Popular Economics Weekly

WEEK OF SEPTEMBER 12, 2005—WHO WILL PAY FOR KATRINA?

The first economic effects of Hurricane Katrina are now appearing, and a tug of war is brewing over who will pay for Katrina's damage. Not only have gasoline and natural gas prices soared, but the week's initial claims for unemployment— the Labor Dept. attributed 68,000 of the 71,000 increase in claims to Katrina. This brought total claims for the week ending Sept. 11 to a whopping 398,000, which has to affect next month's unemployment report, and many more in months to come.

Then we have plunging consumer confidence, as reported by the University of Michigan sentiment survey. It fell more than 13 points to 76.9, the lowest level in 13 years, according to CBS's Marketwatch. Its expectations index also fell 13 points. Most of the decline was attributed to soaring gasoline prices that are now above $3 per gallon.

The Michigan report's measure of median inflation expectations for the year ahead did rise to 4.6% from 3.1%, a logical reaction to what was initially a surge in gasoline prices that hit well over $3 a gallon, said Merrill Lynch economist David Rosenberg. "The data are consistent with our view that consumer spending will remain slow over the next several quarters," he said. The 5-to-10-year inflation expectations component rose more modestly, to 3.1% from 2.8%, but did break slightly out of the near term trend.

The great fear among economists is that Katrina will mean a severe cutback in consumer spending. Retail sales plunged 2.1 percent in August due to slumping auto sales, the largest decline in 4 years. And this was prior to Katrina. But sales are still 7.9 percent higher in 12 months, so it is too soon to tell if Katrina will significantly impact consumers over the long term.

The reactions to Katrina were mixed among Federal Reserve Governors, who must decide on Sept 20 whether to raise the fed funds rate another one-quarter percent, or pause. Chicago Fed President Michael Moskow recently worried that Katrina may cause a further elevation in inflation (so continue to raise the fed funds rate), while San Francisco's Fed President Janet Yellen thought the greater danger was that 450,000 displaced workers may slow economic growth. She advocated a wait and see attitude (meaning don't raise the rate) until the magnitude of Katrina's damage is assessed.

Inflation will be on economists' minds as the recovery effort swings into action. Katrina could take away resources from other sectors at a time when our economy is already nearing its full production capacity. August's inflation indicators did not jump as much as expected, prior to Katrina. Both wholesale PPI and retail CPI indexes showed little or no core inflation—i.e., without taking into account the continuing run up in energy prices. But commodity prices in general have been rising, as well.

WHOLESALE INFLATION—The August PPI rose 0.6 percent, though its core index without food and energy was unchanged. Energy prices were up 3.7 percent. Finished Goods' wholesale prices have risen 5.1 percent in 12 months. But Crude Materials' prices have been ascending, as well, including raw steel, gold ore, and all construction materials—up 11.3 percent in 12 months.

RETAIL INFLATION—The CPI rose 0.5 percent, but only 0.1 percent without food and energy. Gasoline prices in particular increased 8.3 percent, and are up 31.3 percent in the past year. This is affecting transportation costs, as well, up 9.1 percent in a year. One of the results is that Delta and Northwest Airlines have filed for bankruptcy due to the sky high cost of jet fuels.

REAL EARNINGS—Real earnings (after inflation is factored in) are the broadest measure of economic well being to Americans; 80 percent of which are wages and salaries paid to the average Jills and Joes among us. And the fact is real earnings continue to decline, in part because of the soaring energy prices. A 0.1 percent increase in average hourly earnings was more than offset by a 0.6 percent increase in consumer prices for Urban Wage Earners and Clerical Workers in August, reports the Labor Dept. Average weekly earnings have declined a whopping 1.1 percent in 12 months.

INDUSTRIAL PRODUCTION—The Federal Reserve reports on production and capacity utilization, since it tells us why commodity prices and inflation are on the upswing. There is little capacity left in our economy. Capacity utilization has been 79.8 percent for 3 consecutive months, and 81 percent is the long term average since 1972. Industrial production increased 3.1 percent in 12 months, and has now surpassed its 1999 historical high.

The damage debate really hinges on who will pay for Katrina's damage—which means how much will be dumped onto future generations. President Bush has now promised that the Federal government will foot most of the bill. This has caused even conservative Republicans to question the wisdom of making all of his tax cuts permanent in the face of such promises.

So Katrina might also focus attention on who has really benefited from the tax cuts that President Bush wants to make permanent. Former President Clinton stated to ABC's George Stephanopolis that 50 percent of the benefits of the 4 tax cuts enacted to date by the Bush White House have benefited the top 1 percent of income earners in the U.S. Yet Bush has no choice but to find a way to finance the recovery of Louisiana, Mississippi and Alabama. Where will he find the money without further damaging the economy, is the question to be answered.