THE ROLE OF GEOGRAPHICAL DIVERSIFICATION IN THE BUOYANCY OF SPANISH GOODS EXPORTS DURING THE ECONOMIC CRISIS

Spanish goods exports have performed relatively favourably in recent years, despite growing competition from the emerging countries and the slowdown in some of our main trading partners. The cumulative gains in price-cost competitiveness against our main competitors (reflecting the internal devaluation the Spanish economy is undergoing) and developments in our export markets would account for this sound performance (see Panel 1).[1] Recently, however, the buoyancy of Spanish sales to the rest of the world appears to have been systematically greater than would be compatible with the historical average effect of

1 C. García et al. (2008): "Una actualización de las funciones de exportación e importación de la economía española". *Boletín Económico*, Banco de España, December.

1 REAL GOODS EXPORTS AND THEIR MAIN DETERMINANTS: CONTRIBUTIONS TO ANNUAL GROWTH

SOURCES: INE and Banco de España.

1 SPANISH GOODS EXPORTS
In nominal terms

	Structure of exports. % of total				Year-on-year rate of change (%)		Contributions to rate of change (%)	
	2000	2007	2011	2012 Jan-Oct	2011	2012 Jan-Oct	2011	2012 Jan-Oct
Europe	78.2	77.1	73.6	70.6	14.0	-0.4	10.4	-0.3
EU	73.4	70.7	66.0	62.7	12.6	-1.2	8.6	-0.8
Euro area (EMU 17)	60.4	57.1	52.8	49.6	9.6	-2.1	5.3	-1.1
Other EU	12.9	13.7	13.3	13.1	26.6	2.4	3.2	0.3
Rest of Europe	4.8	6.4	7.6	7.9	27.3	7.2	1.9	0.6
North America (a)	6.6	6.1	5.6	6.1	17.3	-5.4	1.0	-0.3
Latin America (a)	4.4	3.1	4.2	4.8	26.2	20.0	1.0	0.8
Rest of the Americas	0.4	0.4	0.1	0.1	-2.0	-9.7	0.0	0.0
Asia	5.8	6.1	7.9	8.4	20.9	15.3	1.6	1.2
China	0.4	1.1	1.6	1.7	28.0	11.3	0.4	0.2
Africa	3.3	4.4	5.4	6.7	11.6	31.0	0.7	1.7
North Africa	2.3	3.1	3.9	5.0	10.8	35.9	0.4	1.4
Maghreb	2.0	2.8	3.5	4.5	13.8	35.5	0.5	1.2
Oceania	0.4	0.7	0.8	1.1	38.3	41.2	0.3	0.3
Unallocated	0.8	2.1	2.3	2.1	26.7	-6.9	0.6	-0.2
WORLD TOTAL	**100**	**100**	**100**	**100**	**15.4**	**4.2**	**15.4**	**4.2**

SOURCE: Ministry of Economic Affairs and Competitiveness.

a Mexico is included in North America.

these two variables, price-cost competitiveness and export markets. This suggests other factors, of a very different nature and which are difficult to capture in the export demand equations, are contributing positively to the increase in Spanish goods exports. Among these, mention may be made of the improvements in non-price competitiveness, increases in the variety of products exported, changes in the geographical direction of exports and the widening of the export base, that is to say, the number of Spanish companies that export.

The changes in a country's productive structure, prompted by the reallocation of productive factors across sectors, occur gradually; accordingly, it seems rather unlikely that the product composition of Spanish exports has changed considerably since the onset of the economic crisis. Conversely, a re-directing of Spanish exports towards markets outside the euro area has been observed. On aggregate Customs figures, nominal exports grew at a year-on-year rate of 4.2% in the first ten months of 2012 (15.4% in 2011). This increase is due to the sound behaviour of sales directed outside the euro area, since exports to the euro area fell in this period (-2.1%) (see Table 1). Specifically, exports to Latin America, Asia and Africa account for most of the growth recorded by goods sales abroad in the January-October 2012 period, with growth rates of 20%, 15.3% and 31%, respectively. The change in direction of Spanish exports has, in particular, been towards regions closer in cultural terms (Latin America) and geographically (North Africa), the demand in both areas being more dynamic than the global average.[2] From 2007, before the collapse in world trade that took place in the final stretch of 2008, the weight of sales to Latin America and Africa in total Spanish goods exports increased by 1.7 pp and 2.3 pp, respectively, to 4.8% (6.3% if Mexico is included) and 6.7% of the total in the first ten months of 2012.[3] Thanks in part to this greater geographical diversification, the contribution of the external sector to GDP has been more positive in recent years. Specifically, around 75% of the contribution of total exports to GDP growth between 2009 and 2012 Q3 (equivalent to around 2 pp of GDP according to QNA) has been due to the increase in exports outside the euro area, compared with little more than 55% in the 1999-2008 period (see Panel 2).

This export diversification process has run in parallel with the increase in the number of Spanish exporting firms targeting emerging markets and developing areas. Given the sluggishness of domestic demand and of some of Spain's traditionally bigger markets, such as Italy and Portugal, firms are being obliged to seek out new markets.[4] According to the data released by ICEX (Spanish Institute of Foreign Trade), prepared drawing on Customs information, the number of Spanish exporting firms has grown significantly in recent years, at an annual average of 6.1% from 2008 to 2011, making for a total of almost 123,000 companies at the end of that period.[5] As well as widening, the export base has also diversified. Whereas in 2007 only 17% of Spanish exporting firms sold their products in Latin America, 22% did so in 2011 (see Panel 3).[6] This percentage

2 This pattern of diversification would be consistent with what gravity models suggest. See C. Martín (2011): "Un análisis del destino geográfico de las exportaciones españolas de bienes a través de una ecuación de gravedad". *Boletín Económico*, Banco de España, July-August.

3 In the same period the weight of exports to the euro area diminished by 7.5 pp, while those in Asia increased by 2.3 pp to 8.4%. In this last case, despite the increase, exports continue to be lower than would be warranted by the characteristics of both markets.

4 Some papers find that, in Spain, national demand negatively influences export volumes. See C. Martínez-Mongay and L.Á. Maza (2009): "*Competitiveness and growth in the emu: the role of the external sector in the adjustment of the Spanish economy*". Economic Papers, no. 355, European Economy.

5 The provisional data for the January-October 2012 period would indicate that the number of exporting firms continued increasing in that period, at a year-on-year rate of 12%, similar to that recorded over the whole of 2011.

6 As the same company can export to more than one area, the sum of companies per area is greater than the total.

2 CONTRIBUTIONS TO GDP GROWTH. GOODS EXPORTS. EURO AREA / REST OF THE WORLD (%) (a)

SOURCE: Own estimate drawing on Customs data.

a The circles represent the annual average contribution of goods exports to GDP growth in pp (right-hand scale).

is even higher in the case of firms exporting to Africa and Asia, standing at 32% and 25% of the total in 2011, respectively, compared with 30% and 22% in 2007.[7] Some countries in these areas (namely, Brazil, China, India, Algeria and Morocco) come under the comprehensive market development plans set in train by the Spanish government to promote trade and economic relations with specific nations.

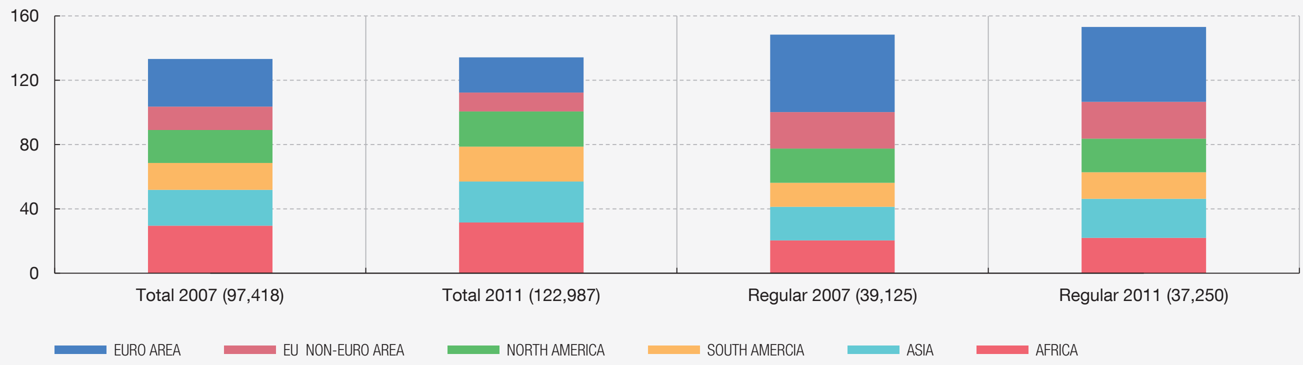
Despite the greater geographical diversification of the export base attained in recent years, the euro area remains the main destination for our exports. Indeed, 53% of our total sales abroad in 2011 went to the euro zone, although only 22% of our exporting firms sold their products in this area. Conversely, and despite the high number of companies exporting to South America, Africa and Asia, sales of goods to these areas continue to have a very small weight in our total exports (4.2%, 5.4% and 7.9%, respectively, in 2011). This result may be indicative of the fact that Spanish companies are having difficulty consolidating their presence in these markets once they begin to export to them. Empirical international evidence finds a positive relationship between the duration of a trade link – stability – and the volume of exports that the company earmarks for those markets.[8] On ICEX information, the companies that regularly export (30.3% of the total in 2011)[9], and which concentrate the bulk of the volume exported (91.5% of the total that year), show a lower geographical diversification than that of the total for the export base. Specifically, of the companies exporting to the euro area in 2011, around 65% did so regularly, compared with 23% in the case of Latin America, 21% for Africa and 29% for Asia. These low percentages denote high potential for further taking advantage

7 In Africa, by country of destination, Morocco (almost 50% of Spanish companies exporting to Africa do so to this country) and Algeria (10%) stand out. There are also other countries to which Spanish goods exports have grown considerably. Specifically, goods sales to Tunisia, Libya, Egypt, Nigeria and Sudan posted rates of more than double figures in the first ten months of 2012. Regarding the number of firms, the ICEX information does not include these countries.

8 T. Besedes and T.J. Prusa (2010): "The Role of Extensive and Intensive Margins and Export Growth", NBER WP series, no. 13628.

9 A regular exporter is one that has done so for the past four years running.

3 NUMBER OF EXPORTING FIRMS (a) (% of total)



SOURCES: ICEX drawing on Customs data.

a A firm can export to more than one area or country; accordingly, the sum of the percentage of firms exporting to the different areas is greater than 100.

RECENT DEVELOPMENTS IN SPANISH CROSS-BORDER FINANCIAL FLOWS

Since mid-2011, the Spanish economy has been seriously affected by the various episodes connected with the heightening of the euro area sovereign debt crisis. International investors' worsening perception of the sustainability of Spanish public finances and the soundness of its financial system has been reflected in the changes in net financing by the rest of the world raised by resident sectors other than the Banco de España (BE), which posted a negative sign and for a very high amount for the twelve-month period to July 2012. The latest data show a change in this trend, set against the easing of financial tensions discussed in the "Overview" in this Bulletin.

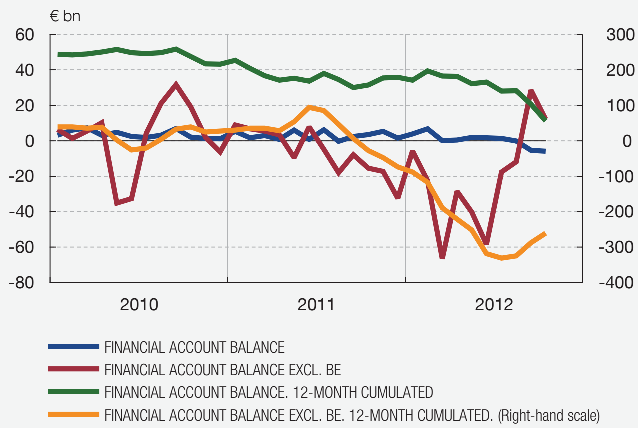
As can be seen in Panel 1, in 12-month cumulated terms, net outflows from the Spanish economy, excluding the BE, peaked in July 2012 (at €331 billion, 31% of Spanish GDP). The funds needed to offset these movements and cover the economy's net borrowing were obtained through a substantial increase (€359 billion) in BE foreign liabilities.

The breakdown by instrument (see Panel 2) reveals that net capital outflows from July 2011 to July 2012 were concentrated in portfolio investment and "other investment", which essentially includes interbank deposits. These net outflows were fundamentally the result of divestment by the rest of the world from the Spanish economy (€292 billion) and only marginally of investment by resident sectors in foreign assets (€44 billion) (see Panel 3).

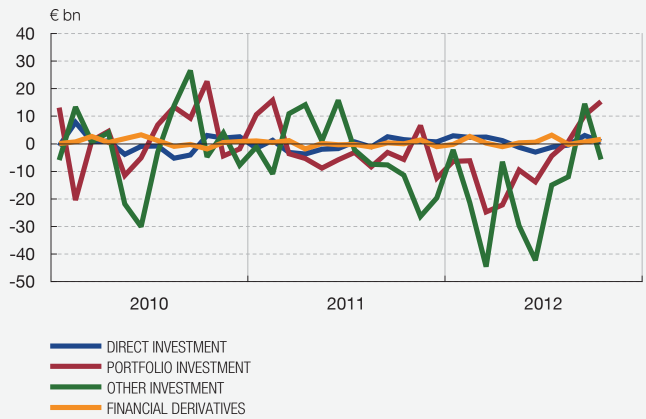
Divestment under the portfolio and other investment headings by non-residents in Spain resulted in similar amounts (€152 billion and €166 billion, respectively). In the first instance, holdings of securities issued both by the so-called "other monetary and financial institutions"[1] (OMFIs) and by general government and Other resident sectors (ORSs) diminished. Under other investment, the fall in the asset-side positions of the rest of the world were concentrated in OMFIs, and specifically in interbank deposits (including transactions settled through central counterparties), the reduction in which would be partly linked to the opportunity that the extraordinary Eurosystem tenders involved, with terms and costs more fa-

1 These include monetary and financial institutions other than the central bank.

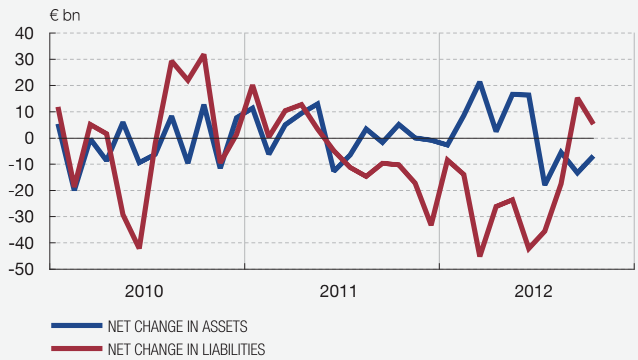
1 FINANCIAL ACCOUNT



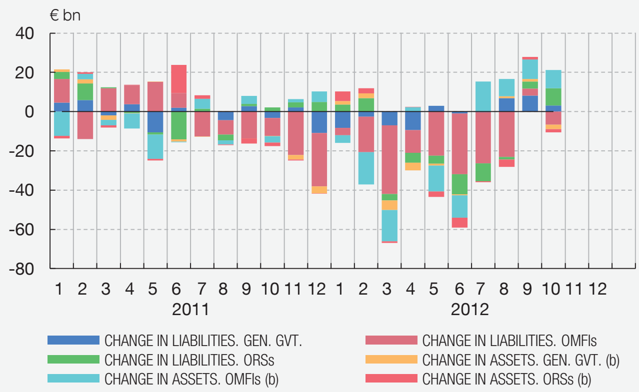
2 FINANCIAL ACCOUNT (EXCL. BE) BY SUB-ACCOUNT



3 FINANCIAL ACCOUNT EXCL. BE (a)



4 FINANCIAL FLOWS FROM ABROAD. SECTORAL BREAKDOWN



SOURCE: Banco de España.

a Financial derivatives are recorded as a net balance of net amounts and are assigned to the net change in assets.
b The change in assets held in the rest of the world by resident agents is depicted with the sign changed. It does not include the change in financial derivatives.

vourable than those prevailing on the market. Hence, as Panel 2 shows, there were particularly heavy declines in the months in which these tenders were allotted (December 2011 and March 2012), although they also continued in the following months, against the background of the heightening financial tensions.

With regard to changes in foreign assets, although resident agents continued to reduce their portfolio holdings of foreign securities, as they have been doing more or less continuously since mid-2007, the flow of funds routed through this channel (€39 billion) was less than the outflow of funds associated with the acquisition of assets encompassed under "other investment" (€70.5 billion). The bulk of this latter outflow was centred on the OMFIs sector, partly as a consequence of the activity of foreign banks located in Spain, which had also taken advantage of the extraordinary Eurosystem tenders to obtaining funds in our country, subsequently channelling them abroad (foreseeably to their parents). Investment in deposits by the other sectors in the rest of the world, including households and non-financial corporations, was, by contrast, fairly moderate.

Net capital outflows (excluding once more flows channelled through the BE) eased in August, and in the two following months (the latest data available) the economy raised funds from abroad for a net cumulative amount of €41 billion. This arose, in virtually equal proportions, both from the pick-up in foreign investment in the Spanish economy, which was positive for the first time since June 2011, and from a disposal of foreign assets held by resident sectors. Further, as can be seen in Panel 4, in September all the sectors raised funds from abroad, which had not occurred since April 2011, and in October all did so again, except the OMFIs. In terms of instruments, the recovery was centred on portfolio investment (€25.6 billion), while flows channelled through other investment and direct investment were also positive, but for much more moderate amounts (€8.9 billion and €3.9 billion). The acquisition of securities issued by general government and ORSs by non-residents turned positive, while resident agents once again unwound positions in the rest of the world. Direct investment (which essentially includes that in shares and other equity holdings, and the financing of related companies and of real estate) by the rest of the world in Spain was also positive, and was concentrated in ORSs, while that by residents abroad was negative, as a result of divestment by MFIs greater than the positive flow this item evidenced for ORSs. In September, net funds raised via other investment (€14.5 billion) was the outcome both of the fall in interbank deposits held by resident OMFIs in the rest of the world and of an increase in foreign agents' deposits in Spanish credit institutions. In October, by contrast, the net amount of funds raised through this channel turned negative (-€5.6 billion).

In sum, the sizeable net capital outflows recorded between mid-2011 and July 2012 in Spain were essentially in response to divestment by the rest of the world in instruments issued by national agents. This phenomenon was a reflection of foreign investors' misgivings about our economy, against a background of high financial tensions, which hampered the rolling over of funds lent. The subsequent easing in tensions has been conducive to a return by foreign investment to our shores, which shows some recovery in the rest of the world's confidence in our economy. In combination with the generation of net lending capacity by our economy in recent months, this return by investors is providing for a decline in the BE's external liabilities.