

9/11 – 5 Years On

Chou En-Lai, the former Chinese leader, was once asked what the impact of the French Revolution had been on modern history. His reply, made some 150 years after the event, was that it was too early to tell. So it is with the true impact of the events of September 11 2001 – we are still trying to understand fully the implications, particularly for the longer-term trends.

To even attempt to gauge the economic impact of the event we need to consider the state of the global economy prior to September 11. In doing so it becomes clear that the attacks caused neither the recession of 2001 nor the bear market in equity prices - which ran from early 2000 through to 2003. The immediate effects were dramatic – stock markets fell sharply, the oil price rose, and general liquidity in capital markets disappeared. As has become their custom in recent decades, central banks acted swiftly to reduce the likelihood of global economic meltdown. The US Federal Reserve cut the FED funds rate by ½% to 3% on September 17, reducing it to 1.75% by December of 2001. This was coupled with the FED making available billions of dollars in liquidity to prop up the system. The bank of England, amongst others, followed suit.

Financial meltdown was averted but there were consequences. Retail sales in the US, which make up $\frac{2}{3}$ of GDP, were dramatically lower in the week of September 11 in the US than they otherwise would have been. This, and a variety of other indices of consumer confidence all took very serious hits in the autumn of 2001. Travel and tourism were two other areas negatively impacted. Surprisingly, an event like this triggers a large amount of unexpected economic activity and spending in the medium term. The cost of rescue, clean up and related impositions has been put at \$11bn, all of which provides a certain amount of stimulus to the economy. It may be argued that subsequent military action, certainly in Afghanistan, and to some extent in Iraq, were inspired by the events of 9/11. All wars come hand in hand with a huge increase in government spending on defence, which in turn boosts economic growth.

Specific sectors, affected by the events of 9/11 were airlines, hotels, retailers and insurers. Airlines and hotels experienced a sudden dramatic drop in customer numbers, and the recovery from this took 2-3 years. Although undoubtedly retailers saw a very sharp drop in sales immediately following the tragic events, levels quickly

returned to more normal rates. Unfortunately the levels of the time were depressed anyway. Insurance industry losses were said to have topped \$50bn according to industry estimates. The longer term consequences for the industry however have turned out to be positive. The massive number of claims brought something home to the industry as a whole – many insurers weren't fully aware of the inter-relationship between many of the risks/claims relating to the events of 9/11, and all of this happened at a cyclical low point for the industry. Post 9/11 risk awareness, and hence efficiency, has improved dramatically within the insurance sector. Also the cataclysmic events sparked a reversal in the trend for premiums which had been contracting. Immediately after the catastrophe insurance and re-insurance premiums jumped, a trend that has lasted for over 3 years, with a corresponding improvement in profitability.

The psychological trauma of 9/11 left a big impact which has only partially faded. Like all such traumas, after the initial shock, the level of immunity to future shocks is higher. This is evidenced by the much more limited market reaction to the bombings in Madrid and subsequently London. The effect on markets of a repetition of 9/11 today could be limited on the basis that investors know how central banks will react, insurers are better prepared, but most importantly investors have developed a certain battle hardened weariness towards such events.

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