The publication of this Quarterly Report virtually coincides with the first anniversary of the referendum that resulted in Britain's decision to leave the European Union (Brexit), a process that was formally set in motion on 29 March. This box describes how flows in trade in goods and exports of tourist services have evolved in the past year, in an endeavour to discern the possible effects of the referendum result on those variables, through a variety of channels. First, the referendum result, given its unexpectedness, had an immediate impact on a set of financial variables. However, most of those effects faded quite rapidly, with the exception of the most significant one from the point of view of foreign trade flows, namely a significant depreciation of the pound (some 10% against both the dollar and the euro), which still persists, with some fluctuations, today.

Second, in respect of the real effects, private sector analysts and international organisations cut their growth projections for the British economy for both the short and medium term. Specifically, the pre-referendum projections that called for economic growth of more than 2% in 2017 were reduced to less than 1% in the months following the referendum (see Chart 1). Nevertheless, one year after the vote, economic activity in the United Kingdom has held up better than expected, no doubt largely owing to the Bank of England's expansionary monetary policy stance. Thus, not only did GDP continue to post sound growth (1.8%) in 2016, but the latest revisions of the growth forecasts for 2017 have been upward, up to around 2%, as shown in Chart 1.

Longer term, a lower level of integration of the United Kingdom in the European markets, to a greater or lesser extent according to the kind of trade relationship that is finally established between the two areas, would reduce trade flows. Indeed, the new system may be in the form of an economic cooperation area or a bilateral trade agreement or it may involve being subject to general World Trade Organization rules, but whatever the final scenario it will most likely result in higher tariff and non-tariff trade barriers that will impact each European country differently, according to the breakdown of their trade with the United Kingdom by type of

Chart 1
ECONOMIC FORECASTS FOR THE UNITED KINGDOM

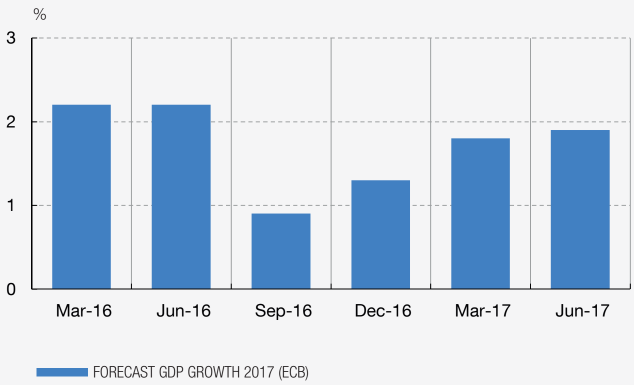



Chart 2
EXPORTS OF GOODS AND SERVICES TO THE UNITED KINGDOM. 2016

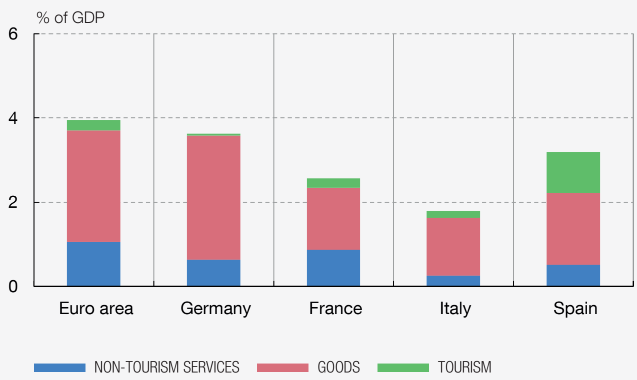



Chart 3
SPANISH NOMINAL GOODS EXPORTS
Y-o-y rates of change

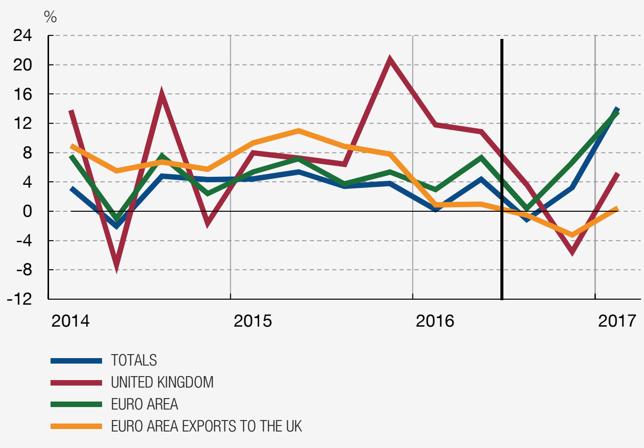
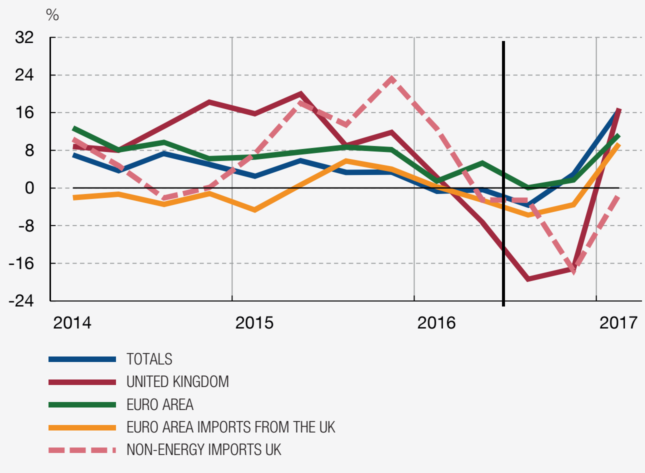



Chart 4
SPANISH NOMINAL GOODS IMPORTS
Y-o-y rates of change




SOURCES: Ministerio de Economía y Competitividad, Banco de España, Eurostat and ECB.

goods and the specific treatment received by each such good in the future (see Chart 2).[1]

In this setting, one year after the referendum, it seems reasonable to assume that the effects of Brexit on the trade flows between Spain and the United Kingdom in that period will have been chiefly determined by the depreciation of the pound. This is because, as indicated earlier, to date there has been no significant impact on domestic demand in the United Kingdom. Moreover, most of the effects relating to the uncertainty surrounding the new legal framework for trade relations between the United Kingdom and the European Union have probably yet to emerge, although the possibility that this uncertainty may have dissuaded certain specific firms from entering into potential new trade relations cannot be ruled out.

There are no clear effects of the depreciation of the pound against the euro on the prices of Spanish exports in euro and on the volume of Spanish exports. If Spanish exporters maintain their prices in pounds, they will protect their market share but they will also see their income decline in euro; if, on the contrary, they choose to maintain their prices in euro, the higher cost in pounds of the products they export will result in a loss of market share, and the lower their market power the greater that loss will be. In any event, the nominal value of their exports will decline, and how that decline is distributed between prices and volumes will depend

1 For a more detailed description of the Spanish economy's exposure to the United Kingdom, see Box 5 of the *Quarterly Report on the Spanish Economy,* September 2016, Banco de España.

Chart 5
PRICES OF GOODS EXPORTS (IN EURO)
Y-o-y rates of change

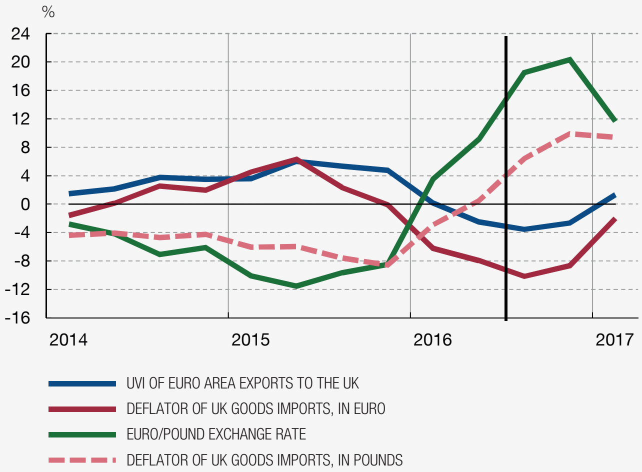



Chart 6
PRICES OF GOODS IMPORTS (IN EURO)
Y-o-y rates of change

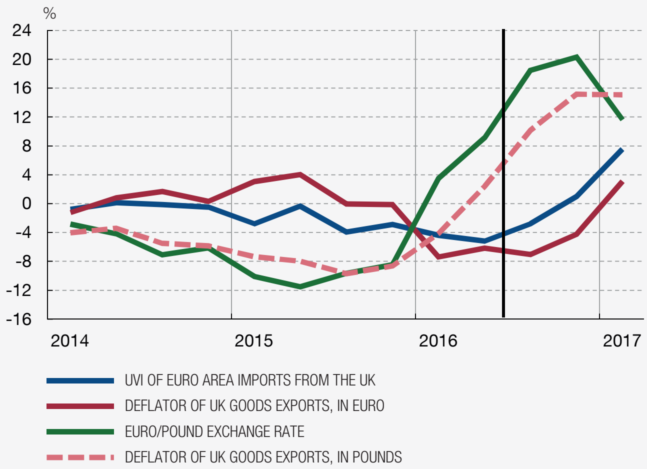



Chart 7
SPANISH REAL GOODS EXPORTS
Y-o-y rates of change

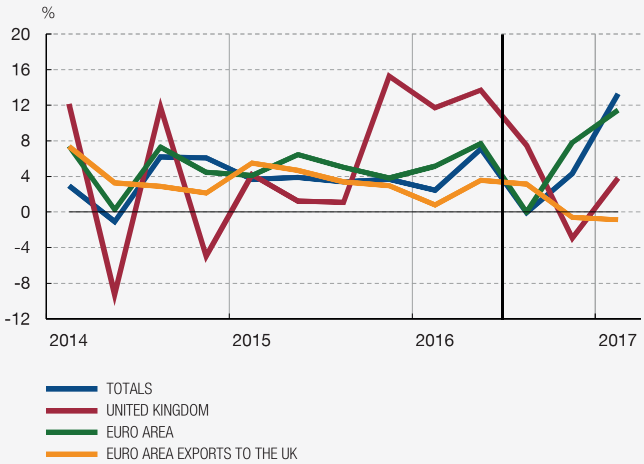
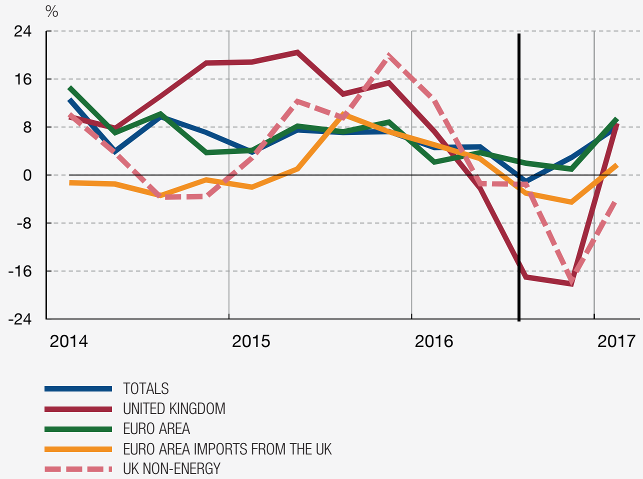



Chart 8
SPANISH REAL GOODS IMPORTS
Y-o-y rates of change




SOURCES: Ministerio de Economía y Competitividad, Banco de España, Eurostat and ECB.

on how exporters set their prices (ultimately determined by the specific structure of each market).

Using Customs data it is possible to analyse how the value of nominal exports from Spain to the United Kingdom evolves over time, but not the breakdown between volumes and prices. In the period leading up to the referendum, Spain's exports to the United Kingdom were rising at a very fast pace (see Chart 3); specifically, by 10.4% in 2015 and 11.3% in the first half of 2016, compared with 6.4% and 5.7%, respectively, for Spain's exports to the European Union overall. Since the referendum, the positive gap between the rates of growth of sales to the United Kingdom and to the European Union overall has turned negative. Thus, for example, the respective rates were -1.1% and 2.5% in the second half of 2016 and -0.9% and 8.8% in the first four months of 2017.

The unit value index (UVI) of euro area exports to the United Kingdom can be used as a deflator to estimate the extent to which those nominal data pass through to volumes. Similarly to the deflator of the United Kingdom's imports in euro, throughout 2016 this index reflected the depreciation in the exchange rate (see Chart 5). It seems, therefore, that euro area exporters have cut their prices in euro, although not sufficiently to offset the currency depreciation, making euro area exports to the United Kingdom more expensive. Indeed, by deflating the nominal value of Spain's exports to the United Kingdom using this index, an approximation of the flow in real terms is obtained that points to a significant decline from the second half of 2016 (see Chart 7).

In the case of Spanish imports of goods from the United Kingdom, the currency depreciation should not have too great an impact on flows in nominal terms measured in euro. If British exporters choose to maintain their prices in pounds, those exports will be cheaper in euro, but will tend to be offset by higher export volumes. If, on the contrary, they maintain their prices in euro (increasing their revenues in pounds), the volume should not be affected (and, therefore, nor the nominal magnitude). In practice, however, imports from the United Kingdom have performed relatively less well than imports from the European Union overall. Thus, for example, while imports from the United Kingdom and the European Union rose by 13.8% and 8.9%, respectively, in 2015, in the second half of 2016 the figures were -18.2% and 0.9%. Nevertheless it should be noted that these figures are marked to a great extent by energy imports, which collapsed in nominal terms in 2016, not only because of the depreciation of the pound but also because of the sharp fall in crude prices (see Chart 4). The figures for the first four months of 2017 reflect an increase in purchases from the United Kingdom, giving a year-on-year rate of growth of 8.2% (6.9% for imports from the European Union overall), related in part to the increase in energy imports, boosted by the higher crude prices at the start of the year.[2]

Imports of goods from the United Kingdom also fell significantly in the second half of 2016 in real terms (see Charts 6 and 8). This suggests that British exporters chose not to pass the depreciation of the pound through to lower prices, but instead maintained their prices in euro (increasing their margins). However, beyond changes in price competitiveness, the uncertainty surrounding the new trade framework with the United Kingdom may have had a downward impact on imports from the United Kingdom, although it is still too soon to draw conclusions in this respect.

Lastly, in the case of tourism, in 2016 Spain received 17.8 million tourists from the United Kingdom, 12.5% more than in the previous year, and the United Kingdom thus consolidated its position as Spain's leading source market for tourism, accounting for 23.6% of total foreign tourist arrivals. Total spending by British tourists also rose considerably in 2016, up 12.8% to €16 billion (20.9% of total receipts). There were also minor increases in average daily spend and average spend per tourist (3.6% and 0.3%, respectively). These favourable developments in tourism from the United Kingdom, despite the notable depreciation of the pound against the euro (down 12.9% on average in 2016) seem to have been founded, essentially, on Spain's growing appeal as a safe-haven destination, against a backdrop of heightened insecurity in some chief competitor destinations. At the start of 2017, the strong momentum of the previous year persisted in British tourist market indicators, which recorded new highs. Thus, in the first four months of 2017, British tourist arrivals rose by 9.6% year-on-year and total spending by British tourists rose at an even faster pace, by 13.9% year-on-year, courtesy of the increase in average daily spend (5.9%).

To sum up, in respect of trade in goods, the year since the referendum has been marked by weaker nominal Spanish trade flows with the United Kingdom than with the other European countries that, especially in the case of imports, cannot be fully explained by exchange rate fluctuations, while tourism continues to show considerable momentum, despite the recent depreciation of the pound.

2 Imports of non-energy goods remained quite weak, down 1.3%.