

Hurricanes Katrina and Rita Unlike Other Natural Disasters

Hurricanes and other great natural disasters cause significant human and material losses. From the point of view of the business cycle, such calamities usually reduce growth opportunities at first, but ensuing reconstruction tends to compensate for some of the loss in growth. The effects of even a large catastrophe are usually relatively small on the world economy.

Hurricanes Katrina and, later, Rita differed from most other natural disasters in that their impact was felt strongly in the main energy-producing region of the United States. The hurricanes and the resultant flooding either stopped or seriously damaged a considerable part of energy production in Louisiana, Mississippi and Texas.

Following landfall of Hurricane Katrina, some 90 percent of crude oil production came to a

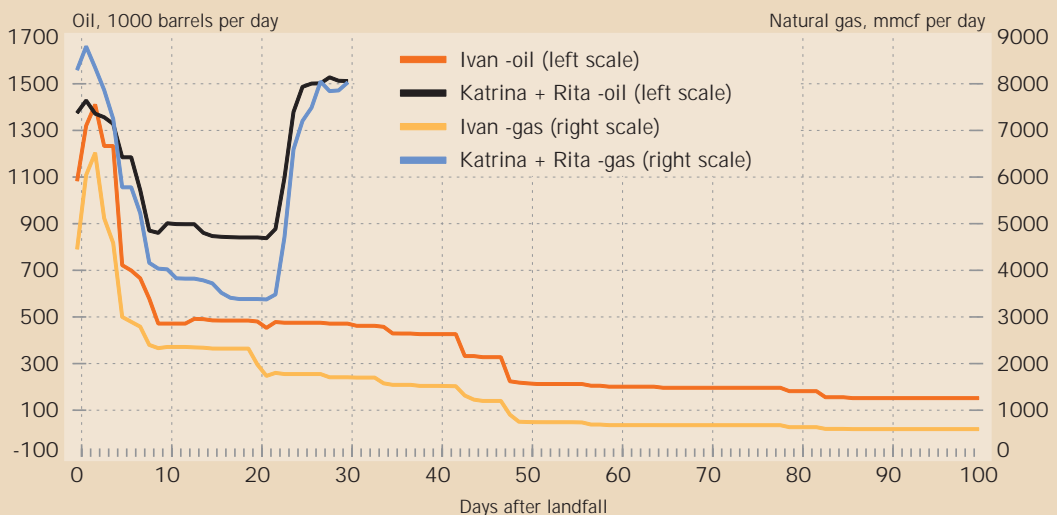


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halt. The Gulf of Mexico (GOM) accounts for 29 percent of total U.S. crude oil production. About 70 percent of gas production, with GOM accounting for 19 percent of total U.S. production, also came to a halt. Some 12 percent of all US refining capacity was shut in the areas

Shut-in Production Comparison of Hurricanes Ivan and Katrina + Rita



Sources: IEA, ETLA.

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affected by the hurricane. Less than a month after Katrina, Hurricane Rita came along and added to the damage. On the 28th of September, 72.4 percent of 819 manned platforms, 47.8 percent of 134 rigs, 100 percent of oil production and 80.3 percent of gas production were still at a standstill in the Gulf of Mexico, according to the Mineral Management Service.

Output has now started to recover and reconstruction is under way. The severity of the situation is reflected in the fact that New Orleans, a city with almost half a million inhabitants, is so badly damaged by the flooding that initiating normal activity will take months.

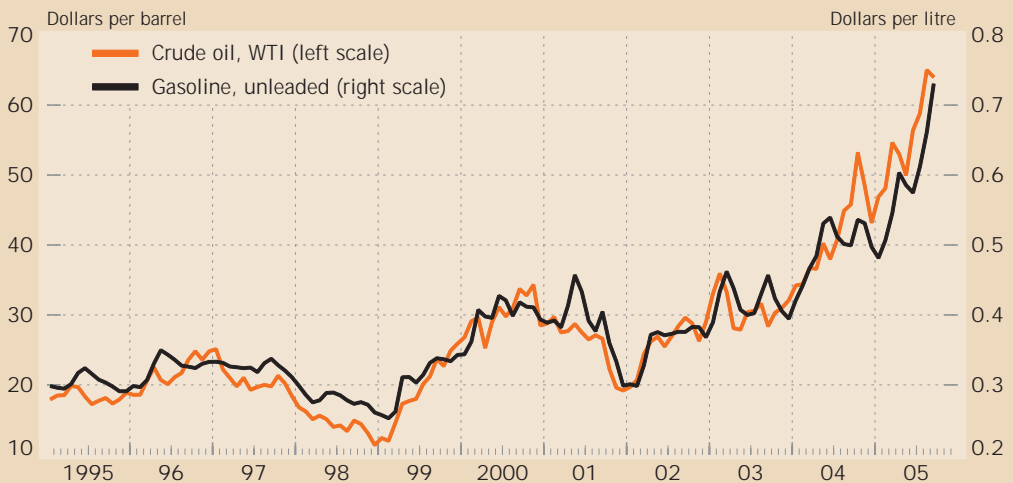
THE PRICE OF GASOLINE HAS RISEN CONSIDERABLY

At first, problems in oil production raised the world market prices of crude oil, gas and fuels considerably. Since then, oil prices have declined because some of the oil in strategic reserves has been released and sold to the

market, while Saudi Arabia has promised to increase its output. This will ease pressures on the prices of oil products such as gasoline because it makes it possible for refineries operating in the disaster area to obtain crude oil. Energy saving and increasing supply will eventually ease the situation.

There were already shortages of refining capacity before the hurricanes struck. Consequently, difficulties in starting up the refineries will keep the gasoline market tight. The price of gasoline rose by about 40 percent in the U.S. during the first couple of days of September to levels exceeding three dollars a gallon. Price pressures have not yet completely abated, though prices have come down somewhat since then. The rise in gasoline prices alone will raise the US inflation rate by one percentage point. In addition to gasoline, the price of natural gas, among other things, has also risen considerably.

Price of Crude Oil (WTI) and Gasoline (Unleaded) in the USA



HURRICANES KATRINA AND RITA WILL NOT PUSH THE WORLD ECONOMY INTO RECESSION, BUT THE RISK OF SLOWER GROWTH REMAINS HIGH

Given the present trends in the world economy, energy markets will remain tight and the use of strategic oil reserves to smoothen the impact of Katrina will reduce the possibilities of adjusting to new shocks should they occur. Heightening risks are already keeping oil prices high. This has raised, for example, the size of necessary reserves and speculation of higher oil prices.

Katrina's impact will be buffered by the good performance of the U.S. economy before the hurricane struck. It is likely that the Federal Reserve and the federal government will react rapidly if any signs of a recession emerge. The increase in fuel prices will reduce households' purchasing power both in the US and in the rest of the world and raise production costs. Indeed, Katrina will cause a dip in economic activity.