

## Inside Spain Nr 172

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### Summary

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### Foreign Policy

#### Navantia loses big US order of frigates to Italy

The US Navy chose the Italian company Fincantieri instead of Navantia to supply up to 10 frigates in a contract that could eventually be worth US\$5.58 billion, the largest ever for a ship of its type.

The loss of the contract caused surprise in Spanish defence circles as the new frigates will be equipped with Lockheed Martin's Aegis combat system, regarded as the world's most advanced, which Navantia has installed in Norwegian, Australian and Spanish frigates, while Fincantieri has no such experience.

A factor that might have swayed the decision in Fincantieri's favour –six months ahead of the US presidential election– is that the company not only offered a better price but is also investing US\$100 million in its Marinette shipyard in the state of Wisconsin, where the frigates will be built.

Italy has a long strategic association with the US in defence matters, to the extent that it prefers US partners to European ones such as Germany and France. Italy joined the UK in the Tempest fighter jet programme last year rather than the FCAS programme of Germany and France.

The US government was also not pleased by Madrid's decision a year ago to pull the Spanish frigate Méndez Núñez out of a US-led naval group in the Persian Gulf because Washington changed the original mission.

The initial idea was a training mission to commemorate the 500<sup>th</sup> anniversary of the first circumnavigation of the world by Ferdinand Magellan and Juan Sebastián Elcano, but Washington announced it would send the fleet to the Persian Gulf, led by the aircraft carrier USS Abraham Lincoln at a time of heightened tension between the US and Iran.

There was also displeasure in Washington at Madrid's suggestion earlier this year that the US could not expect an increased presence at its Rota military base in southern Spain while imposing tariffs that harmed Spanish agricultural exports.

### Spain participates for first time in EU summit that includes Kosovo

The Socialist Pedro Sánchez became the first Spanish Prime Minister to take part in an EU summit (via video conference) with Western Balkan countries including Kosovo, whose independence Madrid does not recognise.

The Popular Party Prime Minister Mariano Rajoy boycotted the last such summit in 2018 even though he was in Sofia at the time. Greece, Cyprus, Slovakia and Romania also do not recognise Kosovo since it broke away from Serbia in 2008, but their leaders attended the summit. A total of 97 countries recognise Kosovo.

Spain's position, which has not changed since independence was declared during the prime ministership of José Luis Rodríguez Zapatero, is that it would recognise Kosovo if Belgrade and Pristina come to an agreement. Serbia still claims the territory.

### Cervantes Institute helps out Gibraltarian students learning Spanish

In a soft power gesture, the Cervantes Institute, the language school and cultural centre endorsed by the government, began providing free online classes in Spanish to secondary school students in Gibraltar, the British overseas territory long claimed by Spain. The classes are for students taking the A-level Spanish exam.

The Popular Party government of Mariano Rajoy closed the institute in Gibraltar in 2015 after four years in a decision widely viewed as purely political, since the operation there was commercially viable and much appreciated by Gibraltarians.

José Manuel García-Margallo, the Foreign Minister at the time, was particularly vociferous in pushing Spain's claim over the Rock. Gibraltar was ceded to Britain under the 1713 Treaty of Utrecht.

## Domestic scene

### Sánchez in key parliamentary vote on state of emergency extension

The left-wing minority coalition government faces a crucial and vitriolic vote in parliament on 20 May when it hopes to avert a political crisis by winning enough support for another extension to the state of emergency declared on 14 March because of the severity of the COVID outbreak.

Prime Minister Pedro Sánchez received the necessary endorsement earlier this month for a two-week extension, thanks to deals with the centre-right Ciudadanos (Cs, see separate story below) and the Basque Nationalist Party (EAJ/PNV). This gave the government 178 votes in favour to 75 votes against, with 97 abstentions.

The conservative Popular Party (PP), the main opposition party, abstained but said it would vote against a further extension. The current one ends on 24 May. This would throw the government's confinement emergence strategy into disarray. Pablo Casado, the PP's leader, claims Sánchez is violating citizens' constitutional rights by continuing to restrict free movement. 'The state of emergency made sense at the start of the pandemic, but it cannot go on indefinitely', he said. He also accuses him of a lack of transparency.

In Madrid's wealthy Salamanca neighbourhood, home to the richest 1%, protestors banging pots and pans, wrapped in the Spanish flag and egged on by Isabel Díaz Ayuso, the PP premier of the region, have been demonstrating in Núñez de Balboa street (73% of whose residents voted in the last election for the PP or VOX). There have also been protests in front of the Socialists' headquarters.

The far-right VOX, with 52 of the 350 MPs, plans demonstrations on 23 May against the state of emergency on board vehicles in all provincial capitals. Santiago Abascal, VOX's leader, challenged the government to ban the protests, arguing this would prove the violation of basic freedoms.

Sánchez is hoping for a final and flexible extension of around a month in order to avoid political battles every two weeks. Having won over Cs, although it might abstain in this vote because it views a month as too long, the key this time will be the Catalan Republican Left (ERC), the pro-Catalan independence party. ERC's 13 MPs backed the formation of Sánchez's government earlier this year and abstained in the last extension vote, threatening to vote against this time.

Spain began to emerge from lockdown on 2 May under a gradual and asymmetrical plan, depending on infection rates in the 50 provinces. All of Spain is out of Phase 0 except for the region of Madrid, Barcelona and some provinces of Castile-León, although some restrictions have been eased in these areas. Some 33 million people are in Phase 1 and 14 million are still in Phase 0.

The PP accuses the government of penalising Madrid for political reasons. Díaz Ayuso said there were no technical reasons to keep the region in Phase 0 where activity is considerably limited. This was contradicted by Yolanda Fuentes, her head of public health, who resigned over Díaz Ayuso's request (denied) to enter into Phase 1, which eases restrictions on gatherings and allows small businesses, hotels and bars and restaurants with terraces to re-open under strict conditions.

Spain is one of the countries to be worst-hit by the pandemic, with over 27,000 confirmed deaths and more than 278,000 cases (see Figure 1). The pandemic is beginning to be controlled: the number of deaths dropped below 100 on 17 May for the second day running (to 59 compared with a peak of 950 on 2 April). The regions of Madrid and Catalonia account for more than 50% of total cases (see Figure 2) and health workers for more than 20%, much higher than Italy's 10%.

**Figure 1. Notified cases and deaths by country**

	Notified cases	Deaths	Cured	Cases per 1mn pop.
World	4,805,186	316,730	1,860,036	616
US	1,527,664	90,978	346,389	4,619
<b>Spain</b>	<b>278,188</b>	<b>27,709</b>	<b>195,945</b>	<b>5,950</b>
UK	243,695	34,636	N/A	3,592
Italy	225,435	31,908	125,176	3,728
France	179,569	28,108	61,213	2,752
Germany	176,651	8,049	154,600	2,109

Figures at 17/V/2020.

Source: <https://www.worldometers.info/coronavirus/#countries>.

**Figure 2. Coronavirus (COVID-19) by region (1)**

	Notified cases	Deaths	Infected per 100,000 inhabitants	Deaths per 100,000 inhabitants
Andalucía	12,420	1,355	148	16
Aragón	5,456	838	414	64
Asturias	2,366	313	231	31
Balearic Islands	1,982	216	172	19
Basque Country	13,291	1,455	602	66
Canary Islands	2,284	151	106	7
Cantabria	2,265	206	390	36
Castilla y León	18,369	1,940	766	81
Castilla-La Mancha	16,587	2,883	816	142
Catalonia	55,824	5,944	727	77
Extremadura	2,958	497	277	47
Galicia	9,041	604	335	22
Madrid	66,338	8,847	996	133
Murcia	1,542	144	103	10
Navarre	5,137	501	785	77
La Rioja	4,020	348	1,269	110
Valencia	10,850		1,365217	27

(1) Figures at 16/V/2020 and excluding the North African enclaves of Ceuta and Melilla.  
Source: Health Ministry.

The government is moving very cautiously. According to an internal army report, there could be two more outbreaks of COVID-19 and the country will take between a year and a year-and-a-half to return to normality.

Only 5% of the 47 million population have contracted coronavirus, based on antibody tests, and, as a result, 'herd immunity' against the pandemic is a distant prospect, a report indicated. If a much larger share of the population was temporarily immune to the virus –about 60%– because they have contracted it without being tested or displayed symptoms then the country might develop 'herd immunity' and be relatively protected against a second wave of the coronavirus.

Spain has not carried out many COVID-19 tests. The OECD ranked the country 17<sup>th</sup> out of 37 countries at the end of April based on the number of tests per 1,000 population (see Figure 3).

**Figure 3. Diagnostic testing for COVID-19 in OECD countries**

	Tests per 1,000 population
Iceland (1)	147.6
Portugal (2)	41.9
Italy (2)	34.9
Germany (2)	30.4
Spain (2)	28.9
OECD average	27.7
France (2)	11.1
Mexico (1)	0.6

(1) Tests performed or samples tested.

(2) People or cases tested.

Note that there are differences as to whether figures include tests, or individuals tested; whether they include all lab tests (public and private) or not; on how regularly data is updated by each country; and other aspects. Date of testing varies between 26/IV/2020 and 3/V/2020.

Source: OECD.

### Ciudadanos moves closer to the centre

The decision of Ciudadanos to break ranks with the Popular Party (PP), with whom it governs in four of Spain's regions including Madrid, and support explicitly or tacitly the coalition government over extending the state of emergency, represents a strategic shift back towards the centre under its new leader, Inés Arrimadas.

Arrimadas took over from Albert Rivera after the party slumped in last November's election, losing 47 of its 57 seats, following a rightward lurch in the belief that the party

would overtake the PP, as it had nipped at the PP's heels in the April 2019 election – winning nine fewer seats–. The hubris cost the party dear: the PP won 78 more seats than Cs last November.

Cs was founded in 2006 in Catalonia to oppose the region's independence and then went national, initially as a liberal, reformist, centrist party, proclaimed with the phrase 'neither reds nor blues'.

Juan Carlos Girauta, Cs' former spokesman in parliament, told the conservative newspaper *ABC* that the party's support for the extension on 6 May and expected again on 20 May would never have happened under Rivera.

Arrimadas' move was supported by 77% of the party's voters in a survey by the pollster Metroscopia. Eight out of every 10 respondents approved extending the state of emergency.

FAES, the think tank founded by José María Aznar, the former PP Prime Minister (1996-2004), attacked Arrimadas for 'snuggling up to the Frankenstein government', in reference to the ruling coalition between the Socialists and the hard-left Unidos Podemos (a revamped Communist Party with other far-left elements).

Toni Roldán, Cs former economics spokesman who broke with the party over its lurch to the right, believes the government should seek more or less permanent support from Cs in order to better meet the pressing challenges including getting its backing for the 2021 budget.

That would demand a considerable balancing act by Prime Minister Pedro Sánchez with his junior partner Unidos Podemos, which sees an opportunity to push a radical economic agenda.

### Supreme Court upholds sentence against Catalan party in kickbacks for contracts scandal

The Supreme Court confirmed the sentence against the defunct *Convergència Democràtica de Catalunya* (CDC) for taking illegal commissions in exchange for awarding public works contracts while it was in power, and ordered it to pay €6.6 million.

The party, together with the smaller *Unión Democrática de Catalunya*, formed *CiU* and ruled Catalonia between 1980 and 2003 under Jordi Pujol.

CDC was re-founded in 2016 as the *Catalan European Democratic Party* (PDeCAT), the party of Carles Puigdemont, the former Premier of Catalonia who is living in self-imposed exile in Belgium, and of his predecessor Artur Mas, under whose tenure Catalonia started to push for independence.

The conviction followed a more than eight-year probe into irregularities at the *Palau de la Música*, a concert hall in Barcelona. The €6.6 million represents the kickbacks between 1999 and 2009 paid by Ferrovial to secure contracts and was disguised as donations to the *Palau*, which were then channelled to CDC.

Two Palau managers, Fèlix Millet and Jordi Montull, now face jail sentences of nine and a half and seven and a half years, respectively, and must return the €23 million they took from the Palau to finance lavish life styles.

### Spain jumps in V-Dem liberal democracy index

Spain shot up 17 places in the V-Dem liberal democracy index to 9<sup>th</sup> out of 179 countries. The index is based on 71 indicators and aggregates variables across several dimensions, including suffrage rights, clean elections, equality before the law, constraints on the executive and freedom of association and expression (see Figure 4).

**Figure 4. Liberal democracy index ranking and components' indices**

Liberal democracy index ranking out of 179 countries and score out of 1	Electoral democracy index (EDI) ranking	Liberal component index (LCI) ranking	Egalitarian component index (ECI) ranking	Participatory component index (PCI) ranking	Deliberative component index (DCI) ranking
1. Denmark 0.858	1	1	2	10	5
7. Portugal 0.817	12	16	27	50	11
9. Spain 0.815	7	12	18	26	26
13. UK 0.79	18	19	38	16	38
17. France 0.783	5	29	24	47	34
20. Germany 0.779	24	9	5	21	7
22. Italy 0.722	17	25	4	3	28
36. US 0.70	38	34	74	20	97

Source: V-Dem 2020 Report.

The sharp rise was due to significant upward revisions to Spain's indicators over the last three years and regressions in other democracies.

Spain's main improvement was in the electoral democracy index (EDI) where it moved from 33<sup>rd</sup> to 7<sup>th</sup> position (see Figure 5). This index captures not only the extent to which countries hold clean, free and fair elections, but also their actual freedom of expression, alternative sources of information and association, as well as male and female suffrage and the degree to which government policy is vested in elected political officials.

**Figure 5. Spain's rise in V-Dem rankings, 2016-19**

	LDI	EDI	LCI	ECI	PCI	DCI
2016	22	23	23	16	33	25
2017	35	39	19	26	34	31
2018	26	33	19	27	39	28
2019	9	7	12	18	26	26

Source: V-Dem.

## The economy

### Pandemic begins to take its toll on employment

Companies are better prepared to meet the impact of the coronavirus pandemic than after the 2008 global financial crisis, according to the Bank of Spain's Governor, but the next two years are going to take a heavy toll.

'Spanish households and non-financial companies are facing this situation with a significantly more favourable financial position than before the global financial crisis', said Pablo Hernandez de Cos, the Governor.

The effect on employment is beginning to be felt. The number of recorded unemployed stood at 3.8 million at the end of April (the first full month since the lockdown on 14 March), 667,737 more than a year earlier and 282,891 higher than March 2020. By far the largest jobless increase was in the service sector (+219,128). The number of people on benefits reached 5.2 million.

That jobless figure excludes the almost 3.5 million workers under the short-term leave scheme for companies known as ERTE (see Figure 6), which now lasts until 30 June and can be extended further. It also excludes self-employed workers receiving subsidies. Including both these categories, the unemployment rate would be 35%. The return to work of workers on ERTEs is going to be a big challenge.



### Figure 6. Temporary lay-offs (ERTEs) in a nutshell

What are they?	An ERTE is a temporary suspension of an employers' employment contract or a reduction in working hours due to financial, technical, organisational or production-related causes, or as a result of force majeure (as in the case of COVID-19).
When can they be used?	ERTEs are intended for companies to be able to reduce their workforce when they are experiencing temporary difficulties, without having to provide severance pay (unlike in the case of general lay-offs, or EREs as they are known).
What are the benefits?	
For the employee:	They receive unemployment benefits while they are not working. They maintain their job position during a crisis (thus avoiding the loss of their job).
For the company:	It can reduce the workforce in times of difficulty (without incurring redundancy costs). It can maintain its human capital when the recovery comes.

Source: CaixaBank Research.

Unemployment has been historically high in Spain. Even at the peak of the almost decade long boom in 2007, the jobless rate was 8%. It hit 27% in 2013 in the wake of the financial crisis and is forecast by the government to rise from 14% at the end of last year to 19% at the end of 2020, with the economy shrinking 9% (see Figure 7). Some forecasts are much more pessimistic and put the GDP reduction at 15%. The government plans to introduce a basic monthly income for the poorest.

### Figure 7. Government's macroeconomic forecasts for 2020

	2019	2020
Real GDP growth (%)	2.0	-9.2
Fiscal deficit (% of GDP)	2.8	10.3
Public debt (% of GDP)	95.5	115.5
Unemployment rate (%)	14.1	19.0

Source: Finance Ministry.

Everything depends on the extent to which the pandemic is brought fully under control and the pace at which economic activity is renewed. The commerce sector was up in arms after the government banned sales, fearing shoppers would tend to agglomerate in big stores.

As well as safeguarding jobs under ERTes for the time being, the government also scrapped the threat of forced liquidation for companies that run up large losses this year in order to stave off insolvencies. Bankruptcy laws have been adjusted and those who invest in businesses during the COVID-19 outbreak will benefit from higher levels of protection if a company goes under.

The government hopes this will make shareholders more willing to stump up money for a struggling company. The waiving of mandatory bankruptcy proceedings applies to all companies and not just those hit by the pandemic. This relieves debtors but is not good news for creditors.

The government's estimate of GDP shrinkage sent to the European Commission is 9.2% this year and growth of 6.8% in 2021. An idea of the depth of the recession can be gauged from the 96% fall in car sales in April (49% in the first four months). Sales in April were roughly the same as in one day in a pre-crisis normal month.

A key factor for the economy's recovery will be what happens to the vital tourism sector, which generates 12% of GDP (40% in the Canary Islands and 30% in the Balearics) and provides 13% of jobs directly, and is at a standstill. Spain is the second most popular tourist destination after France.

The government imposed a 14-day quarantine for foreign travellers coming to the country as of 15 May, as part of the measures to avoid a second wave of contagion from the coronavirus. It will remain in force possibly until the end of June. The government is also keeping its borders with France and Portugal closed (but not with Gibraltar) to most international travellers until July. Social distancing measures will limit the levels of hotel occupancy and might make openings economically unviable.

The Mesa del Turismo, which represents the sector, called for Alberto Garzón, the Tourism Minister, to resign after he said tourism is 'a low value-added sector, with seasonal and precarious activity'.

Toni Roldán, a former MP for Cs and the party's economic spokesman, said the EU should take into account the different levels of the pandemic in the bloc's regions by certifying 'green zones'. This would allow quarantine-free travel between these regions so that tourists could travel, for example, between Bavaria and Mallorca, and help rescue tourism in a coronavirus-safe way.<sup>1</sup>

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<sup>1</sup> See the report by the Esade Centre for Economic Policy at <https://dobetter.esade.edu/en/green-zones-covid-19>.

## Corporate scene

### Telefónica in €38.5 billion deal with Liberty Global to merge UK businesses

Telefónica and the US firm Liberty Global are to merge their British businesses in a deal that will create a mobile and broadband giant to rival market leader BT, with 46 million subscribers (see Figure 8).

**Figure 8. UK telecoms market (millions of lines)**

	Millions of lines
O2 and Virgin Media	46.5
BT	46.3
Sky	22.7
Vodafone	20.2
Three	11.6
TalkTalk	9.0

Source: Telefónica and Ofcom.

In a big shake-up of the UK telecoms sector, the deal brings together Liberty's Virgin Media, the biggest cable TV provider, and Telefónica's O2, the second-largest mobile operator.

Telefónica, weighed down with debt, tried to sell O2 in 2016 to Hutchison-owned Three but the deal was blocked by EU competition regulators.

The joint venture enables Telefónica to stay in the UK and extract €6.5 billion in cash from the deal. The parent companies will equally own the new entity, which has a 34% market share.

### Banks' first quarter results plummet under COVID-19 related provisions

The four main banks reported much lower first-quarter profits, largely because of provisions related to COVID-19 and the impact of the country's deep recession.

Hardest hit was Santander, the euro zone's second-largest bank by market value, whose net profits plummeted 82% year-on-year to €331 million after setting aside €1.6 billion to cover expected loan losses resulting from COVID-19.

Excluding the provisions, the bank's underlying profit was 1% higher at €1.98 billion.

BBVA, Spain's second-largest bank, posted a loss of €1.79 billion due to €3.5 billion of provisions and a writedown in the US on its operations there.

CaixaBank's net profit dived 83% to €90 million and Bankia's 54% to €94 million.

The banking sector, however, is better prepared in terms of solvency to weather the impact of the health crisis than it was after the 2008 global financial crisis, which resulted in an EU bail-out and collapse of many savings banks which either disappeared or were absorbed by other banks.

The total non-performing loan ratio (NPL) of banks stood at 4.79% at the end of February, before the lockdown on 14 March and way down on its peak of 13.5% at the end of 2013. The ratio will rise in the coming months.

The core Tier-1 capital ratio –the strictest measure of solvency– of Santander, one of the 30 global systemically important banks, was 11.58% at the end of March, slightly down at 11.65% at the end of 2019.