

Sad, but limited economic impact of the recent earthquakes in Mexico

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- Mexico has experienced two severe earthquakes in the past few weeks
- Mexico City and the states of Chiapas, Oaxaca, Tabasco, Puebla, Morelos and Guerrero have been significantly affected
- Even though these events have been extremely unfortunate and there has been a plethora of human losses, it is our take that these events will have limited impact in economic activity, inflation, and public finances

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Earthquake of 7.1 in the Richter scale. Mexico City and the neighboring states of México, Morelos, Puebla, and Guerrero faced an intense seismic activity on Tuesday. Unfortunately, these had taken a toll of more than 200 people. Moreover, these must be added to the ongoing problems and victims that other tectonic tremors left in the Southeastern states of Chiapas, Oaxaca, and Tabasco (as it is shown in the map and the table below). It is worth noting that the destructive power of Tuesday’s earthquake was significantly higher compared to the one that hit Chiapas, Tabasco, and Oaxaca two weeks ago -and felt in Mexico City-, despite the fact that it observed a lower number in the Richter scale, 7.1, *vis-à-vis* 8.1. According to the head of the National Center for Disaster Prevention (Cenapred), the epicenter of Tuesday’s earthquake was closer to Mexico City and the other affected areas (120 km or 75 mi), compared to the previous one (700 km/435 mi).

At Banorte we have opened an account at Fundacion Banorte, number 000 000 0019 to receive donations from the public, clients and Banorte employees. Every donation will be matched by Fundacion Banorte. The support for Oaxaca and Chiapas continess through the account numbered 000 000 0010.

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The geography of earthquake-affected areas



Source: Banorte

Basic characteristics of the earthquake-affected areas

State	% GDP	% Population	% Territory
Chiapas	1.6	4.3	3.8
Mexico City	16.8	7.9	0.1
Guerrero	1.4	3.0	3.3
State of Mexico	8.9	13.5	1.1
Morelos	1.2	1.6	0.3
Oaxaca	1.6	3.4	5.0
Puebla	3.2	5.1	1.8
Tabasco	3.2	2.0	1.3
TOTAL	37.9	40.8	16.6

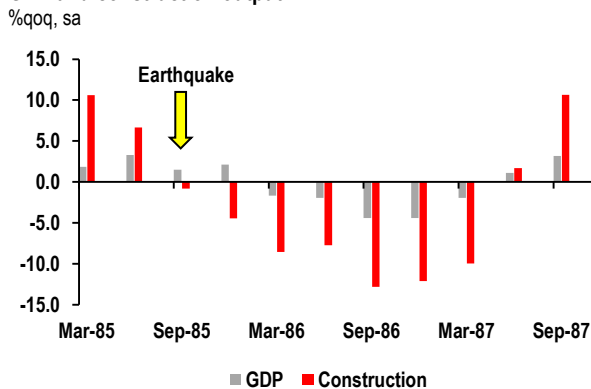
Source: Banorte with data from INEGI

Limited economic impact. While the country mourns its very unfortunate victims, it is our take that the economic impact of these earthquakes will be quite limited. In our view, this is because of two facts. On the one hand, Mexico has learned the lessons from previous deadly tremors such as the 1985 earthquake, that took the lives of more than 10 thousand people in more than 400 collapsed buildings. Since then, construction regulatory standards have been improved in order to accommodate for these sort of extreme telluric movements, and the authorities have implemented frequent programmed drills to evacuate buildings.

Moreover, people’s solidarity to quickly jump into the disaster zones to rescue the victims right after the last seismic wave of the earthquake faded away and the use of technology -mainly SMS, *WhatsApp*, and mobile GPS-, has been key to reduce the number of casualties. Firefighters, police and armed forces have also been trained to handle the aftermath of earthquakes, and President Peña-Nieto, as well as other cabinet members and local authorities have led the relief efforts in a very efficient way. This is why, in our view, the number of collapsed buildings might not surpass 50 -instead of more than 400 back in 1985-, and it is highly likely that the death toll will be under 400 people *vis-à-vis* more than 10,000 in the mid-eighties.

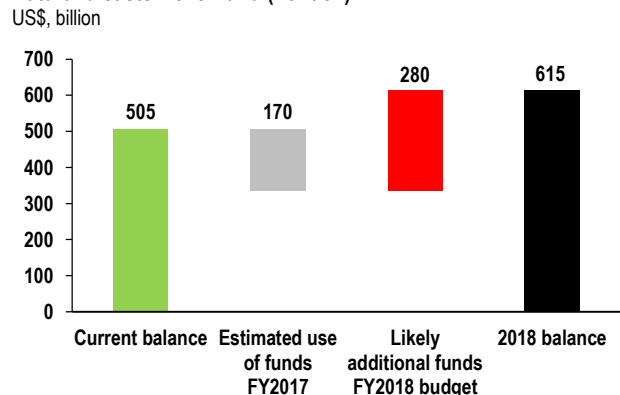
On the other hand, the country is better prepared from a fiscal point of view. In contrast to 1985 -when Mexico was “coming out” from one of its worst balance of payments crisis, right after the nationalization of the banking system that killed pretty much all private-sector investments-, the federal government has created a natural disaster relief fund (Fonden), that currently holds around US\$ 505 million, and is highly likely to be able to gather US\$ 280 million more (please see chart below in the right). Moreover, a significantly higher portion of buildings are now insured, compared to this same number in 1985. In this context, the monetary source of the reconstruction efforts will be mainly government funds and anecdotal evidence suggest that insurance companies fortunately are re-insured in most of their P&C policies. As a result, we do not expect such a negative impact on GDP as it was the case back in the eighties in the aftermath of the earthquake (as it is shown in the chart below on the left).

GDP and construction output



Source: INEGI

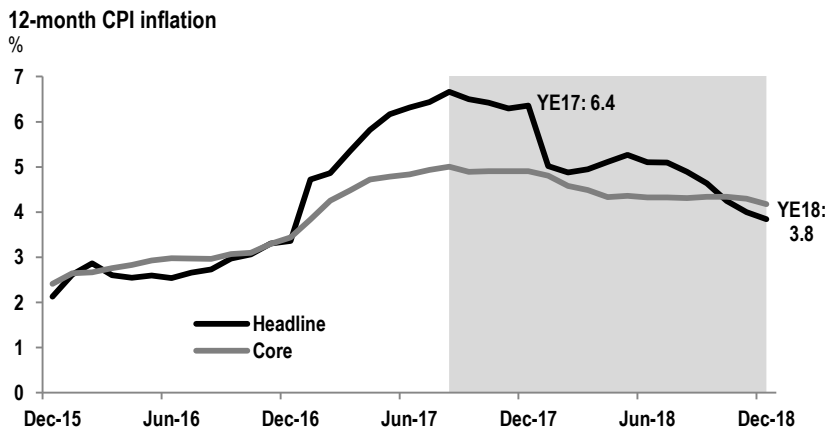
Natural disaster relief fund (Fonden)



Source: Banorte with data from the Ministry of Finance

Growth is likely to pick up. As we all know, destruction does not eliminate or decelerates GDP growth *per se*. It is the number of days that the disaster precludes economic activity from happening. Fortunately, even though the earthquake left quite a mess and there are a number of people homeless, economic activity has not stopped at all, with a very few exceptions in small towns and small areas. In fact, the population relief efforts have actually created a more dynamic economic environment these days. Moreover, another stylized fact of the aftermath of earthquakes is that reconstruction efforts temporarily boost GDP growth rates.

Inflation will not be affected. In our view, inflation will not suffer from the consequences of the earthquake because of three issues: (1) Mexico CPI no longer includes construction materials (since 2010), that could face some inflationary pressures during the reconstruction phase; (2) the passthrough from PPI to CPI in Mexico has been quite mild in the past few years, and we continue to believe it will remain like that; and (3) ANTAD (National Retail, Department, and Convenience Store Association) just signed an agreement among its members to avoid increasing prices of the most commonly demanded products in the aftermath of an earthquake. As a result, the 12-month CPI inflation path that we have anticipated will remain unchanged (YE17 forecast: 6.4%; YE18: 3.8%), as it is depicted in the chart below.



Source: INEGI (historical) and Banorte (forecast)

Managing help. Mexico is a strong and united country. Even though there are political and social discrepancies, Mexicans act together in times of despair. This has been proven many times, including the 1985 earthquake as well as now. In fact, the problem authorities are facing right now is how to distribute the actions people are willing to do within the rescue activities, as well as how to manage the plethora of funds and goods that people in Mexico and around the world is giving to the victims. Volunteers have been forming human chains to remove debris from the affected buildings, hotels are offering rooms at no cost, and even fancy restaurants have changed their menu from *nouveau cuisine* to massive sandwich production. Telecom companies have offered free Internet and free calls. Medical doctors and hospitals are offering services at no cost. Architects and engineers are also offering free consulting services to evaluate the structural state of damaged constructions. All in all, Mexico is living difficult times, but this will make the country grow stronger and more united.

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