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Summary

Spain presses for dialogue over the Ukraine, not military aid.
Podemos consolidates itself as the leading party, Ciudadanos rises.
Spain's growth set to accelerate.
Airport operator AENA in Europe's largest initial public offering.

Foreign Policy

Spain presses for dialogue over the Ukraine, not military aid
José Manuel García-Margallo, Spain's Foreign Minister, joined British Foreign Secretary Philip Hammond in urging a non-military solution to the Ukrainian conflict.

Ukraine's Western-backed government has been appealing for its allies to send weapons to help it fight a 10-month uprising by pro-Russian rebels in the east.

García-Margallo said at a joint press conference in Madrid with Hammond on 19 February that he would like the EU to have a common position on the question of arms.

Earlier in the month García-Margallo visited the Ukraine with a group of businessmen in a bid to forge investment and trade ties.

Spain is among the group of at least 10 countries opposed to imposing more sanctions and new economic measures on Russia, which have to be agreed unanimously by the 28 EU nations.¹

García-Margallo told a meeting of EU foreign ministers in Brussels that Spain had been 'badly hit in terms of agriculture and tourism' by the sanctions.

While the two foreign ministers were broadly in agreement over the Ukraine, they remained far apart on how to resolve the thorny problem of Gibraltar, the UK overseas territory on the southern tip of Spain over which Madrid claims sovereignty.

After taking office at the end of 2011, the Popular Party (PP) suspended the Trilateral Forum for Dialogue (the UK, Spain and Gibraltar), established by the previous Socialist (PSOE) government. Since then there has been no active mechanism for discussing common issues other than sovereignty –which the

¹ For a snapshot of Spain's foreign policy including the Ukraine see the article by Charles Powell at <http://carnegieeurope.eu/strategieurope/?fa=58975>.



UK and Gibraltar are adamant is not on the table– and little more than megaphone diplomacy.

Spain has turned up the heat on Gibraltar. The stringent border controls introduced in July 2013 after Gibraltar enraged Spain by tossing 70 concrete blocks into contested waters off its coast, in order to encourage sea-life to flourish, continue to cause lengthy queues of cars and pedestrians.

As well as the border controls –which are ostensibly a crackdown on tobacco smuggling, as prices are much lower in Gibraltar– the Spanish government is blocking the inclusion of the Rock’s airport in the Single European Sky initiative.

Hammond said he would consider the Spanish proposal for ad hoc talks between the three sides in a wider Forum (ie, including local interests) than the trilateral one, although it remained committed to the Forum.

He made it clear that on matters where the competence has been devolved to the government of Gibraltar under the 2006 Constitution, London would always consult.

Madrid hankers after bilateral negotiations that would exclude Gibraltar.

Both Spain and Gibraltar have elections this year, which make it unlikely that much, if any, progress will be made as neither side wants to be seen to be climbing down.

In a separate development, the Spanish government announced the closing of the Cervantes Institute in Gibraltar, opened in 2006 as part of an agreement by the Forum. García-Margallo said it made no sense to promote Spanish language and culture in an area considered ‘Spanish territory’. ‘In Gibraltar, everyone speaks Spanish apart from the apes’, he said.

Domestic Scene

Podemos consolidates itself as the leading party, Ciudadanos rises

The radical anti-establishment party Podemos (‘We Can’), formed a year ago, would again be the most voted party if elections were held today, while support for another outsider, Ciudadanos (Citizens’ Party), has surged according to the latest opinion poll by Metroscopia (see Figure 1).

Figure 1. Voting intentions (% of valid votes)

	2011 general election	August 2014	October 2014	November 2014	January 2015	February 2015
Podemos	–	10.7	13.8	27.7	28.2	27.7
Socialists	28.7	31.7	30.9	26.2	23.5	18.3
PP	44.6	32.3	30.2	20.7	19.2	20.9
Ciudadanos	–	–	–	–	8.1	12.2
IU/ICV (1)	6.9	4.9	5.2	3.8	5.3	6.5

(1) United Left and Greens.
Source: Metroscopia.

Podemos (27.7% of the vote) and Ciudadanos (12.2%) between them would capture more than the combined votes of the ruling PP (20.9%) and the Socialists (18.3%), breaking the mould of Spanish politics over the last 40 years (see Figures 2 and 3).

Figure 2. What motivates you to vote for Podemos or Ciudadanos (%) (1)

	Podemos (%)	Ciudadanos (%)
Disappointed and disenchanted with the other parties	45	34
The party is closer to what I feel and believe now	36	49
Both the above	18	16

(1) Question formulated to those declaring they will vote for Podemos or Ciudadanos or who manifest their sympathy for these parties.
Source: Metroscopia.

Figure 3. If you vote for Podemos or Ciudadanos it will be... (%) (1)

	Podemos		Ciudadanos	
	Yes	No	Yes	No
To renovate the political system	96	3	93	5
Because of the corruption that currently exists	94	7	86	14
To end the two-party system of the PP and Socialists	92	8	92	8

(1) Question formulated to those declaring they will vote for Podemos or Ciudadanos or who manifest their sympathy for these parties.
Source: Metroscopia.

The Metroscopia survey was conducted after Podemos' massive rally in the centre of Madrid that attracted more than 150,000 people from a wide social spectrum. Podemos, however, slipped a little (from 28.2% to 27.7%) due, according to José Juan Toharia, the chairman of Metroscopia, to its aggressive language, lack of specific policies and its disqualification of Spain's transition to democracy between 1975 and 1978 after the death of

General Franco, a process which, for all its faults (seen in retrospect), many Spaniards regard as successful and hold dear.

Ciudadanos is a Barcelona-based centre-right party, founded in 2005, which has nine deputies in the Catalan parliament and is opposed to the movement in the region for a separate Catalan state. The party's influence is beginning to spread outside Catalonia, particularly among those who previously voted for the PP and are looking for an alternative.

The PP overtook the Socialists, who suffered a big decline in support (from 23.5% to 18.2%), into second place.

The PP and the Socialists, swamped by corruption cases and labelled a caste by Podemos, are making hay with the highly publicised tax affairs of Juan Carlos Monedero, co-founder of Podemos, who voluntarily paid €200,000 in income tax and fines this month to satisfy a debt from €425,150 he earned as a consultant to the governments of Bolivia, Nicaragua, Venezuela and Ecuador. By making a complimentary tax return before he was submitted to a tax inspection, he avoided further tax penalties.

There were well-founded suspicions that the Tax Agency leaked Monedero's details to the press in order to discredit Podemos. Cristobal Montoro, the Finance Minister, denied this.

Spain's Supreme Court summoned three former Socialist chief ministers of Andalusia as suspects in the ongoing investigation into a multi-million euro early retirement fraud. Manuel Chaves, currently a senator, headed the Andalusian government between 1990 and 2009 and was also a deputy prime minister under José Luis Rodríguez Zapatero. Gaspar Zarrías held the top job in the region for just 16 days and is now an MP and Antonio Griñán was chief minister between 2009 and 2013 and is also an MP.

The Socialist Party said it would ask the three to resign their seats if the Supreme Court specified the crime for which they are suspects after they appeared before the court in April. An early election will be held in Andalusia, the Socialists' fiefdom, on 22 March.

So far 271 people are under investigation in the ERE scandal which involves public funds used to pay early retirement compensation at companies laying off large numbers of workers and has embroiled the Socialist Party and the two main trade unions –UGT and CCOO–.

The next general election is not due until December and a lot could happen by then. The PP is putting its faith in Spain's economic recovery that is now firmly underway in the belief it will persuade voters that it is better to have a safe pair of hands to consolidate it, while the Socialists believe that in the end voters on the left will opt for them and Podemos and Ciudadanos face the

handicap of not having the infrastructure and resources of the two main parties, although they do have the attraction of not being tainted by corruption.

Court to probe Socialist government's tax amnesty linked to the 'Falciani list'

A Madrid court is to investigate whether the previous Socialist government unfairly offered tax dodgers what was tantamount to an amnesty in 2010 that saved them from prison terms.

The probe comes in the wake of the ongoing investigation into HSBC Private Banking in Geneva. Swiss prosecutors raided its offices earlier this month and announced a money-laundering investigation.

The case began in 2008 when HSBC employee Hervé Falciani gave the French authorities a list of those holding accounts in Geneva. In 2010, the Spanish authorities contacted Spaniards on the list requesting them to pay back taxes or face an inspection and possible criminal prosecution (see Figures 4 and 5). The letter gave recipients 10 days to reply.

Figure 4. Balance of accounts of 'Falciani list' by country

	US\$ million
Switzerland	27,600
UK	19,200
US	11,900
France	11,100
Italy	6,600
Germany	3,900
Spain	2,000

Source: International Consortium of Investigative Journalists.

Figure 5. Number of clients by country in the 'Falciani list'

	Number
Switzerland	11,235
France	9,187
UK	8,844
Italy	7,499
US	4,183
Spain	2,694
Germany	2,106

Source: International Consortium of Investigative Journalists.

Hundreds responded and avoided prison terms of up to six years, including Emilio Botín, the then chairman of Santander, Spain's biggest bank, and members of his family, who paid €200 million. The Tax Agency collected a total of €260 million.

The Gestha union of tax-office workers filed a complaint against the government of José Luis Rodríguez Zapatero but the case did not prosper in the courts. A Madrid court has now decided to re-open the case and investigate whether the then head of the Tax Agency and the chief of the tax inspection department committed a breach of public duty.

In a separate development, Santiago Menéndez, the head of the Tax Agency, announced a money laundering investigation into 705 people who benefited from the tax amnesty granted by the Popular Party government in 2012 after it won the last general election.

The tax amnesty collected half of the envisaged amount. More successful was the fight against tax fraud last year, which raised €12,318 million (1.2% of GDP), 12.5% more than in 2013.

King Felipe VI takes a 20% cut in salary

King Felipe VI, keen to set an example in austerity Spain, reduced his annual salary by 20% to €234,204 but kept the budget for the royal family unchanged at €7.7 million by distributing it differently.

The King took over from his father, Juan Carlos I, last June when he abdicated. His salary is 80% that of his father's.

The cut is part of the ongoing efforts to change the Spanish monarchy's image, tarnished by events during the reign of Juan Carlos including the corruption case of his daughter, the Infanta Cristina, and son in law, Iñaki Urdangarín, and enhance transparency.

Cristina is charged with two counts of being an accessory to tax fraud. Her husband, who is alleged to have embezzled €5.8 million in public funds, faces charges of money laundering and fraud. Both have denied any wrongdoing.

The couple are in the process of selling their mansion in Barcelona, which was bought for €6 million (plus another €3 million in renovations) and raised questions of where the money came from.

Half of the house was seized by a court in 2013 in order to secure part of Urdangarín's €13.6 million court bond.

The budget of the Spanish royal household is one of the lowest in Europe. For

example, the salary of King William of Holland is €825,000 and the total budget amounts to €38 million, while that of the Danish royal household is €13.2 million.

King Felipe has seen his approval rating steadily rise since assuming the throne. This rating was 71% in February, according to Metroscopia, compared with 31% for Pedro Sánchez, the leader of the Socialists, and 23% for Prime Minister Mariano Rajoy.

Spain's foreign population, the second largest in the EU

Spain's foreign population was just over 5 million in 2013, the second largest in the EU after Germany, and accounted for 11% of its total population according to the latest figures from Eurostat (see Figure 6).

Figure 6. Foreign population in the EU (1)

	Million
1. Germany	7.69
2. Spain	5.07
3. UK	4.92
4. Italy	4.38
5. France	4.08
6. Belgium	1.25

(1) EU and non-EU citizens and excluding naturalised Spaniards.
Source: Eurostat, figures at January 1, 2013.

The foreign population has steadily declined since 2010 when it peaked at 5.4 million, largely due to Spain's economic crisis.

The Economy

Spain's growth set to accelerate

Spain is firmly back on the road of economic recovery, with growth averaging more than 2% over the next two years but with the unemployment rate still above 20%.²

Like the IMF, the European Commission (EC) has had to continuously upgrade its GDP growth forecasts for Spain over the last year. The EC now puts growth at 2.3% in 2015 and 2.5% in 2016, higher than the euro zone average (see Figure 7). The previous forecasts, made last autumn, were 1.7% and 2.2%, respectively. The research department of BBVA, Spain's second-largest bank, puts growth even higher this year at 2.7%.

² See my analysis of the recovery at http://www.realinstitutoelcano.org/wps/portal/web/rielcano_en/contenido?WCM_GLOBAL_CONTEXT=%2Felcano%2Felcano_in%2Fzonas_in%2Fcommentary-chislett-why-is-spain-recovering-faster-than-expected#.VOdHXLDf-ib.

Among the four largest euro zone economies (Germany, France, Italy and Spain), Spain's growth will be the strongest. The jobless rate, however, will remain stuck at more than 20% until 2016.

Figure 7. European Commission forecasts for the EU, 2014-16

	Real GDP (%)			Inflation (%)			Jobless rate (%)		
	2014	2015	2016	2014	2015	2016	2014	2015	2016
France	0.4	1.0	1.8	0.6	0.0	1.0	10.3	10.4	10.2
Germany	1.5	1.5	2.0	0.8	0.1	1.6	5.0	4.9	4.8
Greece	1.0	2.5	3.6	-1.4	-0.3	0.7	26.6	25.0	22.0
Italy	-0.5	0.6	1.3	0.2	-0.3	1.5	12.8	12.8	12.6
Spain	1.4	2.3	2.5	-0.2	-0.1	1.1	24.3	22.5	20.7
Euro zone	0.8	1.3	1.9	0.4	-0.1	1.3	11.6	11.2	10.6
UK	2.6	2.6	2.4	1.5	1.0	1.6	6.3	5.6	5.4

Source: European Commission.

The upturn in domestic demand, easier financing conditions, resulting from the European Central Bank's monetary policy interventions, greater investor confidence, labour market reforms and lower oil prices are spurring growth after three years of recession (which ended in the fourth quarter of 2013) and seven years of adjustments.

Domestic and not external demand is increasingly the engine of growth. Imports (+5.7%) rose faster than exports (+2.5%) in 2014 for the first time since 2006. As a result, last year's trade deficit was 53.4% higher at €24.47 billion, although this was the second-lowest figure since 1998.

Exports continued to set a new record (€240 billion). The EU took 63.4% of exports, up from 62.6% in 2013 (see Figure 8). Those to the US increased 22%, but still only accounted for 5% of the total. Sales to Latin America fell 6.7% and their share of the total (5.8%) was lower than Portugal's (7.5%).

Figure 8. Distribution of exports by geographical area, 2014 (1)

	% of total
Europe	69.8
Euro zone	49.7
North America	5.0
Latin America	5.8
Asia	9.5
Middle East	3.1
Africa	6.8
Oceania	0.8
Total	100.0

(1) Contribution in percentage points to the growth in exports.
Source: Ministry of Economy and Competitiveness.

Automotive exports rose 6.2% and accounted for 14.8% of the total (see Figure 9).

Figure 9. Exports by sectors, 2014 (1)

	% of total
Capital goods	20.1
Food, drink and tobacco	15.5
Automotive	14.8
Chemical products	14.2
Non-chemical semi-manufactured goods	10.7
Consumer manufactures	9.2
Energy products	7.2
Other goods	4.4
Raw materials	2.4
Consumer durables	1.4
Total	100.0

(1) Contribution in percentage points to the growth in exports.
Source: Ministry of Economy and Competitiveness.

House sales rise for first time since 2010

The real estate sector, plunged into crisis when the housing boom ended abruptly in 2008 with the bursting of a huge bubble, began to recover last year when the number of homes sold rose for the first time since 2010.

The recovery, however, was very modest as the increase was only 2.2% to 319,389 and it was mainly due to sales of second-hand homes (see Figure 10). The number of housing starts in 2014 was estimated at 38,000, down from a massive 760,000 in 2006 at the height of Spain's property boom.

Figure 10. Sales of homes in Spain, 2007-14

	Thousand
2007	775.3
2008	552.0
2009	413.3
2010	439.5
2011	359.8
2012	318.5
2013	312.5
2014	319.3

Source: National Statistics Office (INE).

Rajoy and Valls inaugurate new electricity interconnection

Prime Minister Mariano Rajoy and his French counterpart, Manuel Valls, inaugurated the new electricity interconnection between their two countries, which will double the exchange capacity to MW 2,800.

It also strengthens the security of the two electricity systems and promotes the integration of a greater volume of renewable energy, especially wind power from the Spanish system. Additionally, it will guarantee the electricity supply in the province of Gerona and for the future high-speed train.

The 65km project is entirely underground and includes a tunnel of 8.5 km in length and 3.5 metres in diameter which will house the cables in the section that crosses the Pyrenees.

Madrid has long fought for greater interconnection, part of the promised 'energy union' that is a priority for Donald Tusk, President of the European Council since last December, but always ran up against stiff resistance in France, particularly from the state-backed nuclear industry, which generates three quarters of the country's electricity. Spain has achieved a big increase in renewable generating capacity over the past 10 years and wants to export it.

Spain's energy dependence falls significantly

Spain's energy dependence rate, a key strategic element, fell from 81.3% in 2008 to 70.5% in 2013, according to the latest comparative figures from Eurostat (see Figure 11).

Figure 11. Energy dependence rates in the EU, 2008-13 (%) (1)

	2013	2008
France	47.9	50.8
Germany	62.7	60.8
Italy	76.9	85.7
Spain	70.5	81.3
UK	46.4	26.2
EU-28	53.2	54.7

(1) Net imports divided by gross consumption and expressed as a percentage.
Source: Eurostat.

The sharp fall was due to the substantial increase in renewable energy sources, particularly wind power. Wind turbines met 21% of electricity demand in peninsular Spain Peninsula in 2013, up from 12% in 2012.

Spain more identified now with 'crisis' than with flamenco

Spain's economy is recovering, but abroad the country is now more associated with the word 'crisis' than with the traditional stereotype of flamenco, and sun and bulls are not that far ahead of it, according to the latest image barometer produced by the Real Instituto Elcano, which surveyed 10 countries.³

When Germans were asked what immediately came to mind when they thought about Spain, 21.8% said sun, 8.5% crisis and 7.8% fiesta. The British and French also put sun first (28.5% and 26.5%, respectively), but while tourism was in second place for Britons (19 million of whom came to Spain last year), the French said crisis. The Mexicans and Moroccans both put crisis first, followed by bulls and football, respectively.

³ See the full report (only in Spanish) at http://www.realinstitutoelcano.org/wps/wcm/connect/fb309280475a88df9b6fbb12dd3b68de/Barometro_Imagen_España_5.pdf?MOD=AJPERES&CACHEID=fb309280475a88df9b6fbb12dd3b68de.

Corporate Scene

Airport operator AENA in Europe's largest initial public offering

The long delayed listing of AENA, Spain's airport operator, raised €4.3 billion when the state sold a 49% stake in the group. It was Spain's largest initial public offering (IPO) since 2007 and Europe's biggest since Glencore raised €7.1 billion in 2011.

The airports operated by AENA handled around 200 million passengers in 2014, a bumper year for tourism.

Investors who acquired AENA shares and then sold them on the first day of trading made a killing, as the share price rose 20.7%.

The state will hold onto 51% of AENA's shares.

Caixabank launches take-over of Portugal's BPI

Caixabank, Spain's third-largest bank by market value, launched a take-over bid for the 55.9% of Portugal's Banco BPI it does not already own.

Its offer came as BPI considered its own bid for Novo Banco, the lender that was carved out from the collapse of Portugal's Banco Espírito Santo. If BPI acquires Novo Banco and Caixabank ends up owning BPI, then Caixabank would become the largest lender in Portugal and a major force across the Iberian Peninsula.

Caixabank is dwarfed by Santander and BBVA, the other two major players in Spain, because of their significant interests in Latin America and the US, but on its home turf it has the largest market share.

Caixabank has acquired five banks in Spain since 2010 (Caixa Girona, Bankpyme, Banco Civica, Banco de Valencia and most recently Barclays).

Big improvement in 2014 bank results

Santander and BBVA, Spain's two largest banks, which sailed through the health check conducted last year by the European Central Bank, posted greatly improved results last year, providing further evidence of the country's turnaround.

Santander, the euro-zone's largest bank by market capitalisation, generated an attributable profit of €5.8 billion, 39% more than in 2013 and without resorting to capital gains to boost its bottom line. The UK and Brazil contributed 19% each of total group profits and Spain 14%.



Earnings were lifted by an increase in lending and fee income, core activities of its retail-banking-focused business model, and were also aided by fewer provisions for souring loans. Bad loans as a proportion of total lending fell to 5.19% from 5.61% in 2013.

BBVA, Spain's second-largest bank, made an attributable profit of €2.6 billion, up 25.7%. However, it recorded a loss of €1.6 billion in Spain. Mexico contributed the largest share of the group's pre-tax profits (€2.5 billion). The NPL ratio was 5.8%, a full percentage point lower.

Non-performing loans represented 12.5% of total credit at the end of 2014, its lowest level since August 2013.

Bankia and former management ordered to deposit €800 million with court
A judge ordered Bankia, the bank that brought Spain's financial system to the brink of collapse in 2012, and its former management to set aside €800 million to cover possible claims.

The bank, created from the merger of seven savings banks, was disastrously listed under the chairmanship of Rodrigo Rato, a former head of the International Monetary Fund and economy supremo in the last PP government. A year later the EU bailed out Bankia to the tune of €22 billion and the value of its shares was almost entirely wiped out.

Around 350,000 small investors bought into the offering at €3.75 a share. The nominal value of the stock was subsequently written down to €0.01.

The court is investigating whether Bankia provided false and misleading information to investors before the offering. According to two Bank of Spain investigators, appointed by the court, 'the annual accounts for 2011... did not give a true picture of the company'.