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Foreign Policy

A busy international agenda

Having spent most of 2016 on the sidelines of international diplomacy because of the lack of a functioning government, Spain faces a busy year with five EU summits in the first half, Nato and G-20 summits, bilateral meetings with the French, German and Moroccan governments, among others, and state visits by King Felipe VI.

Prime Minister Mariano Rajoy, in office for a second term as of the end of October, re-entered the international arena when he was invited to November's mini summit in Berlin hosted by German Chancellor Angela Merkel for outgoing President Barack Obama, which was also attended by Theresa May, the British Prime Minister, Matteo Renzi, the Italian Prime Minister, and French President Francois Hollande.

Comparatively speaking, Spain is now regarded as something of an 'island of stability', following 10 months without a proper government as a result of two inconclusive general elections. Germany, France and the Netherlands go to the polls later this year, with uncertain outcomes, Renzi resigned in December after he was roundly defeated in a referendum to change the constitution, and the UK decided to leave the EU. Spain's next election is not until 2020, though the ruling Popular Party only has one-third of the seats in parliament.

'Our international presence was affected by the long period of interim government', Rajoy said. 'We now have to catch up... and the circumstances are especially favourable for it'.

A survey by the European Council of Foreign Relations last year showed that of the six largest EU members, Spain played the most marginal role in EU affairs. Poland, it said, was having a stronger impact on EU affairs than Spain.

Brexit is the main item on the EU's domestic agenda. Alfonso Dastis, the new Foreign Minister, is well versed in EU matters. A career diplomat, unlike his predecessor, José Manuel García-Margallo, a former Popular Party politician, Dastis came to the government from Brussels where he was the permanent representative to the EU.

In an interview with *El País*, the leading Spanish newspaper, Dastis said policy would be broadly in line with that of García-Margallo, although 'the tone could be different'. He said the European Commission and the European Council had asked the new government to play a bigger role in EU affairs.

On Brexit, he said the four freedoms enshrined in the EU –movement of people, merchandise, services and capital– could not be separated, as the UK appears to want.

On the thorny issue of the British overseas territory of Gibraltar, he saw a slim chance of joint sovereignty, as Spain has called for, if the UK opposed it, as is the case so far. 'I think you have to be realistic, if the United Kingdom does not want to negotiate it will be difficult to carry it forward'. He made it clear, however, that if Gibraltar wanted to continue to be part of the EU, 'it would have to be consulted with us. That will require a bilateral agreement between Spain and the United Kingdom'.

Dastis later told the Senate's Foreign Affairs Commission that Gibraltar would have to live 'with its back to the European Union' if it continued to reject the co-sovereignty proposal.

King Felipe VI was finally able to make a three-day state visit to Saudi Arabia, a trip that was cancelled twice. The Spanish company Navantia was close to signing a contract for the sale of five warships to Riyadh worth an estimated €2.1 billion.

Human rights groups criticised the deal because they feared the ships would be deployed by Saudi Arabia in the Yemen conflict.

A consortium of Spanish companies is building a high-speed rail link between Mecca and Medina, which is behind schedule and is now expected to be fully operational as of March 2018.

Domestic Scene

Catalan independence: prosecutor seeks nine-year ban from public office for former Minister

The tensions between the central and Catalan governments over holding a referendum on independence for the region in September escalated when the Supreme Court's prosecutor's office called for Francesc Homs, a former Minister, to be banned from holding public office for nine years for organising a non-binding plebiscite on secession in November 2014.

The Court said that Homs, at the time of the referendum Minister of the Presidency, was 'absolutely aware' that 'by doing so he violated the mandatory compliance of the Spanish Constitutional Court's decisions'. That court ruled the referendum as illegal.

Homs said the Court's decision 'proves that the Spanish State has a less democratic culture each day' and that puts Catalonia 'in a cul-de-sac'. He testified before the Supreme Court last September that the referendum was legal as it emanated from a Catalan parliament mandate and that the charge of disobedience against him was politically motivated.

In a related development, Artur Mas, the former President of the Catalan government between 2010 and early 2016, is due to stand trial in early February along with his former Vice President, Joana Ortega, and Education Minister, Irene Rigau, on charges of serious disobedience.

The Popular Party government's bid to negotiate some kind of deal with the Catalan government is going nowhere. Barcelona is adamant it will go ahead with a legally-binding referendum in September, whether Madrid agrees to it or not, while the Constitutional Court continues to strike down laws passed by the Catalan parliament.

'If 50% plus one vote "yes", we will declare independence without hesitation', said Carles Puigdemont, the Catalan President, in his New Year message.

In its latest move, the Court annulled parts of the law approved two years ago which gives Catalonia powers in the international field, including the right to approve the 'independence processes of other states', and declared unconstitutional various laws regarding Catalonia's path to 'disconnection' from Spain.

Fragmented parliament begins to adapt to a new style of politics

A minority Popular Party (PP), two parties on the left (Socialists –PSOE– and Unidos Podemos) and a centrist party (Ciudadanos, C's) are beginning to forge a new style of politics in Spain.

Gone are the days when the PP pushed through royal decrees (emergency laws), which it used (or abused, in the view of opposition parties) between December 2011 and December 2015 more than any other government, even though it enjoyed an absolute majority.

Today, consensus is the watchword and parliament is becoming the central focus of political life, as it should be.

Although it has a pact with C's, it is with the Socialists, which reluctantly allowed the PP to form a new government after 10 months and two inconclusive elections by abstaining in the investiture vote, that the PP is working closely.

This is because of the mathematics: the Socialists have 85 seats in parliament and C's only 32. In order to gain approval for its laws and reforms, the government needs the

Socialists' support much more than that of C's (the PP and C's together have 169 of the 350 seats compared to the 222 held by the PP and the Socialists).

The Socialists look like approving the spending ceiling which would allow the 2017 budget to be finally approved (the 2016 budget was rolled over) and so enable Spain to finally comply with the EU-imposed fiscal deficit target (below 3% of GDP in 2018) that it has consistently missed.

As part of that deal the Socialists extracted from the PP support for an 8% rise in the minimum wage this year.

Prime Minister Mariano Rajoy has a much more fluid and cordial relation with Javier Fernández, the Socialists' interim leader, than with Pedro Sánchez, the former leader who was ousted after a fierce power struggle over whether to allow Rajoy to remain in office for a second term.

The rapport between the PP and the Socialists is fazing C's and the anti-establishment Unidos Podemos, which has 71 seats, as they were created to restrict the two-party system, among other things. The Socialists have no interest in a general election until they have elected a new leader (probably in May) and begun to regain support as a credible alternative. Meanwhile, Unidos Podemos is wrestling with internal divisions over whether to adopt a radical strategy, including actions outside of parliament, or one that is more accommodating.

Rajoy meanwhile wants to see out the four-year legislature. 'We can pass from historic blocking [of him forming a new government] to historic co-operation', he proclaimed. Time will tell.

The PP would again win an election if it were held today, according to the latest Metroscopia poll, but still without an absolute majority, the Socialists have picked up since their crisis last October but would be overtaken by Unidos Podemos and Ciudadanos would gain more seats (see Figure 1).

Figure 1. Voter intention (% of valid votes)

	2011 election	20 Dec. 2015 election	3 Apr. 2016	26 June election	13 Oct.	11 Nov.	12 Jan 2017.
PP	44.6	28.7	27.7	33.0	37.8	35.7	33.2
Socialists	28.8	22.0	21.0	22.7	18.0	17.9	19.1
Podemos	—	20.7	15.9	21.1 (1)	22.1	23.1 (1)	21.7
Ciudadanos	—	13.9	18.8	13.0	11.6	13.0	15.5

(1) Unidos Podemos as of the June 2016 election.

Source: Metroscopia.

Six out of every 10 Spaniards do not speak English

Sixty per cent of people surveyed by the government-funded CIS research centre said they do not speak, read or write English. Only 28% said they could speak and write it (see Figure 2).

Figure 2. Spaniards' knowledge of languages (%)

	Do not speak, write or read it	Only read it	Only speak it	Speak and write it
English	59.8	6.0	5.7	27.7
French	78.0	5.4	5.6	9.0
Portuguese	92.4	2.3	1.1	1.2
German	94.0	0.6	0.9	1.7
Italian	91.3	2.2	1.9	1.7
Another language	84.9	0.2	0.6	0.9

Source: CIS.

Just over one-third of respondents (35.9%) said the education system gave 'little importance' to the learning of languages.

Supreme Court rules out taxpayer funding for Protestant Churches

The Supreme Court ruled that the Finance Ministry was right to deny in 2015 the same right of funding to Protestant Churches in Spain as that given to the Roman Catholic Church.

Taxpayers have the option on their annual declaration of ticking a box in order to assign to the Roman Catholic Church 0.7% of the taxes they have paid.

The Federation of Evangelical Religious Entities (Ferede) appealed against the Ministry's decision on the grounds that it violated the fundamental rights of equality before the law and religious freedom.

The box in favour of the Roman Catholic Church is based on the 1979 concordat between the Spanish state and the Holy See, which gives the Church special treatment, though not as much as during the 1939-75 dictatorship of General Franco when it was rewarded for supporting his uprising against the democratically-elected government of the Republic.

The 1978 Constitution states that 'there shall be no state religion', but Article 16:3 declares: 'the public authorities shall take the religious beliefs of Spanish society into account and shall in consequence maintain appropriate cooperation with the Catholic Church and the other confessions'. No other religious group is mentioned by name.

The Socialists at the time saw this as introducing 'covert confessionality' and voted against the wording in the committee that drafted the text. Spain's Roman Catholic face has changed considerably in the last 36 years: for example, 96% of marriages in 1980 were in the Catholic Church, 60% in 2005 and 22% in the first half of last year.

Under a Socialist government reform in 2007, the state stopped paying an annual 'budget complement' to the Church and compensated for this loss by increasing the voluntary donations that taxpayers can make on their yearly tax declaration from 0.52% to 0.7%.

More than 7 million taxpayers, around one-third of the total, tick the box. In 2014 (latest year available), they contributed more than €250 million to the Church (see Figure 3).

Figure 3. Taxpayers' contribution to the Roman Catholic Church (€ million)

	2007	2008	2009	2010	2011	2012	2013	2014
Contribution	241.3	252.6	249.9	248.6	247.1	248.5	246.9	250.2

Source: Conferencia Episcopal Española.

According to Europa Laica, which campaigns against the public funding of religions, the Spanish state contributes €11 billion worth of subsidies and tax exemptions to the Church including the financing of grant-assisted schools known as *concertados*, often run by the Church.

Under the 1979 concordat, the Church was slated to be self-financing as of the 1990s, but this has still not happened.

The Socialists, Unidos Podemos and Ciudadanos, which together have a majority of seats in parliament, called earlier this month for the Tribunal de Cuentas (Audit Court) to supervise the funds the Church receives from taxpayers, as it does for other institutions.

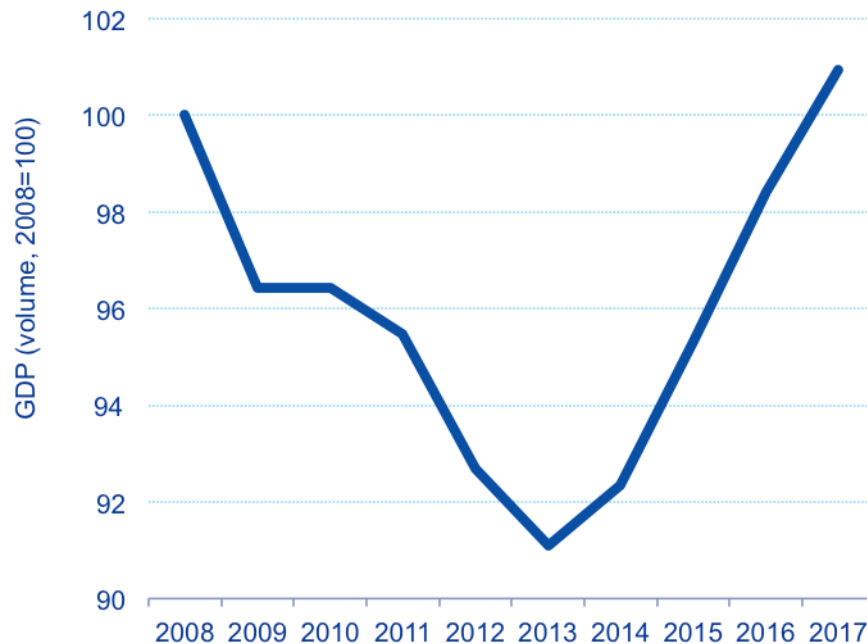
The Economy

Pre-crisis GDP (2008) will finally be recovered this year

The economy grew 3.3% in 2016, a tad faster than expected, according to the government, spurred by stronger consumption, buoyant exports and another record year for tourism, among other factors, as well as low oil prices and the European Central Bank's accommodative monetary policy.

As a result, the pre-crisis GDP level (2008) will at last be recovered in real terms this year (see Figure 4). This tends to be forgotten when Spain's growth rate, around double the euro zone average, is trumpeted.

Figure 4. GDP: finally bouncing back



Source: BBVA.

The brisker growth pushed down the number of jobless registered in the government's employment offices last year by 390,534 to 3.7 million, the biggest decline since the statistical series was started. The fall in registered unemployment in the last four years was 1.14 million (a decline of more than 20%).

The figure of 3.7 million is 600,000 less than the number of unemployed based on the latest quarterly survey and which is the figure that provides the headline jobless rate (18.9% at the end of September).

The difference between the registered and stated figures reflects those who might have exhausted their right to unemployment benefits, were not on state training-programmes, were working in the shadow economy or had given up seeking a job.

According to the World Economic Forum, Spain's labour market is one of the most inefficient in the world (see Figure 5).

Figure 5. Labour market efficiency

Ranking (1 to 138)	Country	Score (on a scale of 1 to 7)
1.	Switzerland	5.95
5.	UK	5.46
22.	Germany	4.80
51.	France	4.42
69.	Spain	4.25
119.	Italy	3.64

Source: Global Competitiveness Report, 2016-2017, World Economic Forum.

The number of social security contributors increased by 540,665 to 17.84 million, the highest since October 2009 but still well below the peak of 19.37 million in 2007.

The bulk of new social-security contributors were in the commerce and hotel trades. Spain received more than 75 million tourists last year, up from 68.2 million in 2015 and notching up another record (see Figure 6). They spent an estimated €77 billion. Some 130,000 new jobs were created in the tourism industry in 2016.

Part of the increase was due to holidaymakers switching from turbulent countries such as Turkey and Egypt to Spain.

Figure 6. Number of tourists and spending, 2012-16

	Number of tourists (mn)	Spending (€ bn)
2012	57.4	53.9
2013	60.6	59.3
2014	64.9	63.0
2015	68.2	67.2
2016 (estimate)	75.3	77.0

Source: Ministry of Energy, Tourism and Digital Agenda.

Labour Minister Fátima Báñez quickly seized on the employment figures as evidence that the Popular Party's reforms in 2012 were working. The Socialists and the radical left Podemos, however, want to overturn these reforms, which lowered dismissal costs, among other things. They do not have enough seats in parliament to do this and would need the backing of the centrist Ciudadanos which has a pact with the minority PP government.

While there is no doubt that employment prospects have improved, job precariousness remains high (27% of total jobs are short-term). The average length of contracts signed last November was 51 days compared with 93 in 2011 as a whole.

There was also better news in car sales. The number of new cars sold last year (1.14 million) was the highest since 2008, despite the ending of the government-financed scrappage deal scheme, but still far from the 1.61 million in 2004 (see Figure 7)

Figure 7. New Car sales, 2008-16

2008	2009	2010	2011	2012	2013	2014	2015	2016
1,161,176	952,772	982,015	808,100	699,589	722,789	855,308	1,034,232	1,147,007

Source: Anfac.

Spain also emerged from two years of deflation. The Consumer Price Index rose 1.6% last year.

The brighter picture, however, was not reflected in the Spanish stock market even though corporate earnings were generally better. The Ibex-35, the benchmark index, fell 2% in 2016 to 9,352, still a long way from the peak of 15,945 in November 2007 (see Figure 8).

Figure 8. Stock Market Indices (% change), 2016

Index	
Ibex-35 (Spain)	-2.01
Dax (Frankfurt)	+6.87
FTSE 100 (London)	+14.43
Euro Stoxx 50	+0.70
Dow Jones	+13.42
Nikkei (Tokyo)	+0.42

Source: Markets.

The economy is forecast to grow less this year as the tailwinds have started to abate. The general consensus is growth of around 2.5% (see Figure 9).

Figure 9. Macroeconomic forecasts (annual rates of change in % unless otherwise stated)

	2016	2017
Real GDP	3.3	2.5
Private consumption	3.3	2.3
Public consumption	1.2	1.8
Internal demand (contribution to growth)	3.0	2.3
Exports	5.5	3.5
Imports	5.1	3.1
External demand (contribution to growth in pp)	0.2	0.2
Jobless rate	19.7	18.1
Current account balance (% of GDP)	+1.3	+1.7
Public debt (% of GDP)	100.2	99.5
Fiscal deficit (% of GDP)	4.6	3.6

Source: BBVA.

European Court of Justice orders banks to reimburse unfair mortgage interest...

The European Court of Justice dealt a severe blow to Spanish banks and ordered them to reimburse clients with mortgage contracts that prevented them from benefiting from the fall in interest rates. The ruling could cost banks more than €4 billion.

Spain's Supreme Court ruled in May 2013 that so-called mortgage 'floor clauses', which impose a limit on how far mortgage interest rates can fall in tandem with the benchmark rate, were unfair because consumers had not been properly informed of the consequences. But the court said lenders did not have to reimburse clients for any excess interest payments before the date of that ruling.

Borrowers challenged that part of the decision and took it to the Luxembourg-based court. Some of them lost their homes because banks did not pass on the cut in interest rates and they could not meet their mortgage payments.

'The situation of unfairness must have the effect of restoring the consumer to the situation that [the] consumer would have been in if that term had not existed', the court said in a statement. 'Consequently, the finding that "floor clauses" are unfair must allow the restitution of advantages wrongly obtained by the seller or supplier to the consumer's detriment'.

The ruling means that those banks affected by the decision will have to make substantial extra provisions, which will dent their 2016 profits. BBVA, Spain's second-largest bank,

said it expected to take a hit of €404 million and the ailing Banco Popular, struggling with massive bad real-estate loans, €334 million. Popular's Chairman, Ángel Ron, was ousted last month after a shareholders' revolt. Banco Santander, the largest bank, is not affected by the ruling as it never used floor clauses.

... Bank bailout 'cost taxpayers €41.8 billion'

Bailing out savings banks, many of which collapsed following the bursting of a massive property bubble in 2008, cost €60.7 billion, €41.8 billion of which came from the state via the Orderly Bank Restructuring Fund (Frob) and the rest from the Deposit Guarantee Fund, according to the Audit Court.

The full cost will not be known until all the rescued banks are privatised, particularly Bankia, the largest, and the 'bad bank' known as Sareb is liquidated. The Court said a large chunk of the cost would not be recovered.

The state still controls 65% of Bankia and BMN (headed by former savings bank Caja Murcia).

While the bailout was bad news for taxpayers, it was good for advisors, consultancies, lawyers and other professionals who were paid €58 million by Frob.

Social protection spending still lower than EU average

Spain's social protection expenditure in GDP terms hardly changed between 2011 and 2014 (latest available year), according to Eurostat (see Figure 10).

Figure 10. Social protection expenditure (% of GDP), 2011-2014

	2011	2014	PPS per capita, 2014 EU = 100
France	32.7	34.3	131
Italy	28.5	30.0	98
Germany	28.6	29.1	131
EU	28.3	28.7	100
UK	29.1	27.4	100
Spain	25.3	25.4	77

Source: Eurostat.

The largest share of spending went on sickness, healthcare and disability (33.4%), followed by unemployment (10.8%), family and children (5.3%) and housing and social exclusion (1.4%).

Underlying the massive unemployment problem, expenditure on this item was more than double the EU average of 5.1% while that on housing and social exclusion was much lower than the EU average (4.0%).

In purchasing power standard (PPS), which adjusts for price level differences and where the EU-28 is 100, Spain's spending is 77.

Corporate scene

Repsol resumes oil activity in Libya

The oil company Repsol began to extract oil again in Libya after a break of around two years because of security concerns.

The conglomerate has operated in Libya since 1975 and was pumping around 330,000 barrels a day before it ceased activity in 2014. Repsol hopes to produce 270,000 b/d by April.

ACS wins Aberdeen port expansion contract

The construction company ACS signed a contract worth €411 million to expand the port at Aberdeen in Scotland.

Abertis enters India with purchase of two toll roads

Abertis, a world leader in the management of toll roads, entered India by acquiring two toll roads from Australia's Macquarie Group for €140 million.