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## HURRICANE KATRINA AND ITS IMPACT ON LATIN AMERICA

This issue of the FAL Bulletin contains the report prepared jointly in September 2005 by three ECLAC divisions (the Division of International Trade and Integration, the Economic Development Division and the Statistics and Economic Projections Division) on the consequences of Hurricane Katrina for the Latin American countries, especially in relation to international trade and macroeconomic impacts in the region.

In addition, the web version of this issue includes two tables with data on United States imports from Latin American countries and the proportion that enters through the Port of New Orleans .

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### I. IMPACTS ON THE UNITED STATES ECONOMY

Katrina was one of the most destructive hurricanes that has ever struck the United States . The storm, which made landfall on 29 August 2005, caused a number of breaches in the levees that protect New Orleans , causing the flooding of that city and catastrophic damage. The hurricane caused equally extensive damage in the coastal areas of Louisiana , Mississippi and Alabama . The combined gross domestic product of those three states accounts for 61% of the product of the State of Florida and the affected area produces around 30% of the country's refined oil and a little over 20% of its natural gas. New Orleans , the city most affected by the loss of human life and destruction of infrastructure, contributes about 0.4% to the economy of the United States . Another relevant aspect is the percentage of poverty in this city, which is 18.4%, compared to the national average for cities of only 10.9%.

The passage of this hurricane resulted in the closure of the ports of the Gulf of Mexico and affected 95% of the refining capacity of the Louisiana area, which meant a reduction of about 30% in the refining capacity of the United States . According to estimates by the International Energy Agency (IEA), there were production cuts of 1.5 million barrels a day in the case of oil, and 2 million barrels a day in the case of refined products. The affected infrastructure also includes the largest sugar refineries in the country, as well as most of the liquid hydrogen producing plant (a chemical

product needed for the manufacture of cold laminated steel and semiconductors). Despite the fact that the affected region contains only about 1% of the United States work force, it accounted for around US\$ 150 billion of the country's external trade (20% of the total) in oil, steel, grain, veneered wood and other goods that enter the United States through its ports. It is estimated that the damage caused by Katrina will exceed US\$ 100 billion.

In view of the supply cuts caused by the passage of the hurricane, the IEA made available to the market the equivalent of 2 million barrels a day of oil for a period of 30 days. It also contacted the main producer countries, and they made a commitment to increase the availability of oil on the international market. As a result, international oil prices fell in mid-September in relation to the values recorded after the passage of the hurricane: by 6.3% in the case of the Brent oil price, 5.9% in the case of producer countries not members of OPEC, and 6.8% in the case of the OPEC member countries, with the price of the OPEC basket at around US\$ 58 per barrel.

Despite the costs and social consequences of the storm, the economic impact is expected to be short-lived for the United States. According to a survey carried out in September 2005 by the Wall Street Journal Online, the effects of Hurricane Katrina will mean lower growth in the United States economy as well as considerably higher inflation in the second half of the year, but the economy is expected to improve at the beginning of 2006 owing to the reconstruction efforts in the areas affected. The results of the survey produced a reduction in the growth rates projected for August 2005 of 4.2% and 3.6% for the third and fourth quarters of the year, respectively, to 3.6% and 3.2% for the same period<sup>[1]</sup>. The projections for growth in the first half of 2006, however, remain practically unchanged, producing an average of 3.3%. More recently, estimates from both ECLAC and the International Monetary Fund<sup>[2]</sup>, published in their latest report, indicate that the impact of Katrina will result in a reduction by one tenth of a percentage point of the country's estimated annual economic growth rate for 2005.

The Congressional Budget Office of the United States Congress, in its first estimate of the economic impact of Katrina, predicted a reduction in employment in the first few months of 400.000 persons, and a fall in economic growth of between 0.5% and 1% in the second half of 2005, mostly because of the slump in economic activity (both in production, mainly of oil and derivatives, and in demand) and the significant hike expected in refined petroleum prices during September. The impact will probably be limited over time, however. Subsequently, the United States Secretary of the Treasury, John Snow, recognized that the country's economic growth would be affected by 0.5% in the second half of the year.

The impact of the hurricane will also have significant implications for the fiscal accounts of the United States. Congress approved an amount equivalent to 0.5% of GDP for emergency assistance to the affected areas, and additional expenditure by local and state governments is expected. The federal estimates of the costs of reconstruction and assistance to those affected by the hurricane are at US\$ 150 billion, which will add directly to the country's fiscal deficit.

The expectations of economic agents with regard to the handling of monetary policy by the United States Federal Reserve (FED) were also affected by the passage of Hurricane Katrina. Immediately after the passage of the hurricane, the financial markets assumed that there would be slower growth in interest rates. However, the Federal Open Market Committee of the FED, at its meeting on 20 September, decided once again to raise its interest rate by one quarter of a percentage point, bringing it to an annual 3.75%. This decision shows that its main concern in relation to Hurricane Katrina was not the possible slowdown in economic activity, but the risk of this

disaster increasing the volatility of energy prices, thus applying inflationary pressure. According to the United States Energy Information Agency (EIA), increases are expected next winter in both fuel and electricity prices; these will reach about 71% for natural gas, 31% for gas oil and 17% for electricity. The expenditure on reconstruction made possible by the increase in federal administration spending and insurance payments will lead to an increase in domestic demand and will push up the prices of reconstruction materials. All of this implies that the concern for inflationary pressures and the possible acceleration of debt placements by the United States federal government will continue.

The main economic impact of the passing of the hurricane is expected to be in relation to fuel prices, as by December 2005 the price of a gallon of petrol will be 37% higher than in September 2005.

## **II. SIGNIFICANCE OF THE PORT OF NEW ORLEANS FOR THE UNITED STATES**

The Port of New Orleans and the Port of Louisiana form the largest port complex in the United States in terms of tons of cargo moved. Together with other ports of the Mississippi River as far as Baton Rouge, they constitute a multimodal port system which, with the exception of Baton Rouge, has been seriously damaged by the hurricane. In 2004, 4.5% of total United States exports (US\$ 36.8 billion) and 5.4% of total imports (US\$ 78.8 billion) were transported through this port system. In addition, 62% of the grain exported by the United States (including wheat, maize and soya) is transported through New Orleans.

The wheat market received the most immediate impact from the closure of the New Orleans port. For 2005, the estimated increase in the exports of wheat from the United States, especially high quality wheat (hard red winter, or HRW), was 18% for this year in the period prior to Katrina in relation to 2004. Although a high percentage of HRW wheat is transported through the Galveston-Texas port, the congestion in this port as a result of the reorientation of export and import traffic from the ports affected by Katrina, will make the difficulties of normalizing shipments more acute. The closure of the affected ports, congestion in the closest ports and the higher costs of transport associated with the deviations of shipments to other ports, have caused a fall in the cash prices received by the producers. In view of the difficulties in normalizing the supply of products in the country, the United States government is considering the possibility of foregoing its right of exclusive coastwise carriage (in reference to the Jones Act) and allowing foreign vessels to transport grains from the affected zone to other United States ports.

It is expected to take a number of months for the whole system to return to normal. Those farmers that have the infrastructure required to store their harvests for 60 to 90 days will suffer smaller losses. The United States Government is optimistic in view of the grain stockpiles of the country's main grain purchasers: China, which is the largest soybean purchaser, has an estimated reserve of 4.1 million tons or 10% of the country's annual consumption, and Japan, which is the largest purchaser of United States wheat, has reserves of around 1.3 million tons.

## **III. MACROECONOMIC EFFECTS FOR LATIN AMERICA**

The concerns about the effects of Hurricane Katrina in Latin America focus on two aspects: the rise in oil prices and the lower growth of the United States economy. In the short term, the impact of the hurricane in the region will be negative, but in the medium-term this will be reversed as opportunities

are generated in various countries of the continent.

In the short term, and according to the estimates made using a model which reflects the calculation of elasticities by estimating a demand function for exports from Latin America to the United States, the lower growth of the latter country would imply a reduction of 0.2% of the total projected exports of goods and services from the region to the United States, which would reduce the growth rate of GDP in Latin America by 0.05%. According to the ECLAC projection for the annual growth rate of GDP in Latin America for 2005, however, this effect will be more than compensated for by increases in the projected growth rates of Argentina, Brazil and Venezuela.

Within the region, the greatest impact will be felt in Mexico and Central America, although only temporarily, both in terms of the reduction in exports and the fall in remittances generated by the Hispanic population of the affected region and the increase in transport costs in the Gulf region. In the case of Mexico, the negative effect of Hurricane Katrina will intensify the slowdown which the economy has experienced since the second half of this year, reducing the annual growth rate of Mexican GDP to a value close to 3%.

Honduras and Mexico, which have the largest immigrant communities in the affected area, may stop receiving at least US\$ 100 million each, owing to the reduction in remittances in 2005, which is the calculated amount sent by Honduran and Mexican residents<sup>[3]</sup> in Louisiana, Alabama and Mississippi. For Honduras, as its remittances account for close to 20% of GDP<sup>[4]</sup>, a loss of half of one percentage point in its projected growth rate of 4% for 2005 is expected. The impact of remittances in Mexico is not very relevant in terms of growth.

The effects of the hurricane on economic activity are expected to be local and temporary. The loss of jobs in the United States will be temporary because as of the end of 2005 and the beginning of 2006 the reconstruction will bring a recovery of employment and will promote growth and the recovery of the lost capital stock. For this reason, increases in exports from the region to the United States are expected, especially of wood products and construction goods<sup>[5]</sup>.

Despite the fact that oil prices have increased continuously in 2005, the negative impact of Katrina on the production of oil and refined petroleum in the Gulf of Mexico caused an additional increase to international prices of these products. The high prices will benefit the countries in the region which are net crude oil exporters (Argentina, Colombia, Ecuador, Mexico and Venezuela), but will also affect those countries in the region which are net importers, and to a greater extent those whose domestic fuel prices are more closely related to the international prices of those products. It is hoped that this larger increase will be temporary, however, and that prices will return to their pre-Katrina levels. Nevertheless, some countries have taken measures to mitigate the domestic effects of high international prices for crude oil; at the beginning of September Chile established a price stabilization fund with resources from its highest recorded copper export revenues.<sup>[6]</sup>

In relation to the development of exchange rates of the countries of the region in relation to the dollar, both in real and in nominal terms, there are a few elements to consider. Changes in the real exchange rates will be influenced by the impact of high oil prices on countries' domestic prices, and in particular, on their consumer price indexes. In nominal terms, the future price of the dollar in relation to other currencies will be affected by contradictory trends: on the one hand, there is a trend to appreciation of the United States currency owing to the gradual increase in interest rates and the favourable economic performance; on the other hand, there is a trend to depreciation caused by the

large fiscal and balance-of-payments deficits, which will probably be deepened by the higher expenditure resulting from the hurricane. In terms of future trends, and taking into account the growth rates observed in other economies, it is considered most probable that the net impact will be a depreciation of the dollar in relation to other currencies. In relation to the real effective exchange rates in Latin America and the Caribbean, the latter have been appreciating during 2005; an increase in the United States double deficit is expected to strengthen the trend in that direction.

Lastly, there are impacts on the export performance of some products from countries in the region, as the closure of New Orleans has prevented a significant variety of Latin American products from reaching the United States market. In addition, the difficulty of access to some products, especially minerals, which were stored in that city, has caused international price rises. At the same time, however, the reconstruction work related to the disaster is increasing the demand for some products from the region, in particular cement from Mexico and veneered wood from Brazil . The product supplies required by the United States for the reconstruction work offer the opportunity of a rise in import quotas and a reduction in tariffs for the emerging economies by that country. Even if such measures were temporary, by the time they were terminated the exporters would have created commercial links with United States purchasers.

#### **IV. THE SIGNIFICANCE OF THE PORT OF NEW ORLEANS FOR LATIN AMERICAN TRADE**

In 2004, products from Latin America with a value of US\$ 17.425 billion entered the Port of New Orleans , and products with a value of US\$ 24.409 billion entered the Port of Houston-Galveston, and US\$ 4.396 billion through the Port of Tampa . Although the Port of New Orleans was the port directly affected by the passage of the hurricane, the ports of Houston-Galveston and Tampa , as the alternative ports, have been suffering significant congestion owing to the increased demand. Venezuela is the largest exporter to the United States through the Port of New Orleans , accounting for over US\$ 6 billion in 2004.

The products imported through New Orleans which are relevant for Latin America are mainly coffee, sugar, fruit, steel and oil. In 2004, about 6.1% of exports from these countries to the United States (amounting to about 3.5% of total exports from the countries considered) entered that country through New Orleans . In the second quarter of 2005 this percentage rose to 7.1%; 9.7% for Argentina , 13.2% for Brazil , 8.4% for Ecuador and 22.2% for Venezuela . In the case of petroleum oil, these percentages are 70% for Argentina , 18% for Brazil , 99% for Ecuador , 71% for México and 87% for Venezuela . Other products include non-alloy pig-iron (31%) and unroasted coffee (6%) in the case of Brazil , methanol (49%), sawn wood (14%) and iron ore (13%) in the case of Chile , and zinc ore (27%), Portland cement (24%) and unalloyed tin (19%) in the case of Peru .

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[1] Annualized rates, seasonally adjusted.

[2] International Monetary Fund (2005), *World Economic Outlook*, September, Washington D.C.

[3] This estimate includes both the 7260 legal residents, according to the 2002 Current Population Survey of the United States , and the 143,000 undocumented residents, calculated on the basis of information provided by the Presidential Commissioner for Honduran Communities Abroad, René Becerra.

[4] It is estimated that in 2004 remittances from Honduran immigrants resident in the United States amounted to US\$ 1.2 billion and it was projected that at the end of 2005 they would reach US\$ 1.6 billion, accounting for about 20% of GDP. The reduction of US\$ 100 million represents a fall of between 0.4% and 0.6% of GDP for 2005.

[5] The countries benefiting the most are Mexico (cement and concrete) and Brazil (wood) and to a lesser degree Chile, Argentina and Colombia. The increased levels of exports will benefit from temporary tariff relief according to economist Gary Hufbauer of the Institute for International Economics in Washington.

[6] This fund is operational until 30 June 2006.

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