Hurricanes: Understanding the Economic Impact

American journalist and novelist Carl Hiassen once said, "The first rule of hurricane coverage is that every broadcast must begin with palm trees bending in the wind." The point, of course, is that the media loves drama. Hurricane season is once again upon us and to understand it's economic impact we need to keep Hiassen's point in mind.

Thankfully, most of us will not have to worry about our houses being damaged or our streets being flooded, and while the effects of hurricanes can be felt globally, more often than not, the economic impact is small or negligible. So far this year, Gustav and Ike have made huge headlines and are seen by many as a threat to oil and gas production in the Gulf region and a cause for short-term spikes in oil futures trading. The truth, however, is that neither have had a major impact yet and oil has quickly traded back to trend lines. In order to understand the impact of hurricanes on the economy, we need to set aside the often-devastating toll they take on the lives of those living in the areas that are hit.

As with most things in the investment world, history is a great teacher. Three years ago, Katrina slammed into the southern United States and wreaked havoc there and in the global market place. But what is rarely reported is the remarkable recovery in the energy sector and the ability of producers and refiners to cope with, and rebound from, massive destruction.

The aftermath of Katrina is a more realistic and informative view of what hurricanes mean to the global energy markets. Katrina was, by nearly all measures, about as bad as it gets. When she hit, the first concern was, as it is now, for the offshore oil and gas platforms and the affect it would have on U.S. production. Additionally, the area is a major import hub for the United States. Prices spiked (going from around $58 a barrel to $70, a 20% move) and the theory was that as more oil and gas had to be imported, production would not be replaced for months, if not years, and repairs would be extremely expensive. What later became apparent was that the refinery market may have been more damaged than production since the flooding that ensued shut down a major percentage of U.S. refining capacity. In all, 30 oil platforms were damaged or destroyed and 10 refineries had to be shut down.

Before the storm, one-tenth of all crude oil consumed in the US and almost half of the gasoline produced in the country came from refineries in the Gulf region. In addition, 24% of the natural gas supply is extracted or imported in the region. By September 7, 2005, only nine days after Katrina hit the Louisiana coast, Gulf oil production had returned to 42% of normal and four of the 10 refineries were back to full capacity within the week. The worst-case scenario did not come to pass and oil prices soon fell back to below pre-Katrina levels. Over the next several months, production and refining were restored and strengthened.

Ike is going to cause massive damage, much more than bending palm trees. And, certainly, more big hurricanes will come in the years that follow. This isn't news to the oil companies. They're prepared and resilient, and after the storms hit, business resumes and infrastructure rebuilds. As investors, we need to be aware of that and not let emotions dictate our actions.