Exports as a driver of Spain's economic recovery?

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The external sector's contribution to GDP has been positive since the start of the crisis in 2008 due to the growth of exports, but to an even greater degree, to the fall in imports. In this article, we analyze the factors that limit the capacity of the external sector alone to drive the Spanish economic recovery.

The Spanish export sector has registered positive performance throughout the years of the economic crisis. Nevertheless, the general perceptions of Spanish export performance in recent years may be overly optimistic. The orientation of many Spanish firms towards external markets in reaction to falling internal demand may be merely cyclical. At the same time, the relative weight of the export sector in the Spanish economy, although having increased during the crisis, is still below that of other countries. Finally, given the high proportion of imports in Spanish exports, the generation of value added remains modest. In previous crises, the export sector led the recovery, but on those occasions, devaluations were more intense and the external context more favourable, circumstances not present in the current environment.

The role of exports in recent trends in the Spanish economy

Since 2008, the Spanish economy has been undergoing a process of profound adjustment as the imbalances that built up over the long preceding growth phase are corrected. This has been reflected in a drop in domestic demand of 12.1% in real terms between 2008 and 2012. Nevertheless, at 5% the drop in GDP has been significantly smaller than that in demand. This is explained by the relatively strong performance of the external sector, in the form of both growing exports and falling imports.

Since 2009, Spanish exports of goods and services have risen by 23.4% in real terms, a rate somewhat higher (although not significantly) than the euro area average of 21.4%. As a share of GDP, exports rose from in the order of 26% in the pre-crisis years to 32.2% in 2012. In parallel, imports of goods and services fell by 14.8%. This is a sharper drop than that in total domestic demand, a fact which can be explained by the way the drop in demand has been concentrated in goods with high income elasticity, as these are more often imported than are basic goods, for which demand has contracted less sharply.

Consequently, the combination of export growth and a fall in imports has meant that the external sector's contribution to GDP growth has been positive in all years since 2008, whereas during the growth phase its contribution was always negative. Moreover, in 2012 the trade balance in

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goods and services was positive for the first time since 1997.

The vibrancy of Spanish exports since the start of the crisis in 2008 has often been mentioned. However, the change in sign of the export sector's contribution to GDP growth is attributed as well to the fall in imports over the period, which has been even greater than the increase in exports.

As can be seen in Table 1, the average contribution of exports to GDP growth between 1996 and 2007 was 1.7 percentage points, whereas their average contribution between 2010 and 2012 was 1.9 percentage points (excluding the anomalous years of 2008 and 2009 from the analysis, given the collapse in global trade in the wake of the bankruptcy of Lehman Brothers). Between 1996 and 2007 imports subtracted an average of 2.6 percentage points from GDP growth, compared with an average of 0.2 percentage points between 2010 and 2012. In other words, the variation in the external sector's overall contribution to growth, which was -0.8 pp between 1996 and 2007 and 1.7 pp between 2010 and 2012, has been due more to the fall in imports than the rise in exports.

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Thus, 65% of the turnaround in the trade balance in goods and services between 2007 and 2012, was due to export growth –a quarter of which was in the form of services– and the remainder was due

Table 1

Contribution of exports and imports to GDP growth

(percentage points)

	Contribution of exports	Contribution of imports
1996	2.3	-2.0
1997	3.5	-3.1
1998	2.1	-3.8
1999	2.0	-3.7
2000	2.7	-3.1
2001	1.2	-1.5
2002	0.6	-1.2
2003	1.0	-1.8
2004	1.1	-2.8
2005	0.7	-2.3
2006	1.7	-3.2
2007	1.8	-2.6
2008	-0.3	1.7
2009	-2.7	5.6
2010	2.7	-2.4
2011	2.1	0.3
2012	0.9	1.5
Average 2001-2007	1.7	-2.6
Average 2010-2012	1.9	-0.2

Source: INE (National Accounts).

to shrinking imports. However, the worsening of the terms of trade in this period needs to be taken into account. In the case of trade in goods, the price of exports rose by 3% over the period, while the price of imports rose by 9%. In real terms, the increase in the volume of exports was 18% and that of imports was -17.8%. In constant prices, 42% of the reduction in the goods deficit between 2007 and 2012 was due to increased exports and 58% due to falling imports.

Table 2
Short-term elasticities of exports

Growth of foreign markets	1.39
Price-competitiveness of exports (1)	-0.88
Growth in domestic demand	-0.82

(1) Real effective exchange rate with developed countries; an increase to this indicator means a loss of competitiveness and a decrease means a competitiveness gain.

Source: Own elaboration.

Factors explaining recent trends in exports

In order to analyse the factors underlying export performance in recent years, we have estimated the Spanish economy's goods export function using data from 1981 to 2012. This has enabled us to obtain their short-term elasticities with respect to their explanatory variables (Table 2). The first of these variables is growth of the external market, measured as weighted average growth of imports by countries to which Spanish goods are exported. The second explanatory variable is the price-competitiveness of Spanish exports, measured in terms of the real effective exchange rate with developed countries, calculated with the industrial producer price index. Finally, the export function reveals domestic demand growth to be a statistically significant variable, with a negative sign, indicating that Spanish businesses react to a slump in the domestic market by reorienting their business towards export markets. In other words, this could lead us to believe that a part of the export growth could be merely cyclical, in response to a contraction in domestic demand. Therefore, in the moment that domestic demand recovers, we could see a negative impact on the external sector.

This observation is backed by the fact that of Spain's 3.5 million businesses, only 130,000 exported in 2012, and only 38,000 do so regularly. And this figure has barely changed over the last ten years[2]. This confirms that most of the companies that export at present only do so in response to economic circumstances. Moreover, exports are concentrated in a handful of companies: only 1,000 firms are responsible for two thirds of all Spain's exports. This highlights the fact that Spain's economy is not truly export driven. While this is a characteristic which could be changing, it is still too early to tell whether the change will be consolidated in the future.

Based on elasticities, Exhibit 1 shows the contribution of each explanatory variable to goods exports growth since the start of the crisis. The main factor shaping the growth observed in the last three years has been the recovery in external demand in 2010 and 2011, and the fall in domestic demand in 2012. Price-competitiveness gains have barely influenced the performance of foreign sales. Indeed, in 2011 the effect was moderately negative. In fact, despite the significant cost-competitiveness gains, with Spain's unit labour costs falling since 2009 –a drop of 15.3% in manufacturing industry– export prices have not fallen, but have continued to rise.

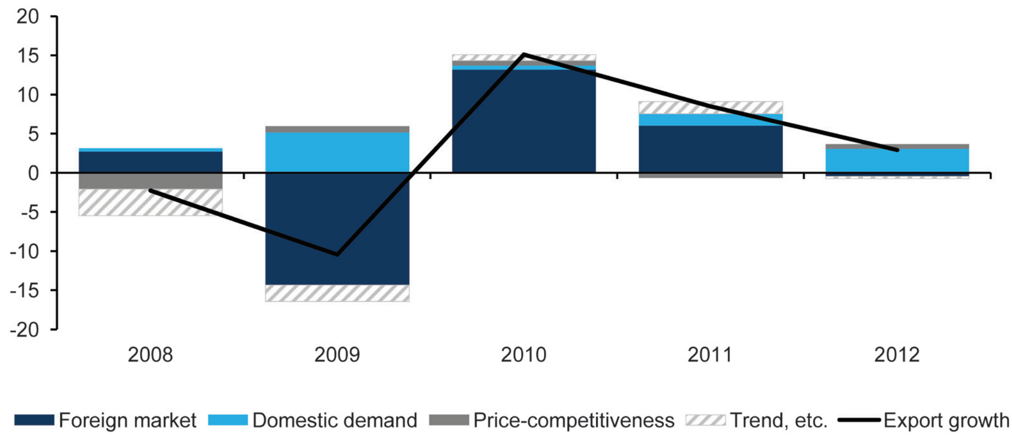
Thus, for example, since 2009 export prices, measured in terms of unit value indices, have risen 2.2% more than the developed-country average, while Spanish industrial prices rose by 2.5% more. The slight gains registered in the real effective exchange rate over this period, whether

[2] Data from the Spanish Institute for Foreign Trade (ICEX).

Exhibit 1

Determinants of export growth

Contribution to growth in percentage points



Source: Own elaboration.

calculated using relative industrial prices or relative export prices, have been entirely driven by the depreciation of the euro[3].

In other words, Spanish export businesses have not needed to reduce prices to remain competitive in international markets. In this way, they have been able to capitalise on the drop in labour costs to increase profit margins and improve the health of their balance sheets. This contradicts the general perception that Spanish exports have grown in recent years thanks to the improvement in competitiveness brought about by the drop in unit labour costs. Thus, the exporting sectors' improved capacity to generate profits will encourage productive resources to be reallocated to them, helping the necessary restructuring of the productive system. Moreover, this leads to an increase in the competitive advantage of Spain, which is reflected in an improved capacity to retain or attract foreign investment –as demonstrated recently in the case of various automotive plants.

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Reasons for the limited capacity of exports to stimulate economic recovery

The capacity of Spanish exports to pull along the rest of the economy and stimulate a recovery is limited for two reasons. The first is the relatively low share of GDP that exports represent. Despite the increase in the last few years, exports still account for a much smaller share of GDP than the EU average, which was 44.7% in 2012, compared with Spain's 32.2%. Considering only goods

[3] According to Bank of Spain data.

exports, these figures are 22% for Spain against 33.8% for the EU.

The second reason for the limited capacity of exports to stimulate economic growth lies in the fact that Spain's exports embody a large portion of imported goods. This means that the value added external demand is able to generate for the domestic economy is relatively modest. Using data for 1981-2012, we have estimated the goods import function for the Spanish economy, enabling us to obtain the short-term elasticity of imports relative to a number of explanatory variables (Table 3). The results confirm that the performance of purchases abroad is related not only to the growth of domestic demand and price competitiveness of national production –calculated as the deflator of goods and services with respect to the industrial production price index– but also to the variation in the volume of exports.

Table 3

Short-term elasticities of imports

Contribution of exports	0.55
Growth in domestic demand	2.40
Price-competitiveness of national production (1)	-0.41

(1) Deflator of imports in relation to the industrial price index; an increase to this indicator means a gain of competitiveness and a decrease means a competitiveness loss.

Source: Own elaboration.

Exhibit 2, which shows the contribution of each of the above variables to Spanish import growth based on these elasticities, highlights how the main factors influencing the trend in recent years have been the drop in domestic demand (negatively) and growth in exports (positively). As in the case of sales abroad, the price-competitiveness gains have hardly had any influence on the drop in imports since 2008. According to the indicator used to represent price-competitiveness, this is because it has hardly grown in recent years, demonstrating, in a similar way to what has happened to the price-competitiveness of exports, that the drop in unit labour costs has not been utilised to reduce domestic prices in relation to imports.

Using the elasticities calculated based on the import and export functions it is possible to simulate the conditions which, broadly speaking, would be needed for Spain's external sector to induce sufficient growth in the domestic economy to produce a significant reduction in unemployment, i.e. of between 2.5% and 3%, which gives a view of the feasibility of a purely export-led recovery.

Bearing in mind the relationships between the variables expressed in the elasticities, and assuming that imports and exports of services move in parallel with those of goods –which is consistent with their behaviour in the past– if domestic demand growth is zero –given domestic conditions it is not plausible to expect growth in domestic demand in the next few years– and there are no price-competitiveness gains, exports would have to grow at a rate of between 17% and 20% for GDP to grow at the indicated rate, which would require a growth in Spain's export markets of more than 12% a year. This is a figure higher than that registered even in the years when global economic growth was at its fastest.

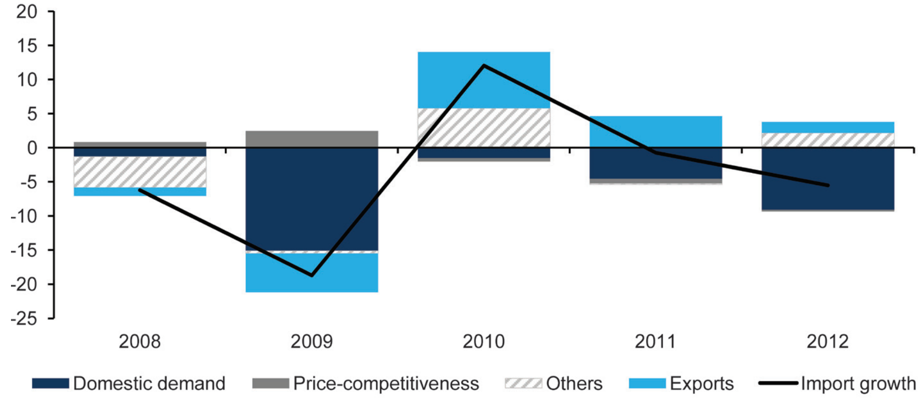
Starting from the more realistic assumption –but even so, optimistic given the current state of the main destination markets for Spanish exports– that Spain's export markets will grow by 4%, and assuming zero growth in domestic demand, the price-competitiveness of Spanish exports and national production need to improve, by around 5% year-on-year, to enable increased imports and exports to produce GDP growth rates of over 2.5% a year.

There are very few instances of competitiveness gains on this scale in the historical series of data for the indicator used to calculate the export function. Those that do exist were the result of currency devaluations. Given that a devaluation

Exhibit 2

Determinants of import growth

Contribution to growth in percentage points



Source: Own elaboration.

is no longer possible, the inflation differential –whether measured in terms of industrial prices or any other indicator– necessary to achieve price-competitiveness gains on this scale would be unachievable.

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In past economic crises, it has been export growth that lifted Spain out of crisis, but on those occasions the external environment was much more favourable and the devaluations were more intense, with sales abroad consequently growing even more vigorously than at present. Additionally, export growth stimulated a recovery in domestic demand through the boost to investment, which subsequently fed through into employment and consumption. However, the presence of a number of limiting factors on the components of domestic demand growth over the medium-term make it look unlikely that this will take place to a similar extent today.

Conclusions

It is true that the Spanish export sector has registered positive performance throughout the economic crisis. Nevertheless, the usual assessment of the recent performance of Spanish exports may be overly optimistic. In this article, we analyze several elements that help to provide a more realistic assessment of the sector.

In absolute terms, Spanish exports have not grown significantly faster than European exports. Given the difficulties facing the Spanish economy, it is understandable that there is an overly optimistic assessment of the positive performance of export data, but we highlight that the performance has not been so extraordinary. This leads us to our second more realistic point: the improved contribution of the external balance to GDP can be explained to a greater degree by the reduction of imports derived from the fall in domestic demand, than by the increase in exports. As a consequence, the correction of Spain's external imbalances has been achieved, incorporating circumstantial elements that could make this positive result only temporary.

On the other hand, the competitiveness gains derived from the reduction in unit labour costs are helping the necessary restructuring of Spanish companies –both exporting and non-exporting businesses– but this has not been the determining factor in the boost of sales abroad. The increase in profit margins has allowed Spanish companies to strengthen their external competitiveness as well as improve performance in domestic markets.

The final element where over-optimism must be subdued is regarding the export sector's capacity to bring about a solid and sustainable recovery of the Spanish economy. As we have seen, the relative size of the export sector continues to be reduced. Moreover, there is a high degree of imported goods that are incorporated into the export process, resulting in the fact that the level of value added generated by exports is modest.

In conclusion, unlike on past occasions, the Spanish economic recovery cannot be driven solely by a boost in exports, unless it is accompanied by the reactivation of domestic demand. Moreover, in order for the pick-up in domestic demand not to immediately generate new external imbalances (because imports would be more competitive than local products), it will be necessary, in addition to the benefits derived from the drop in unit labour costs, to improve other aspects of Spanish companies' competitiveness through reforms in the market for goods and services that would help to stimulate the restructuring process already underway.