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An analysis of the trade exposure of Spanish firms to the United Kingdom



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The trade exposure of Spanish firms to the United Kingdom is significant, albeit lower than that to the main euro area countries. In 2017 the growth in Spanish firms' goods exports to the UK market that dated back to 2012 came to an end, against a background of sterling depreciation against the euro. The potential vulnerability of Spanish firms with a presence in the UK market to Brexit is somewhat limited by their distinctive characteristics; these companies are on average larger, more productive and more geographically diversified than those that export to the main euro area countries. In any event, the ultimate impact of this process on Spanish firms with a presence in the United Kingdom or with the potential to gain access to this market will largely depend on the terms eventually established for trade relations between the United Kingdom and the European Union.

AN ANALYSIS OF THE TRADE EXPOSURE OF SPANISH FIRMS TO THE UNITED KINGDOM

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Introduction

The vote in favour of leaving the European Union (EU) in the referendum held in the United Kingdom in June 2016 means that trade relations between Spain and the UK economy are due to be set on a new footing. Given the range of possible outcomes of the political negotiations currently in progress between the UK and EU authorities there is significant uncertainty regarding the specific details of the new arrangements. Possible scenarios include those in which the existing trade relations are mostly conserved (as would be the case if the United Kingdom remained in the European Economic Area), and others bearing less resemblance to the current situation, in which relations between the EU and the United Kingdom would be governed by the rules of the World Trade Organisation (WTO).

Spain has a significant aggregate trade exposure to the United Kingdom.¹ This country is Spain's fifth largest trading partner, accounting for around 7% of all Spanish goods exports, although this exposure is smaller than that of the euro area as a whole to the UK economy (around 13% of goods exports). The relative weight of Spanish imports from the United Kingdom is significantly lower, standing at 4% of total imports.

This article analyses in greater depth the trade exposure of Spanish firms to the UK economy, along with the specific characteristics of such firms. It does this using the aggregate data on cross-border transactions up to 2017 published by the Spanish Institute of Foreign Trade (ICEX by its Spanish abbreviation), as well as microeconomic information from the Banco de España's records of cross-border transactions, available up to 2013, and from the Central Balance Sheet Data Office.² The rest of the article is organised as follows. The second section describes the changes in recent years in the base of exporters to (importers from) the United Kingdom using data compiled by the ICEX. The third section analyses the characteristics of the firms behind these developments using microdata on cross-border transactions. Finally, the main conclusions are set out in the last section.

Recent changes in the base of exporters to and importers from the United Kingdom

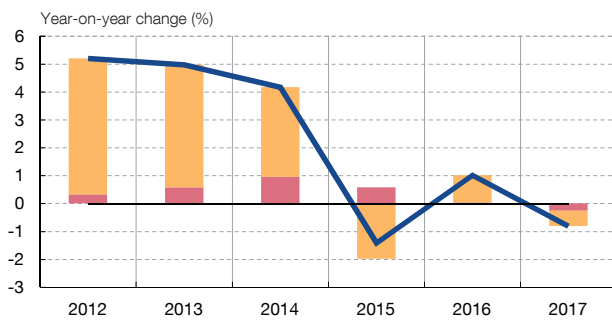
The United Kingdom is a significant market for Spanish firms. According to ICEX data, around 7% of Spanish exporting firms export goods to the UK economy, while 10% of importing firms import goods from the UK economy. The information available suggests that the proportion of these firms that have the United Kingdom as their sole international market, which would in principle be the most vulnerable to Brexit, is much lower (around one-quarter of the firms in both cases).

The number of Spanish firms that sell goods to the United Kingdom increased by 8% between 2012 and 2017, to a total of 11,695 (see Chart 1). However, in 2017 this growth came to a halt, both in the case of large firms and SMEs, with a fall of 0.8% in the total number of such firms. This decline was greater than in the case of other markets and, as

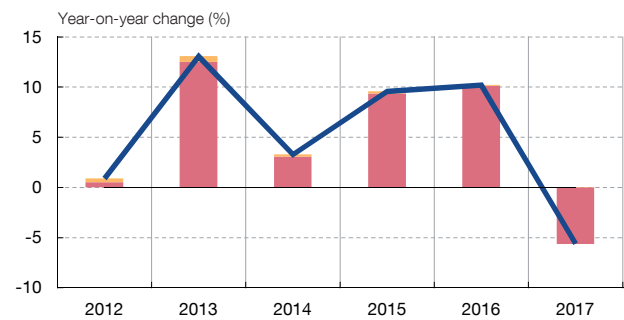
¹ Spain's exposure to the United Kingdom is greater if services are included as this country is the largest market for Spain's tourism services. See "The Spanish economy's exposure to the United Kingdom", Box 5, *Economic Bulletin*, Banco de España, September 2016.

² This database has been used in previous studies of the external sector of the Spanish economy (see Martín Machuca *et al.* (2009)).

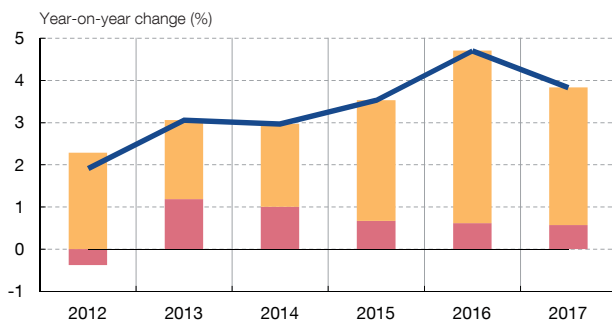
1 NUMBER OF EXPORTING FIRMS



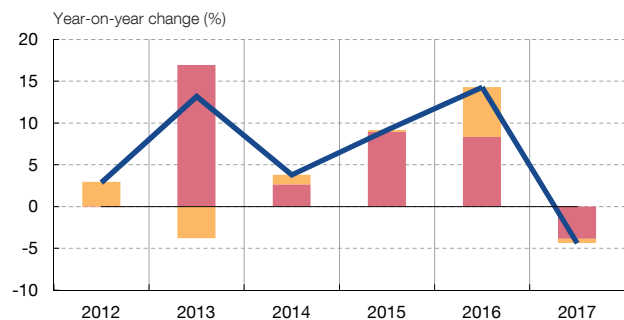
2 VALUE EXPORTED



3 NUMBER OF REGULAR EXPORTERS

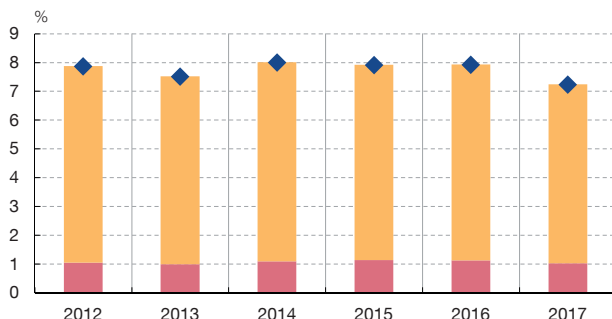


4 VALUE EXPORTED BY REGULAR EXPORTERS

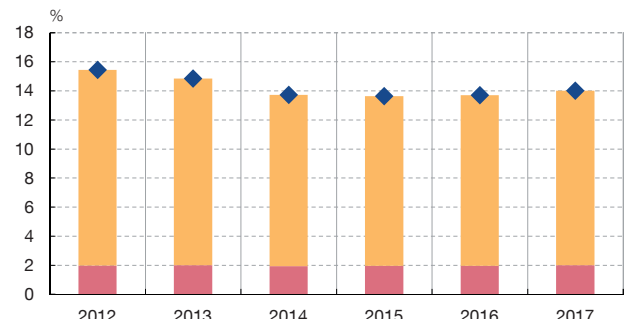


SMEs LARGE FIRMS TOTAL

5 PERCENTAGE OF FIRMS EXPORTING TO THE UK



6 PERCENTAGE OF FIRMS REGULARLY EXPORTING TO THE UK



LARGE FIRMS SMEs TOTAL

SOURCES: Banco de España and Instituto de Comercio Exterior.

a result, the proportion of firms exporting to the United Kingdom, which has fluctuated since 2012 at around 8% of all exporting firms, declined slightly in 2017.

The expansion over the period 2012-2017 in the base of exporters to the United Kingdom was accompanied by a constant increase in the number of regular exporters³ (19% over the same period), although as this growth was seen in many markets it was not sufficient to increase the relative weight of the UK economy in the total population of regular exporters. In any case, despite the uncertainty generated by Brexit and the slight fall in the

3 Defined as those which export for at least four successive years.



SOURCES: Banco de España and Instituto de Comercio Exterior.

- a The extensive margin is defined as the contribution to the increase (decrease) in the value exported arising from an increase (decrease) in the number of firms.
- b The intensive margin is defined as the contribution to the increase (decrease) in the value exported arising from an increase (decrease) in the amount exported per firm.

number of exporters to the United Kingdom in relative terms, the weight of regular exporters to this country held steady in 2017 (see Chart 1.6).

ICEX data allow an indirect estimate to be made (through export value bands) of the size of exporters to the United Kingdom.⁴ As is normal in other markets, most of these firms are SMEs (over 85% of total and regular exporters) although large firms account for around 90% of the volume of exports to the United Kingdom.⁵ The relative weight of the United Kingdom in the whole population of Spanish exporting SMEs stands below 7%, while the percentage of large exporting firms that export to the UK economy is higher, and has increased in recent years, to around 11%.

The value of goods exports to the United Kingdom rose by 33% over the period 2012-2017, a somewhat higher rate than was recorded for goods exports to the EU (27%). However, in 2017 exports to the United Kingdom fell by around 6%, driven down by the performance of the sales of large firms, against a background of sterling depreciation against the euro (by an annual average of 7%). In fact, the sales to the United Kingdom of regular exporters decreased by 4% in 2017, owing mainly to the performance of those of large firms. This behaviour contrasts with the 8% increase recorded by exports to the EU.

The behaviour of exports is determined by the interaction between the number of exporting firms (extensive margin) and the volume of exports per firm (intensive margin). As seen in Chart 2, the expansion of exports to the United Kingdom between 2012 and 2016 was based on both these margins, in particular the intensive one. The behaviour of the intensive margin basically reflects the contribution of large firms, since these firms account for the majority of exports. The fall in exports to the UK market in 2017 stemmed from the behaviour of the extensive margin and, especially, of the intensive margin.⁶

⁴ When ICEX data are used in this article, firms whose exports amount to less than one million euro are considered to be SMEs.

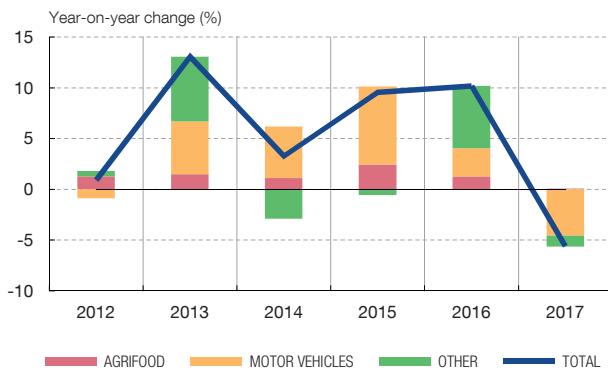
⁵ This high concentration is a stylised feature of the international empirical evidence and partly reflects the lower rate of survival of SMEs in export activity relative to large firms (see Galán Lucha and Martín Machuca (2012)).

⁶ It should be noted, when analysing this breakdown, that the long-term growth capacity of exports depends essentially on the behaviour of the extensive margin (in particular, of firms that export regularly), while export growth in the short term mainly reflects the behaviour of the intensive margin (see Martín Machuca et al. (2009)).

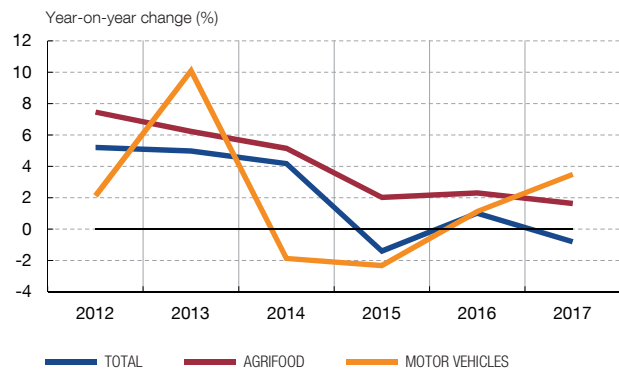
FIRMS EXPORTING TO THE UNITED KINGDOM, BY INDUSTRY

CHART 3

1 EXPORTS, BY INDUSTRY



2 NUMBER OF EXPORTING FIRMS, BY INDUSTRY

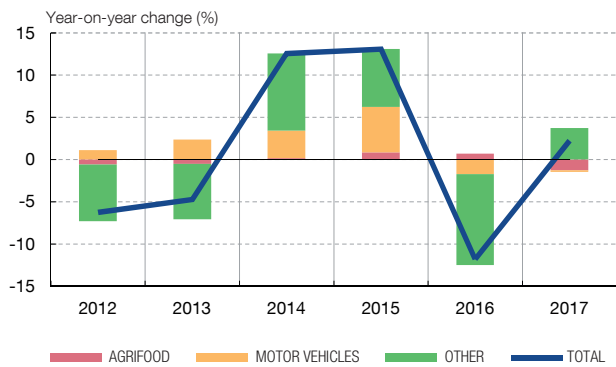


SOURCES: Banco de España and Instituto de Comercio Exterior.

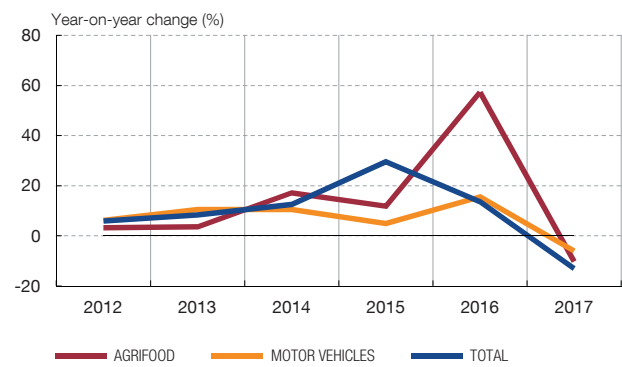
FIRMS IMPORTING FROM THE UNITED KINGDOM

CHART 4

1 IMPORTS, BY INDUSTRY



2 NUMBER OF IMPORTING FIRMS



SOURCES: Banco de España and Instituto de Comercio Exterior.

By sector, the agrifood and motor vehicle industries are notable, accounting for around 50% of exports. In fact, a large proportion of the fall in exports to the UK economy in 2017 corresponded to motor vehicles (which had, in contrast, shown sustained growth until 2016) (Chart 3). And this occurred despite an increase in the number of motor vehicle exporters in 2017.

The information provided by the ICEX on goods importing firms is much less detailed. Nominal imports from the United Kingdom increased over the period 2012-2017 by 9%. Goods imports from the United Kingdom increased by 2% in 2017, following a decline in 2016 (of 12%), which reflected the sharp adjustment in oil prices and the effect this had on the value of energy imports. As for the number of importers from the United Kingdom, it rose by 56% between 2012 and 2017, a much higher rate than that recorded for exporters, with the number of agrifood firms especially buoyant (see Chart 4). This increase involved a rise in the relative weight of importers of UK products in the total number of importers, from 9% in 2012 to 12% in 2016. However, in 2017 the base of importers from the UK economy fell by 13%, which entailed a decrease in their relative weight of two percentage points (pp).

Characteristics of the base of exporting and importing firms exposed to the United Kingdom

The potential vulnerability of firms exporting goods to the UK economy to the result of the negotiations between the EU and the United Kingdom depends not only on the relative weight of exports to the UK in their total sales, but also on certain intrinsic characteristics of the firms themselves. Microdata on cross-border transactions can be used to compare the characteristics of firms exporting to and importing from the UK market with firms that trade with similarly sized EU countries, namely Germany, France and Italy.⁷

When firms exposed to the United Kingdom are compared with the average firm trading goods with the main euro area economies, it is apparent that the former are, on average, larger, both in terms of number of employees and turnover, and their productivity, in terms of value added per employee, is higher (see Chart 5.1). As regards the debt ratio, there is no significant difference between these two groups of firms. Restricting the analysis to the agrifood and motor vehicle industries, there is still a positive gap in size and productivity, although it is significantly smaller in the case of the latter variable (see Chart 5.2). The evidence suggests that the productivity per employee of firms exporting to the United Kingdom is higher than that of firms exporting to the main euro area economies, which could contribute to mitigate at least partially the potentially negative impact of Brexit.

Those firms that trade goods with the United Kingdom only⁸ are smaller and have a lower level of productivity than those that also trade with other countries, in addition to the United Kingdom (see Chart 5.3). This is in line with the predictions of theory and the empirical evidence on international trade, insofar as a firm that is present in various markets must bear the costs associated with export activity and larger companies are in a better position to do so.

The potential vulnerability of firms to Brexit depends not only on their characteristics but also on the magnitude of their exposure to the UK economy, which is generally lower than to the main euro area economies. Indeed, in 2012, the relative weight of the United Kingdom in firms' total exports (imports) was lower than that of France, Germany or Italy (13 pp, as seen in Chart 5.4), in line with the geographical composition in aggregate terms of goods trade with the rest of the world and with the higher degree of geographical diversification (as approximated by the number of markets per firm) of firms present in the UK economy (see Chart 5.5). Also, exports to the UK economy as a proportion of total turnover were around 5% in 2012 (see Chart 5.6). On the import side, purchases from the UK economy account for around 5% of total turnover, a similar proportion to those of firms importing from France and Germany. Considering the agrifood and motor vehicle industries only, the exposure of exporters to the UK market is seen to be significantly lower than that of firms exporting to the main euro area countries, both in terms of the share of total exports and the relative weight of their turnover (see Chart 5.2).

Restricting the analysis to those firms that trade goods with the United Kingdom only, the relative weight of exports in their turnover is significantly lower than in the case of the other countries analysed. On the import side, this exposure is significantly higher, which may indicate potential risks in the event of a more restrictive trade agreement following Brexit, insofar as such imports correspond to products that are not readily substitutable.

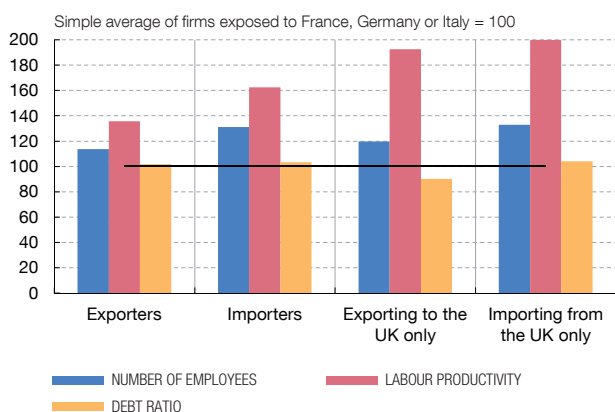
7 A firm may trade with the UK economy at the same time as with other countries of the comparison, since the number of firms that export to only one of these markets is much smaller.

8 According to the microdata on cross-border transactions, the industries that may have a higher percentage of firms that trade with the United Kingdom only would mainly correspond, on the export side, to machinery and other equipment, agrifood products and motor vehicles; and, on the import side, machinery and equipment, motor vehicles and other manufacturing.

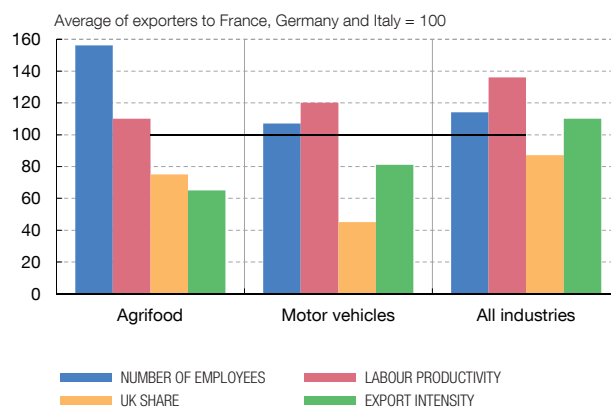
CHARACTERISTICS OF FIRMS THAT TRADE GOODS WITH THE UNITED KINGDOM
 Information obtained by data matching between the Balance of Payments
 and the Central Balance Sheet Data Office and Mercantile Registries (2012)

CHART 5

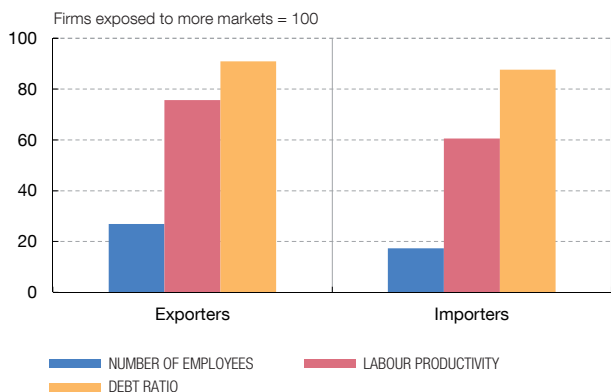
1 CHARACTERISTICS OF FIRMS THAT TRADE WITH THE UK



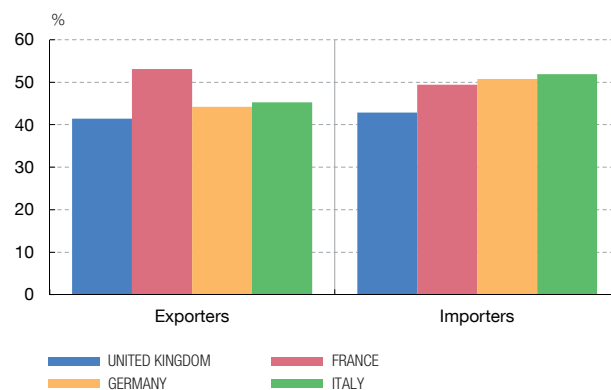
2 CHARACTERISTICS OF AGRIFOOD AND MOTOR VEHICLE FIRMS THAT EXPORT TO THE UK



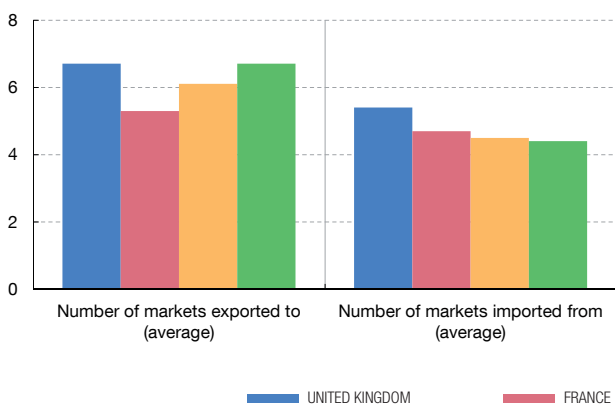
3 CHARACTERISTICS OF FIRMS THAT EXPORT TO THE UK ONLY, COMPARED TO THOSE EXPOSED TO MORE MARKETS



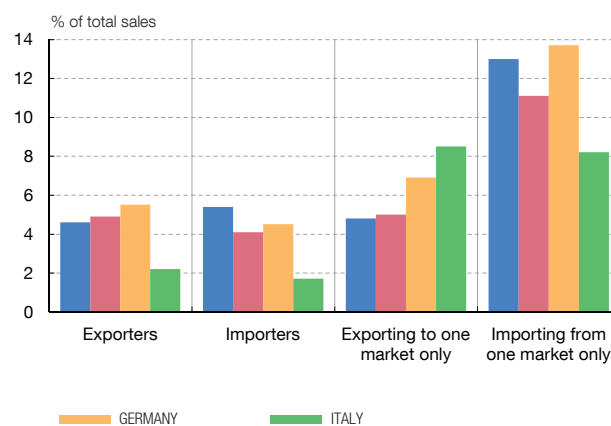
4 AVERAGE SHARE OF EACH MARKET



5 GEOGRAPHICAL DIVERSIFICATION OF SPANISH EXPORTERS



6 EXPORT/IMPORT INTENSITY (a)



SOURCE: Banco de España.

a Defined as the ratio of exports (imports) to turnover.

Conclusions

Trade relations between Spain and the United Kingdom, in terms of goods exchanged, were significantly strengthened during the period 2012-2016, in accordance with the expansion of the export and, especially, the import bases, as well as the growth in the value of such trade transactions. As a result, the trade exposure of firms to the United Kingdom is significant, although more limited than their exposure to the main euro area countries (France, Germany and Italy). However, in 2017 there was a slowdown in goods exports to the UK economy, following the announcement in June 2016 of the United Kingdom's departure from the EU and against a background of sharp depreciation of sterling against the euro. Even so, in some industries of importance insofar as trade with the United Kingdom is concerned, such as agrifood products and motor vehicles, the export base has continued to expand.

The vulnerability to Brexit of Spanish firms present in the UK market may be reduced by the fact that they have certain distinctive characteristics; on average they are larger, more productive and more geographically diversified than firms that export to the main euro area countries. The exposure of firms to the United Kingdom, in terms of its weight in exports and in total sales, is lower than to other similar markets. However, on the import side, firms that trade with the United Kingdom only are seen to have a relatively high exposure. This could be an element of potential fragility insofar as it reflects the purchase of products that are not readily substitutable.

In short, the evidence would suggest that the potentially adverse impact of Brexit on Spanish businesses may be mitigated by the geographical diversification of the firms that currently export to and import from the UK economy and by their efficiency levels. In any event, if the negotiations between the United Kingdom and the EU result in the imposition of trade barriers, Spanish firms that trade with the UK will be affected and those potentially interested in penetrating the UK market will have fewer possibilities of doing so.

17.5.2018.

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