Testimony of Keith Hall -- Chief Economist, U.S. Commerce Department
Before the Subcommittee on Commerce, Trade and Consumer Protection
Chairman Cliff Stearns
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Chairman Stearns, Ranking Member Schakowsky, Members of the Subcommittee.
My name is Keith Hall. I am the Chief Economist at the U.S. Department of Commerce.

I would like to summarize my written testimony and would ask that it be submitted for the record.

Thank you for the opportunity to talk with you today about our economy and the effect of Hurricane Katrina.

Clearly the effects to the Gulf Coast have been devastating to residents there. Those of us who have not been through such overwhelming loss cannot imagine it, much less assign it a number.

However, the statistical agencies in Commerce and other Federal departments are working quickly to estimate Hurricane Katrina's effects on the overall economy as well as the regional, state, and even some local economies, using the range of existing economic surveys and data collections. We can also examine the effects of Hurricane Katrina on the population, using the American Community Survey and other population surveys.

We are seeing some Katrina-related shifts in the data already and can expect to see more in the future. All of the economic consequences are not known and the full effects of the hurricane may never be completely revealed in economic data because the upheaval in the Gulf Coast will be diluted in macroeconomic data by continued strong economic growth elsewhere in the country

I can discuss with you today some of the data released so far and how Katrina is similar to and different from other storms.

In 2004, the resilient U.S. economy generated approximately $11.7 trillion in Gross Domestic Product. Louisiana's economy was $152 billion last year. Alabama's economy measured $139 billion and Mississippi's economy was $76 billion in 2004. Together the three states therefore accounted for about 3.1% of U.S. GDP.

Employment and production in the region are quite diversified. However, the affected area accounts for an unusually large portion of U.S. employment in certain industries. These include shipbuilding and repairing, petroleum refining and many types of chemical manufacturing, and tourism, including casinos.

The ports damaged by Katrina accounted for 4.5% of total exports of goods from the United States last year, and 5.4% of total U.S. imports. Importantly, 19% of all crude petroleum imports into the U.S. entered the country in the New Orleans customs district.

For the most part, economic data released in the past two weeks have measured economic activity prior to the impact of the hurricane. They do not, therefore, answer the question posed at this hearing. The Bureau of Labor Statistics' employment release on October 7 will give us the first monthly data to estimate the effects of the storm. These data regularly show absences of work due to bad weather, with regular spikes in the summer and fall months of hurricane season. In the past decade, the east coast blizzard of 1996 caused the largest work stoppage of any single episode—but that may be challenged by the Katrina-related disruptions.

We do have some limited weekly data about unemployment insurance. For the week ending September 10, initial claims for unemployment insurance shot up 71,000 from the previous week. This was the largest jump since the 1996 blizzard. The Department of Labor estimates that 68,000 of that increase was hurricane related.

What makes the employment disruptions different now is that we have an unusually high displacement of workers and economic activity for an as-yet-unknown period of time. Many of the affected workers must wait for the water to be pumped out of New Orleans and for very significant cleanup and infrastructure repair to be completed before they can return to their homes and their jobs. Will these workers return to New Orleans to advance the rebuilding or will they stay in Houston or Baton Rouge or Atlanta? And if they do not return to New Orleans, how long will it take for them to find jobs?

The devastation in the affected area is already reflected in lower industrial production. While industrial production was up in the most recent report for August, the Federal Reserve estimates Katrina-related declines in several industries reduced overall growth by 0.3 percentage points— even though Katrina only affected production for the last few days of the August reference period.

At the same time, Katrina's impact on August retail sales and construction activity seems to have been very small. Of course, those releases only cover the first few days of Katrina's effect. We will only be able to begin to gauge the broader impact of the storm when the Census Bureau releases estimates for September.

Please understand that it may be impossible, in some cases, to ever fully differentiate Katrina's impact from other changes in economic activity that were occurring at the same time. At both the national and regional levels, the precise impact of a natural disaster on GDP and other data cannot be separately measured because our statistical system is designed to estimate what actually occurred rather than what might have happened in the absence of the disaster.

The broadest summary measure of our economy is Gross Domestic Product (GDP). The most important thing to understand when thinking about the impact of Katrina is that

GDP measures new things being produced. Storms and floods damage old things that were produced in the past. The loss of those old things does not figure into GDP—although it does figure into the Bureau of Economic Analysis's estimate of depreciation (the amount of capital expended during a given period). Thus, the destruction of capital itself will not affect current GDP—although the fact that workers and factories are not producing anything because they are closed, underwater, or damaged *will* reduce future GDP. In the coming quarters, however, the economic activity required to replace all those old things—to rebuild houses, factories and infrastructure—will eventually show up as increased economic activity.

We can see how this worked during last year's hurricane season. Third quarter 2004 growth was a strong 4% despite a heavy hurricane season—including four hurricanes in Florida. The hurricanes' effect on activity and employment (much smaller than Katrina's, admittedly) was overwhelmed by the fundamental forces that underpinned the nation's strong economic growth, and was also offset by the immediate rise in construction activity as the structures damaged by those hurricanes were rebuilt.

Katrina is unusual because of its impact on the economy's energy sector. For some time now, economists have been concerned about the potential effects of rising energy prices on the economy. The direct effects from Katrina are expected to be significant but still modest relative to the overall economy. Last year, consumers spent $230 billion for gasoline. At about $3 per gallon, recent gasoline prices were 50% above levels one year ago. If consumers wish to purchase the same amount of gasoline, they would spend ($115 billion) less on other goods and services, all other things being equal. Gasoline prices have already declined from peak levels and are expected to continue to decline. Price increases in other energy products—mainly natural gas and fuel oil—will add to the burden. But consumers spend considerably less on these products than on gasoline.

By comparison, total consumer spending grew about $500 billion in 2004. Thus the higher energy bill will have a significant impact—but there is no reason that real consumer spending on other goods and services cannot continue to grow at a healthy rate despite the higher energy bill.

Substantial pre-Katrina energy price increases did not appear to lead to inflation or pricing pressure elsewhere in the economy. Core inflation—a measure of the underlying inflation pressure in the economy—has remained low even as energy prices rose to unusual levels The consumer price index for core goods and services increased at a modest 1.3-percent annual rate during the past five months (from March to August, 0.1 percent per month), a step-down from the 2.4-percent pace over the prior 12 months (March 2004 to March 2005).

Mr. Chairman, my team at the Department of Commerce will continue to monitor these economic data for evidence of the storm's impacts. I would be happy to update you on our analysis of the hurricane and its consequences. I would also be pleased to take your questions.