

KATRINA

When we read, "*Tsunami*", last quarter's newsletter about the global financial imbalances affecting our economic lives, little did we realize that now we'd be reflecting on the social, political, and moral imbalances which exist in our own backyard unearthed by *Katrina's* destructive rage.

Unlike the terrorists' attacks of four years ago which brought our country closer together, united against a common enemy, Katrina's wrath has exposed the cavernous rifts of economic disparity here at home. The media coverage not only revealed Katrina's physical destruction, but also exposed the deep, persistent poverty in the gulf coast region which many believe is rooted in our history's economic inequality.

In early 2001, the Federal Emergency Management Agency (FEMA) ranked the potential hurricane damage to New Orleans the third most likely of potential catastrophic disasters in the US. (The first two being a major earthquake in San Francisco and, prophetically, a terrorist attack in New York City.) Even though we anticipated the likelihood of this tragic devastation, our response was feeble at best, with every misstep chronicled by the media.

Katrina exposed our emergency mismanagement and uncovered our lack of preparedness for a catastrophe of this magnitude. Hurricane Katrina's storm surge also eroded our faith in our government's response:

- FEMA director, Michael Brown, resigns;
- Public support of the prolonged Iraq war decays further;
- Bush's overall approval has fallen to a personal record-low of 40%; and
- Americans grow more pessimistic about the economy.

Source: Wall Street Journal/NBC News Poll of Sept. 9-12

The negative political swell will subside, but the human concerns exposed by Katrina are entrenched in our nation's fiber and will take generations to resolve. *Will Katrina also waterlog our economy exposing a weak foundation or will the devastation be transitory, reinforcing our economic power?* Some pundits proclaim severe economic fallout citing the \$3.00+ gas prices we've paid at the pump to confirm their opinions. Other experts believe that Katrina's fiscal disruptions will be transitory, quickly absorbed by our resilient economy.

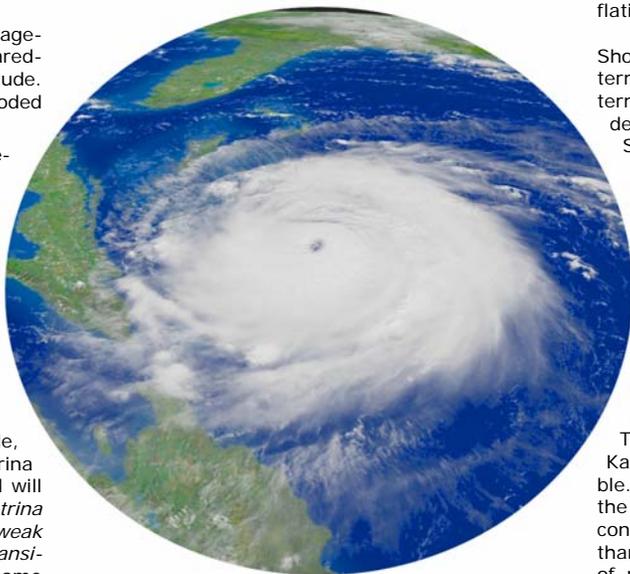
Before we look at the national picture, let's look at the effects at ground zero, New Orleans itself. To many, Mardi-Gras, the French Quarter and jazz are New Orleans - the free and easy lifestyle of the *Big Easy*. But its foundation is weak. The U.S. Geological Survey (USGS) says it's like a bowl ringed by levees protecting it from the Mississippi River and Lake Pontchartrain. The

city is the lowest point in Louisiana averaging 8 feet below sea level and is sinking only slightly less than 1/2" per year, requiring an intricate system of pumps and canals to keep it dry.

The wetlands of the Big Muddy's delta and the surrounding levees are the city's only protection. However the wetlands are falling into the ocean at an alarming rate, exposing the city to the brunt of hurricanes, and the levees are inadequate to control Mother Nature. Once this vast bowl fills with water it takes a long time to be pumped out. According to one USGS report, within 50 years New Orleans may be the next Atlantis and slip into the sea.

For years everyone's known, "*The Big Easy is in big trouble!*" It's easy to see just how much trouble when the rainfall from Rita, which made landfall only at a category 3 and well over 200 miles away, caused the city to flood a second time. And at this writing we're not even halfway through the hurricane season!

Why rebuild? According to the October 3rd issue of *Forbes*, New Orleans exists because it's port is central to world trade. The Port of New Orleans is the largest in the US and the 5th largest in the world! Last year it transported 200 million tons of imports and 80 million tons of exports. Disasters jolt local economies but rarely destroy them. The port is too vital. It will survive.



The supply disruptions wrought by Katrina's waters, while producing price shocks primarily in gasoline, oil and natural gas, will also effect other commodities - zinc, steel, and grains. The price spikes precipitated by these supply shocks, though magnified by Katrina, are in fact a result of escalating worldwide demand and lack of capacity. These stresses will dampen our economy and fuel inflation.

New Orleans is necessary to help alleviate these mounting pressures. The city and the region were languishing. Injecting billions in regional reconstruction will initially offset the depressing effects to our GDP. The media attention has shed light on the importance of New Orleans as

our long-term premier trade center. An aggressive solution, to the long ignored erosion of the delta, will stabilize the region and the Port of New Orleans will, in time, emerge, revitalized.

Some experts who alleged that \$50 oil (now at \$65) could cause a recession, now contend that Katrina will be a critical test of the resilience of our economy. However, the Bureau of Economic Analysis (BEA) reported that the GDP increased by 3.5% in the first half of 2005. GDP growth had been accelerating and economists who were projecting pre-storm growth at about 4.0% for the last half of the year have mildly pared their estimates down to 3.5%. Even so, this long-term, solid growth exemplifies reduced volatility. When the reconstruction gets in full swing in 2006, the estimates are higher.

Many hoped that Katrina would allow Greenspan to deviate from his "measured pace" rate hikes. However the Federal Open Market Committee (FOMC) voted for the eleventh straight time to increase the Fed rate, now at 3.75%. The FOMC minutes may give some insight - although Katrina's economic dislocations and oil price spikes "have increased uncertainty about near-term economic performance...they do not pose a more persistent threat. Rather...robust underlying growth in productivity...and longer-term inflation expectations remain contained."

Short-term economic uncertainties, long-term, low-inflationary growth. These short-term uncertainties have been manifested as detailed on the front page of today's Wall Street Journal - personal income falls \$5.3 billion, the largest drop in consumer spending since 9/11, and inflation jumped 0.5%, the biggest increase in 15 years. According to Greenspan, these short term penalties from Katrina are transient and will be supplanted by long-term growth resulting from increases in productivity with longer-term inflation remaining contained.

Greenspan's words don't spell immediate RELIEF, but they do spell RESILIENCE. The resilience of our economy to weather Katrina's wrath, \$70 oil, and a housing bubble. But actions speak louder than words and the rate hike reveals that the Fed is more concerned with Katrina's impact on inflation than her dampening effect on growth. Costs of rebuilding will deepen our budget deficit and fuel inflation. Can our resilient economy weather this storm too?

Just like the foundations of the Port of New Orleans will take time to fortify, so too, will the economic fissures of our trade and budget deficits. There was nothing pretty about Katrina, just a reminder of the power of the universe and the need for us to work as one.



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