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SPAIN: POPULISTS LOSE VOTES BUT STALEMATE CONTINUES

Berenberg Macro Flash

Will Britain's shock vote to leave the UK embolden populists elsewhere in Europe? That has become the key question for Europe. The result of Spain's repeat election on Sunday shows no trace of such contagion effects. Instead, those populists who - like the Brexiteers - campaigned on promises that look almost impossible to keep in economic terms fared significantly less well than expected in Spain. The snag is that the result does not solve Spain's political crisis. After some noise, the most likely outcome seems to be an alliance between the centre-right and centre-left. That would be good news for Spain and Europe.

THE RESULT: RAJOY UP BUT STALEMATE ONCE AGAIN

At the Spanish repeat election, Prime Minister Rajoy's conservatives (PP) raised their share of the vote from 28.7% to 33.0%, doing much better than opinion polls had projected. The mainstream Socialists advanced slightly from 22.0% to 22.7% while the young liberal party Ciudadanos fell back a little from 13.9% to 13.15%. Contrary to expectations, the radical left "Unidos Podemos" failed to overtake the Socialists, garnering only 21.1%. That is significantly less than the 24.4% which its two components, the upstart Podemos and the old-style communists, had attracted in December 2015 with 20.7% and 3.7%, respectively. Taken together, the mainstream parties (PP, Socialists and liberals) advanced by 4.3% as some voters returned to the conservatives. The new political parties or movements, radical left Podemos and the liberals, who had been the big winners in December, both fell back somewhat in what can be seen as a Spanish vote for safety and stability.

However, the shift in votes does not resolve the political stalemate. Neither a pro-business alliance between conservatives and liberals nor a hypothetical left-left alliance between Socialists and the radical left would have the 176 seats required for a majority in the 350-seat parliament. While the conservatives move up from 123 to 137 seats, quirks of the Spanish election system translate the small loss in votes for the liberals into a significant loss of seats from 40 to 32. The radical left kept the 71 seats which its two components, Podemos and Izquierda Unida had won in December. The remaining 25 seats go to a number of mostly Catalan and Basque regional parties.

THE OPTIONS

As before, the election result leaves four major options:

- A "grand coalition" between the mainstream centre-right and centre-left, possibly including the liberals
- A shaky alliance between Socialists and the radical left that would have to be supported either by most of the regional parties
- An alliance between Socialists and liberals supported by the radical left
- New elections

Once again, all four options look difficult. (i) Having to ask Spaniards to vote for a third time would cast a very bad light on Spain's political elite, to put it mildly. And the outcome may not be very different anyway. (ii) The Socialist leader Sanchez already suggested that his party does not want to co-operate with the conservatives. While that could probably be overcome if Rajoy were to make way for a new face at the helm of the conservative party, Rajoy can interpret the partial rebound in support for his conservatives as a mandate to stay. (iii) Any tie-up between the Socialists and Podemos could founder on the regional question as parts of Podemos are in favour of granting Catalonia an independence referendum while many Socialists



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are strongly opposed to that. One positive aspect of the repeat election result to note is that Podemos is as far away from leading a government in Spain as it was before.

The most likely outcome after some noise is a **grand coalition** between the two traditional mainstream parties, the conservatives and socialists, possibly even backed by the liberals. The pressure on the mainstream parties to avoid a third round of elections will be immense. While the fate of current leaders of the conservatives and Socialists is uncertain, the result gives Rajoy a stronger claim than before to lead the new government. Such a grand coalition would not reverse many reforms **but** would not get much done either. For Spain, that would be good enough. It would allow the country to reap the benefits of the earlier Rajoy labour market and other reforms. A Socialist-led government including the pro-reform liberals would likely keep Spain on a fairly steady course as well even if it had to make some concessions to the radical left. In case of a shaky **left-left alliance** with support from most of the regional parties, Spain could be heading for a Portuguese-style situation. Such a government would harm trend growth somewhat (from 2.5% to 2.0% for Spain?) by reversing some supply-side reforms. But it would probably shy away from a full confrontation with the EU about fiscal policy.

Political uncertainty continues in Spain. But the Spanish population remains pro-EU and has little appetite for a confrontation with Brussels. The EU may use its delayed verdict on Spain's 2015 fiscal overshoot due in July to put serious pressure on any government that might include or require support from the radical left to not make too much nonsense. A government that does not reverse pro-growth reforms could expect a more lenient treatment. The key message from the point of Europe is that, in Spain, the advance of the populists did not continue. Confronted with reality and unable to deliver results, even populists can lose some of their allure over time.

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