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### Summary

Fresh election on the cards as parties fail to bury differences and form new government.  
Catalan acting Prime Minister Artur Mas quits to avert new elections.  
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### Domestic Scene

Fresh election on the cards as parties fail to bury differences and form new government...

One month after an inconclusive election, parties struggled to form a new government, raising the prospect of a fresh election.

The anti-austerity Podemos and the centrist Ciudadanos broke the hegemony of the conservative Popular Party (PP) and the centre-left Socialists (PSOE), the two parties that have alternated in power since 1982, but the results of the election on 20 December created a very fragmented parliament with few coherent options to form a government.

The PP of Mariano Rajoy won 123 of the 350 seats in parliament on close to 30% of the vote, way down on the absolute majority of 186 it obtained in the 2011 election and its lowest number (107) since 1989 (see Figure 1). The Socialists captured 90 seats, their worst performance since 1988 (118). Podemos captured 69 seats (27 of them won by its affiliated offshoots in Catalonia, Valencia and Galicia which went under different names) and Ciudadanos 40.

**Figure 1. Results of general elections, 2015 and 2011 (seats, millions of votes and % of votes)**

	2015			2011		
	Seats	Votes	%	Seats	Votes	%
Popular Party	123	7.21	28.7	186	10.83	44.6
Socialists	90	5.53	22.0	110	6.97	28.7
Podemos (1)	69	5.18	20.6	–	–	–
Ciudadanos	40	3.50	13.9	–	–	–
Catalan Republican Left	9	0.59	2.4	3	0.25	1.0
Democracy and Freedom (2)	8	0.56	2.2	16	1.0	4.2
Basque Nationalist Party	6	0.30	1.2	5	0.32	1.3
Popular Unity (3)	2	0.92	3.7	11	1.68	6.9
EH Bildu (4)	2	0.21	0.9	7	0.33	1.37
Canarian Coalition	1	0.08	0.3	2	0.14	0.6

(1) Podemos won 42 seats and 27 more in alliances in Catalonia, Valencia and Galicia.

(2) In the 2011 election, the Catalan CiU alliance, which broke up in 2015.

(3) Ran as United Left in 2011.

(4) Amaiur in 2011.

Source: Interior Ministry.

The PP and the Socialists were severely but far from mortally wounded: their combined share of the vote plummeted from 73.4% in 2011 (84% of the seats) to 50.7% (61% of the seats, see Figure 2). They held on to the Senate winning 171 of the 208 elected seats (58 are appointed by regional parliaments).

**Figure 2. The Rise and fall of Spain's two-party system in municipal, general and European elections, 1986-2015 (1)**

	1986	1987	2003	2007	2008	2011	2014	2015
Municipal	–	54.5	69.1	70.5	–	65.3	–	52.0
General	70.1	–	–	–	83.8	73.4	–	50.7
Cleavage	–	63.8	–	–	–	–	49.1	–

(1) Percentage of votes won by the Popular Party (Alianza Popular until 1989) and the Socialists.

Source: Interior Ministry.

The political establishment did not collapse as Greece's did in 2014-15, but the shape of Spanish politics has significantly changed. No image better illustrated the composition of the new parliament than the 33-year-old Podemos MP Alberto Rodríguez with dreadlocks walking past a bemused Rajoy (aged 60 and looking his years).

In another photo that made the headlines and stirred a debate in social media, Podemos deputy Carolina Bescansa brought her five-month old son to the parliament. Not everyone supported her decision: she angered feminist groups and conservatives. Carme Chacón, a former Socialist Defence Minister, pointed out that there was a day nursery in the parliament. 'I was still breastfeeding when I was Minister and the child stayed in my office', she said. 'After three hours I had to call a recess so I could feed him'.

The only combination of parties that would give a solid parliamentary majority is a German-style coalition of the PP and the Socialists (213 of the 350 seats), but this would be hard for the Socialists to swallow as it would leave Podemos, a party that was only formed in January 2014 and won almost as many votes as the Socialists, as the leader of the opposition and in a position to outflank the Socialists, which is their long-term goal. The Socialists' share of the vote halved to 22% between 2008 and 2015, as more than 6 million voters turned their backs on the party.

The cleavage between left and right is particularly acute in Spain, going back to the country's 1936-39 civil war. Such a government could be seen as shoring up the creaking political establishment, which the new parties campaigned to regenerate. But this would not be the case if Ciudadanos were included in the coalition, and if Rajoy, the incumbent Prime Minister, stepped down and made way for someone more acceptable to all three parties. Forty-three per cent of respondents who identified themselves as PP voters said in a Metroscopia poll that they rejected Rajoy's continuation in office. Despite their differences, more unites these three parties than divides them: they oppose the independence of Catalonia (and a referendum on the issue), and to varying degrees support reforming the Constitution and the electoral law and believe in a free market economy.

Pedro Sánchez, the Socialists' leader, believes he can forge a 'progressive' government with Podemos, but the latter's leader, the pony-tailed Pablo Iglesias, has set a 'red line' of a legally-binding referendum on independence for Catalonia, which is unacceptable to the Socialists. If Iglesias relented, his allies in Catalonia (12 seats) would most likely break away from Podemos. Such a coalition, moreover, would only have 159 seats, below the 'magic' number of 176 and would need support from the (pro-independence) Catalan Republican Left (ERC, with nine seats), the Basque Nationalist Party (six seats) and other parties.

The Socialists' 'regional barons' were not happy with Sanchez's decision to help the two pro-Catalan independence parties in the Senate –ERC and Democracy and Freedom– form their own group in the upper house. This was seen as an attempt by Sánchez to back him as Prime Minister.

Talks between the main leaders failed to resolve any of the basic differences ahead of the first attempt in parliament, probably in early February, to form a new government. This leaves four options:

- A minority government led by the PP, which has the most seats but this would require the support or abstention by the Socialists and Ciudadanos. Sánchez has made it clear he will not do anything to ensure Rajoy's investiture for a second term in office.
- A minority left-wing government led by the Socialists. This requires the support of Podemos and others, and would be very weak. The Socialists would be in the uncomfortable position of having Podemos constantly breathing down their neck. A coalition government of these parties needs Podemos to abandon its campaign promise to hold a referendum in Catalonia.
- A German-style grand coalition, which is what the electorate appears to want as voters gave none of the parties an absolute majority and the entry of the two upstart parties (Podemos and Ciudadanos) was a vote for change. Sixty-one percent of respondents in a Metroscopia poll said it was good for Spain that no party had an absolute majority, and the same percentage were in favour of an agreement between parties to form a new government.

Such a government would show that Spain is not 'different' (to quote the slogan in the 1960s during the Franco dictatorship to encourage tourists to visit the country). In the view of many analysts, it is what Spain needs as it would give the country the political stability to consolidate the fledgling economic recovery and enable the constitution and discredited institutions to be reformed with a broad consensus. The election of the Socialist Patxi López as the parliament's new speaker was a move in this direction. He was supported by Ciudadanos and tacitly backed by the PP. He is the first speaker in Spain's post-Franco democratic history who is not a member of the party with the most votes.

- Fresh elections, probably in May, with no certainty that the results would be significantly different and at the risk of the power vacuum eroding the recovery and making markets nervous. According to a poll by Metroscopia, the PP's share of the vote would improve marginally to 29%, Podemos would overtake the Socialists into second place with 22.5% (up from 20.7%), the Socialists would drop to 21.1% from 22% and Ciudadanos would rise from 13.9% to 16.6%. The same poll showed that 61% of respondents wanted the parties to agree a new government and not hold new elections.

King Felipe VI appealed for dialogue and unity in his Christmas-Eve message following the election. 'Political plurality, expressed at the ballot box, without a doubt offers different sensitivities, visions and perspectives; and it involves a way of exercising politics based on dialogue, consensus and commitment. Now, what should matter to all, first and foremost, is Spain and the general interest of the Spanish people'.

The Spanish stock market, the worst performer in Europe last year, continued to decline more than other markets (-10.4% until 19 January) and the risk premium on Spanish government 10-year bonds increased a little from around 120bp before the election to 130bp. Valdis Dombrovskis, the European Commission Vice-president for the euro and social dialogue, said there was no justification for the next government to ask for yet another postponement in reaching the budget-deficit threshold of 3% of GDP (due in 2016), as the Socialists say they want. Jean-Claude Juncker, the President of the European Commission, urged the parties to put aside their differences and form a stable government.

### ... Catalan acting Prime Minister Artur Mas quits to avert new elections

Artur Mas, the pro-independence regional Prime Minister of Catalonia for the last five years, stepped down in order to avoid triggering a new regional election, which would have been the fourth in five years.

In a last minute deal with the anti-capitalist Popular Unity Candidacy (CUP), he bowed out in favour of Carles Puigdemont, the Catalan Democratic Convergence (CDC) mayor of Girona and, like Mas, an ardent defender of secession from Spain.

The DCP and Republican Left of Catalonia (ERC) formed a joint ticket called *Junts pel Sí* (Together for Yes) which contested last September's regional election, and won 62 of the 135 seats in the Catalan parliament. Together with CUP's 10 seats it has a majority in the parliament but only 48% of the vote.

CUP viewed Mas as too business-friendly, and he was also damaged by a string of corruption scandals, particularly that of Jordi Pujol, Mas's political mentor, Prime Minister of the region's autonomous government from 1980 to 2003 and the preeminent nationalist leader in Spain.

Pujol became a discredited figure after he admitted publicly in 2014 that he had offshore bank accounts with a considerable amount of money in Andorra, which he claimed was left to him by his father. He was stripped of his honorary privileges. Pujol and his wife Marta Ferrusola have been subpoenaed to testify before a court in February in connection with a probe into money-laundering. They denied that the money came from corrupt activities during his 23 years as Prime Minister. Several of their children are also under investigation.

CUP repeatedly refused over the course of three months to back the incumbent Mas ahead of the 9 January deadline to form a new government, and in the end it got its way at the cost, perhaps, of making the pro-independence camp beholden to a far-left party that has nothing in common with conservative, middle class supporters of secession from Spain. The ditching of Mas also revealed the divisions among politicians in favour of independence.

Puigdemont hit the headlines in 2013 when he quoted a Catalan journalist executed under the Franco dictatorship who said that 'the invaders will be expelled from Catalonia',

in reference to the Spanish government. This endeared him to the radical wing of the pro-independence camp, making him a candidate to replace Mas.

Puigdemont took the oath of office omitting the traditional vows of loyalty to Spain's constitution and King, and he appointed the region's first Minister for Foreign Affairs. State lawyers are investigating both decisions to see whether they are illegal.

### King Felipe's sister the Infanta Cristina on trial for tax fraud

The Infanta Cristina became the first member of the Spanish royal family to be put on trial. She is accused of tax fraud in a case that involves her husband, Inaki Urdangarín, and 16 other defendants.

She faces eight years in jail if found guilty, while Urdangarín, accused of embezzlement and money laundering, faces 19 years and six months.

The case relates to Urdangarín's supposedly non-profit Noos Institute sports foundation, which was allegedly used as a vehicle to win falsely inflated contracts from regional government bodies, before channelling the money to personal accounts via tax havens.

Cristina was a board member of the foundation and with her husband co-owned a real-estate company called Aizoon, which prosecutors say was used to launder embezzled funds.

Her lawyer is seeking to throw out the charges because it is not supported by public prosecutors. The only accusation against her was made privately, by anti-corruption group *Manos Limpias* ('Clean Hands'). The tax authorities said they had no case against her. Lawyers cited the so-called 'Botin doctrine', named after a case dropped against the former Chairman of Banco Santander in 2007.

Dismissing the case against her, in a country where corruption has become a hot topic, would be controversial and seen as not making all citizens equal before the law.

### *Madrid city government to do away with last street names from the Franco regime*

The leftist government of the city of Madrid is to change the names of some 30 streets and squares that are associated with the 1939-75 regime of General Franco.

An alliance of left-wing groups including Podemos together with the Socialists have run the city since last May's local elections, which ended the conservative Popular Party's unbroken 24-year rule.

Many street names were changed under the so-called historical memory law passed by the socialist government of José Luis Rodríguez Zapatero in 2007.

The remaining 'Francoist' streets includes several named after generals who took part in the uprising against the democratically-elected Republican government in 1936, which sparked a three-year civil war, and a street (*Calle Caídos de la División Azul*) that

commemorates the Spanish division that fought with Nazi Germany's armed forces against Russia during the Second World War.

*Spain, third-highest recipient of migrants crossing Mediterranean to Europe*

Spain received close to 4,000 migrants who crossed the Mediterranean in 2015 en route to EU countries, a drop in the ocean compared with the almost 850,000 who made it to Germany (see Figure 3).

**Figure 3. Arrivals and deaths of migrants crossing the Mediterranean to reach Europe in 2015**

	Arrivals	Deaths
Greece	847,084	805
Italy	153,052	2,892
<b>Spain</b>	<b>3,845</b>	<b>74</b>
Cyprus	269	–

Source: International Organisation for Migration.

## The Economy

### Registered jobless drops to lowest level since 2010...

The number of people registered as unemployed in government offices ended 2015 at just over 4 million, 354,000 fewer than a year earlier and the lowest level since 2010. The number of social-security contributors increased by 533,000 to 17.3 million, but was still far from the peak of 19.3 million in 2007, before the onset of the crisis (see Figure 4).

**Figure 4. Social security contributors, 2007-15 (million)**

	<b>Million</b>
2007	19.3
2008	18.5
2009	17.8
2010	17.6
2011	17.2
2012	16.4
2013	16.3
2014	16.7
2015	17.3

Source: Ministry of Employment and Social Security.

The stated unemployment figure (quarterly as opposed to the monthly number for the registered jobless and based on a household survey) was also expected to be lower when released on 28 January. At the last count, it stood at 4.85 million.

The stated figure is the one that makes the headlines. The difference between the two figures reflects those who might have exhausted their right to unemployment benefits, are not in state training-programmes, are working in the shadow economy or have given up seeking a job.

New car sales increased 21% to just over one million, the highest figure since 2008 and well above average growth of 9.3% in the EU (see Figure 5).

**Figure 5. New car sales in main EU countries, 2015 (million units and % increase)**

	<b>Million</b>	<b>% rise</b>
Germany	3.20	5.6
UK	2.63	6.3
France	1.91	6.8
Italy	1.57	15.8
<b>Spain</b>	<b>1.03</b>	<b>20.9</b>

Source: Anfac.



### ... IMF upgrades growth forecasts

The International Monetary Fund (IMF) raised its GDP growth forecast for Spain from 2.5% to 2.7% for this year and from 2.2% to 2.3% in 2017, but this is still below the government's projections of 3% and 2.9%, respectively (see Figure 6).

**Figure 6. GDP growth in the main euro zone economies, 2016 and 2017**

	2016	2017	Difference with October 2015 forecast	
			2016	2017
France	1.3	1.5	-0.2	-0.1
Germany	1.7	1.7	0.1	0.2
Italy	1.3	1.2	0.0	0.0
<b>Spain</b>	<b>2.7</b>	<b>2.3</b>	<b>0.2</b>	<b>0.1</b>
Euro zone	1.7	1.7	0.1	0.0

Source: IMF.

The IMF saw no impact on the economy at the moment because of the political uncertainty stemming from the failure to form a new government. As a big oil importer, Spain is benefiting from the very low prices.

### Banks meet ECB capital requirements

In a clear sign of turnaround, only six Spanish banks have to undergo the EU-wide stress test in 2016 conducted by the European Banking Authority (EBA), compared with 15 at the last test in 2014.

All banks meet the Common Equity Tier 1 (CET1) ratio required by the European Central Bank. This key metric varies depending on a bank's assets, risk profile and systemic importance (see Figure 7)

**Figure 7. Common equity tier 1 (CET1) ratios of main Spanish banks (%)**

	CET1 required (consolidated)	CET1 at 30/IX/2015
Caixabank	9.05	12.80
Bankia	10.31	13.60
Santander	9.75	12.39
BBVA	9.75	11.70

Source: National Securities Market Commission.

### Government names and shames tax debtors

The Tax Agency published a list of individuals and companies who owe more than €1 million (see Figure 8).

**Figure 8. Top five corporate tax debtors (€ mn)**

	€ million
Reyal Urbis	378.2
Nozar	203.1
Grupo PraSa	101.8
Banreal Holding	98.3
Aifos Arquitectura y Promoción Inmobiliaria	96.2

Source: Tax Agency.

Almost all the 50-largest company debtors are construction firms. One of them, Reyal Urbis, owes €378.2 million. Among the 4,855 individual debtors is Mario Conde, the former Chairman of Banesto (1987-93), imprisoned for embezzlement and document forgery. He owes €9.9 million. The total amount owing is €15.6 billion.

### Minimum wage rises 1%

The minimum monthly wage rose by 1% to €655.2. Workers receive 14 payments (extra ones in July and December), which leaves the annual amount at €9,172.8. The two-year freeze on increasing the wage ended last year (see Figure 9).

**Figure 9. Spain's minimum monthly wage, 2008-14 (1)**

	€
2008	600.0
2010	633.3
2012	630.3
2012	641.4
2013	645.3
2014	645.3
2015	648.6
2016	655.2

(1) There are 14 payments a year.

Source: Ministry of Employment and Social Security.

## Corporate scene

### Santander acquires Portugal's Banco Banif

Banco Santander, the euro zone's largest bank by market capitalisation, acquired most of the assets and liabilities of Portugal's failed Banco Internacional do Funchal (Banif) for €150 million.

Santander operates in Portugal through its subsidiary Santander Totta. The purchase of Banif's increases Santander's market share in loans and deposits in the country from 12% to 14.5% and makes it the second-largest privately-held bank after BCP-Milenium. Banif is the main bank in the archipelagos of Madeira and the Azores.

The Portuguese State will inject a further €2.26 billion to cover future contingencies on top of the €1.1 billion of fresh capital injected into the lender in January 2013 to allow it to meet minimum capital thresholds. Souring assets will be transferred to a vehicle that will later be liquidated at an additional cost to the State of €422 million.