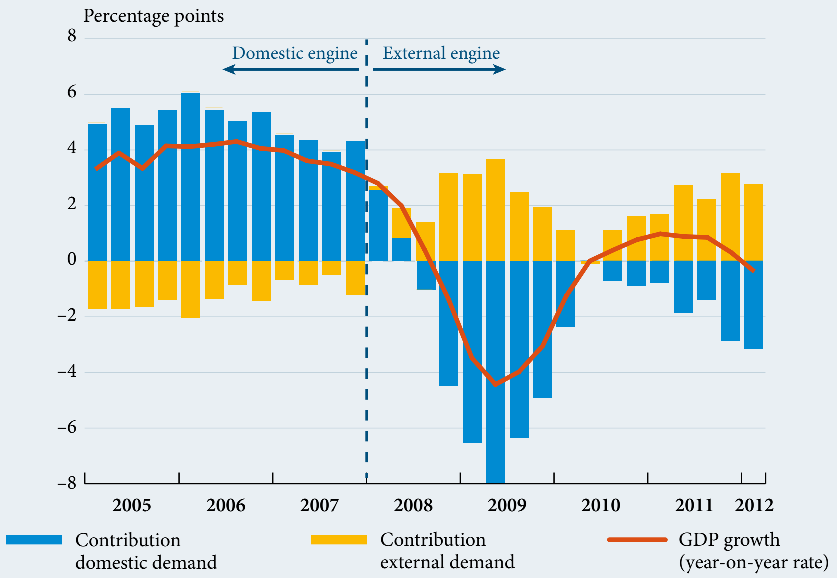
The external sector: driving the recovery

The outlook for the Spanish economy in 2012 does not invite optimism. Households, firms and public administrations must not only push forward with their deleveraging but must also do so within a double-dip recession. These adjustments will continue to hinder domestic demand for several years, so that any redirection towards a recovery that helps to create jobs will necessarily involve exports. But can the external engine restart this recovery all on its own?

CHANGE OF ENGINE: THE CRISIS IMPOSES A NEW GROWTH MODEL

Contribution to GDP growth



SOURCES: National Institute of Statistics and own calculations.

To answer this question, first we need to clarify how fast exports need to increase for the economy to grow at a pace that supports job-creation. Traditionally, any sustained recovery in employment in Spain has required GDP growth rates of around 2% and this will be the figure we will use in the simulation that follows. Assuming that the contribution from domestic expenditure is completely null, this 2% needs to come entirely from an increase in net exports (net of the import content; i.e. the part of the value of goods and services exported that corresponds to the intermediate consumption of imports and that, as such, does not contribute to growth in domestic production). The Bank of Spain estimates that this import content of Spanish exports accounts for 39% of their value. So, for the contribution of net exports to the final growth in GDP to be 2 percentage points, their gross contribution needs to be 3.3 percentage points: 2 points in order to contribute to economic growth plus 1.3 points to offset the 39% of the value exported that is imported. Given that the relative weight of exports in Spain's GDP stood at 30.5% in 2011, this contribution requires a 10.8% growth in the foreign sale of Spanish goods and services. If this happened, total imports would grow by 4.2% (resulting from the combination of a 10.8% growth in imports related to exports and 0% in imports related to domestic demand).

In short, to grow by 2% without any assistance from domestic expenditure, exports must increase by almost 11% in real terms (see the table below). Taking into account the fact that, during the boom prior to the crisis (2000-2007), exports grew at an annual average rate of just 5.4%, this 11% seems excessively ambitious. However, when we take into account the fact that, in 2011, exports grew by 9% and in 2010 by 13.5%, it no longer seems so exaggerated. Moreover, if domestic demand contributed something to growth, even if this were modest, exports could grow a little less and GDP growth would still reach 2%.

For example, if domestic expenditure grew by 1% it would contribute 1 percentage point to growth in GDP (as the relative weight of domestic demand for GDP is close to 100%), so the contribution required from net exports would fall by 1 percentage point. In this scenario, the rise in imports would not only correspond to the imported content of exports but also to the imported content of the different components of domestic expenditure (private consumption, public consumption and investment) and to final domestic expenditure on imported goods and services.(1) In this case, the rise required in the foreign sale of goods and services would be less than in the previous scenario, down to 6.9%, with a consequent increase in imports of 3.6% (see the table below).

Is it, then, reasonable to expect exports to grow by almost 7% per year? As we argue below, it is. Past experience, the tried and tested know-how of Spanish exporters, gains in competitiveness and the potential of as yet unexploited markets all support this conclusion. To begin with, we should cast our eyes back again: we have already said that, before the crisis, the volume of exports grew by almost 6% year-on-year. Although this figure might not seem very spectacular at first sight, it should be seen as a success when we take into account the fact that it was achieved within a doubly adverse context: on the one hand, cost competitiveness was being lost (between 10% and 14% depending on the indicator chosen), (see the box «Gains in competitiveness to restart the external engine» on page 33)

HOW FAST MUST EXPORTS GROW TO SUSTAIN THE RECOVERY?

Growth and contribution to GDP (% and percentage points, respectively)

	Scenario 1		Scenario 2	
	Growth	Contribution △ GDP	Growth	Contribution △ GDP
Domestic demand	0.0%	0.0 p.p.	1.0%	1.0 p.p.
Exports	10.8%	3.3 p.p.	6.9%	2.1 p.p.
Imports	4.2%	–1.3 p.p.	3.6%	–1.1 p.p.
Net contribution Foreign demand		2.0 p.p.		1.0 p.p.
△ GDP = +2%				

SOURCE: Own estimates.

(1) The estimated import content of private consumption is 29%, for public consumption it's 13% and for investment it's 36%.

and, on the other hand, it coincided with the entrance of large emerging economies in world trade; for example, China went from exporting 3% of world trade in 1999 to 8% in 2008. In spite of facing this double challenge, Spanish exports managed to keep their share of global exports almost stable, both in goods (around 1.7%) and in services (around 3.5%).

This was achieved, on the one hand, thanks to the positioning of Spanish exports in goods from medium-high technology sectors, where competition is not so much driven by price as by brand or quality. On the other hand, Spanish exporters managed to maintain a higher level of competitiveness than the average for the country (the loss of competitiveness measured in terms of export prices was 5%, almost one third of its equivalent in terms of unit labour costs) and a similar level of productivity to their foreign competitors (see the box «Strong exports, weak competitiveness: an odd couple?» from June 2011).

These signs of strength endorse the capacity of our export sector to drive the recovery. Even more so when the advances being made in the area of competitiveness are substantial (see the box on page 33) and when a weak euro (compared with the pre-crisis period or even 2011) will also help to improve trading conditions outside the euro area.

This improvement is particularly welcome given that the greatest market potential for Spain's exports is located outside Europe. Most of the world's growth is currently concentrated, and will continue to be so, in the emerging economies and in some advanced countries where Spanish exports still have a long way to go. In fact, recent foreign trade figures reveal that it is precisely the weak economy both in Spain and the euro area that has provided the necessary push for many Spanish firms to finally take on these markets and take advantage of their great potential. In China, India and Russia, for example, the share of Spanish exports has been rising since the year 2000 while those of its most direct rivals have lost ground; Italy has lost share in all of them while Germany has seen its share fall in India; in Brazil, all of them, including Spain, have lost market share.

In summary, in a situation such as the present, where growth in domestic expenditure is being restricted by adjustments, the recovery needs to be supported by exports, making the most of business opportunities in other more dynamic markets. Spain cannot devalue nor can it resort to monetary or commercial policies to improve its competitiveness but it does have room to pursue structural reforms that boost such competitiveness via efficiency, investment, innovation and the quality of human capital, and strengthening its appeal as an exporting base. The areas for such reforms range from improving regulation and bureaucracy to increasing competition or facilitating foreign trade by investing in infrastructures.

And although the institutional sphere may carry out initiatives to promote this internationalization, its true driving force lies in companies themselves and their directors. In the short term, the engine for Spain's recovery is also in their hands... and it would be difficult to find a better place for it.

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