Co-funded by the
Europe for Citizens Programme
of the European Union

TEPSA
Trans European Policy Studies Association

Trans European Policy Studies Association

TEPSA BRIEFS

JUNE 2020

Effects of the Coronavirus Crisis on the Trade of the Iberian and Visegrád Countries

Andrea Éltető*

Abstract

This Brief discusses the coronavirus crisis-effects on the foreign trade of Visegrád countries and Iberian countries. Developments in the past prove high trade dynamism but high dependence on global production too. I find that short-term crisis effects will be severe in manufacturing. However, the composition of the service trade is more favourable for the Visegrád region than for the Iberian countries regarding the crisis-shock. Long-term effects stemming from the reorganisation of Global Value Chains (GVCs) can also favour the Visegrád region.

Introduction

In the first half of 2020, the world has been hit by the coronavirus pandemic. Because of the lockdowns, high global economic costs are expected, partly through disruptions in world supply chains and trade. The pandemic caused closures of businesses worldwide and restricts the movement of people and goods, disturbing international trade.

The primary disturbances were in Chinese industries, and this negatively influenced world trade since China is an important manufacturing hub. The pandemic spread soon to Europe. In the core economies of the EU there are several headquarters of multinational companies, sourcing also from Asia. Many companies today produce in the so called "just-in-time" system with hardly any inventories. The components supplied are often highly specialised and tailored to the needs of the next step in the value chain. As a result, there are often no alternative suppliers able to be found quickly and for the same price as before[1].

The coronavirus epidemic has, obviously, short term and long-term effects on the world economy and trade. In the beginning of 2020, demand and supply fell and although there has been an increased level of trade for essential goods (often at a higher price), trade has been reduced for non-essential goods. The coronavirus crisis is a supply and demand crisis

[1] Bofinger et al, 2020, Farell-Newman, 2020.

* *Andrea Éltető* is *Senior Research Fellow and Research Director* at *Institute of World Economy (CERS), Hungary*. All the opinions expressed in this briefing are the sole view of the author, and do not represent the position of the *Institute of World Economy (CERS)* nor of the Trans European Policy Studies Association (TEPSA).

at the same time, so world exports and imports will further decrease too.

Former trade slowdown

In the past decade, world exports showed signs of stagnation. Scholars detected several reasons for this phenomenon, partly cyclical (slowing growth and decreasing demand) and partly structural (slowing trade liberalisation, reduced income-elasticity of trade, saturation of global production and political uncertainties). The reorganisation (shortening) of global value chains is also important. In some cases, previously off-shored production facilities were re-shored to the home country or to nearby countries (near-shoring).

During the present coronavirus crisis one part of the service trade (travel) largely decreased, but certain other parts (internet-based communication, ICT and business services) can even increase. In this regard, Iberian countries are in a worse position than the Visegrád ones, because travel services represent a high share in services export.

The export slowdown, however, was not apparent in the case of the Iberian and Visegrád countries. Their exports grew above the world export growth even after 2015[2]. The main reason for this better-than-average performance is the activity of multinational companies in these economies. The figures of gross trade also reflect the cross-border deliveries of product parts and components and the intrafirm trade. The Visegrád economies are highly integrated into the global production, and their relevant indicators based on value-added trade data (Trade in Value Added, World Input-Output Database) show extremely high global value chain (GVC) participation[3]. The Visegrád countries together with Germany and Austria form a "Central European Manufacturing Core"[4] with an over-proportionate presence in Europe's exports. Altogether, participation in global value chains is more intensive in the case of the Visegrád countries than for the Iberian ones.

In global production it is increasingly difficult to differentiate goods from services. Services are at the beginning (R&D and design) and the end of the value chain (distribution, marketing, and services) but even in core production activities, logistics and other services are also needed.

Spain is one of the main service trader countries within the EU (with more than a 2% share in world service exports). The share of services within the total exports is 42% and 32% in Portugal and Spain[5]. In Slovakian and Czech exports this share is 13-15% and in Hungarian and Polish exports is 22-28%. The composition of service trade has changed in the last decade: the share of "other business services" has grown to 20-25% in the case of the Visegrád countries. On the other hand, the share of travel services is outstanding (40-50%) in the Iberian countries[6].

During the present coronavirus crisis one part of the service trade (travel) largely decreased, but certain other parts (internet-based communication, ICT and business services) can even increase. In this regard, Iberian countries are in a worse position than the Visegrád ones, because travel services represent a high share in services export. Thus, Iberian service trade

[2] Éltető, 2020.

[3] Johnson, R. C.- Noguera, G. 2012, Foster-Stehrer, 2013

[4] Stehrer-Stöllinger, 2014

[5] World Bank, World Development Indicators, 2017 data

[6] UNCTAD data

will suffer more than that of the Visegrád economies.

Recession and short-term trade effects

In early May 2020, the European Commission published estimates on the extent of the recession in 2020. According to these, the real (inflation adjusted) GDP will decrease (-9.4% in Spain and -6.8% in Portugal) and unemployment will increase significantly (to 10-18%) in the Iberian countries. Among the Visegrád economies, Hungary and Slovakia will have relatively high GDP decreases (-7.0 and -6.7, respectively).[7]

In Spain, a sharp export decrease can be expected this year, and recovery for service trade will be longer than that for goods. In Portugal both exports and imports are projected to drop at double digit rates in 2020. In Slovakia and Czechia, exports of goods are expected to recover rather quickly, together with the restart of automotive production. Poland has a more diversified export structure and after temporary disruption, trade will probably be balanced relatively soon (EU Commission 2020). It should be mentioned that forecast uncertainties are higher now than ever. The European Bank for Reconstruction and Development's forecast in May for example expected a much lower recession (-3.5%) in Hungary and Poland.[8]

Most of the export structure of the countries under analysis is rather concentrated, so the first five product groups (among 290 ones) adds up to around an average 30%, but in Slovakia and Portugal even to 42-60%[9]. To the EU and to other regions, motor cars are the most important export articles from Czechia, Hungary and Slovakia. Among the most important extra-EU export products we can find other items too, like rubber tyres (SK) or medication (HU). Slovakian exports are highly concentrated on motor cars (giving almost half of the non-EU exports). The Polish leading export product groups contain furniture, cosmetic preparations and plastic articles too. Poland has the least concentrated export structure in the group.

During the present crisis, production problems have already been manifested as automotive and supplier multinational affiliates shut down production for a while and dismiss workers. Recovery and upsurge of demand for cars and components could take a long time. The Visegrád countries' economic dependence on the globalised automotive and electronic value chains makes them especially vulnerable to global production problems.

For Spain and Portugal, motor cars are leading export items towards the EU, but outside of the EU, petroleum oils lead. We can also find meat, fruits, vegetables, alcoholic beverages, and paper among the most important export products. Portugal's export concentration has increased considerably during 2010-19. This is due to the increase of motor cars and components exports to the EU and petroleum product exports to non-EU regions[10]. Countries in the Iberian and Visegrád countries export up to 50-70% the same product groups to the EU, while export structures are much different to the rest of the world[11].

Apart from the disturbances in manufacturing production and trade, the radical decrease of oil prices and decreased demand for petroleum has also damaged the export of Iberian countries. Portuguese, Spanish and

[7] EU Commission (2020)
[8] https://www.ebrd.com/news/2020/ebrd-economies-seen-contracting-by-35-per-cent-in-2020-48-per-cent-rebound-in-2021.html
[9] Éltető, 2020

[10] In the port of Sines there is a big oil refinery of Galp Energia which has become a major energy hub. Portugal does not have its own crude oil, it is dependent on imported oil, refining and reexporting it.
[11] Éltető, 2020

Hungarian refineries stopped temporarily or reduced production.

The Iberian countries and Slovakia are members of the Eurozone. They do not have the tool of currency devaluation as a kind of export incentive. The three other Visegrád countries can let their currency depreciate, although this is a questionable step, because of the high import-intensity of their economies. From mid-March 2020, the exchange rates of the Polish, Hungarian, and Czech currencies vis-à-vis the euro depreciated significantly. On the long term this weakening can increase the risk of inflation, so Central Banks have to manoeuvre carefully.

Long-term effects

Before the pandemic, Brexit and trade protectionism efforts made future European trade already uncertain. Now, analysts warn that the coronavirus crisis will be as severe as the 1929-33 Great Recession[12]. The coronavirus crisis is different from the previous 2008 financial crisis, because this time it originates from the real economy, being a supply and demand shock at the same time. It is also possible that after the first wave of the pandemic, after easing the lockdowns, a second wave of infections may take place. This would make the negative economic effects longer and stronger. As mentioned, one major feature of the present crisis is uncertainty, the future is largely unpredictable. Therefore, based on the above described characteristics and trends only some possible consequences can be indicated here for the trade-effects in the Visegrád and Iberian countries.

Stricter hygiene and bio-safety requirements for goods will prevail to minimize any possibility of disease spread. Demand for travelling, entertainment and for non-essential goods will remain restricted, as people will save money[13]. Thus, goods and service trade will be affected negatively in the long term.

During and after the financial crisis of 2007-8, Spanish and Portuguese firms strengthened their internationalisation, their export activities as a kind of tool for survival, because domestic demand collapsed. Although domestic demand is decreasing again in the present coronavirus crisis, prospects for export expansion are now gloomy, even existing trade capacities suffer.

In the years after the financial crisis, Iberian and Visegrád governments intended to boost trade with non-EU regions (like Asia and Latin-America) aiming for the geographical diversification of exports. (In Hungary, this policy was called the “Eastern Opening”). Among the emerging markets outside the EU, China was one of the most important target markets for all countries. However, significant geographical diversification of exports has not taken place, despite government intentions, the EU’s share has remained high. Because of the coronavirus crisis, investors and trading firms of these countries may lose enthusiasm towards Asia, so policy makers may rethink trade promotion policies.

Reorganisation of GVCs – strengthening EU integration?

The first export market (with 22-31% of all exports) for the Visegrád countries is Germany. In the past decades Germany became the main trade hub for the Central European region. Already in the nineties, German companies could benefit from the outward processing regulations of the EU involving Central European firms. These early contacts provided a good basis for the later inclusion of Visegrád companies in the German-controlled global

[12] https://blogs.imf.org/2020/04/14/the-great-lockdown-worst-economic-downturn-since-the-great-depression/

[13] Baldwin-Tomiura, 2020

value chains. During the past decade also, the trade of the Visegrád countries with Germany has increased at a much larger pace than the trade of the Iberian economies.

The integration of the Visegrád countries in the German production chains enhanced not only trade between this region and Germany, but also intraregional trade, mainly for car components, motors, electronic parts, and cars. For all Visegrád countries the second most important export partner is another Visegrád country.

For the Iberian countries Germany is less important as an export market; its share is just above 10% in total exports. For Spain, Germany is the second partner after France and for Portugal the third after Spain and France. Portuguese exports are largely (up to 25%) bound to Spain anyway. The importance of intra-Iberian trade is asymmetrical for the two countries, Portugal is much more dependent on Spain than vice-versa.

During and after the coronavirus crisis, the organisation of global production can change. The epidemic made the overdependence of the global manufacturing on China evident. This causes multinational companies to consider shifting their sourcing and production locations from China. This process has already begun with the shortening and reorganisation trends in the GVCs and now it may increase further. The US and perhaps other governments will probably further promote back-shoring[14]. If China (or Asia) weakens as the world's manufacturing and supply chain hub, other nations can even gain in world trade. European (especially German) multinational companies can increase near-shoring, the relocation of production facilities from Asia to Europe, which can benefit the Visegrád countries and to some extent the Iberian ones too. Central European countries have already built capacities and practices that makes them prepared to accept new investments and cooperate with multinationals. The extent to which these economies can benefit from nearshoring depends on the Visegrád countries' policymakers.

If "Factory Europe"[15] will be stronger because of the GVC reorganisations, then the Central-European Manufacturing Core[16] will also be stronger and that will probably enhance intra-regional trade among the Visegrád countries.

[14] Gruszczynski, 2020
[15] Baldwin and Lopez-Gonzalez, 2013
[16] Stehrer-Stöllinger, 2014

References

Baldwin, R, Tomiura, E. (2020): "Thinking ahead about the trade impact of COVID-19". In Economics in the Time of COVID-19. edited by Richard Baldwin and Beatrice Weder di Mauro, London: CEPR Press, 2020.

Baldwin, R., Lopez-Gonzalez, J., (2013): Supply-Chain Trade: A Portrait of Global Patterns and Several Testable Hypotheses (NBER Working Paper No. 18957). National Bureau of Economic Research, Inc.

Bofinger, P., Dullien, S., Felbermayr, G., Fuest, C., Hüther, M., Südekum, J., di Mauro BW (2020): Economic implications of the COVID-19 crisis for Germany and economic policy measures. In: Mitigating the COVID Economic Crisis: Act Fast and Do Whatever It Takes edited by Richard Baldwin and Beatrice Weder di Mauro, London: CEPR Press, 2020.

Éltető, A (2020): Coronavirus crisis – trade effects for the Iberian and Visegrád countries IWE Working Paper no. 260, p.33

EU Commission (2020): European Economic Forecast Spring. Institutional paper 125. May.

Farrell, H., Newman, A. (2020): "Will the Coronavirus End Globalization as We Know It?", Foreign Affairs, 16 March 2020

Foster-McGregor, N., Stehrer, R. (2013): Value added content of trade: A comprehensive approach', Economic Letters, 120. pp. 354-357.

Gruszczynski, L.(2020): The COVID-19 Pandemic and International Trade: Temporary Turbulence or Paradigm Shift? European Journal Risk Regulation, 1–6. https://doi.org/10.1017/err.2020.29

Johnson, R. C., Noguera, G. (2012): Accounting for intermediates: Production sharing and trade in value added. Journal of International Economics, 86 (2), 224–236. doi:10.1016/j.jinteco. 2011.10.003

Landesmann, M.A., Stöllinger, R. (2019): Structural change, trade and global production networks: An 'appropriate industrial policy' for peripheral and catching-up economies. Structural Change and Economic Dynamics, Frontiers of Industrial Policy: Structures, Institutions and Policies 48, 7–23. https://doi.org/10.1016/j.strueco.2018.04.001

Stehrer, R., Stöllinger, R. (2014): The Central European Manufacturing Core: What is Driving Regional Production Sharing? FIW Research Reports, 15, 2.

Trans European Policy Studies Association

Rue d'Egmont 11, B-1000

Brussels, Belgium

To know more about TEPSA visit: www.tepsa.eu

Follow TEPSA on:

@tepsaeu

@tepsa.eu

TEPSA – Trans European Policy Studies Association

Institute of World Economics, Centre for Economic and Regional Studies (IWE CERS)

4 Tóth Kálmán Street

1097 Budapest, Hungary

To know more about IWE CERS visit: www.vki.hu/

Follow IWE CERS on:

@KRTK

Co-funded by the Europe for Citizens Programme of the European Union