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Dear Friends:

The tragedy of Hurricanes Katrina and Rita touched us all. As the Gulf Coast continues to rebuild, the consequences of these unusually destructive storms are still being felt.

The U.S. economic downturn attributed to the hurricanes should persist into the first quarter of 2006. But growth should return to pre-Katrina levels in the first half of 2006, economists say (p. 1-2).

The maritime industry, particularly some of the nation's most crucial port areas, sustained heavy damage during the hurricanes. Much needs to be done to restore key trade pipelines to full capacity (p. 3).

Finally, in other news, a new "Framework of Standards" for secure trade adopted by the WTO promises to extend American-style security initiatives to the world. For U.S. companies already on board at home, the eventual transition should be a smooth one (p.4).

We hope you enjoy this issue and welcome your comments.

Sincerely,

John A. Rowney
Division President
Ocean Marine Division

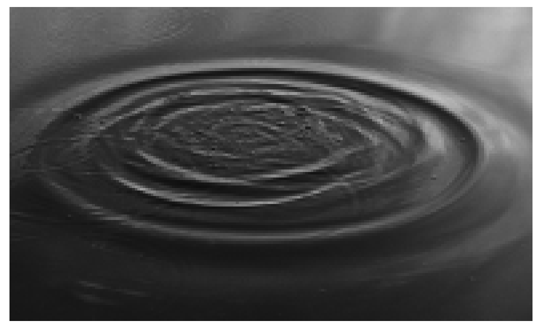
Hurricanes' Wrath Still Being Felt

Economic effects should dissipate in early 2006

Although the heartbreaking images of destruction and despair linger, the effects of Hurricanes Katrina and Rita on the U.S. economy should continue to fade during the first quarter of next year, according to economists. New Orleans and surrounding areas will face a year of challenges as they rebuild, but Gulf Coast reconstruction should, in fact, stimulate the national economy and help offset high energy prices.

Hurricanes rarely make their mark in national economic data because the region affected is relatively small and business usually recovers before damages can impact GDP. Katrina's and Rita's surgical strikes, however, have been a different story. The ports of Louisiana, Texas, Mississippi and Alabama are directly linked to U.S. trade in petroleum, grain and farm products, fruit, poultry, coffee, chemicals and steel, says Gary LaGrange, president and CEO of the Port of New Orleans. The Crescent City, in particular, is the focal point for cargo moving to 28 states, supporting $37 billion in U.S. economic benefits and 380,000 jobs.

As a result, businesses nationwide have seen profits eroded by broken supply chains and spikes in energy costs. The tab for rebuilding physical damage is expected to run into hundreds of billions of dollars, making Katrina and Rita the costliest storms ever to hit the United States.



Assault on Energy

One could hardly have picked a more effective attack on the U.S. energy infrastructure than that chosen by Mother Nature in August and September 2005. By September 25, the one-two punch of Katrina and Rita had shut down 20 petroleum refineries representing one-quarter of U.S. refining capacity. Oil and natural gas rigs also sustained major damage. Despite around-the-clock efforts to restore production, as of early November, both oil and natural gas production in the Gulf were operating at less than 50 percent of pre-Katrina levels, according to testimony by Federal Reserve Chairman Alan Greenspan.

Crude oil prices, the single largest determiner of gasoline prices, were on the rise well before Katrina and Rita struck. But the refinery outages and supply disruptions caused prices to soar to a national-average high of $3.12 per gallon. In recent weeks prices have trended downward as more supply enters the system, primarily in the form of imports. The average price of

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gasoline dipped as low as $2.48 by the first of November after four straight weeks of decline. The outlook seemed even brighter as crude oil prices dropped to a three-month low by November 7.

Still, the long-term challenge of boosting supply while reducing demand remains. Even with lower prices at the pump, consumers are bracing for an expensive winter season as natural gas prices remain high. The Conference Board Consumer Confidence Index, which experienced sharp declines in September, dipped again in October to a level almost 20 percent lower than pre-Katrina levels. On the bright side: Past declines in the Index following violent storms or terrorist attacks have always proven temporary.

GROWTH BACK ON TRACK?

Despite the disruption of energy production and the related price jumps, the big picture for the U.S. economy is not quite as uncertain as it once seemed days after Katrina struck. Real GDP is expected to grow about half a percentage point less over the second half of 2005 as a result of the hurricanes. It should return to its previous trend by early 2006, however, and later rise above that as rebuilding raises economic activity and energy prices ease, according to economists with the Organisation for Economic Cooperation and Development.

Business leaders also expect industry to weather the storms, though not without getting a little wet. The most recent CEO Economic Outlook Survey by the Business Roundtable, taken after Katrina, showed more negative sentiments toward projected capital expenditures, sales and employment through the first quarter of 2006. CEOs ranked higher energy prices, damage to infrastructure and supply disruptions as the primary hurricane impacts on business. Survey respondents did not feel, however, that the negative effects would last long. Almost two-thirds believed the storms' consequences would linger three to 12 months, while 32 percent said less than three months.

Worth mentioning is the fact that the infusion of billions in federal aid could be a double-edged sword. While government spending should have a positive effect on the economy in 2006, its contribution to the already burgeoning budget deficit and potentially higher interest rates could have harmful results down the road.

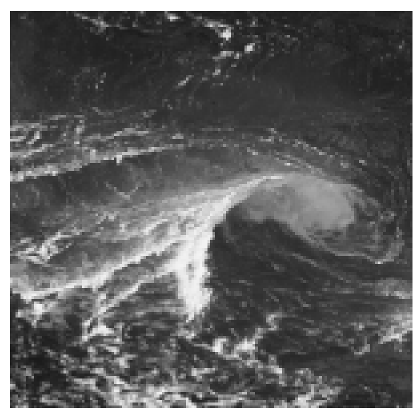
Companies can't be so lean that they give up flexibility during times of natural disaster or terrorist threats, particularly when shipping through vulnerable ports, experts say. Supply chain managers must know the weak links in their distribution channels and make contingency plans for alternative transportation.

DIVERTING TRADE

Despite progress in restoring transportation in the region, logistics headaches persist. Until major Gulf ports, particularly New Orleans and South Louisiana, can restore full capacity, many shippers will have to continue to divert cargo through other ports or through less-efficient transportation systems (see "Maritime System Works toward Recovery" in this issue).

"Should port services not be restored, any rerouting of traditional port cargoes would increase related supply chain costs, including those associated with trucking and rail services, barging, distribution and warehousing, and ocean freight," LaGrange said in testimony before Congress in September. Diverting poultry products from their standard Gulf ports, for example, could increase costs by $7 to $8 a ton, rendering U.S. poultry products uncompetitive in the global marketplace, LaGrange said.

Few companies can afford to move operations out of New Orleans or to other regional ports permanently, because frankly, there is nowhere else to go that offers such direct access to the American heartland, particularly now as the fall harvest heads overseas. What's more, many other ports are already running at near capacity.



This brings into focus a valuable lesson on the limits of just-in-time production. Companies can't be so lean that they give up flexibility during times of natural disaster or terrorist threats, particularly when shipping through vulnerable ports, experts say. Supply chain managers must know the weak links in their distribution channels and make contingency plans for alternative transportation. It may prove costly if implemented, but no more so than a container ship stuck at sea, waiting for a berth at the dock. ■

Maritime System Works toward Recovery

It would be difficult to overstate the importance of the Gulf Coast ports touched by Hurricanes Katrina and Rita earlier this year. Four of the top five and 11 of the top 25 U.S. ports in terms of total trade (in tons, 2003 data) lay in the path of one or both storms. When combined, the Ports of New Orleans and South Louisiana are easily the largest U.S. port area and one of the largest in the world.

All told, within a one-month period, Katrina and Rita pounded at least 20 commercial ports in the Gulf as well as dozens of smaller private and public ports, according to the American Association of Port Authorities. For many, the impact was considerable. As of late September, one month after Katrina, the Port of New Orleans was only 20 percent operational, according to Gary LaGrange, the port's president and CEO.

Not surprisingly, early figures from the U.S. Census Bureau indicate that levels of trade for all affected ports dropped in September—in some cases, dramatically. New Orleans, for example, saw a 31 percent decline in the value of exports it processed in September compared to August. The smaller port of Gulfport, Miss., experienced a massive 94 percent drop, signifying Katrina's crippling effect. While New Orleans slowly accepted more container and breakbulk ships during the month of October and anchorages were open along the Mississippi River, much rebuilding remains to be done with a labor force far below normal.

Restoring the System ...

Getting the ports back online will not only be crucial for the nation's trade pipeline, it will also facilitate the quick rebuilding of the region, which will require a huge influx of supplies and materials from around the world.

By the first week of November, all ports in the region were open, though most still experienced restrictions due largely to blocked navigation channels or a shortage of workers. Key highway and rail connections linking the ports of southern Louisiana with the Alabama and Mississippi coasts remained restricted or closed entirely due to storm damage, according to the U.S. Department of Transportation.

... With Help from Uncle Sam

The region's to-do list is a long one. Owners and insurers face the challenge of restoring local and regional support fleets damaged by the storms. More than 100 barges, for example, reportedly sunk or ran aground south of New Orleans. But most of the maritime infrastructure repair will depend on ample federal assistance.

First, despite shrinking budgets for maintenance dredging in recent years, the U.S. Army Corps of Engineers must receive adequate funding for reopening navigation channels as soon as possible, port officials say. In one day, Katrina and Rita filled waterways with sediment to an extent that usually takes years. Second, given their budgets already strained in recent years by security upgrades, ports need help in repairing communications, power sources and structures. LaGrange estimates that the Port of New Orleans alone will need $1.7 billion to restore facilities damaged by the storms. Yet local governments lost their tax bases when their populations dispersed.

Third, in areas where local residents have lost their homes, temporary housing and housing aid have become major issues for ports starved of labor. Many port employees in New Orleans have lived aboard vessels provided by the DOT Maritime Administration, but a more permanent solution must be put in place before the port can reach full capacity. Finally, the all-important intermodal connections—road and rail—surrounding major ports sustained heavy damage. Until repaired, these areas will become cargo chokepoints even before full capacity is restored at the docks.

The question remains whether or not the renewed maritime transportation system can improve upon the old. Long before the hurricanes, ports nationwide faced an urgent need for upgrades as commerce threatens to double over the next decade. Road and rail connections, for example, are clearly a weak link in American supply chains. So far, however, federal dollars for significant improvement have not materialized. Perhaps the Gulf Coast can now become a shining example of how it's done. ■

SECURITY STANDARDS GO GLOBAL

Since its post-9/11 reorganization, U.S. Customs and Border Protection (CBP) has worked diligently to safeguard trade—an uphill battle since a large span of virtually every supply chain is beyond the regulatory power of the U.S. government.

While the Customs-Trade Partnership Against Terrorism (C-TPAT) attempts to cover entities through its voluntary standards, the program still does not include foreign manufacturers (except some in Mexico) that fill U.S. bound containers. Currently C-TPAT covers less than half of containerized imports into the U.S, by value, according to CBP.

As a result, U.S. importers and exporters should anticipate the globalization of American security efforts, a trend already underway with June's unanimous adoption of the World Customs Organization's "Framework of Standards To Secure and Facilitate Global Trade." Immediately 52 of the WCO's 168 members—CBP among them—indicated their intention to implement the Framework. That number had jumped to 116 countries by early October. The WCO now enters the implementation phase following a successful October meeting in Miami among high-level trade leaders.

"The adoption by the WCO of the Framework of Standards represents a global response to the threat of terrorism," said CBP Commissioner Robert Bonner earlier this year. "The Framework makes safer worldwide trade a reality. Its implementation by customs authorities around the world will revolutionize the security of trade."

The Framework should bolster the international reach of programs like C-TPAT and ideally will result in a global "trusted shipper" system. More importantly, its workable standards should eliminate the prospect of a variety of separate C-TPAT-like programs around the world that would clog tradelanes. For developing nations that wish to implement the standards but lack the resources required, CBP has pledged assistance.

According to the WCO, the Framework will:

- Harmonize advance electronic cargo information requirements on inbound, outbound and transit shipments;
- Establish a consistent risk management approach to addressing security threats among joining nations;
- Require that a sending nation's customs administration perform an outbound inspection of high-risk cargo at the reasonable request of the receiving nation;
- Set up an Authorized Economic Operator designation that provides tangible benefits to businesses that meet minimal supply chain security standards and best practices.

Sound familiar? For companies already dealing with the 24-Hour Rule, the Container Security Initiative, and C-TPAT on a daily basis, the Framework in action should appear at first as a convenient outgrowth of those initiatives. Companies not already part of C-TPAT will find more reasons for membership.

And while it's impossible to predict exactly where an international cooperative system will ultimately end up—or whether it will eventually evolve into regulation of some kind—clearly the time for thinking of cargo security as a U.S. problem, with strictly a U.S. solution, is long past. ■

For more information on how we can help your business stay profitable, contact your agent or Ed Wilmot at (212) 510-0135, ewilmot@gaic.com

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