Hurricane Sandy: Monster Storm Just In Time for Halloween

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Contacts:
Katherine Smith

IHS Global Insight US Economists Gregory Daco and Nigel Gault’s analysis and commentary on the Preliminary Evaluation of the Economic Impact of Hurricane Sandy

As the East Coast of the United States awakes to devastation in the wake of Hurricane Sandy, IHS Global Insight has produced a preliminary evaluation of the macroeconomic impact of the superstorm.

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Category 1 Hurricane Sandy has now become the largest tropical system recorded in the Atlantic measuring around 900 miles across – covering an area close to one and a half times the size of Texas. According to the National Weather Service, Hurricane Sandy was reinforced by two cold fronts from the north and west transforming it into a post-tropical superstorm (i.e. nor’easter) with heavy rains, snow and gusting winds as it moved up the Eastern coast.

National Macroeconomic Impact Versus Regional Impact

Early estimates of potential infrastructure damages currently stand around $10 billion of insured damages and about twice as much, or $20 billion, in terms of total damages. This would put Sandy on par with Irene in terms of total infrastructure damage estimated around $15 billion. However, with Sandy being a much larger storm, it is likely to end up causing more flooding damage than its 2011 peer which would increase total damage estimates.

In addition to infrastructure damage, Sandy has forced the idling of about 70% of the East Coast’s oil refineries. This does not bode well for the supply of refined oil products as capacity was already quite tight prior to the shutdowns. We are likely to see an accumulation of crude supply and a shortage of refined products in the coming days which will inevitably put upward pressure on gasoline prices. Already, on Monday the November reformulated gasoline blendstock for oxygenate blending (RBOB) gasoline futures price had increased.

Finally, Sandy looks likely to result in important disruptions to business activity as it hit the East coast on a Monday (versus a Sunday for Irene in 2011). The commercial shutdown of the East Coast is likely to result in gross domestic product losses that may outweigh infrastructure damages. And, while some of these losses will be offset by ex-ante “preparation” sales as well as clean-up, repair and reconstruction activity – thus lessening the “observable” GDP growth impact in the fourth quarter – part of the loss in economic activity is permanent (for example spending at restaurants).

Combining all of the above disruptions from Sandy, early estimates point toward total economic losses of around $30-$50 billion.
The region affected by Hurricane Sandy will be similar to the one affected by Hurricane Irene in 2011 – a region stretching across 15 states on the East Coast with a gross regional product of around $3 trillion. Assuming the total economic losses are around $30 billion to $50 billion that would represent losses equivalent to 1.0% to 1.7% of gross regional product (GRP) for the states affected.

This would be larger than the damages from Hurricane Irene which represented about 0.5% of GRP for the 13 most states affected, but it would be much less than Hurricane Katrina, which caused around $120 billion in damages, amounting to 9.6% of gross regional product for the states most impacted - Alabama, Florida, Louisiana, and Mississippi.

- National

On a national scale, $30 billion to $50 billion in economics losses would represent about 0.2% to 0.3% of nominal GDP. Part of these losses will eventually be made up by reconstruction activity, but it would be naïve to put forward the view that a hurricane is in some sense a stimulus for the economy. There's no guarantee that reconstruction activity will be extra activity, on top of what would otherwise have occurred, rather than a substitute for that activity.

In the private sector, insurance will cover some of the reconstruction costs, but not all. Other reconstruction may take place at the expense of costs pared elsewhere, or simply may not be done at all. And even the reconstruction covered by insurance is not a “free lunch”, since it comes out of insurers' profits and perhaps could lead to higher insurance premiums.

The effect on growth for the fourth quarter will not be catastrophic but might still be noticeable, especially in an economy with little momentum anyway. Suppose that the affected regions lose just 25% of their overall output for two days that is not recoverable later. That would knock about $25 billion annualized ($6 billion actual) off GDP, and could take as much as 0.6 percentage points off annualized fourth-quarter real GDP growth rate.

IHS Global Insight will continue to monitor the storm damage, and we will update our thinking as damage estimates become firmer.

Better Safe Than Sorry

Although it is hard to gauge the precise estimate of current and future damages from Hurricane Sandy, the superstorm is likely to cause severe infrastructure damage and has already disrupted business activity. Many homes in flood-prone areas along the coast were ordered to evacuate, thousands of flights have been cancelled and many public transportation services have been closed. In addition, numerous schools and businesses were shut down while the U.S. securities industry canceled equity trading on all markets on October 29 and October 30 – the first shutdown of the New York Stock Exchange since 9/11, and the first 2-day shutdown for weather since 1888. Finally, numerous refineries and a couple of nuclear facilities along the East Coast were either shut down or run at lower capacity.

President Obama has asked the Federal Emergency Management Agency (FEMA) to coordinate efforts with states affected by the Hurricane, and he has signed emergency declarations for New York, Massachusetts, Connecticut, Rhode Island, New Jersey, Pennsylvania, Maryland, and the District of Columbia

A Look At Prior Hurricanes

While it is still early to give a full accounting of the cost of Hurricane Sandy, IHS Global Insight has looked back at previous hurricanes to provide a range of macroeconomic impacts.

- Hurricane Irene

The current trajectory of Hurricane Sandy has some similarities to that of Hurricane Irene that pummeled the East Coast in August 2011. Irene left behind it a path of destruction worth about $15 billion – or, about 0.1% of nominal GDP in 2011 – across 13 states. But, while the livelihood of many households and businesses was affected by this storm, a couple of factors played a key role in minimizing its final impact. First, the Hurricane rapidly weakened to a tropical storm as it moved up the coast. Second, the storm made landfall on a weekend, hence reducing business disruptions (although some business activity was affected during the following week by flooding, power losses, and travel disruptions). Unfortunately, none of these mitigating factors look likely for Hurricane Sandy, which is also a bigger storm – so Sandy’s damages should be larger than Irene’s.
Hurricane Katrina

Hurricane Katrina hit the coast of southeast Louisiana about seven years ago, on August 29th 2005, as a Category 3 hurricane with winds around 120 miles per hour and a storm surge close to 28-feet in Louisiana. Damage was extensive along the Gulf coast from Florida to Texas, with the most severe impact taking place in New Orleans, Louisiana where the hurricane surge protection system failed to contain the storm surge. Katrina is considered one of the most destructive Atlantic hurricanes of all times in the United States with total property damage estimated around $120 billion, or about 0.95% of GDP in 2005. And, with a death toll of 1,836 people, it was the deadliest hurricane since the 1928 Okeechobee hurricane. Fortunately, authorities have been proactive in preparing for this superstorm mandating evacuations of risk zones, reinforcing storm surge systems and declaring a state of emergency in many states. This will hopefully limit infrastructure damages and casualties in the wake of Sandy.

Political Complications

The storm has put a damper on the presidential campaigns of President Obama and Governor Romney, and has produced a very strange situation where the election, just days away, has been temporarily driven out of the news. Both candidates have had to cancel scheduled campaign stops in key swing states including events in Ohio, Florida and Virginia. This adds another twist in a race that looks pretty tight. Both will want to be very careful not to appear to be trying to make political capital out of a natural disaster.

by Gregory Daco and Nigel Gault

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