

Suite 300

1015 Eighteenth Street, N.W., Washington, D.C. 20036

Telephone: (202) 777-3000 Facsimile: (202) 777-3010

ECONOMIC NEWS UPDATE

02 September 2005

This is the weekend on which many Americans usually fire up their barbecues for the last time before closing their summer places and returning to work, while others pile into their cars to visit relatives, amusement parks, and the beach. Not a weekend for work-a-day worries.

Not this year. The horrendous consequences of Katrina are filling the television screens and driving up gasoline prices even in parts of the country spared a direct hit by the storm, which shut down 20% of US oil production (less than 10% of consumption needs), nine refineries accounting for 10% of national capacity, and major ports and pipelines. It may have been foolish, even hubristic, to build a city, New Orleans, some six feet below sea level, and for thousands of people to disregard warnings and refuse to leave their homes. And the looting of sporting goods stores and the "guns and ammo" section of Wal-Mart are sights not likely to increase the sympathy of Americans for the plight of New Orleans' citizens, or their confidence in the ability of their government to cope with lawlessness.

No matter. Led by President Bush, Americans have decided that our

own "tempst-tost" are as worthy of sympathy as the immigrants to whom that phrase, inscribed on the base of our Statue of Liberty, is inscribed. The President is hoping that his combination of sympathy, promises of material help, and optimism that we shall overcome will boost his popularity.

Perhaps, but only perhaps. In polls taken before Katrina whipped through the Gulf Coast region, 66% of Americans rated economic conditions as only fair or poor, 63% said they are getting worse, and 58% say it is a bad time to find a quality job. Yet 2.2 million jobs have been created this year, the unemployment rate is a low 4.9%, and 86% of Americans say they are completely or somewhat satisfied with their own jobs. Indeed, 91% say they "love" (32%) or "like" (59%) their jobs, according to a compilation prepared by Karlyn Bowman, Washington's premiere poll analyst.

That high level of job satisfaction may be why 61% of workers say they would continue to work even if they won \$10 million in the lottery, unless, of course, they don't want to answer in the alternative: "If I won \$10 million I would become a lazy lay-about."

In short, it is not easy to discern the state of the American psyche pre-Katrina, much less since the storm hit. Perhaps the best indicator is provided by a Harris poll that concludes, "With a few exceptions, Americans are generally happier with their lives and more optimistic about their future than are Europeans....Fully 58 percent of Americans are very satisfied with their lives compared to the 15-country European average of 31 percent". Moreover, 65% of Americans expect their personal situations to improve in the next five years, compared with 44% in the EU.

It is unlikely that the natural optimism of Americans will be shattered by Katrina. After all, the job market is improving to the point where The Wall Street Journal reports this is "The Best Fall in Years For Job Seekers". Equally important, social indicators are flashing brighter signals: Weekly Standard colleague and New York Times columnist David Brooks reports that violent crime is down by 55% since 1993, drunken driving fatalities have fallen by 38% since 1982, and teenage pregnancy, promiscuity, and suicides have dropped sharply. "American is becoming more virtuous," he concludes.

Which bodes well for the long term. Whether those trends will be overshadowed by Katrina will depend on the durability of the storm's effects, a subject on which experts are divided.

David Malpass, global economist at Bear Stearns, advises that "the US and global economies will continue growing relatively fast despite the hurricane damage and high oil prices." Katrina, he believes, will cut third-quarter GDP but add to fourth-quarter GDP as rebuilding expenditures accelerate.

Relatively optimistic analysts are expecting that Katrina will force the Federal Reserve Board to abandon its policy of "measured" interest rate increases, at least for the balance of the year. That should keep interest rates down, and the housing sector powering ahead.

That is an attempt to convert a nightmare into a delightful dream, say other analysts. If the Fed abandons its program of interest rate increases, inflation will take off. More fundamentally, the already-slowing US economy has suffered a severe, growth-stifling, supply-side shock. The port of New Orleans, the world's fifth busiest, is closed; offshore oil platforms have either disappeared or been mangled; the refinery sector, already short of capacity, has been hit hard; the electricity system, on which the refinery and pipeline sectors depend, is shattered. The combination of soaring demand for oil by China and India, and this supply-side disruption will keep gasoline prices high, strain consumers' pocketbooks, and bring economic growth to a screeching halt.

Which set of forecasters will prove right will depend on how rapidly damaged facilities can be repaired. The important 5,519-mile Colonial Pipeline, which delivers almost 100 million gallons of gasoline and other products to twelve states every day, restored its flow to over 60% of normal only a few days after Katrina struck. Mississippi Power Company, which serves the hardest hit cities in the state, is restoring power to its customers at a rapid rate, and Entergy expects to have power back to the region's refineries within two weeks. The Corp of Engineers expects to pump New Orleans dry by the end of this week. If experiences in Chicago

(fire), San Francisco (earthquake), and Johnston (flood) are any guide, New Orleans will be back.

None of this means that there will be an easy fix to the problems created by Katrina. But it is too early to guess what we Americans will be thinking and doing at this time next year, when summer's all-too-short lease expires.

[ET



THE SUNDAY TIMES

A version of this Update appeared in
The Sunday Times (London)