



**BERENBERG**

PARTNERSHIP SINCE 1590

## MACRO NEWS

30 / 10 / 17

Holger Schmieding, Chief Economist | [Holger.schmieding@berenberg.com](mailto:Holger.schmieding@berenberg.com) | +44 20 3207 7889

### THE CATALAN RISK

#### Berenberg Macro Flash

Spain has descended into its worst political crisis since the foiled coup d'état in 1981. Nonetheless, markets seem largely unfazed by the standoff between Madrid and a region that accounts for 20% of the Spanish economy. Over the last four weeks, the Spanish-German 10-year yield spread has widened by a mere 7bps, driven by a modest drop in German yields without any significant move in Spanish yields. During the euro crisis six years ago, much less serious problems had sufficed to cause widespread panic in European markets. Are we underestimating the Catalan risk? Probably not. While the political risks for Spain are noteworthy, the economic impact will likely remain temporary and muted.

We see little reason to fear that the local Spanish issue could turn into a systemic threat for the Eurozone as a whole.

- **No financial contagion:** Markets now know that, with the **European Stability Mechanism (ESM)** and the **European Central Bank's OMT** programme, the Eurozone has the required instruments to stop any irrational market panic fast. As a result, markets are not inclined to panic.
- **No political contagion:** The risk that other regions in Spain or in other euro member countries may follow suit looks remote. Instead, as in the case of Trump and Brexit, the contrast between the impossible things the Catalan populists had promised and harsh reality could turn voters elsewhere away from any temptation to go down a similar route.
- **Solid economic fundamentals:** The **Eurozone economy** is enjoying a broad-based economic recovery at a pace well above 2%. As all countries, sectors and components of demand are contributing to the upswing, it would take an extreme shock to derail the recovery. A local issue in Spain poses no serious risk beyond some modest short-term uncertainty.
- The **Spanish economy** itself is recovering well with a pace of growth of roughly 3.3% in the first three quarters of 2017. Unemployment has fallen from a peak of 26.1% in early 2014 to 16.5% in Q3 2017. Spain can weather a temporary setback. Today's October release of the European Commission's economic sentiment index provides a first hint on how much the conflict between Madrid and Barcelona is affecting the Spanish economy.
- The outcome of the current Catalan bid for independence seems clear: The **Catalan regional government** does not have enough support in Catalonia to win a prolonged stand-off with Madrid. It has also misjudged the situation in two major ways: First, the EU is siding fully with Madrid instead of supporting the dream of some Catalans to become an independent country within the EU. Second, the major economic impact of the standoff seems to be a shift in the tax base from Catalonia to other regions of Spain as companies relocate their legal headquarters. So far, there is no sign of a general Spanish crisis that could force Madrid to go soft.

#### WHAT NEXT? THE RISKS TO WATCH

The politics look awkward: Madrid should have offered a genuine dialogue much earlier, the Catalan pro-independence forces have steered themselves into a cul-de-sac where the temptation to go down as self-styled heroes of resistance instead of conceding defeat may look irresistible. The very weakness of the Catalan pro-independence forces adds to the political risks such as that of ill-considered behaviour.

After the Catalan parliament narrowly passed a motion on Friday that amounts to a second-class declaration of independence, Madrid reacted by activating Article 155 of the Spanish constitution, dissolving the Catalan regional government and the Catalan parliament and calling new regional elections for 21 December. Over the weekend, Madrid has started to take control of key Catalan institutions. The ousted Catalan president called for peaceful civil disobedience against Madrid. Some 300k people protested against the



**BERENBERG**

PARTNERSHIP SINCE 1590

## MACRO NEWS

attempted secession from Spain in Barcelona on Sunday. While the Spanish constitutional court will almost certainly reject the Catalan declaration of independence fast, Catalonia's top court may possibly do the same. If so, that could deal a significant blow to the pro-independence forces.

The key issue to watch in coming weeks is whether Madrid succeeds in taking sufficient control of Catalan institutions without having to resort to excessive force. The clumsy way in which Madrid had – unsuccessfully – tried to prevent the Catalan “referendum” on 1 October highlights the risk. The best strategy for Madrid would be to keep its interference in Catalan affairs to a minimum while offering more autonomy and waiting for pro-independence forces to fall apart.

For the political future of Spain, the stand-off carries two risks:

- First, what if the Catalan pro-independence forces win the regional election on 21 December decisively? An overly heavy-handed approach by Madrid could potentially swell the ranks of the pro-independence forces in Barcelona. So far, the stand-off does not seem to have had that effect. According to a Dos Sigma poll “El Mundo” newspaper in Madrid (which opposes Catalan independence), the pro-independence groups would lose some support in a snap regional election, taking between 61 and 65 out of 135 seats in the regional parliament, down from the 72 they hold at the moment. But in a volatile situation and with almost eight weeks to go, that opinion poll with 1000 respondents need not be a clear predictor of the possible election result. If the pro-independence forces were to win a new regional election, Catalonia would still not become independent. However, the standoff could then last longer, with some further economic damage in early 2018.
- Second, a heavy-handed approach could make a post-crisis reconciliation even more difficult, raising the risk that – at some time in the future – a more radicalised pro-independence movement in Catalonia may try its luck again. In the end, Spain needs majority support in a key region like Catalonia to thrive in the long-run.

**Bottom line:** We do not expect the Catalan crisis to pose a major risk to the Eurozone economy and its markets. Still, for Spain's own long-term political stability, the Spanish authorities should restrain their intervention in Catalan affairs to the inevitable minimum and offer the kind of enhanced autonomy and respect that most Catalans would probably settle for.

This message has been produced for information purposes for institutional investors or market professionals, it is not a financial analysis within the meaning of § 34b or § 31 of the German Securities Trading Act (Wertpapierhandelsgesetz), no investment advice or recommendation to buy financial instruments. The message does not claim completeness regarding the information on the developments referred to in it. On no account should it be regarded as a substitute for the recipient's procuring information for himself or exercising his own judgements. The message may include certain descriptions, statements, estimates, and conclusions underlining potential development based on assumptions, which may turn out to be incorrect. Berenberg and/or its employees accept no liability whatsoever for any direct or consequential loss or damages of any kind arising out of the use of this message or any part of its content. -- For full economics reports please visit our website or contact [capitalmarkets@berenberg.de](mailto:capitalmarkets@berenberg.de).

Joh. Berenberg, Gossler & Co.  
KG  
60 Threadneedle Street  
London EC2R 8HP  
Phone +44 20 3207 7889  
[www.berenberg.com](http://www.berenberg.com)  
hol-  
ger.schmieding@berenberg.co  
m