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Summary

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Divided left 'close' to absolute majority in upcoming election.
Registered jobless drops below 4 million for first time in six years.
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Foreign Policy

Rajoy warns of consequences of Brexit

The Spain-UK relationship would suffer if Britain votes on 23 June to leave the EU, acting Prime Minister Mariano Rajoy warned.

More than 400,000 British citizens live in Spain, the largest such group in the EU, and their status would change if Brexit happens as they would lose their automatic right to live, work and own property in the country.

At present, UK citizens are entitled, for example, to healthcare via the European health insurance card or free health insurance from the Spanish government under EU law, but Spain would not be obliged to continue to offer free healthcare to non-EU citizens.

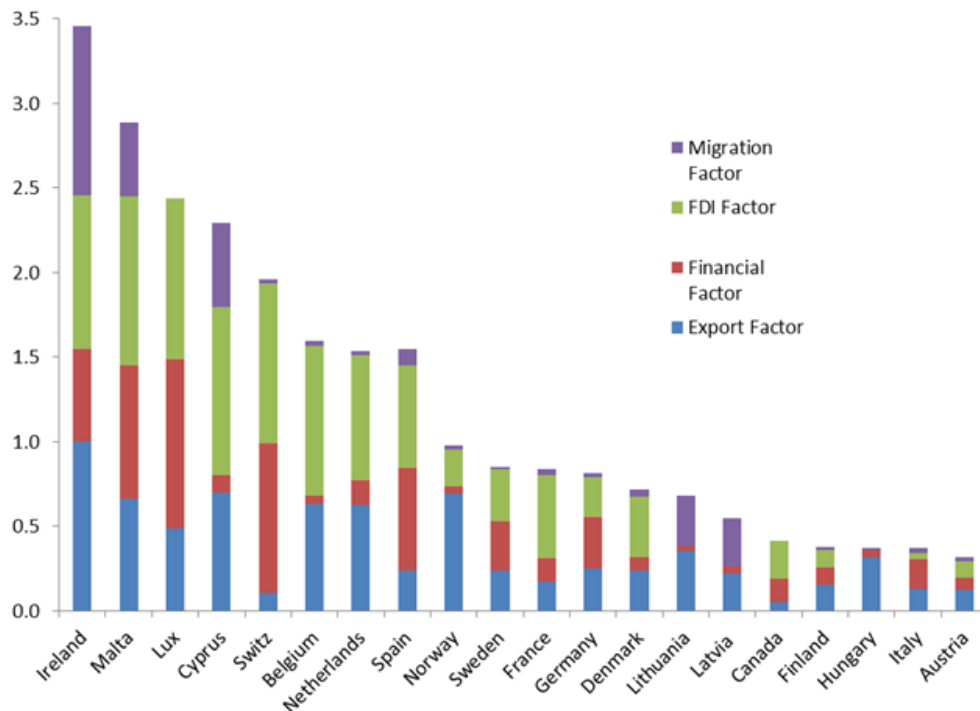
'I have no doubt whatsoever, as I have repeatedly stated, that it would be very negative if the United Kingdom left the European Union', Rajoy told Spanish news agency EFE. 'Above all, it would be very negative for British citizens: the European Union is based, ever since its foundation, on the principles of freedom of movement of people, goods, services and capital'.

The UK is the main destination for Spanish investment abroad (with a stock of £58.7 billion in 2014) and the UK is the fifth-largest investor in Spain (€1.7 billion). One-fifth of all foreign direct investment in Spain since 1993 has been British. Spanish companies in the UK with major investments include Telefónica, Iberdrola, Santander and Ferrovial. Sixteen million British tourists came to Spain last year (and 2.2 million Spaniards to the UK).

According to a Metroscopia poll, 74% of respondents said Brexit would be bad for the Spanish economy, and 79% for the EU as a whole. Close to 80% of respondents said EU membership (since 1986) had been good for Spain.

S&P Global Ratings classifies Spain as the eighth country most exposed to a UK exit from the EU (see Figure 1).

Figure 1. Brexit sensitivity index



Source: S&P.

The index is based on exports to the UK as a percentage of GDP (2.7% in the case of Spain), financial sector claims on an ultimate risk basis including derivatives and guarantees (44.9% of GDP), inward foreign direct investment (3.8% of GDP) and bidirectional migration as a percentage of the population (0.9%).

A vote to leave the EU would enable Madrid to step up the pressure on the British Overseas Territory of Gibraltar, ceded to the British crown under the 1713 Treaty of Utrecht and whose sovereignty has long been claimed by Spain. With the UK out of the EU, the border between Spain and Gibraltar would become an external and not an internal EU frontier, which has to be kept open under EU rules.

José Manuel García-Margallo, the acting Foreign Minister, said the only way for Gibraltar to retain access to the EU single market in the event of Brexit would be to accept 'co-sovereignty', or joint control by Spain and the UK.

Prime Minister David Cameron visited Gibraltar to drum up support for remaining in the EU, although opinion polls show an overwhelming vote in the territory against Brexit. Cameron's visit was the first by a British Prime Minister since Harold Wilson's in 1968. He cancelled his anti-Brexit rally, however, because of the murder of Labour MP Jo Cox, which happened while he was travelling.

‘The government does not like Mr Cameron travelling to Gibraltar’, affirmed Rajoy. According to the Prime Minister, ‘What is being debated is that the United Kingdom remain in the EU or leave the EU and the campaign for that should happen in the United Kingdom and not in Gibraltar’. Gibraltar, he claimed, ‘is Spanish whether Brexit wins or loses’.

Obama to visit Spain after elections

President Obama will visit Spain in July two weeks after the country’s June 26 general election called as a result of December’s inconclusive election that left a fragmented parliament unable to agree a new government.

Obama will arrive in Madrid after attending a NATO summit in Warsaw. He will meet Mariano Rajoy, the acting Prime Minister, and King Felipe.

‘The visit to Spain, an important NATO ally, will highlight robust security cooperation, a strong political and economic relationship, and longstanding people-to-people ties’, said White House Press Secretary Josh Earnest.

Domestic Scene

Divided left ‘close’ to absolute majority in upcoming election

Spaniards return to the polls on 26 June for the second time in six months, following December’s inconclusive election, with the prospect of Unidos Podemos and the Socialists winning between them close to an absolute majority of seats in parliament.

Unidos Podemos (UP), the radical left-wing alliance between the anti-establishment Podemos and United Left (the revamped communist party), forged in May, is forecast to overtake the Socialists into second place after the Popular Party (PP), which will continue to win the most seats.

According to the latest Metroscopia poll, UP would win 93 seats and the Socialists 82, giving between them 175 of the 350 seats (see Figure 2).

Figure 2. Estimate of seats of the four main parties and % of votes in 26 June election (1)

	Seats	% of votes
Popular Party	114 (123)	29.0 (28.7)
Unidos Podemos (2)	93 (71)	26.0 (21.5)
Socialists	82 (90)	20.5 (22.0)
Ciudadanos	39 (40)	14.5 (13.9)

(1) Results of the December election in brackets.

(2) The sum of Podemos and United Left in December.

Source: Metroscopia.

By running on the same ticket and not separately, Podemos and United Left are set to benefit from the d'Hondt system of proportional representation which favours parties that are strong in a particular region over those that have broad but low support across the whole country (the case of United Left). The Catalan offshoot of Podemos, En Comú Podem, won 927,940 votes in December's election compared with United Left's 922,638 but got six times more seats in the national parliament. UP's 93 seats would be 22 more than Podemos and United Left won in December when they ran separately.

Podemos's alliance with United Left was forged in the face of considerable hostility between the two parties. Only a year ago Iglesias called United Left 'losers'. 'I don't want political losers, who in 25 years have been incapable of doing anything, whose leaders, and I worked for them, have been incapable of reading the political situation, to get close to us. Let them remain with their Red Flag and leave us in peace. I want to win'.

UP's surge would be a humiliating defeat for the Socialists (eight fewer seats than December, making it the party's worst ever result in post-Franco Spain) and would embolden Pablo Iglesias, Podemos's leader, to seek a coalition government between the two parties.

The Socialist leadership, however, is extremely reluctant to get into government with UP, while the party's militants are more in favour. The leadership was particularly angered by Iglesias labelling UP the 'new social democracy.'

The Socialists agreed a common programme with the centrist Ciudadanos (C's) after December's election but their attempt at forming a minority government did not garner sufficient parliamentary support.

On the basis of Metroscopia's figures, the other government options would be a minority PP administration (114 of the 350 seats), which could only happen if the Socialists and C's abstained at the investiture vote, resurrecting the deal between the Socialists and C's (121 seats), dependent on the PP abstaining, a government of the PP and Socialists (196 seats), which is highly unlikely, and a so-called German-style grand coalition of the PP, the Socialists and C's (235 seats).

The Socialists could well hold the key to the formation of a new government, as they could force the PP into giving its blessing to a government of the Socialists and C's or rejecting it and pushing the Socialists into the arms of Podemos.

The electorate is very polarized. Close to 98% of PP voters say they would never vote for UP and 92% of the PP's voters say the same about UP (see Figure 3).

Figure 3. Which party would you never vote for? (%)

Potential voters of...

Popular Party	Socialists	Unidos Podemos	Ciudadanos	Would never vote for
1	81	98	37	Popular Party
92	40	1	78	Unidos Podemos
28	1	24	14	Socialists
4	9	32	0	Ciudadanos

Source: Metroscopia.

Moreover, there are deep divisions within the right and not just within the left. Ciudadanos says it will have nothing to do with the PP as long as Mariano Rajoy remains at the helm because of the party's many corruption scandals.

Almost three-quarters of respondents in a Metroscopia poll said Rajoy should step down if, as the leader of the most voted party, this was a condition made by other parties for forming a coalition government. Significantly, this idea was supported by 57% of respondents who said they were PP voters. Rajoy will probably push again for a German-style grand coalition involving the Socialists and Ciudadanos.

The generational split is also profound: the largest share of PP voters is pensioners while that of UP is the unemployed. The average age of PP voters is 57 and that of UP 43 (see Figure 4).

Figure 4. Profile of voters by age, sex and occupation

	PP	PSOE	Unidos Podemos	Ciudadanos	Electoral avge
Potential voter (%)					
Men	46	44	57	51	48
Women	54	56	43	49	52
By age group (%)					
18-34	12	13	35	22	21
35-54	28	33	41	55	39
Over 55	60	54	24	23	40
Average age	57	55	43	46	50
By occupation (%)					
In work	30	38	46	50	41
Pensioner or retired	40	36	11	13	25
Unemployed	10	10	23	18	16
Student	6	4	16	8	8
Unpaid domestic work	13	12	4	10	10
Ideological placement (3)	6.5	4.1	3.3	5.3	4.6

(1) Electoral average.

(2) Average.

(3) Scale of 1-10 where 10 is extreme right and 1 extreme left.

Source: Metroscopia.

The age profile of the electoral census has changed considerably in the last 35 years, reflecting the ageing of the population. In 1981, 35% of voters were under the age of 34 compared to 21% today (see Figure 5).

Figure 5. Electoral census by age, 1981 and 2016 (%)

	2016	1981
18-34	21.5	35.4
35-54	38.4	34.3
Over 55	40.1	30.3

Source: Metroscopia.

UP is attracting the vote of disaffected young adults who have been hard hit by Spain's prolonged recession. The youth employment rate –the percentage of those between the ages of 20 and 29 with a job which is a different way of looking at the labour market situation to the jobless rate– plummeted from close to 70% in 2007, at the height of the economic boom, to 47% in 2015, by far the steepest decline in the EU (see Figure 6).

Figure 6. Youth employment rate, age group 20-29, 2015 and 2007 (%)

	2015	2007
Netherlands	75.8	83.6
UK	74.2	74.7
Germany	71.4	68.1
EU-28	61.4	65.4
France	60.9	64.5
Spain	47.1	69.4
Italy	40.4	53.5

Source: Eurostat.

Alfredo Pérez Rubalcaba, the previous Socialist leader when the party was trounced in the 2011 election, blames the party's decline on the failure to 'recover confidence as people are going through a very hard time and some of them remember that the problems began when we were in government'.

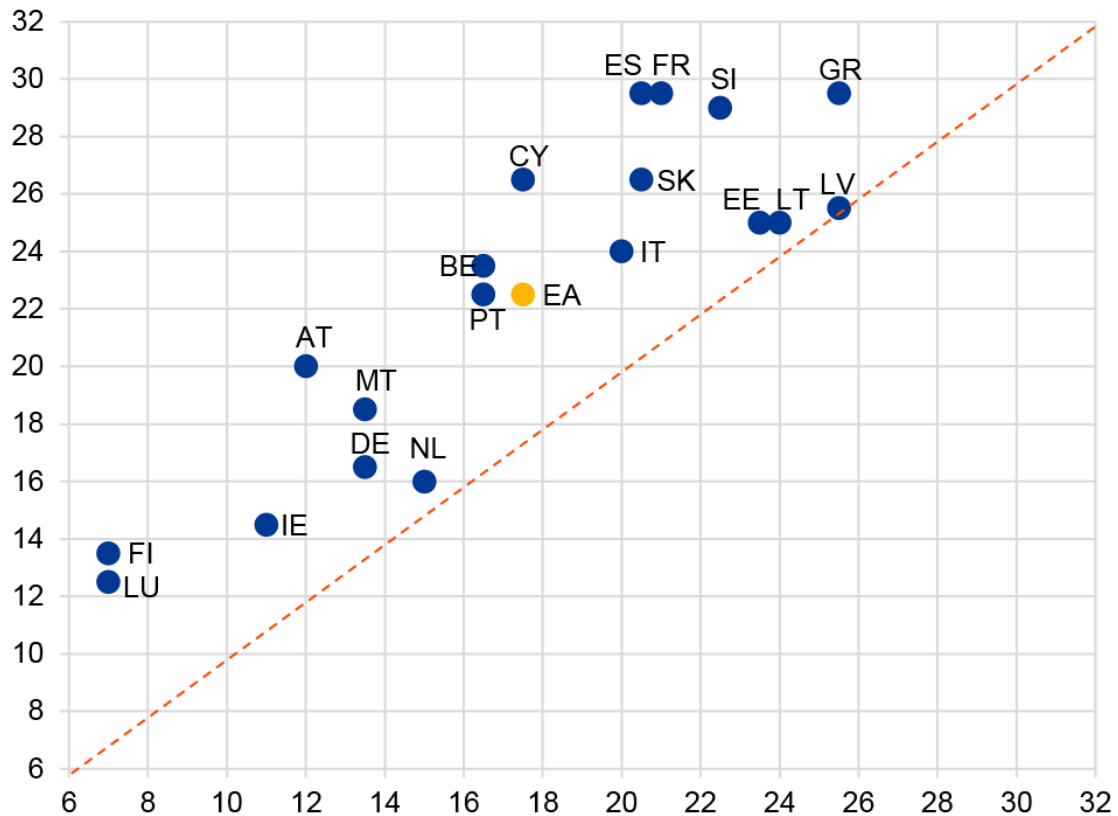
The party is also embroiled in corruption scandals, though to a lesser extent than the PP. Manuel Chaves and José Antonio Griñán, both former Socialist premiers of Andalusia, the party's fiefdom, were formally accused this month in the mega ERE corruption case involving the alleged misappropriation of millions of euros of public money to help companies make severance payments to laid-off workers.

Spain, together with France and Greece, are the countries with the highest political risk, according to the latest Financial Stability Review published by the European Central Bank (see Figure 7). Without naming UP, the ECB says the 'increasing support for political forces which are seen to be less reform-oriented, may potentially lead to the delay of much needed fiscal and structural reforms' and it warns this could 'cause renewed pressure on more vulnerable sovereigns and potentially contribute to contagion and re-fragmentation in the euro area'.

The International Country Risk Guide's political risk rating is based on 12 sub-categories including government stability, socioeconomic conditions, investment profile and corruption.

Figure 7. Political risk rating in individual euro area countries: a challenge to fiscal and structural reform implementation

(x-axis: spring 2008; y-axis: spring 2016)



Source: PRS Group (International Country Risk Guide) and European Central Bank calculations.

This was the first time the report mentioned populist movements as a risk to the euro zone. It followed the Austrian presidential election, which was nearly won by the ultraconservative FPÖ.

Budget rejection raises prospect of fresh elections in Catalonia

The anti-capitalist and pro-Catalan independence CUP, which together with a coalition of separatist parties (Junts per Sí) has an absolute majority in the Catalan parliament, rejected the annual budget bill, triggering a confidence vote in September that could lead to a new election, the fourth in six years.

Carles Puigdemont, the Premier of Catalonia, said he would call a confidence vote in to test whether his government still had the CUP's support.

The failure to agree a budget highlighted the fragility of Catalan finances and the squabbling in the pro-independence camp. The heavily-indebted region is being kept afloat by funds from the central government.

Junts per Sí and CUP agree on holding an illegal referendum on Catalan independence (and their supporters can be expected to vote in favour), unlike the Popular Party, the

Socialists and Ciudadanos, but ideologically are poles apart. The two parties have 72 of the 135 seats in the Catalan parliament with 48% of the vote.

The Socialist leader Pedro Sánchez called for a political pact that would insert new wording into the Spanish Constitution recognising Catalonia's 'singularity' and improving its self-government powers. While the Catalan branch of the Socialist party welcomed the idea, the Andalusian branch said it rejected any deal that granted some regions special powers and privileges over others.

Rafael Arenas, the head of Societat Civil Catalana, a civic organisation against Catalan independence, met with Puigdemont and urged him to abandon secession, respect the law (a referendum would be unconstitutional), be the Prime Minister of all Catalans and not just those in favour of secession and ensure that the region's administrations and media (including a TV channel) are neutral.

Spain moves up the Soft Power 30 ranking...

Spain rose two places in the latest Soft Power 30 ranking to 12th position, while the UK (2nd), Germany (3rd) and France (5th) all moved down a notch (see Figure 8).

Figure 8. Soft Power 30

2016 ranking and score	2015 ranking and score
1. US 77.96	1. UK 75.61
2. UK 75.97	2. Germany 73.89
3. Germany 72.60	3. US 73.68
5. France 72.14	4. France 73.64
11. Italy 63.79	12. Italy 63.09
12. Spain 63.47	14. Spain 61.70

Source: Portland.

The Soft Power 30, drawn up by the London PR company Portland and Facebook, is determined by a composite index that combines objective metrics of countries' soft power resources and subjective international polling data. It uses six sub-categories: digital, culture, enterprise, engagement, education and government. Spain's highest ranking is in culture (6th) and its lowest in enterprise (21st).

... Ranked 19th in Better Life index...

The quality of life, as measured by a series of indicators and not just per capita income, is better in Spain than Italy and not far from that in France, according to the OECD's latest Better Life index. Spain is ranked 19th out of 38 countries (see Figure 9).

Figure 9. Better Life index, ranking of selected countries

Ranking	Ranking
1. Norway	16.UK
2. Australia	18.France
9. US	19.Spain
12. Germany	25.Italy

Source: OECD.

The index is based on 11 topics regarded as essential in the areas of material living conditions and quality of life. They are: housing, income, jobs, community, education, environment, civic engagement, health, life satisfaction, safety and work-life balance.

Spain ranks above the average in work-life balance, housing, health status, social connections and personal security but below average in income and wealth, civic engagement, environmental quality, education and skills, and jobs and earnings.

The country's average net-adjusted disposable income per capita is \$22,007 a year, well below the OECD average of \$29,016. The top 20% of the population earn close to seven times more than the bottom 20%. In terms of employment, 57% of those aged 15 to 64 have a paid job compared to the OECD average of 66%. Only 57% of those aged 25-64 have completed their upper secondary education, way below the OECD average of 76%. Life expectancy, however, is 83 years, three years higher than the average and one of the highest in the OECD.

... 20th in Good Country index

Spain is ranked 20th out of 163 countries in the Good Country index, which seeks to measure how much countries contribute to the 'common good of humanity' (see Figure 10).

Figure 10. Good Country index, ranking of selected countries

Ranking	Ranking
1. Sweden	8. France
2. Denmark	18. Italy
4. UK	20. Spain
5. Germany	21. US

Source: Good Country index.

Using 35 datasets broken down into seven areas, such as technology, health and culture, the index, launched by Simon Anholt in 2014, ranks countries on how much they do for others globally.

Spain's highest ranking is in culture (18th), followed by health and wellbeing (19th) and planet and climate (21st). Its lowest is in international peace and security (94th).

The Economy

Registered jobless drops below 4 million for first time in six years...

The number of people registered as unemployed fell in May to below 4 million for the first time since August 2010. The decline of 119,768 brought the total to 3.89 million.

May is a seasonally good month for employment, largely due to the buoyant tourism industry.

There was also good news on the social-security front where the number of contributors rose by 198,004 to 17.6 million, but still far from the peak of 19.5 million at the height of the economic boom in 2007 before the bursting of the massive property bubble.

According to the other measurement of unemployment, based on a quarterly labour force survey and the headline figure, the number of unemployed was 4.8 million in March. The difference between the two 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.

... Bank of Spain governor calls for more labour-market reforms to reduce temporary jobs...

Luis María Linde, Governor of the Bank of Spain, called for more labour-market reforms in order to reduce the 'excessive protection' still given to workers on permanent contracts that makes temporary hires very attractive.

Around one-quarter of employees in 2015 were on fixed-term contracts, the highest share across OECD countries except for Poland but lower than the pre-crisis levels as the recession took a disproportionate toll on temporary workers.

'To correct the strong incentive offered by current regulations to temporary hiring, it is necessary to boost the attractiveness of permanent hires, preventing their excessive protection from encouraging the resort to temporary employees', said Linde.

The 2012 reforms among other things allowed companies to opt out of collective pay-setting agreements within industries and to make their own deals with workers. Severance payments in the case of unfair dismissal for those on permanent contracts were reduced from 45 days per year worked with a maximum of 42 months to 33 days per year with a maximum of 24 months. Employment protection legislation became less strict, though severance pay for permanent workers in relative terms remained among the highest in OECD countries.

Successive reforms to tackle the duality problem (which originated in a 1984 reform) have failed. Generally speaking, neither the trade unions nor employers are really interested in changing the situation. Temporary contracts suit employers as it gives workers limited protection, while trade unions defend the interests of insiders as they account for most of their members.

... 167,000 public sector jobs lost since 2012

The number of public sector employees dropped from 2.65 million in 2012 to 2.54 million at the end of 2015, as a result of the Popular Party government's cutbacks. The number, however, was only 66,000 below that in 2008 at the height of the economic boom (see Figure 11).

Figure 11. Public administration employees, 2008, 2012 and 2016 (1)

	2008	2012	2016
Central	561,551	581,861	527,801
Regional	1,300,232	1,351,883	1,294,765
Local	623,214	597,212	548,944
Universities	97,849	153,881	147,770
Total	2,585,846	2,685,837	2,519,280

(1) January 1 of each year.

Source: Ministry of Finance and Public Administrations.

The largest fall since 2012 was in the number of regional government employees (57,118).

Spain continues to rise in IMD competitiveness ranking

The improvement in the economy, with the country coming out of recession, improved Spain's position in the IMD competitiveness ranking from 37th position to 34th out of 61 countries (see Figure 12).

Figure 12. IMD world competitiveness ranking 2016, selected countries

Ranking	Change over position in 2015
1. China Hong Kong	+1
2. Switzerland	+2
3. US	-2
12. Germany	-2
18. UK	+1
20. Finland	-
32. France	-
34. Spain	+3
35. Italy	+3

Source: IMD.

IMD defines competitiveness as the ‘ability of a country to create added value and thus increase national wealth by managing assets and processes, attractiveness and aggressiveness, globality and proximity, and by integrating these relationships into an economic and social model’.

The rankings are based on four input factors: economic performance, government efficiency, business efficiency and infrastructure, each with five sub-factors. The strongest improvement was in the economic performance (see Figure 13). In government efficiency, Spain dropped six places to 49th, largely due to its institutional framework.

Figure 13. Competitiveness input factors, ranking in each category and overall ranking

	2012	2013	2014	2015	2016
Economic performance	51	53	51	39	30
Government efficiency	40	50	46	43	49
Business efficiency	46	50	42	46	41
Infrastructure	27	27	27	29	27
Overall ranking	39	45	39	37	34

Source: IMD World Competitiveness Yearbook 2016.

Per capita income as a % of EU average inches up

Spain’s per capita GDP was 92% of the EU average last year, up from 91% in 2014 but still well below its peak of 103% in 2007 (see Figure 14).

Figure 14. Per capita GDP in purchasing power standards, 2015 and 2017 (EU = 100)

	2015	2017
France	106	107
Germany	125	117
Italy	95	105
Spain	92	103
UK	110	117

Source: Eurostat.

Corporate Scene

Telefónica teams up with Facebook and Microsoft in fibre-optic cable venture under Atlantic

Telefónica has joined forces with Facebook and Microsoft in laying a fibre-optic cable across the Atlantic Ocean, which Telefónica's new infrastructure company Telxius will manage once it is finished.

Known as Marea, the Spanish for high tide, the more than 6,400km cable with eight pairs of fibre-optic strands will link Virginia and Sopelana on the Basque coast in northern Spain. It will be the highest-capacity link across the Atlantic and is expected to enter service next year.

Zara moves up global brand ranking

Zara, the flagship chain of stores of Inditex, the world's largest fashion retailer, was ranked 35th out of 100 companies in the latest BrandZ rankings compiled by Millward Brown, the research group, up from 42nd slot in 2015.

Zara's brand value was put 14% higher at US\$25.2 billion.

Listed Spanish companies generated 64% of their revenues abroad in 2015

The 117 companies listed on the main market of the Spanish stock exchange generated 64.3% of their revenues abroad last year, up from 62.2% in 2014 and 20 points higher than 10 years earlier (see Figure 15).

Figure 15. Revenues of listed Spanish companies generated abroad (% of total)

	%
2011	57.8
2012	60.6
2013	61.9
2014	62.2
2015	64.3

Source: Bolsas y Mercados Españoles.

Of the total €493.1 billion of revenues, €176.1 billion came from the domestic market, 4.5% lower than in 2015, and €317 billion from abroad (+7.8%). The EU accounted for €101.3 billion (+7.5%), OECD countries €97.7 billion (+11.7%) and other parts of the world €117.9 billion (+5.1%).