

## Box 9

**LONGER-TERM DEVELOPMENTS IN EXTRA-EURO AREA AND INTRA-EURO AREA TRADE**

Trade is an important contributor to the economic development and growth of a country. When measuring euro area real GDP, only extra-euro area trade contributes to real GDP growth as intra-euro area exports are, by definition, equal to intra-euro area imports. From an individual country perspective, however, not only extra-euro area, but also intra-euro area trade is an important source of growth. This box provides an overview of the developments in euro area countries' total trade in goods, as well extra and intra-euro area trade in goods and the resulting net contribution to real GDP growth, since the introduction of the euro in 1999.<sup>1</sup>

Measuring intra and extra-euro area trade contributions to growth requires the combination of several statistical sources. In the quarterly national accounts data for euro area countries, a split of trade between intra and extra-euro area countries is not available. A breakdown, in nominal terms, is available from Eurostat's monthly trade statistics, which provide consistent coverage of trade in goods across countries. The intra and extra-euro area trade shares obtained from the monthly trade statistics can then be applied to the national accounts data for total trade in goods, with a view to providing estimates for the contribution of trade to GDP growth.<sup>2</sup>

Euro area trade in goods grew significantly over the last decade, with the level of real imports and exports in 2010 more than 50% above that in 1999. Growth in trade was faster than growth in real GDP, leading to an increasing openness of the euro area economy, which, as measured by the sum of imports and exports of goods as a share of GDP in real terms, reached 64% in 2010, compared with 47% in 1999.

Trade in goods among euro area countries accounts for around half of total euro area trade in goods (49% in 2010 compared with 53% in 1999) and was equivalent to around 30% of euro area GDP in 2010.<sup>3</sup> Empirical studies show that bilateral trade between euro area countries tends to be

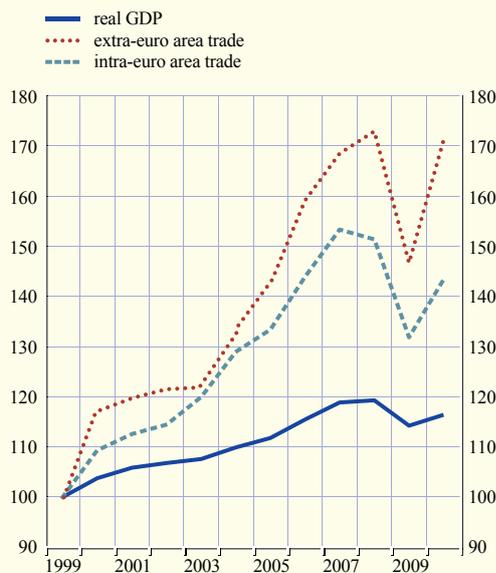
1 Countries which joined the euro area after 2006 are excluded from the analysis, i.e. Estonia, Cyprus, Malta, Slovenia and Slovakia. The intra and extra-euro area split is performed only for trade in goods due to the lack of information on the intra and extra-euro area breakdown for trade in services.

2 The methodologies for the monthly trade statistics and the national accounts differ. In monthly trade statistics, intra-euro area arrivals (dispatches) are attributed to the transit country rather than the source (final destination) country. The fact that the trade flows are boosted by transit flows is commonly referred to as the "Rotterdam effect". In contrast, in the national accounts, intra-euro area arrivals and dispatches are attributed according to the country of origin and final destination. Another significant difference is the valuation of the goods: in the national accounts, goods are recorded without transport and insurance costs, whereas the monthly trade statistics include them.

3 The size of intra-euro area trade is overestimated since one country's exports are the other country's imports. Without this double-counting, the intra-euro area trade share was around 15% of GDP in 2010.

**Chart A Euro area real GDP and volumes of intra and extra-euro area trade in goods**

(index: 1999=100; annual data)



Sources: Eurostat and ECB calculations.

growth. It should be noted, however, that such a growth accounting exercise ignores important effects of trade on growth and welfare, for example, technology spillovers and a larger product variety.<sup>6</sup> Nevertheless, the net trade contribution is an indicator for the developments in the trade balance: a positive (negative) net trade contribution in a country points to an improvement (deterioration) in its trade balance. Over a longer time period, a positive average net trade in goods contribution reflects an improving goods trade balance and gains in export competitiveness, whereas a negative average net trade contribution reflects a consistently deteriorating goods trade balance in a given country, pointing to a loss in export competitiveness.

For the euro area as a whole, net trade in goods contributed 0.1 percentage point to euro area real GDP growth on average from 2000 to 2010, reflecting a broadly stable extra-euro area goods trade surplus as a share of GDP over this period (at 0.6% on average). For individual countries, the results are heterogeneous in view of the different trade balance dynamics across countries. Total net trade in goods made a positive contribution to GDP growth over the period 2000-10 (see Chart B) in several countries. This was particularly the case for Ireland, which has served as an export platform for a number of large multinational companies, followed by Germany, the Netherlands and Austria. For other countries, net trade was broadly neutral or subtracted from real GDP growth from 2000 to 2010, on average. Notably, net trade in goods contributed negatively to real GDP growth in Luxembourg (the financial services trade centre) and in some of the less open euro area economies (Italy, Spain, France and Portugal).

significantly higher than one would expect on the basis of standard determinants, including proximity and size. These tight trade linkages can partly be explained by the existence of the single market and the single currency (the “euro effect”).<sup>4</sup>

Over the period 2000-10, extra-euro area trade grew at a faster rate than intra-euro area trade. From 2000 to 2010 extra and intra-euro area trade in goods increased by a cumulated 71% and 43% in volume terms, respectively (see Chart A). This was mainly due to demand growing at a faster rate in the rest of the world than in the euro area. Notably, in the period following the exceptional collapse in trade during the global downturn of 2008-09,<sup>5</sup> extra-euro area trade also recovered sooner than intra-euro area trade.

It is common to refer to the net trade contribution to real GDP growth as a measure accounting for the effect of trade on economic

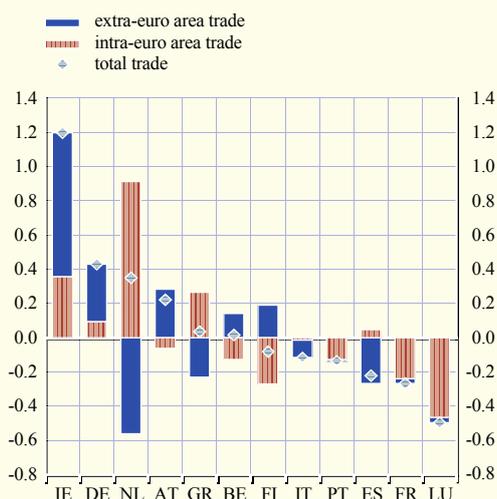
4 For an overview of the literature on the “euro effect”, see, for instance, Baldwin, R. et al., “Study on the impact of the euro on trade and foreign direct investment”, *European Economy Economic Papers*, No 321, May 2008.

5 See “Recent developments in global and euro area trade”, *Monthly Bulletin*, ECB, August 2010.

6 For an overview of the related literature, see, for instance, Irwin, D.A., *The Case for Free Trade: Theories, New Evidence*, Chapter 2, Princeton University Press, 2009.

**Chart B Average contribution to real GDP growth from net trade in goods for selected euro area countries from 2000 to 2010**

(percentage points)



Sources: Eurostat and ECB calculations.

Notes: Countries are ordered according to the net contribution to real GDP growth from total trade in goods. Data for Greece start from 2001.

In terms of the breakdown, intra-euro area net trade in goods positively contributed to growth in the Netherlands,<sup>7</sup> Ireland and Greece, and, to a lesser extent, in Germany, and Spain (see Chart B). In Austria and, to a lesser extent, Belgium and Finland, a negative contribution from intra-euro area trade was offset by a more positive contribution from extra-euro area trade. In other countries the average negative net trade in goods contribution over the period from 2000 to 2010 and the overall deterioration in the trade in goods balance mainly reflected developments in extra-euro area trade (Italy and Spain), while for some others it reflected developments in intra-euro area trade (France, Portugal and Luxembourg).

For most euro area countries, the average net trade contribution over the period from 2000 to 2010 is not significantly altered by including or excluding the period after 2008. The main exceptions are Spain, Greece and Finland. In the run-up to the economic and financial crisis, Spain and Greece had excessive growth in domestic demand, which resulted in sizeable average negative net contributions of trade to real GDP growth from 2000 to 2008. Since 2008, however, in the context of subdued domestic demand, net trade has made a major contribution to real GDP growth in these countries. In Finland, the average contribution to real GDP growth from net trade in goods was positive from 2000 to 2008. In 2009 Finland experienced the largest decline in exports and the largest negative net trade contribution to real GDP growth, compared with other euro area countries.

When interpreting the results reported so far, an important caveat should be kept in mind, namely that the analysis excludes trade in services, which accounts for around 20% of total euro area trade.<sup>8</sup> For some countries, net trade in services has contributed significantly to real GDP growth over time. In particular, this was the case for countries with large financial or business services sectors, such as Luxembourg and Ireland, as well as for Austria, Portugal and Germany. For Austria and Portugal, trade in travel services has been particularly important, while for Germany the positive contribution from trade in services came from a variety of sectors.

With respect to the most recent developments, available data for 2011 indicate that, in most euro area countries and for the euro area as a whole, total net trade in goods and services contributed significantly to real GDP growth. The large positive net trade contribution reflected faster growth in euro area foreign demand compared with growth in domestic demand.

<sup>7</sup> The positive intra-trade net contribution to real GDP growth is, however, overestimated for the Netherlands because of the "Rotterdam effect" (see footnote 2).

<sup>8</sup> See "Euro area trade in services: specialisation patterns and recent trends", *Monthly Bulletin*, ECB, May 2011.

To conclude, euro area trade (both intra and extra) has grown significantly over the last ten years. While the average net contribution to GDP was slightly positive for the area as a whole, the net contributions to real GDP growth differ across individual euro area countries, reflecting dynamics in trade in goods balances over time. Looking ahead, net trade is expected to continue to support euro area real GDP growth in the near term.