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ECONOMIC REPORT

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HARVEY, IRMA ECONOMIC IMPACT TO BE SMALL; Q2 PRODUCTIVITY BETTER, WITH STRONG SERVICE REVENUES

SUMMARY

- Hurricanes Harvey and Irma will weigh on third quarter GDP, but the final impact will be small and temporary.
- Initial unemployment insurance claims jumped by 62,000 in the week ended September 2 in the wake of Harvey.
- Job growth will slow in September because of the hurricanes, but will quickly bounce back.
- Productivity growth in the second quarter was revised up to 1.5 percent, but remains disappointing.
- Revenues in service industries rose by a strong 6.2 percent in the second quarter.
- Wholesale inventories rose 0.6 percent in July. Inventory accumulation will add to economic growth in the near term, although Hurricane Harvey could disrupt petroleum inventories.

Like Hurricane Harvey before it, Hurricane Irma is unlikely to seriously damage the U.S. economy, although Florida could take a temporary hit. Irma will result in a temporary loss of output as businesses shut down for the storm. Closures and property damage from Irma will also result in a temporary decline in economic activity. And if there is extensive damage to tourist destinations in Florida, travelers could stay away from the state. As a result, Irma could weigh on U.S. GDP growth in the third quarter of 2017, as Hurricane Harvey has already.

But any economic damage will be small and temporary. Florida accounts for about 5 percent of U.S. GDP, and about 6 percent of national employment. Much economic activity in the state will **not** be disrupted by the storm. And most people will get back to work shortly after Irma leaves the state. Tourist traffic to Florida could suffer, but consumers will likely spend their recreation dollars elsewhere, so the national economy will not suffer.

In addition, any lost output and employment are likely to be made up in subsequent quarters. Reconstruction in the wake of Irma, funded by insurance payouts and federal aid, will boost the state's economy and hiring in late 2017 and early 2018. Similar patterns have been seen with other natural disasters, such as Superstorm Sandy, Hurricane Andrew, and the Northridge earthquake.

The one recent U.S. natural disaster that had a significant long-run economic impact was Hurricane Katrina. Because of extensive flooding there was a permanent decline in population and employment in New Orleans. But the national impact was limited as economic activity flowed to other parts of the country. And the extensive and permanent damage to New Orleans in the wake of Katrina is unlikely to be repeated with Florida and Irma.

Irma is unlikely to affect national energy markets. With Gulf Coast refineries temporarily shut down in the wake of Harvey, gasoline prices have risen by about 30 cents a gallon nationwide, according to AAA, to their highest level in more than two years. But Irma is unlikely to affect national energy markets, consumers are in good condition to weather the increase from Harvey, and gas prices should come down in the weeks ahead as closed refineries reopen.

Despite this year's hurricanes the current U.S. economic expansion, now in its ninth year, will continue. The fundamentals for the US economy remain sturdy, with solid job growth providing support to consumer spending, an expanding global economy, good corporate balance sheets, and stable financial markets. U.S. economic growth will briefly slow in the third quarter because of Harvey and Irma, but should bounce back later this year and into 2018.

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There were modest job losses at the end of August following Hurricane Harvey, according to the first hard data on the labor market since the storm hit the Gulf Coast. Initial claims for unemployment insurance jumped to 298,000 in the week ending September 2, from 236,000 the previous week (unrevised). The one-week jump in claims of 62,000 was the biggest since an increase of 81,000 in November 2012 in the wake of Superstorm Sandy (see Chart 1). Claims jumped by 96,000 in the week after Hurricane Katrina in September 2005. Claims are likely to jump again for the week ending September 9, from Irma-related layoffs. But claims so far suggest that the hit to the national job market from Harvey and Irma will be limited. Monthly job growth weakened immediately after both Katrina and Sandy, but employment did not decline outright.

Outside of the storms, the U.S. labor market remains in solid shape. With improving demand businesses continue to hire, and the economy is close to full employment.

Nonfarm business productivity growth in the second quarter was revised up to 1.5 percent at an annualized rate in the second quarter, from the previous estimate of a 0.9 percent increase. Nonfarm business output growth was revised up to 4.0 percent in the second quarter (from 3.4 percent), while growth in hours worked was unrevised at 2.5 percent. Compensation per hour (adjusted for inflation) grew at a 2.1 percent pace, revised up from 1.9 percent. With compensation rising faster than productivity, unit labor costs rose a modest 0.2 percent in the second quarter, revised down from 0.6 percent.

Although productivity growth in the second quarter was revised higher, the trend remains disappointing. During the current expansion, which began eight years ago, productivity has grown at just a 1.0 percent annual pace, about one-half the rate of productivity growth during the two previous expansions. This has contributed to weaker growth in real wages and standards of living; over the long run, productivity and wages should increase at about the same pace (see Chart 2). For now, weak productivity growth is boosting job growth as businesses need to hire to keep up with stronger demand.

The Quarterly Services Survey showed total revenue for

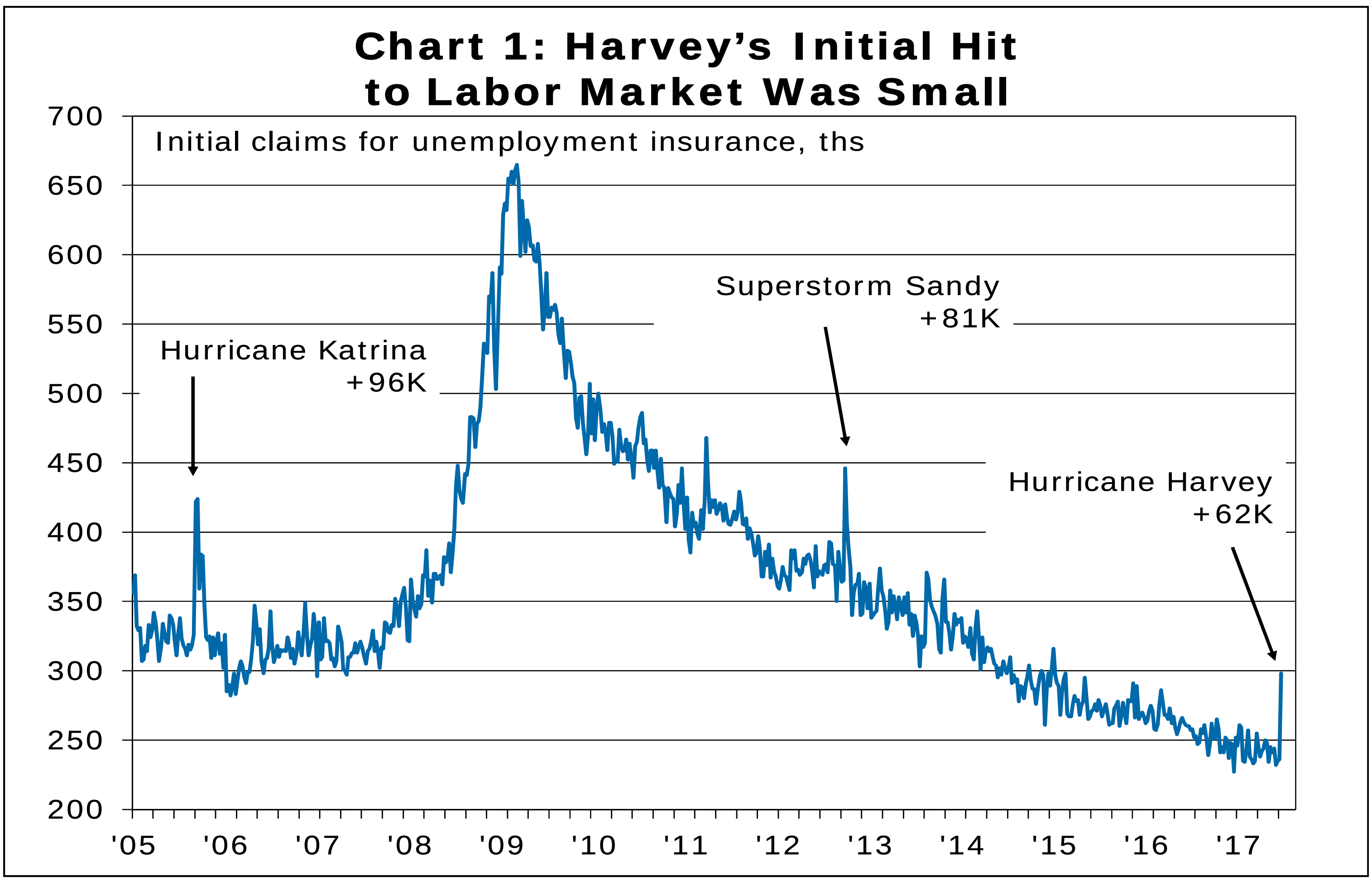

Chart source: U.S. Employment & Training Administration

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selected services grew 6.2 percent in the second quarter from a year ago on a nonseasonally-adjusted basis. This figure was unrevised from the advance estimate and follows a 6.3 percent increase in revenue in the first quarter. All major industry groups reported revenue growth on a year-over-year basis.

The Quarterly Services Survey for the second quarter bodes well for revisions to second quarter GDP. Strong and unrevised revenue growth indicates that consumer spending likely grew by a strong 3.3 percent annualized rate in the second quarter, as previously estimated. Growth in services revenues, and in the overall economy, will slow in the third quarter because of Harvey and Irma, but should quickly bounce back.

Seasonally-adjusted wholesale sales fell 0.1 percent in July from June, before adjusting for inflation, compared to a 0.6 percent gain in June. On a year-over-year basis wholesale sales rose 5.9 percent in July, up from 5.3 percent in June but down from its recent peak of 10.1 percent in February.

Wholesale inventories rose 0.6 percent for a third straight month in July. Stockpiles of durable goods rose 0.9 percent, while nondurable inventories rose 0.2 percent. The inventory-to-sales ratio ticked up to 1.30 from 1.29 in June.

The July wholesale figures support PNC's forecast for inventory accumulation to add to economic growth in the second half of 2017. However, Hurricane Harvey is a downside risk to inventories as much of the nation's petroleum refining capacity is concentrated in the Gulf Coast, and so refined product inventories are likely to decline.

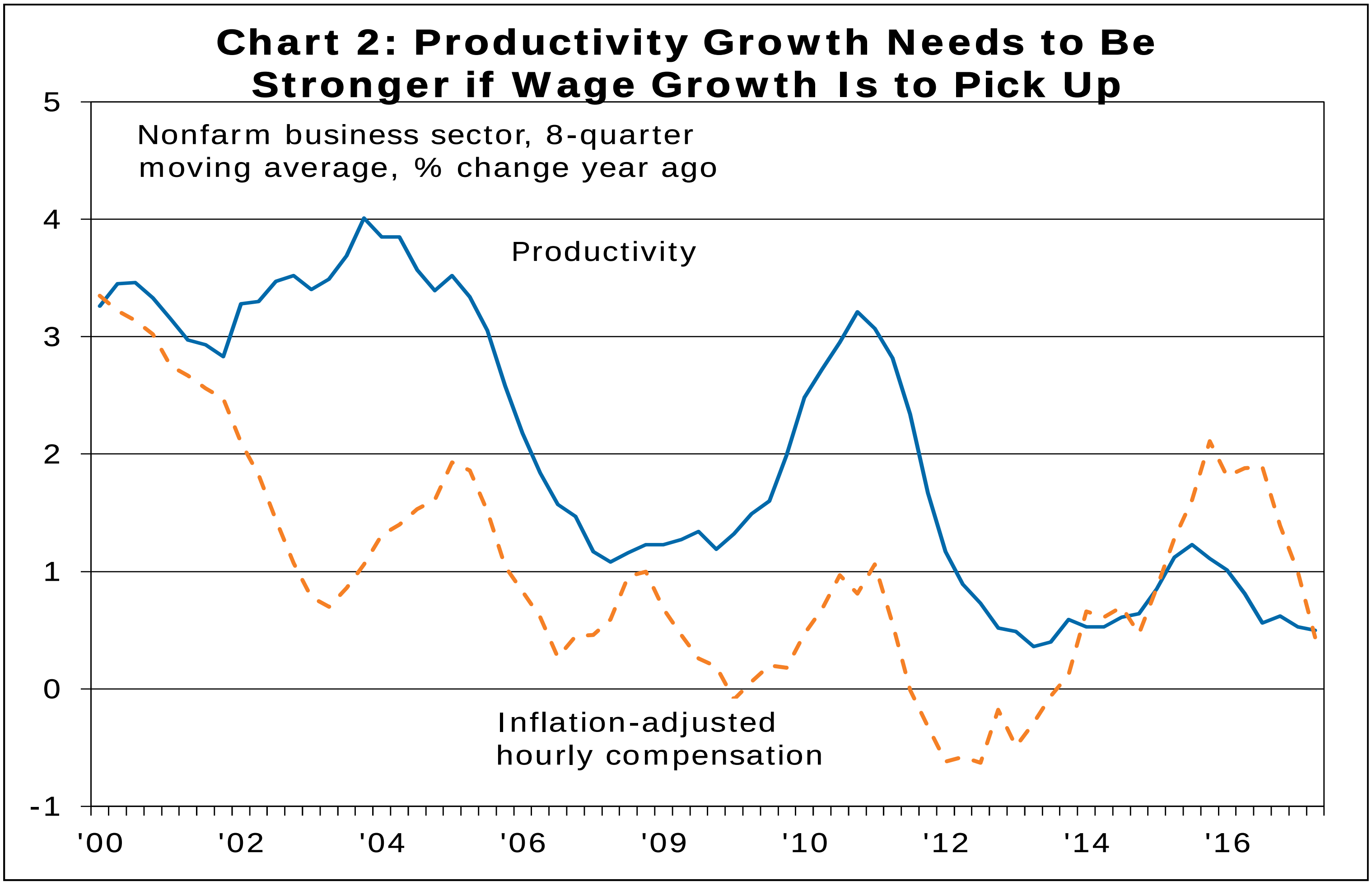

Chart source: Bureau of Labor Statistics

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