and reach new highs, because that's what people do when they're free, disaster or not. Godspeed to all those affected directly, and to those helping in recovery.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
9-5 / 9:00 am	Factory Orders – Jul	-3.3%	<b>-3.0%</b>	<b>-3.3%</b>	+3.0%
9-6 / 7:30 am	Int'l Trade Balance – Jul	-\$44.7 Bil	<b>-\$44.8 Bil</b>		-\$43.6 Bil
9:00 am	ISM Non Mfg Index – Aug	55.5	<b>55.5</b>		53.9
9-7 / 7:30 am	Initial Claims – Sep 2	244K	<b>246K</b>		236K
7:30 am	Q2 Non-Farm Productivity	+1.3%	<b>+1.4%</b>		+0.9%
7:30 am	Q2 Unit Labor Costs	+0.3%	<b>+0.3%</b>		+0.6%
9-8 / 2:00 pm	Consumer Credit– Jul	\$15.0 Bil	<b>\$17.4 Bil</b>		\$12.4 Bil