

Impact of Hurricane Harvey on the economy of Texas

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The sun has come out again in the east of Texas as stock taking of the physical damage caused by the passage of Hurricane Harvey continues. Harvey will be remembered as one of the most destructive storms in the history of the United States. Given the extent of the damage, there is growing interest in the repercussions that Hurricane Harvey will have for the regional and national economy.

As a general rule, it is important to bear in mind that physical damage caused by natural disasters is divided into two kinds. The first kind consists of damage caused by the destruction of physical capital such as homes, commercial properties, machinery and equipment and public infrastructure, as well as the consequent degradation of services and the reduction in tax revenues generated by this capital. The second kind consists of the losses caused by the total or partial interruption of economic activity. Considering both elements as well as their secondary effects, our preliminary estimates suggest that the gross cost of Harvey could easily exceed US\$60 billion. This would put Harvey as the third most costly storm in the history of the United States, surpassed only by Hurricanes Katrina and Sandy in 2005 and 2012 respectively. Material losses in those two cases were around US\$160 billion and US\$70 billion respectively.

We should highlight the fact that although the impact is heavily negative, as conditions return to normal, economic activity is usually affected positively, providing that insurance and assistance funding is available. The majority of studies on the net economic effects of natural disasters - excluding losses of the capital stock - tend to arrive at relatively low figures once both positive and negative effects are taken into account. In fact, the negative effects of storms tend to diminish and are inverted in a time frame of between 12 and 18 months. Our analysis suggests that in 2017 and 2018, real GDP growth of Texas will be around 3.7% instead of 4.3%, and 4.1% instead of 3.8% respectively. These figures may of course change as more details become available regarding the damage caused by the hurricane.

In addition to the regional effects, the US economy as a whole will also be affected, albeit to a lesser extent. For example, we do not expect prolonged price rises in gasoline. Nor do we forecast a resurgence of adverse factors for the economy in the short term, something which could lead the Fed to abandon its current monetary policy normalisation course. On the other hand, the effects for the banking industry will make themselves felt in the form of NPL rates, which might show an uptick, and also in a deterioration of the quality of the guarantees provided in the affected areas. Nonetheless, the largest and most diversified banks should be able to overcome these obstacles with greater ease. Lending could accelerate as businesses and consumers take part in the reconstruction work.

In any case, what seems clear from the preliminary figures is that the effects of Harvey will continue to make themselves felt for several years. Texas, and in particular Houston, will face the challenge of maintaining their economic attractiveness given the likelihood of more frequent storms as destructive as Harvey or possible even more so. This probability has increased as a result of climate change. In the absence of a long-term strategy, natural disasters of this kind may force the population to leave and discourage both

investment and migration in the future, reducing the region's economic potential. We should bear in mind that twelve years after Hurricane Katrina, both non-farm employment and wages in New Orleans are still lower than they were before the storm. Hence the urgent need to take action at every level of society and government in order to minimise the effects of Harvey and other super-storms.

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