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Holger Schmieding, Chief Economist | Holger.schmieding@berenberg.com | +44 20 3207 7889**MONDAY MACRO UPDATE: SPAIN, PORTUGAL, GERMANY**

Berenberg Macro Flash

Spain: Socialists cave in

After ten months of gridlock, Spain's political crisis will likely be over next weekend. After the Socialist Party yesterday decided with a 139 to 96 majority to abstain in a parliamentary vote of confidence, centre-right prime minister Mariano Rajoy will likely get a royal mandate to form a government after two days of royal consultations and be confirmed by parliament just ahead of the 31 October deadline. The Socialist Party's decision avoids new elections which would have to be called for 18 December if no candidate for prime minister could have mustered a majority in parliament.

Governing Spain will be tough for Rajoy. Even a likely backing by the liberal Ciudadanos leaves his conservative Popular Party seven seats short of a majority in parliament. So he needs Socialist abstentions not just for this week's vote but for the years ahead. Given the strong rise in support for Rajoy's party in recent opinion polls (see chart), a third round of elections on 18 December might even have been the more attractive option for him, as long as he could have pinned the blame for an unpopular repeat election on another party.

The refusal of ousted Socialist leader Sanchez to tolerate a Rajoy-led conservative government and the subsequent turmoil with the Socialist Party have caused a slump in support for the Socialists to just 17% (average of the last four opinion polls), with one poll at just 14%. Because the Socialists would have most to lose from early elections, we expect them to allow Rajoy to pass a mostly sensible budget. Rajoy may not be able to pass many further pro-growth reforms, having to focus on defusing the conflict with Catalonia instead. But a conservative-liberal alliance will at least prevent serious reform reversals.

Invigorated by earlier Rajoy reforms, the Spanish economy has weathered the political turbulence rather well. The recent dent in confidence indicators caused by political uncertainty should soon be over. After growth of just above 3% this year, Spain will likely remain the fastest-growing of all major European economies in 2017, beating not just France and Italy but also Germany and the UK by a wide margin.

Portugal: Six-month reprieve

Pointing to some fiscal progress, DBRS rating agency confirmed Portugal's sovereign debt rating as one notch above junk status with a stable outlook. Portuguese debt thus remains eligible for ECB purchases. Short-term, this is a significant relief for the country and its centre-left minority government backed by some ultra-left parties. Long-term, Portugal remains one of the weakest links in the Eurozone. Partly because the leftist government reversed some of the key labour market reforms Portugal had introduced while it was in a troika-supervised adjustment programme, the growth outlook for Portugal (trend rate of around 1%) remains weak. In the long-run, the penchant of the leftist government, namely to hike taxes to meet fiscal targets instead of pursuing pro-growth reforms, could add to Portugal's problems instead of defusing them. A risk remains that Portugal could still be downgraded in the future, hit the rocks and potentially require an ESM credit line. The conditions for such outside support might then nudge Portugal back on the reform path. The next DBRS review is due in April 2017. For now, Portugal is one more issue that Europe doesn't have to worry about, at least not yet.



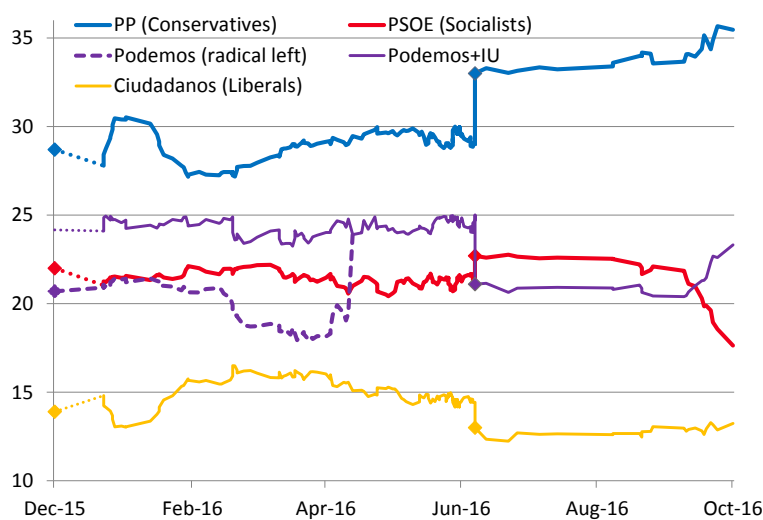
MACRO NEWS

Germany: Preparing the ground for another Merkel victory?

Will Merkel run again in 2017? As expected, the political groundwork is being laid for her to announce ahead of the party convention of her CDU on 6-7 December 2016 that she will go for a fourth term as chancellor at the September 2017 elections. Her key problem in recent months has been an open dispute between her and Bavarian CSU leader Seehofer. This has kept the controversial refugee issue in the limelight despite a major drop in the number of refugee arrivals. The noisy clash has diverted attention away from the fact that Germany has changed policy to be much less welcoming to new refugees and is now coping with the issue fairly well.

Since April, the monthly number of refugee arrivals in Germany has been well below an annualised rate of 200k. That matters because it makes the CSU demand of imposing a hard cap of 200k per year somewhat obsolete for the time being. In the strongest sign that the CSU may bury the hatchet, CSU deputy leader Weber told 'Spiegel' magazine that the CSU would support Merkel as joint CDU/CSU candidate for chancellor. Although Merkel herself - somewhat conspicuously - has left it open whether she will run again, we expect a long line of conservative party grandees to urge her to do so in the next few weeks, paving the way for her to announce before 6 December that she will heed the wish. With the refugee issue less in the limelight, support for her CDU/CSU could easily rebound from the current 33% to 35% or above in the September 2017 elections. That would almost very likely mean that no government could be formed against her.

Spanish opinion polls for the next national election



Opinion polls in Spain, first value: 20 December 2015 result. Sudden jump on 26 June 2016: result of repeat election. Source: Spanish election commission, national opinion polls, Berenberg calculations.

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