



Political Instability is the New Normal in Spain

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Spain is currently under a period of alleged political instability. The acting Social Democratic government (winner of April's general election with 7.5 million votes and more than 28% of the vote share) was not able to reach an agreement with Podemos (left-wing) or Ciudadanos (liberals), condemning the country to hold its fourth general election in four years. What to expect from political actors and how will this situation affect the economy are the key questions to be answered as we enter another pre-electoral period.

Spain is heading to its fourth general election in four years, after its political parties failed to reach a governing deal in the wake of the inconclusive April 28 polls. Despite months of negotiations, no agreement was reached between the Social Democratic Party (PSOE) and its most likely partner, left-wing Podemos. Acting Prime Minister Pedro Sánchez was also unable to strike any kind of deal with the two other biggest parties on Spain's political spectrum, the conservative Popular Party (PP) and Ciudadanos (Liberal-Democrats).

The general election of April produced a fragmented parliamentary scenario. The Social Democrats (PSOE), though being the clear winners in the ballots and the only political party that could head a future government with 123 seats – the conservative Popular Party was second with 16.7% of the vote share and 66 seats –, were left short of a majority and forced to reach an agreement with other political groups in order to govern. From the beginning, the PSOE was met with the frontal rejection of Ciudadanos to cooperate, while Podemos declared its willingness to come to an agreement. This seemed to clear the way for an understanding of the centre-left bloc. However, the greatest point of disagreement in the negotiations between both parties was the presence of Podemos' ministers in the government,

which the PSOE sought to avoid at all costs. A second important issue was the "lack of trust", presented almost as a personal problem between the leaders of both parties, Social Democrat, Pedro Sánchez and the leader of Podemos, Pablo Iglesias.

Amid this unstable political scenario, and with no agreement reached between none of the parties, Spain will hold a snap general election on November 10 in a context of European and global economic downturn.

Back to the ballot box - the abstention rate is likely to be a deciding factor

Spain is poised to become the only country in the world to hold four general elections in a four-year period. Since 2015, Spaniards have already experienced three appointments with the ballot boxes, a no confidence-vote and more than 400 days of acting governments that have impeded the normal functioning of political institutions and legislative activity.

Pollsters predict that the Social Democrats will grow compared to April's election, while Podemos, Ciudadanos and far-right Vox will lose ground. The People's Party would make gains at the expense of Ciudadanos and Vox but would continue far away from toppling the PSOE.

The abstention rate is likely to be a deciding factor in the results of a repeated election given that disenchanted voters could punish those parties that have been unable to reach an agreement through a significantly lower voter turnout. This could pose a risk for the leftist parties (PSOE and Podemos) and could translate into a rise of the centre-right.

In general, two scenarios can be foreseen for the next elections. Based on the latest polls, the most likely outcome will be a situation similar to the last general election, but with greater strength of the PP and a weakening of Ciudadanos. In this scenario, the PSOE would continue needing to reach an agreement with other political groups: either with the left or with the right (which would be exceptional).

A less likely scenario, would be a rise of support of the three centre-right parties, allowing them to govern together. In this sense, with a left-leaning voter demobilization similar to the one of the 2016 electoral repetition, the centre-right parties could reach the absolute majority through a coalition headed by the Popular Party.

Ongoing legislative activity at a historic low – though acting government continues to work

Throughout the last governments of Mariano Rajoy and Pedro Sánchez (2016-2019) only 106 bills were passed by Parliament, the least productive period in the history of Spanish democracy. The 13th term of the Spanish Parliament will end without a single bill having been passed by Congress. However, law-makers and civil servants have continued with their activity. Ministries have continued to work on the transposition of EU directives – the transposition of EU Waste Directives or the Audiovisual Media Services Directive (AVMS) have recently been submitted for public consultation -, which have increased their weight in domestic regulation and will continue to be crucial in the next legislature as well.

In spite of the economic recovery, the acting government has promised to stick to the fiscal discipline path. The lack of a 2019 budget and the subsequent extension of the 2018 accounts, approved by the last Rajoy cabinet, as well as the blockade of new financial transfers from the State to the autonomous regions, are forcing the regional governments to make financial engineering and may lead to new cuts if the country continues without a government. In this sense, the ECB recently warned Spain that it has no margin to lower taxes or increase spending.

The much-needed structural reforms (Education, Energy, Digital Agenda, Tax reform, Circular Economy) that generate wide consensus will have to be postponed until a new government is formed and Congress is back to work. In addition, during the investiture negotiations, the PSOE published a political manifesto containing its vision for the next political period, among them a minimum 15% Corporate Tax, a financial transaction tax and the so-called 'Google Tax'. Whether it will be able or not to carry out this programme will depend on the outcome of the election on November 10th and the final distribution of seats in Parliament.

Looming risks - a new period of economic and institutional turmoil?

One of the main arguments in favour of Pedro Sánchez's investiture is that Spain could be entering a new period of economic and institutional turmoil as fears of a global recession also intensify. The Spanish economy has benefited in the last expansive cycle from several externalities: the ECB's expansive monetary policy, the overall recovery of the European economy, the political instability of some of Spain's main competitors as a tourist destination in the Southern and Eastern Mediterranean and oil prices that have remained low. Of these four elements only the ECB's low rates policy is expected to be maintained in the medium term. The other three seem to be slowing down the main drivers of Spain's recovery after the crisis.

In this sense, almost 203,000 jobs were destroyed in Spain last August, the worst figure since 2010. This figure has led to a strong resurgence in recent days of the slowdown in the country's economy after years of growth. Two other indicators have also been published in recent days that have contributed to this sense of a potential sudden economic downturn: vehicle registrations - a key indicator on how consumption is behaving - plummeted by 30.8% in August, the biggest fall since 2008; and last July, Spain was visited by 1.3% fewer foreign tourists, a figure that has also triggered the alarms as tourism is one of the economic engines of the Spanish economy.

The ongoing political crisis in Catalonia is another risk factor that has been used by the PSOE to support its case. The Supreme Court is expected to hand down a ruling on the case against independentist leaders for the 2017 illegal breakaway attempt in the first half of October. This may trigger social unrest, as pro-independence groups have already called citizens to disobedience "through non-violent struggle". The Catalan government, a coalition of two pro-independence parties, has publicly supported this view. With an acting government and an incoming general election campaign, it is difficult to foresee a repetition of the political consensus that allowed the establishment of direct ruling (article 155) when things felt apart in 2017. Moreover, renewed tensions in Catalonia may exert internal pressure in the PSOE, considering the division between hard-liners and the PSC's

(PSOE's Catalan party) leadership, which could weaken Pedro Sánchez's election outlook.

Lastly, a 'no-deal' Brexit materialising next October 31st is also seen as an incoming destabilising factor, although acting President Sánchez recently stated in Congress that the country was ready for a hard breakaway of the United Kingdom from the European Union. Spain currently has a trading surplus of 7.5 billion euros and the British continue to be the main driver of a vital sector such as tourism – as well as the first destination for non-tourist export services in 2018. In addition, around 300,000 UK nationals live in Spain – many own a residence - and benefit from the freedom of movement in the EU. For all these reasons, the Spanish General Council of Economists estimates that a Brexit without an agreement could cost the Spanish GDP around 0.9 percentage points.

The president of Spain's main business organization, the Confederación Española de Organizaciones Empresariales (CEOE), has stated that, despite political parties' failure at turning the will of the people into a stable government, "maybe is better (to be heading for) a new election". This demonstrates how business leaders are more afraid of a government with an anti-business stance rather than an extended period of political instability. In this sense, are these elections really a surprise to anyone?

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