

The potential impact of the Catalan crisis on the Spanish economy

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The crisis in Catalonia, sparked by the regional government's illegal proclamation of an independent state last month, is already exacting a toll on the Catalan economy, and threatens to seriously weaken the wider Spanish economy if the situation is prolonged.

The region plays a key role in the economy. Its GDP is slightly larger than Portugal's and it generates one quarter of Spain's exports.

Catalonia accounts for one-fifth of Spain's economy

Share of Spain's total gross domestic product, by region



Note: GDP shares are nominal estimates for 2016, in euros.
Source: Instituto Nacional de Estadística, accessed Oct. 27, 2017.

PEW RESEARCH CENTER

Source: Pew Research Center

The most notable impact since the Catalan parliament declared independence on 27 October, in a disputed vote declared illegal by Spain's Constitutional Court, has been the exodus of companies from Catalonia, which quickly turned into a stampede. More than 2,200 companies have located their legal headquarters in other parts of Spain. Tourism (Catalonia received 18 million of Spain's 75.3 million tourists last year) and consumption have also taken a hit.

The Bank of Spain warned earlier this month that the economy could lose between 0.3 and 2.5 points of GDP in two years (2018-19), depending on how long the crisis lasts and its impact on consumption, investment, employment and financing.

Under its benign scenario, the worst of the uncertainty would end after the snap election on 21 December, called by the central government under its activation of direct rule of Catalonia following the independence declaration. The accumulated cost to the economy would be 0.3 points of GDP or around €3 billion.

The Bank of Spain does not say this, but this scenario assumes that the anti-secessionist parties –the conservative Popular Party, which governs Spain, the Socialists and the centrist Ciudadanos– could win more seats than the pro-independence parties, an unholy alliance of conservative nationalists (PDeCAT), the more rabidly secessionist Republic Left of Catalonia and the anti-capitalist far-left CUP.

In the worst-case scenario, following a victory by the pro-independence bloc and a continued stand-off with Madrid, up to 60% of the projected growth for 2018 and 2019 could evaporate. A lot is riding on this election.

The pro-independence parties won 72 of the 135 seats in the 2015 election on 47.8% of the vote. Recent polls show these parties narrowly gaining control of the parliament again, but Madrid is hoping that the anti-secessionist parties will galvanise the increasingly vociferous 'silent majority' against independence into voting on a larger scale than previously.

The Bank of Spain is currently holding to its GDP growth forecasts of 3.1% this year, 2.5% in 2018 and 2.2% in 2019. Luis de Guindos, the Economy Minister, has already lowered growth from 2.7% to 2.3% next year.

'A potential heightening, or prolongation, of the political situation might adversely impact the economic outlook and financial stability in Spain', says the Bank of Spain's report. 'Greater uncertainty might dent economic agents' confidence and thereby affect their spending and investment decisions, subsequently exerting a negative impact on economic activity and employment'. The report also underscores 'the political tension in Catalonia and its potential repercussions for funding conditions on the capital markets and for the Spanish economy as a whole'.

The Bank of Spain is careful to emphasise that its scenarios are hypothetical and depend on a set of assumptions, and should not be construed as economic growth forecasts. 'They serve to evidence the significant economic risks and costs of the situation caused by the independence initiatives in Catalonia'.

The companies that have voted with their feet include CaixaBank, Spain's third-largest bank, the bank Sabadell and Codorníu, the cava producer. CaixaBank, the main financial institution in Catalonia, has played a major role in the region's economy and as a sponsor of cultural and social programmes through its foundation. It has close to 40% of the total deposits in Catalonia and Sabadell 15%. Both banks have also moved their tax residence.

These two banks, in particular, moved their legal, though not corporate, headquarters in order to protect the interests of depositors and shore up confidence. The banks need to remain within the euro zone to maintain regulatory continuity and in order to continue to access the European Central Bank's liquidity mechanism –which would not be the case if Catalonia ever became an independent country–. It would have to re-apply for membership and would only need one EU country to veto it (such as Spain, obviously) and membership would be scuttled.

The banks' move, followed by branch managers taking to the phone to reassure customers that their investments were safe, had the desired effect and reversed to some extent a run on deposits. The big banks Santander and BBVA were not affected (they benefited from the run) as their legal domiciles are not in Catalonia.

Similarly, the shares of both banks took a knock on 4 October, three days after the illegal referendum on Catalan independence, when 90% of the 2.3 million that voted were in favour of secession. Sabadell's share price fell 5.69% and CaixaBank's 4.96%. The Ibex-35, the benchmark index of the Madrid Stock Exchange, fell 2.85%, the largest one-day fall since the UK decision in June 2016 to leave the EU, to below 10,000 for the first time in some six months and far from this year's peak of 11,250 reached in May. By 7 November the index had recovered to 10,230.

Six of the companies that have relocated form part of the Ibex-35. Multinationals such as Volkswagen, which owns the Seat plant near Barcelona making 2,000 cars a day, are keeping a close watch on the situation.

In what could be a pointer for the future, until the uncertainty ends, Catalonia was the region whose number of registered unemployed increased the most in October (+14,698), its largest rise since the same month of 2008. Its month-on-month growth in the unemployed of 3.67% was twice the rate for the whole of Spain.

Spain has gone through a lot since the 2008 crisis to restore and consolidate growth, and it would be a tragedy if this evaporated because of the actions of hotheads.