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Summary

Draft law approved allowing descendants of Sephardic Jews to seek Spanish nationality. Crown Prince Felipe to assume the throne after King Juan Carlos abdicates. Socialist leader Rubalcaba quits after poor results in European elections. IMF says Spain has turned the corner, stock market rallies.

Foreign Policy

Draft law approved allowing descendants of Sephardic Jews to seek Spanish nationality
Descendants of Sephardic Jews expelled from Spain in 1492 will be able to seek Spanish nationality under the terms of a draft law approved by the government this month, and without renouncing their current citizenship.

The law is guaranteed passage through parliament as the Popular Party (PP) has an absolute majority of seats.

Up to 300,000 Jews lived in Spain before the Catholic monarchs Isabella and Ferdinand ordered Jews and Muslims to convert to the Roman Catholic faith or leave the country.

There are an estimated 3.5 million Sephardic Jews whose ancestors settled in countries such as Israel, France, the US, Turkey, Mexico, Argentina and Chile.

Applicants must prove their Sephardic background through a certificate from the federation of the Jewish community in Spain or from the head of the Jewish community in which they reside.

Spain in bid to boost business with Mexico
The government hopes to increase trade and investment with Mexico by taking into account in two laws the proposals of executives on smoothing obstacles to their business expansion.

José Manuel García-Margallo, Spain's Foreign Minister, told a meeting, organised as part of the official visit to Madrid of the Mexican President Enrique Peña Nieto, that the executives' observations would be considered for incorporation to the recent law on the guarantee of market unity and to the upcoming tax reform.

Spain was the leading EU investor in Mexico last year and Mexico the leading non-EU investor in Spain.

Like Spain, Mexico is currently undergoing many reforms, though in different areas. The protected energy and telecommunication sectors, in particular, are being opened up.

Pemex, Mexico's state-owned oil company, sold most of its 9.2% stake in Repsol, Spain's energy group, earlier this month after major disagreements over strategy and corporate governance.

Domestic Scene

Crown Prince Felipe to assume the throne after King Juan Carlos abdicates…
Spain will have a new King on 19 June, following the abdication of King Juan Carlos earlier this month in favour of his son, Crown Prince Felipe. Like his father almost 40 years ago when he succeeded the dictator General Franco as head of state, Felipe VI faces enormous but very different challenges.

Juan Carlos knew that the only way to secure the monarchy was by piloting the transition to democracy. Under him, Spain joined NATO in 1982, entered the European Community in 1986 and enjoyed the longest period of stability and prosperity in its modern history. When Francoist diehards tried to turn back the clock in 1981 and staged a military coup, Juan Carlos faced them down and won the day. As a result, he became a hugely popular figure and many people became *juancarlistas* as opposed to outright monarchists.

In recent years, however, Juan Carlos and the monarchy as an institution have lost support. On a scale of 0 (no confidence) to 10 (a lot of confidence), the monarchy scored 3.72 in April, down from 7.48 in 1995, according to the barometer of the government-owned CIS, while support for the restoration of a republic (the 2nd Republic was established in 1931 and came to an end in 1939 after General Franco won the Civil War) has been growing.

The King's son-in-law, Iñaki Urdangarín is embroiled in an ongoing investigation into alleged financial irregularities and tax evasion, involving the misuse of public funds, which has made him *persona non grata* in the royal family. Urdangarín, who denies any wrongdoing, is expected to stand trial. The King also did not endear himself to his subjects at a time of national crisis by going on an elephant-hunting trip to Botswana in 2012 (for which he later publicly apologised), after saying he was losing sleep thinking about Spain's whopping youth unemployment rate (55%). And, as part of the establishment blamed for not anticipating the country's deep crisis, the King was perceived as part of the problem.

Juan Carlos had always implied that he would die as King and not abdicate. But as well as the scandals, his health deteriorated over the last few years and he has been in and out of hospital for various operations. At 76, he was visibly tired and finding it an increasing strain to keep up with his duties and travel abroad promoting Spanish business.

Uppermost in his mind, when he took the decision to abdicate, was to smooth the path for his son Felipe (46), and here politics probably played a part. The two main parties, the ruling conservative Popular Party (PP) and the Socialists (PSOE), between them have more then 80% of the seats in parliament and so were able to ensure passage through parliament of the legislation for the handover to Felipe. The next general election is not scheduled until November 2015, and the results could change the political map substantially (see the next item).

The King's abdication announcement was greeted by pro-republic demonstrators in Madrid and other cities calling for a referendum on the future of the monarchy. The distinctive red, yellow and purple colours of the republican flag were very much in evidence.

Close to two-thirds of those who responded to a survey by Metroscopia published in *El País* said they were in favour of a referendum and 34% against, but if held 49% would support the monarchy and 36% a republic. The abdication was welcomed by 83% of respondents.

In another poll, published in *El Mundo*, almost two-thirds said they had a good or very good opinion of Juan Carlos, up from 41% in January, and 77% of his son.

… Socialist leader Rubalcaba quits after poor results in European elections
Alfredo Pérez Rubalcaba, the Socialist leader, stepped down after the party was defeated in the European elections, opening up a battle to select the party's candidate for prime minister in the general election to be held by November 2015.

The PP also fared badly in the European elections, as expected, but it still achieved the most seats, albeit very narrowly as it only won one more than the Socialists (see Figure 1). It is a measure of the Socialists' crisis that the party failed to capitalise on the PP's unpopular reforms and spending cuts.

Podemos ('We can'), a new pro-republic party born out of the 2011 grass roots protest movement of *los indignados* ('the indignant ones'), won five seats. The CIS had predicted it would win just one. Its result stunned the widely discredited and complacent political establishment, tarnished by corruption scandals and blamed for the depth of Spain's five-year recession (which started under the previous Socialist government) and massive unemployment.

Figure 1. Spain's results in the European elections (1)

Party	Seats	% of votes cast
Popular Party	16 (24)	26.0 (42.1)
Socialists	14 (23)	23.0 (38.8)
Plural Left	6 (2)	10.0 (3.7)
Podemos	5 (-)	7.9 (-)
UPyD	4 (1)	6.5 (2.8)
CEU (2)	3 (3)	5.4 (5.1)
L'Esquerra (3)	2 (-)	4.0 (-)
Ciudadanos	2 (-)	3.2 (-)
Los Pueblos Deciden (4)	1 (1)	2.1 (2.5)
Primavera Europea (5)	1 (-)	1.9 (-)
Total seats	54	

(1) 2009 results in brackets.
(2) Coalition for Europe of several regional parties.
(3) Coalition of several Catalan parties in favour of a referendum on the region's independence.
(4) Coalition of several Basque parties in favour of the right of self-determination.
(5) Coalition of various regional parties.
Source: Interior Ministry.

For the first time since the establishment of Spain's democracy after the death of General Franco in 1975, the two main parties captured between them less than 50% of the total votes cast (see Figure 2). This result intensified the debate on the decline of Spain's *de facto* two-party system, something that opinion polls have been showing in recent months.

Figure 2. Results of the two main parties in European elections, 1987-2014 (seats and % of votes)

	1987	1989	1994	1999	2004	2009	2014
PSOE	28 (39.1)	27 (39.6)	22 (30.8)	24 (35.3)	24 (41.2)	23 (38.8)	14 (23.0)
PP	17 (24.6)	15 (21.4)	28 (40.1)	27 (39.7)	24 (41.2)	24 (42.1)	16 (26.0)

Source: Interior Ministry.

Voter turnout at 45.8% was slightly higher than in 2009 (see Figure 3).

Figure 3. Voter turnout at European elections, 1987-2014 (% of total eligible voters)

	1987	1989	1994	1999	2004	2009	2014
Turnout	68.5	54.7	59.1	63.0	45.1	44.9	45.8

Source: Interior Ministry.

Podemos gained 1.2 million votes (8% of the total) and according to two polls would win between 30 and 58 seats in parliament in the next general election. Led by Pablo Iglesias, a charismatic 35-year-old political science teacher at the Complutense University and a former communist militant in his youth, most of Podemos's supporters voted for the Socialists or the United Left (IU) in the 2011 general election and are aged between 35 and 54. Podemos has yet to produce a programme and become a fully fledged political party.

The departure of Rubalcaba (62), part of the Socialists' 'old guard' (he served in governments between 1992 and 2011), was not openly welcomed by the PP. Despite being trounced at the 2011 general election and tempted to radicalise the party, he remained moderate. Prime Minister Mariano Rajoy found him a useful ally in rejecting Catalonia's push for a referendum on independence. He also contained the pro-republic elements in the Socialist party.

Compounding the Socialists' meltdown, Pere Navarro and Patxi López, respectively the Socialist leaders in Catalonia and the Basque Country and two of the party's regional 'barons', also threw in the towel because of the European elections and other factors. In the case of Navarro, Catalan Socialists are divided over the independence issue.

The Socialists' new secretary-general will be chosen next month, and the party's candidate for prime minister, who could also be this person, in November in principle. The frontrunners in the primaries so far are Eduardo Madina (38), head of the Socialists' group in parliament, and Carme Chacón (43), a former Defence Minister, although neither has yet declared they will run.

Former PP regional minister given eight-year jail sentence for corruption
Rafael Blasco, a prominent Popular Party politician and a former minister in the Valencian regional government, was sentenced to eight years in prison for appropriating millions of euros of public funds allocated for development cooperation projects in Latin America, Africa and Asia.

Blasco is appealing the sentence and avoided going to prison by posting €200,000 bail and surrendering his passport.

The 69-year-old began his political life while a student in the Spanish Communist Party. He then joined the Socialists and subsequently the Popular Party. He held various ministerial portfolios in Socialist and PP governments in Valencia between 1983 and 2011, and was the PP's spokesman in the Valencian parliament until 2012 when he was forced to step down after he was implicated in the 'cooperation scandal'.

Four-hundred African migrants successfully storm border fence at enclave of Melilla
Around 400 sub-Saharan migrants broke through the six-metre razor-wire fence at Spain's North African enclave of Melilla, adding to the wave of migrants already there.

Many kissed the ground with joy as they were now in the EU after travelling from various parts of Africa to the Moroccan side of the border with Melilla.

Jorge Fernández Díaz, Spain's Interior Minister, said the centre in Melilla where migrants are held while the authorities decide whether to grant asylum or repatriate them was 'at its limit'. The centre was built for 500 and now holds around 2,500, a significant number of whom are Syrians who fled the civil war in their country.

The number of migrants who crossed illegally into Melilla and the other Spanish enclave of Ceuta last year was 49% higher, at 4,200.

According to the European Commission, 60% of the 317,840 people refused entry into the EU last year were refused in Spain.

Spain dislodged from the ranking of the top 10 countries with most doctors
Spain is no longer among the top 10 countries in the world in terms of the number of doctors per 10,000 inhabitants, according to the latest ranking by the World Health Organisation.

It dropped from 10th to 16th place in the ranking; the number of doctors declined from 39.6 per 10,000 inhabitants to 37 in 2013, but this is still above the European average of 33. The calculation is made on the basis of the average number over an eight-year period and not the figure for a particular year.

The Economy

IMF says Spain has turned the corner, stock market rallies…
The economy is out of the woods, led by stronger exports, an incipient recovery in domestic consumption and better financial market conditions, but the recovery needs to be more inclusive so that the 5.9 million unemployed benefit from more job opportunities, according to a team from the International Monetary Fund which visited Madrid last month.

The IMF recommends domestic measures on three fronts:

- Help firms expand, hire and invest. Banks can do more to restructure the excessive debt of operationally-viable SMEs by offering a menu of standardised restructuring terms. The government, in turn, should allow outstanding tax and social security claims of such firms to be restructured to sustainable levels if other creditors do the same. Consideration could also be given to introducing a personal insolvency framework that would allow insolvent debtors to have a fresh start after having given up their non-exempt assets and a substantial period of good faith efforts to pay the outstanding debt.

- Reduce regulatory barriers. Under the Market Unity Law, which came into effect at the end of 2013, a company that meets the requirements of a particular region has the right to do business in the rest of Spain and cannot be asked for additional requirements. The 2,700 regulatory barriers identified need to be quickly eliminated.

- Pursue growth- and job-friendly fiscal consolidation. The budget deficit is still very high (7% of GDP in 2013) and public debt has ballooned to almost 100% of GDP. Indirect revenues can be increased by raising excise duties and environmental levies, and gradually reducing preferential treatments in VAT. The base of income taxes should be broadened by reducing exemptions and special treatments. There is little scope for cutting top personal income tax rates (at 52%, one of the highest in the EU).

Luis de Guindos, the Economy Minister, ruled out implementing most of the IMF's recommendations as the government had its own road map, while Luis Linde, the governor of the Bank of Spain, broadly backed the IMF's tax proposals.

The government announced tax cuts and a €6.3 billion stimulus package. The top corporate tax rate will be lowered from 30% to 25% and income tax rates will also be reduced, even though there are concerns about the still high budget deficit and the political difficulty of reducing spending further as the country approaches elections no later than November 2015.

The deficit will be 5.6% of GDP this year, according to the latest forecast by the European Commission, and 6.1% in 2015. The government is committed to reducing the deficit to the EU threshold of 3% in 2016.

The stock market has rallied since May and is Europe's star performer, but the Ibex-35 index at 11,058 on 17 June was still far from its peak of 16,040 on 9 November 2007 (see Figure 4). The stock market has never taken so long to return to its pre-crisis level.

Figure 4. Main stock market indices (% change)

	1 January-17 June
Ibex-35 Spain)	**+11.5**
Dax (Frankfurt)	+3.8
FTSE 100 (London)	+0.2
Euro Stoxx 50	+5.3
Dow Jones	+1.4
Nikkei (Tokyo)	-8.0

Source: Markets.

The risk premium on 10-year government bonds has dropped sharply, reflecting the improvement in macroeconomic fundamentals and investor sentiment toward Spain (see Figure 5). This led the government to reduce its estimate for net debt issuance this year by €10 billion to €55 billion and to announce in a confidence-building move that it would begin to repay ahead of schedule the €41 billion banking rescue loan granted by the euro zone in 2012. It will repay €1.3 billion.

Figure 5. 10-year government bond yields (%) and spreads over Germany's bund (pp)

	Yield 16 June (%)	Spread over Germany (p.p.)
Germany	1.41	–
Greece	6.02	+4.61
Ireland	2.48	+1.07
Italy	2.84	+1.44
Portugal	3.45	+2.05
Spain	**2.73**	**+1.32**

Source: ThomsonReuters.

The beginning of an upturn in domestic demand was reflected in stronger growth in imports in the first four months. They rose 4.9% year-on-year to €86.68 billion (8.8% in real terms), with imports of capital goods up 12.5%. Exports grew 1.4% (1.7% in real terms) to €78.03 billion. The trade deficit was 51% higher at €8.64 billion.

… But more than 3 million have been unemployed for over a year and the female employment rate has plummeted…

Some 60% of Spain's 5.9 million stated unemployed had not worked for at least a year in 2013 and 20% for more than three years, according to a labour force survey published by the National Statistics Office.

The sharp rise in the long-term unemployed is one of the most serious legacies of Spain's five-year recession, which has ended, and creating jobs for them one of the greatest challenges. The share of long-term unemployment in total unemployment jumped from 1.7% in 2007 to 13% last year, more than double the EU average (see Figure 6).

Figure 6. Long-term unemployment (% of working population) (1)

	2007	2013
Greece	4.1	18.4
Spain	**1.7**	**13.1**
Italy	2.9	6.9
EU-28	3.1	5.1
France	3.2	4.2
UK	1.3	2.7
Germany	4.9	2.4

(1) Jobless for more than a year.
Source: Eurostat.

The longer someone has been without work the more difficult it is to get a job. Unemployment benefits run out after two years, and then there is an exceptional subsidy of €400 only for special cases and for six months.

The survey also highlighted the fact that a better education leads to a greater chance of finding work. The jobless rate for those with only basic education (ie, students who left school at 16) was 32.5%, compared with 6.8% for those with a degree in mathematics.

Many of the jobless with only basic education left school during Spain's illusory boom years to work in the construction and property sectors, and are poorly qualified.

Women, in particular, have suffered the consequences of the crisis. The female employment rate (the proportion of women between 15 and 64 years old who are working) dropped in Spain from 54.9% in 2008 to 49.7% in 2013, one of the largest falls (see Figure 7).

Figure 7. Female employment rates in the EU, 2008 and 2013

	2008	2013
Sweden	71.8	72.5
Germany	64.3	68.8
UK	65.8	65.9
France	60.2	60.4
EU-28	58.8	58.7
Spain	**54.9**	**49.7**
Italy	47.2	46.5

Source: Eurostat.

There was better news on the registered unemployment front. The number of job claimants dropped by 111,916 in May, the largest fall in that month since the statistical series began, to 4.5 million. This registered unemployed number is 1.4 million less than the stated one (based on a quarterly household survey). This difference is due to the fact that not everyone who is jobless is eligible for, or claims, unemployment-related benefits. The number of social security affiliates rose last month by 198,320 to 16.6 million –still far from the peak of 19.4 million in 2007 before the crisis but the largest rise since July 2005–.

Prime Minister Mariano Rajoy said the latest figures showed there was a ‘change of cycle in the labour market’.

… And vulnerable groups have borne the brunt of the housing bubble burst
The government needs to do more to protect the most vulnerable victims of the country’s housing bubble burst and debt crisis, according to a report by Human Rights Watch (HRW).

‘Many tens of thousands of people have been evicted or face foreclosure and eviction due to defaults on their mortgage payments. Many are left with heavy debts even after their homes are repossessed’, the report says. ‘Spain has inadequate personal insolvency laws that perpetually saddle people with massive debts they cannot repay or discharge, leading to situations of chronic debt’.

This vicious cycle needs to be broken.

During the economic boom year before 2007, there were frenzied purchases of homes, driven by the lack of affordable housing, low interest rates and easy access to mortgages.

Spain has one of the EU’s highest home ownership rate (85%), smallest stocks of private rental housing (11%) and lowest stock of social, or subsidised, rental housing (2%).

When the property bubble burst, throwing the country into recession, unemployment and house evictions surged, but it was not until March 2012 that the Popular Party government, after trouncing the Socialists in the November 2011 general election, took the first steps to address the mortgage crisis. Measures were introduced to protect temporarily certain groups against evictions.

HRW said the measures were too narrow and arbitrary, and ‘do not comport with international law’. For example, a two-parent household with a child aged three years or younger can benefit from the moratorium on evictions, while the two-parent family with a child aged four or older living next door cannot.

Legal reform to allow judges to determine whether a mortgage contract contained unfair clauses that 'constitute the basis for the foreclosure' or 'determined the payable amount' came only after the EU's Court of Justice ruled, in March 2013, that the inability to allege unfair contractual terms violated EU consumer protection regulations.

The government is also criticised for not reforming the insolvency laws to 'create an accessible, fair, and efficient mechanism for over-indebted individuals to discharge their debt'.

The inability to deal more satisfactorily with the mortgage crisis was one factor among many that propelled 1.2 million people to vote in last month's European elections for the fledgling Podemos party, which stunned the political establishment.

AENA airports authority to be privatised
The government is to privatise 49% of the state-owned AENA airports authority, which runs 46 airports in Spain and 15 abroad and handles some 200 million passengers a year, making it the world's largest airport operator.

The previous Socialist government wanted to privatise part of AENA in 2011 but it never got off the ground because of investor uncertainty due to Spain's recession.

After years of losses, AENA made a profit of €597 million last year, due to cost cuts.

The privatisation would be Spain's largest in 16 years.

Spain moves up six places in the IMD world competitiveness ranking
Spain rose six places in the latest world competitiveness ranking of the IMD, the Swiss business school, to 39th spot out of 60 countries. Its rise was greater than that of any other European country (see Figure 8).

Figure 8. IMD world competitiveness ranking, 2014 and 2013

	2014 ranking	2013 ranking
US	1	1
Germany	6	9
UK	16	18
France	27	28
Spain	**39**	**45**
Italy	46	44

Source: IMD World Competitiveness Yearbook 2014.

The global ranking is based on four categories: economic performance, government efficiency, business efficiency and infrastructure. Each of these categories, in turn, is based on five elements (see Figure 9).

Figure 9. Factors that comprise Spain's overall ranking

	2010	2011	2012	2013	2014
Economic performance	41	47	51	53	51
Government efficiency	45	38	40	50	46
Business efficiency	44	38	46	50	42
Infrastructure	28	26	27	27	27
Overall ranking	36	35	39	45	39

Source: IMD World Competitiveness Yearbook 2014.

Spain, fourth-largest recipient of FDI projects in 2013

Spain received 221 new foreign direct investment (FDI) projects last year, which created 11,118 jobs. While the number of projects was down 19%, the jobs created were 10% higher, according to a report by Ernst and Young (see Figures 10 and 11).

Figure 10. Top Six European countries by FDI projects, 2013

	2013	2012	% change 12/13	% share (2013)
UK	799	697	+15	20
Germany	701	624	+12	18
France	514	471	+9	13
Spain	**221**	**274**	**-19**	**6**
Belgium	175	169	+4	4
Netherlands	161	161	0	4

Source: EY's 2014 European attractiveness survey.

Figure 11. Top six European countries by FDI job creation

	2013	2012	% change 12/13	% share (2013)
UK	27,953	30,311	-8	17
France	14,122	10,542	-34	8
Poland	13,862	13,111	+6	8
Russia	13,621	13,356	+2	8
Serbia	12,179	10,302	+18	7
Spain	**11,118**	**10,114**	**+10**	**7**

Source: EY's 2014 European attractiveness survey.

Spain was ranked the sixth most attractive Western European country in which to invest in 2014 (see Figure 12) and the 25th best place in the business environment ranking of the Economist Intelligence Unit (EIU), up one position (see Figure 13). The EIU ranking is based on 10 categories.

Figure 12. Most attractive Western European countries to establish operations

	% of respondents who chose it	Change from 2013 in pp
Germany	40	+2
UK	22	+6
France	11	-6
Netherlands	3	-1
Denmark	2	+2
Spain	**2**	**-1**

Source: EY's 2014 European attractiveness survey.

Figure 13. Business environment ranking, selected countries (1)

Global ranking 2014-18	Score 2014-18 out of 10
1. Singapore	8.65
7. US	8.25
12.Germany	7.98
22. UK	7.44
24. France	7.38
25. Spain	**7.36**
48. Italy	6.44

(1) Out of 82 countries.
Source: EIU.

Ernst and Young's research among 808 companies, now in its 12th year, tracks FDI projects that have resulted in new facilities and the creation of new jobs. It excludes portfolio investment and M&A.

Barcelona was named the sixth most attractive city in Europe for FDI and Madrid the eighth (see Figure 14).

Figure 14. Top 10 most attractive European cities for FDI

	% of respondents who chose it
London	54
Paris	29
Berlin	24
Frankfurt	15
Munich	11
Barcelona	**8**
Amsterdam	7
Madrid	**5**
Hamburg	5
Moscow	5

Source: EY's 2014 European attractiveness survey.

Corporate Scene

S&P upgrades ratings on Spanish banks
The ratings agency Standard & Poor's upgraded the ratings on four banks and changed the outlook on another three from stable to positive. This followed its decision last month to raise Spain's sovereign debt rating from BBB- to BBB.

The rating on Santander, the euro zone's largest bank by market capitalisation, was raised from BBB to BBB+ with stable outlook, that of BBVA from BBB- to BBB with stable outlook, Cecabank's from BB+ to BBB with positive outlook and Bankinter's from BB to BB+ with positive outlook.

The outlook for Caixabank, Banco Sabadell and Bankia was changed from stable to positive.

Inditex's profits hit by currency depreciations
Inditex, the world's largest fashion retailer best known as the owner of Zara, reported a 7.6% fall in net profits to €406 million. It was its biggest fall in quarterly profits in five years.

The group's significant proportion of business outside of Europe was hit by the strengthening of the euro against other currencies.

Ebro Foods acquires Italian pasta company
Ebro Foods, the world's largest trader of rice and the second biggest producer of pasta, agreed to buy a majority 52% stake in Italian pasta company Pastificio Lucio Garofalo for €62.5 million.

The unlisted company, founded in 1789, is the owner of high-end dried pasta brands Garofalo, Santa Lucia and Russo de Cicciano.