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SPAIN: PROSPECTS FOR NEW ELECTIONS

Berenberg Macro Flash

Trouble in Spain? After Italy's 4 March election ended in political turmoil, observers fear that Spain could follow in Italy's footsteps. Spanish Prime Minister Mariano Rajoy faces a no-confidence vote on Friday after the National Court last week convicted several of his former allies from the conservative Popular Party (PP) on corruption charges. The opposition centre-left Socialist party (PSOE) proposed its leader Pedro Sanchez as a replacement for Rajoy. Other opposition parties such as left-wing Podemos already agreed to join the motion, but Sanchez will also have to convince either the centre-right Basque PNV party or the young liberal Ciudadanos party to reach enough support. The horse trading is in full swing and the chances for Sanchez to win have increased over the last 48 hours as PNV is now seriously considering to vote for Sanchez. Even if Rajoy survives Friday's confidence vote, the risk of early elections would still be high as his minority government has lost the support of Albert Rivera, the leader of the Ciudadanos party. Rivera had backed Rajoy's minority government so far.

Can a bitterly divided opposition unite against Rajoy? In case the PNV does not support Friday's motion to unseat Rajoy and the PSOE/Podemos/Ciudadanos can not agree on a new election date, Rajoy could theoretically stay on as a lame duck until the next regular general election is due in summer 2020. To force new elections, the opposition parties would need to work together to unseat him, but are internally deeply divided (e.g. Rivera takes a hard line against Catalonia's secessionists and regional privileges while other opposition parties are softer on Catalonia than Rajoy). The 2018 budget, which was approved by the lower house last week in a major victory for Rajoy, can be rolled over into 2019. Because of PP's drop in the opinion polls to slightly above 20% vs. 33% in the 2016 election, Rajoy wants to delay any potential early election as long as possible. Rivera favours early elections but does not want to replace Rajoy by Sanchez beforehand, as the PSOE is proposing. According to the latest opinion polls, Ciudadanos are in the lead (up to 10% ahead of PP and PSOE) and could potentially triple their number of seats.

What are the main risks? The timing of the no-confidence vote could not have been worse. Southern European investors want to avoid repeating the mistake of not [pricing in the populist risk early enough](#). Amid political uncertainty and some contagion from Italy, the spread of Spanish bond yields over Germany increased earlier this week to the widest in a year. Investors worry that Podemos could be part of the next government. Podemos pledge to raise social spending while increasing the budget deficit similar to the plans of the anti-establishment 5Stars in Italy. Although in much better shape than Italy on many counts with growth of 3% last year, Spain is still suffering from the effects of the financial crisis with an unemployment rate of c.16% in March 2018 vs. c.11% for Italy and a budget deficit of 3.1% of GDP vs. 2.3% for Italy in 2017. According to the polls, Podemos would receive currently slightly below 20% of the votes. But as witnessed in Italy and in previous Spanish elections (e.g. 2016), anti-establishment parties support can rise rapidly during election campaigns. The potential victory of Ciudadanos in the next election could also reignite the Catalan political turmoil. The party takes a hard stance against the Catalan separatists, reducing the chances of a compromise which could defuse the Catalan problem.

Why Spain is different from Italy: In Italy, a combination of right and left-wing radical parties received more than 50% of the votes. It is very unlikely that the same could happen in Spain. The three mainstream pro-EU parties (PP, Socialists and Ciudadanos) should get around 70% of the votes according to the polls. Even if Podemos did better than projected, the lead of the mainstream parties is huge. In addition, Po-

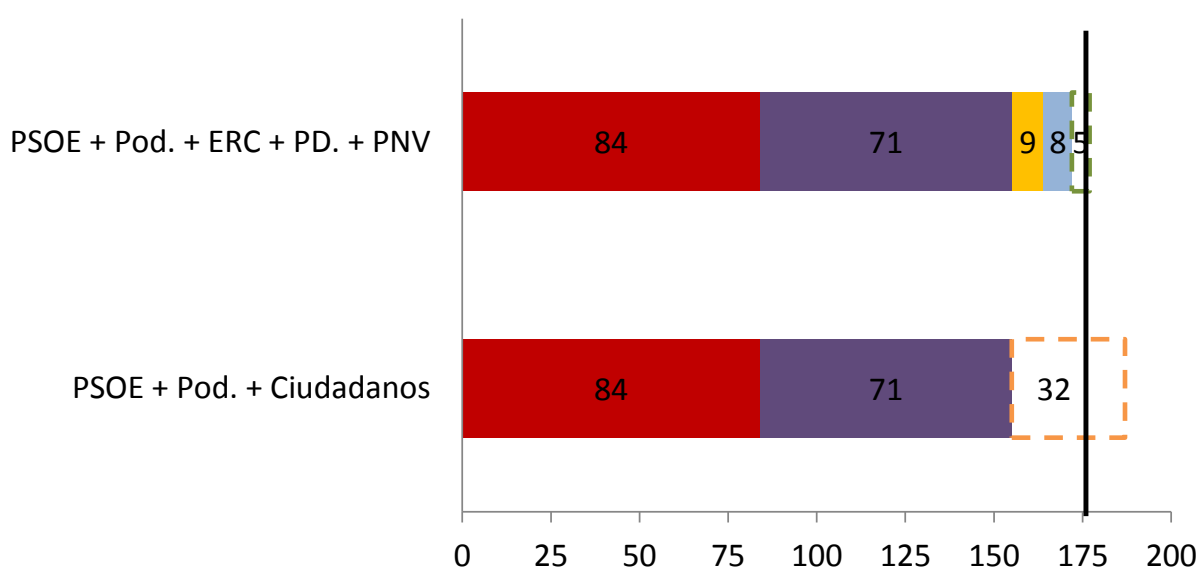


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demos has become less radical over time, having watched the sorry fate of Syriza and Greece in 2015. The risk that any new Spanish government could adopt policies that would really jeopardise Spain's place in the euro or trigger a new euro crisis looks extremely small. Furthermore, Spain's economy is more dynamic following Rajoy's structural reform agenda in 2012. Over the last four years Spain created twice the amount of jobs and its GDP rose three times faster compared to Italy. Spain's debt to GDP ratio is significantly lower than Italy's (98% vs. 132%). Importantly, the support for the euro is significantly higher in Spain vs. Italy. According to the Eurobarometer survey in November 2017, 81% of Spanish respondents are in favour of the euro (among the Top 5 in the EU) vs. only 59% in Italy and an EU-28 average of 61%. As Spain is abiding by the rules of the euro, the country would profit from Eurozone tools that can counteract serious contagion of risk spread jumps – see [What if: could Italy spark a new euro crisis](#) and [Italian crisis: does the sell-off make sense?](#)

Italian contagion to Portugal and Greece? Portugal and Greece were caught in the cross-fire of the Italian sell-off early this week as investors switched into risk-off mode. The credit ratings of Portugal and Greece are weaker than Italy's. Greece is in the middle of finalising its last bailout review and currently negotiates with the lenders about future monitoring once the last bailout officially ends in August. As a potential blessing in disguise, the rise in its bond yields could strengthen the hand of the official lenders in those negotiations with Greece. Greece needs to continue on its reform path to regain investor confidence and not to delay (as seen several times in the past) the implementation of reforms. The contagion pressure caused by Italy could force Greek Prime Minister Tsipras to stay on track. Meanwhile, Portugal's government recently faced pressure by the Left Bloc to increase the budget deficit target for 2018. The recent increase in Portuguese bond yields could strengthen the hands of the ruling centre-left Socialist party to continue targeting a smaller budget deficit, reducing the risk of a financial crisis in the long-term.

PSOE leader Sanchez needs the support of at least 176 members in the 350-seat parliament to unseat Rajoy.



Pod. = Podemos, PD. = PDeCAT. The centre-left PSOE together with left-wing Podemos, Catalan independence parties ERC and PDeCAT and Basque centre-right PNV would achieve 177 votes. PSOE together with Podemos and liberal Ciudadanos would gather 187 votes. Source: Wikipedia



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