Trying to Reason with Hurricane Season: The Aftermath of "Harma"

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Key Points

- Harvey will sit on top of the costliest hurricanes, and now has Irma in its coattails.
- Hurricanes' impact on economy tends to be felt most acutely in unemployment claims.
- "Harma" will unlikely dent the Fed's plans to continue monetary policy normalization.

Our hearts go out to everyone affected by Harvey and now Irma. I did little over the weekend except sit glued to the TV watching Hurricane Irma coverage. That's because I have a home in Naples, FL, on one of the southern intercoastal waterways. As of the writing of this, I have no idea how our home fared. My fingers are crossed (which could lead to typos).

Of course, before Irma unleashed her wrath, Houston got battered by Harvey; and last week the questions started coming in about Harvey's economic and/or market impact.

Needless to say, the U.S. economy is massive and diverse, making it a tricky task to "unpack" a prior natural disaster's impact for the purpose of forecasting the impact from Harvey/Irma (perhaps we should collectively call them "Harma").

Limited stock market impact likely

As you can see in the table below, more often than not, the market did not suffer sustained losses following the six costliest hurricanes in U.S. history. The one exception was in the aftermath of Hurricane Ike in 2008. Clearly though, there was another powerful storm happening at the time—the global financial crisis—which easily gets the blame for the market's carnage.
From an industry perspective (hat tip to Strategas Research Partners), following the 10 costliest U.S. hurricanes, the most consistent beneficiaries in the subsequent three-to-12 months were:

- Professional Services
- Construction & Engineering
- Road & Rail
- Real Estate

The most consistent losers in the same period were:

- Diversified Consumer Services
- Auto Components
- Thrifts & Mortgage Finance
- Health Care Technology
- Real Estate Management & Development

**Harvey more costly, but less impactful than Katrina**

Evercore ISI does some of the most comprehensive company surveys out there. Their data in the post-Harvey period shows that although Harvey's cost will be greater than Katrina's (see below), it hasn't had the same national impact. And Houston's mayor, Sylvester Turner, recently noted: "Most of the city is now dry. Houston is open for business. The water system is safe. The transit and airport systems are both up and running."

Moving on to the economy more broadly, the hits have come quickly in areas like unemployment claims; but tend to be a bit more spread out in overall gross domestic product (GDP). It will admittedly be difficult to discern whether any negative economic reports are a result of the storms' damage and
then whether stronger reports owe to the effects of recovery/rebuilding. But I would expect inflation to lift a bit in the near term, especially given Harvey-related refinery disruptions.

**Harvey on pace to be #1**

The three costliest hurricanes in U.S. history were Katrina ($49.8b), Andrew ($24.5b) and Sandy ($19.9b). Based on preliminary estimates, Harvey will usurp Katrina at the top of the list, with estimates running as high as $100b. It's way too early to get a sense of the damage associated with Irma, but Munich Re estimates losses of between $20-30b, putting it in the top-five.

Initial unemployment claims tend to get hit first, and hit hard. As you can see in the chart below, claims spiked immediately in the aftermath of Harvey.

![Initial unemployment claims (thousands) chart](chart.png)

Source: FactSet, as of September 1, 2017.

Looking at the three costliest hurricanes, you see a familiar pattern: a quick and sharp hit, followed by a recovery-to-trend in the out weeks. In those three cases, by eight weeks following the hurricane, claims had finished their "round trips."
Net worth and Fed impacts

Important to note is that the destruction of homes and businesses don’t get directly calculated into gross domestic product (GDP), but they would show up in household net worth statistics. One complication from Harvey is that many of Houston’s homes are not insured for flooding, so the negative effect on household wealth could be meaningful.

I’ve also gotten a couple of questions about whether "Harma" might impact the Federal Reserve’s decision-making. In short, it’s doubtful. In fact, as news was reported that Irma inflicted less damage than initially predicted, the probability of another interest rate hike this year jumped from 26% on Friday to 36% today. And we still expect the Fed to announce the start of its balance sheet normalization process at this month’s Federal Open Market Committee (FOMC) meeting.

The net is that we expect to see a dip in economic activity in the short-term, followed by a boost associated with the recovery/rebuilding efforts. However, the U.S. economy is nearly $20 trillion in size with more than 150 million workers; so the effects of "Harma" will admittedly be difficult to unpack from the typical volatility in economic data.

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