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CATALONIA: PRO-INDEPENDENCE PARTIES MAINTAIN MAJORITY OF SEATS

Berenberg Macro Flash

Catalonia neither endorsed independence nor turned its back on the pro-independence parties. We expect the conflict to simmer on, probably without a renewed escalation comparable to the October events.

The results of the Catalan regional election are a wake-up call for Spanish Prime Minister Mariano Rajoy. He suffered two major defeats yesterday.

First, the three pro-independence parties won combined the majority of seats in the regional assembly (70 out of 135), after 99.9% of the votes were counted, despite Rajoy's efforts to reduce the power of the independence movement following the illegal 1st October independence referendum. PM Rajoy efforts included triggering Article 155 at the end of October, dismissing the Catalan government, dissolving the Parliament and calling for a regional election on 21 December. The two main pro-independence parties had to campaign while their leaders were either in prison or on the run in Belgium.

Second, Rajoy's own party, the centre-right PP, ended in last place among the major mainstream parties, winning only 3 seats. 8 less than in the previous Catalan election in 2015.

Who are the winners? Former Catalan president Carles Puigdemont's pro-independence Junts per Catalunya party performed better than anticipated, winning 34 seats and 21.6% of the votes. Despite campaigning from his self-imposed exile in Brussels, Puigdemont can claim a mandate to lead the secession campaign. His party surprisingly outperformed the second major pro-independence party, the centre-left ERC (32 seats, 21.4% of votes). But the separatists' success overall is limited and they need to tread carefully. They gained fewer seats than in 2015 (70 vs 72) and won fewer votes (47.5% vs. 47.9%). The fact that the pro-independence parties support was below 50% strengthens the case of the pro-Spain parties. They will argue that less than half of the Catalan voters want independence. It is also obvious that the Catalan voters don't support unilateral independence. The communist CUP party, the only party campaigning for unilateral independence, won just 4 seats. 50% less than the latest opinion polls had predicted. The ERC party stated earlier that it prefers negotiations with Madrid over unilateral independence. It is questionable if yesterday's result is enough to revive the separatist movement which lost a lot of momentum over the last weeks.

The pro-Spain Ciudadanos party, headed by 37 year old Ines Arrimadas, was the second winner of the night. She won most seats (37) and by a clear distance the most vote (25.4%). However, the election system favours the pro-independence parties as they are strong in rural parts where it is easier to win seats.

What happens next? Both sides need to review their strategies. Unilateral declaration of independence will not work. EU and Madrid do not support this. It would therefore likely have devastating consequences for Catalonia's economy. First, the pro-Spain parties need to convince Madrid to give them back their lost autonomy. Rajoy promised to cancel the direct rule and that he is open to discuss constitutional reform. But he also warned that direct rule could be re-imposed if a new government illegally pushed for independence again in the future. The only real option for the separatists is to negotiate with Madrid. We think that Catalonia could receive more autonomy over the long-term, similar to the Basque region.

The environment remains difficult for Catalonia's economy and investments. The region represents c20% of Spanish GDP. A slowing Catalonia is thus bad for wider Spain. However, the Spanish economy is very robust and is expanding currently at a rate of c.3% annually. It would need major disruptions to stop this positive momentum. The latest leading indicators, such as the Spanish EC economic sentiment index, suggest that the



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Catalan political turmoil had no significant negative impact so far on economic confidence. We think this will remain the case. For 2018 we expect 2.9% GDP growth and 2.7% for 2019, above Bloomberg consensus of 2.5% and 2.2%, respectively. The bond markets are also supportive, both the Catalan and Spanish bond yields declined decisively over the last weeks and are even lower than before the 1st October referendum. Not surprisingly, the euro reaction overnight to the Catalan results was relatively muted. The euro lost only c.o.2 cents vs. the USD.

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