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Further thoughts of the economic impact of the latest earthquake and a comparison with Kobe in 1995

1. It will probably take weeks, if not months, before we know the exact human tolls and business fallout from the latest earthquake in China. As the search and rescue mission for victims has come close to an end, market concerns have again been shifted to the economic impact from the earthquake. In this context, Japan's experiences from the Kobe earthquake in 1995 have been cited by some commentators as risks that the potential economic fallout from China's latest earthquake could be more severe than expected initially.
2. Notwithstanding the much higher human tolls from the Sichuan earthquake (the expected death tolls could reach 50,000), its economic impact is likely to be much less significant than Kobe (with 6,500 deaths). Aside from being a relatively more important agricultural area, the national shares of population, GDP, and industrial production for the Sichuan quake-affected areas are about less than one fourth of those for the Kobe earthquake in 1995 (see Exhibit 1).

Exhibit 1: Comparing the impacts of the Sichuan and Kobe earthquakes

% share of severely affected areas* in a national context	2008 Sichuan earthquake	1995 Kobe earthquake
Population	1.0	4.4
GDP	0.8	4.1
Agriculture production	1.3	2.1
Industrial production	0.7	4.8

* We include the 40 counties in Sichuan Province that are classified by the government as being "severely hit." In terms of Japan, we used data for the Hyogo Prefecture which includes the city of Kobe.

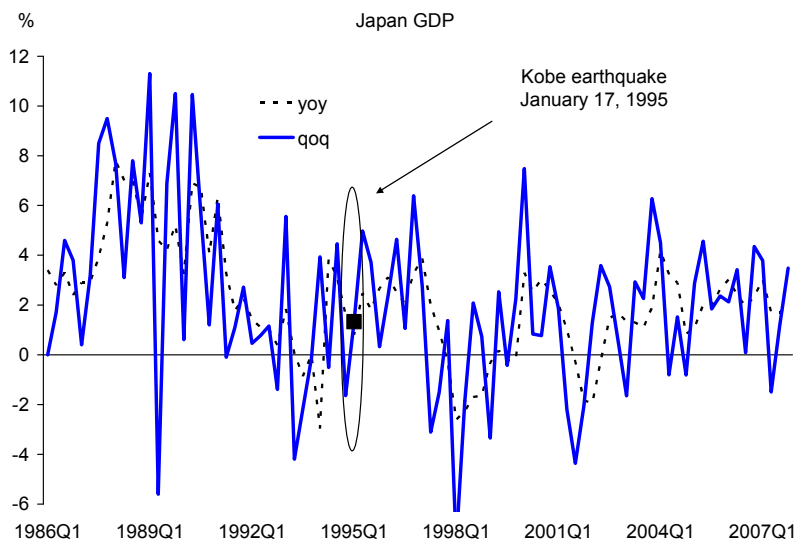
Source: Sichuan Statistical Yearbook, CEIC, Goldman Sachs Economics Research.

3. Specifically, the heavily-damaged counties are mostly in remote mountain areas this time in China, whereas Kobe and its surrounding areas are known for its manufacturing prominence. For example, Kobe boasts one of the largest steel smelters and the world's sixth largest container port. Therefore, the quake-induced disruptions to manufacturing and trade transportation were severe for Japan, and the damages are said to have cost Japan US\$200 billion or 2.5% of GDP at the time (it was known as the costliest natural disaster to fall in any one country).



4. In spite of such severe economic damage, Japan's economic activities actually held up better than expected, and indeed rebounded quickly (see Exhibit 2). Immediately after the Kobe quake, industrial activities, as well as consumer sentiment and consumption, all plunged. But they all came back quickly on the back of strong reconstruction demand. Looking at the quarterly data, one can hardly detect much negative impact from the earthquake: real GDP grew +1.2% (quarter-on-quarter annualized) for the quake, a rebound from the negative 1.5% qoq in the previous quarter, and accelerated to +5.1% qoq in the following quarter.

Exhibit 2: Japan's GDP growth



Source: CEIC, Goldman Sachs Economics Research.

5. Because of Sichuan's relative importance in agriculture, there are also concerns that pork and other agriculture product prices may surge as a result of the losses caused by the earthquake. While such risks are real and need to be monitored closely going forward, official information suggests the amount of losses is limited so far. The loss of hogs is estimated to be just below 1 million, out of an existing national stock of around 400-500 million. Consistent with this, pork prices have been stable in recent days as well. The direct impacts on grain production should be even more limited.
6. Some investors are also concerned that the knock-on effects to basic materials and energy prices from China's reconstruction demand could be significant, and this was something Japan did not need to worry about after the 1995 Kobe quake. Yes, the after-quake reconstruction demand will likely complicate China's macro policy making given elevated domestic inflation and global commodity prices. But the "economic" size of the affected areas (see Exhibit 1) still suggests rebuilding the area should have limited impact on nation-wide aggregate demand, and thereby, prices, if the overall macro policy stance remains unchanged.
7. On the other hand, a premature easing of monetary policy, whether it is in response to the earthquake damages or outcries from a few exporters, would worsen the inflation outlook and aggravate China's macro challenges down the road. At this point, we still see this as an unlikely scenario, but will watch the policy space closely for upside risks to inflation.

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