

David Rosenberg on Hurricane Sandy: Missing the Boat

By David Rosenberg

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The following is excerpted from the November 1 edition of "Breakfast with Dave," a publication from the Canadian research firm Gluskin Sheff:



As I read and digest reports estimating the damage from the devastating storm, I sense that there are far too many economists who are relying too heavily on past major hurricanes as they draw their conclusions from the current experience with Sandy.

I am concerned that as is the case so often, complacency has set in. The consensus view of a mere decimal place impact on Q4 real GDP growth from the storm seems like a pipe dream to me and has not been carefully thought out, in my opinion. Of course the devastation to the capital stock across so many dimensions affects net worth and not GDP, which measures the flow of spending in the economy, but it is indeed the spending portion that has also been seriously impaired, and a good part of it is not coming back and the inevitable pickup in spending of generators, sump pumps, cement and plywood is not going to be enough to provide an offset, at least over the next few months. Logic should prevail more than history here, because there is no appropriate historical comparison, and yes, I include Katrina in that assessment.

Yes, there will at some point be a revival in building activity and repair damage that will support spending and real GDP growth to be sure. But something tells me that this process may be delayed somewhat as the claims get tallied up and the fallout from the disaster continues. That should help out first quarter activity but from a lower level and, of course, assuming that the economy doesn't fall off any fiscal cliff.

The problem is two-fold. One is magnitude. The other is the demographic involved. With regards to magnitude, we are talking about 60 million people being affected, not three, or four or five million spread across corn and cotton fields in the south. There has not been such devastation affecting so many participants in the U.S. economy before. We're talking about New York, New Jersey, Connecticut and Philadelphia here — not Waco. When such masses do not go to the office, they then don't do what they usually do, which is buy their coffee at Starbucks. They don't line up for pizza and sushi. That spending is not coming back. They are eating at home, and pulling out the box of macaroni and the can of tuna fish they bought three months ago. Then there are movies, sundries and even vacations that are not coming back any time soon into the spending sphere. And the cabs that drive people or the sales people at the clothing store that rings up your bill that have been out of work for the past few days aren't making the money they need to buy burgers and shakes



and whatever else. So the ripple effect or what economists call the multiplier also has to be taken into consideration here.

And a few days in a quarter when expressed at an annual rate is actually a much bigger deal than a few decimals on a GDP growth figure. The consensus, I think, is in for a big surprise. And keep in mind that the downtrend in mortgage apps, the general weakness in the regional manufacturing surveys, the stalling-out in the improving trend in jobless claims and the fact that chain store sales in October were already running below plan, reveals an economic backdrop that lacked momentum even before the storm took hold.

The other factor I mentioned was the demographic. We don't know how many Starbucks or Coaches there are in Waco or Galveston, but there are 255 in New York City. It's not just size. It's also tastes. We are talking about the storm hitting the most free-spending consumers in America. And that is also because these are the states with the highest per capita incomes — the major states of the Northeast have on average household spending power that is 40% higher than in the deep south where storms and floods have historically been prevalent (again rendering comparisons with the past nearly totally useless when it comes to estimating near-term GDP impact). These are the same northern dilettantes who the Confederates wanted to secede from nearly 150 years ago and these high-income/high wealth folks love to shop — not only do they have the means compared to their southern brethren, but their marginal spending propensities are huge and, as such, the impact on GDP from this perspective cannot be over-exaggerated, especially the likely depressing effect on luxury goods and services.

Of course, there is this other little problem that in many cases, basic insurance coverage is not covered for floods. So either Uncle Sam ponies up here or all the economists hinging their forecasts on a boom in building activity may end up being frustrated by the length of time it takes to get started. In the meantime, the spare room in the basement at cousin Jack's place is going to be just fine (and Jack's 30-year old boomerang kids just got kicked to the recreation room) and his wife's meat loaf is going to replace the traditional one night a week out at Il Mulino.

And don't forget one other factor that I did not mention — which is the timing. Normally these major weather shocks happen in August or September. We are already in November and on the precipice of the most important time of the year for the retailing sector, which has already staffed up in anticipation of good tidings this year. This prognosis may have to be revisited because the temptation to shop at Tiffany's may be just a little bit tempered by the repair bill to your principal residence and it is also highly doubtful that cousin Jack is going to buy a tree for his family to put in the living room and one for yours in the basement.

So the surprise for Q4? A negative GDP print. The next question is whether there will be a Q1 rebound. Remember, as I mentioned yesterday, three of the major four ingredients to the NBER (National Bureau of Economic Research) recession all peaked in tandem in



July. And it would be a slam-dunk four if the service sector had already followed goods-producing payrolls on the road to perdition.

The following is excerpted from the November 2 edition of "Breakfast with Dave":

The more I see, the more I believe that my analysis on Sandy's severe economic impact is correct. Not just that the latest damage estimates are up to \$50 billion from \$20 billion initially. It is that the negative effects on income and spending and the delays in the recovery will have more adverse impacts on GDP for the next several months, if not quarters. Just have a look at *Millions Stuck in the Dark, Cold* on the front page of the *WSJ* and *Gasoline Shortages Disrupting Recovery from Hurricane* on the front page of the *NYT* for a reality check.

For those who see a big building boom coming (and lumber prices have surged with that hope in mind), keep in mind that the vast majority of homeowners are not covered for flood insurance. They may be staying in Cousin Jack's basement a lot longer than economists think. See *Many Affected Lack Flood Coverage* on page A4 of the *WSJ*. The impact on confidence and spending is likely to be considerable and lasting as we head into the most important time of the year for consumer spending.

A long-time subscriber (a doctor) sent this over to me:

You have the Hurricane Sandy impact just right. Nobody went to the doctor or had a CAT scan this week. Power is not restored to any of our three offices (or my home). When was the last time you got a call from an insurance company, asking if you would like to file a claim, as happened to me today? The companies are trying to eliminate losses, of course, but they also try at the outset to deflect homeowners claims (which they pay) to flood claims (which taxpayers pay).

What is also not appreciated by the consensus is that the storm occurred late and not early in the fall. We are now heading into the winter season which is predicted to be colder and snowier than normal in the Northeast. If that is true, construction may be more spread out and delayed into the spring. By the time all power is restored and roads cleared, it will already be mid-November at the earliest. The seasonal factors underpinning the incoming data flow will be wreaking havoc. Another important issue that a subscriber brought to my attention is that the storm wiped out all the protective dunes. All these beach areas will suffer minor flooding with just a moderate winter storm. The dunes will have to be restored before the rebuilding begins. That will be a while. The beach areas will not be back to normal for a long, long time.



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