

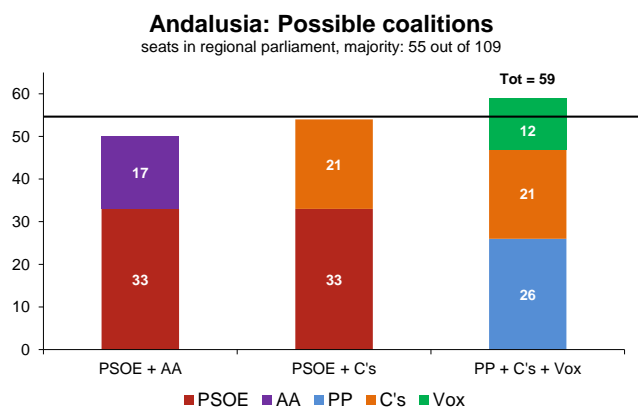
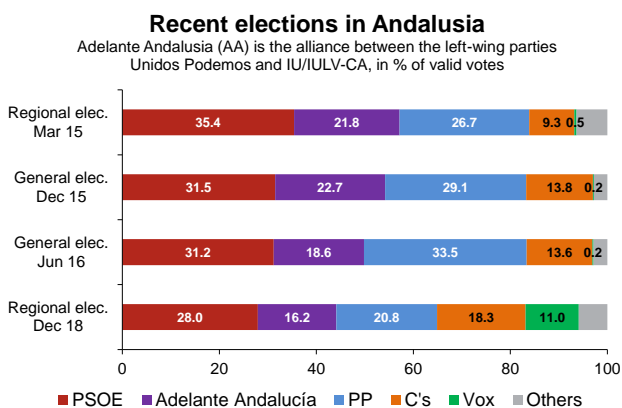
GIAM Macro & Market Research - Market Commentary

Political earthquake in Spain as right-wing Vox emerges as kingmaker in Andalusian regional election

- Yesterday's regional election in Andalusia marked an unexpected setback for PM Sánchez as the Socialists (PSOE) are set to lose the control of the region after 36 years.
- The centrist Ciudadanos (C's) and the center-right People's Party (PP) could reach an agreement with the right-wing Vox, whose votes skyrocketed from 0.2% to 11.0%.
- The Andalusian vote further weakens PM Sánchez, who already has so far failed to secure the needed support to pass the 2019 budget.
- However, it also makes a snap election in 2019 less likely. Facing the risk of moving to the opposition, PM Sánchez could try to extend his mandate until 2020. The Catalan regional parties could help him remain in charge by softening their critiques, as a new government with Vox would adopt a harsher stance on Catalan separatism.
- The reaction on Spanish Bonos this morning was muted. Investors are likely balancing the fading risk of a national snap election in 2019 with the risks posed by a future larger role of this right-wing party in Spanish politics.

Yesterday's regional election in Andalusia resulted in an unexpected setback for the Socialist Party (PSOE). The regional leader, Susana Díaz, who called the snap election after losing the support of the centrist Ciudadanos (C's) in the regional assembly in October, led the **Andalusian PSOE** to its **worst result in history** (28.0% of valid votes and 33 seats out of 109). Even more importantly, the simultaneous poor performance of the left-wing platform Adelante Andalucía (AA, Unidos Podemos and IULV-CA) – who secured only 17 seats – deprived a PSOE-AA alliance of the absolute majority – which was the base case according to opinion polls ahead of yesterday's vote.

Also the center-right People's Party (PP) scored its worst performance in history (20.8% and 26 seats). However, its candidate Juan Manuel Moreno could be sworn as new President of Andalusia should the PP reach an agreement with the two **winners of yesterday's vote, the centrist C's and the right-wing Vox**. The latter was the main surprise as it enters for the first time in the regional parliament with 12 seats, after securing 11.0% of votes. This compares with a mere 0.5% in the last regional election held in Andalusia in March 2015 or 0.2% in general elections held in December 2015 and June 2016. The three parties combined would control 59 seats out of 109, thus exceeding the required majority. Spokesmen of both the PP and C's opened to a possible alliance with Vox.

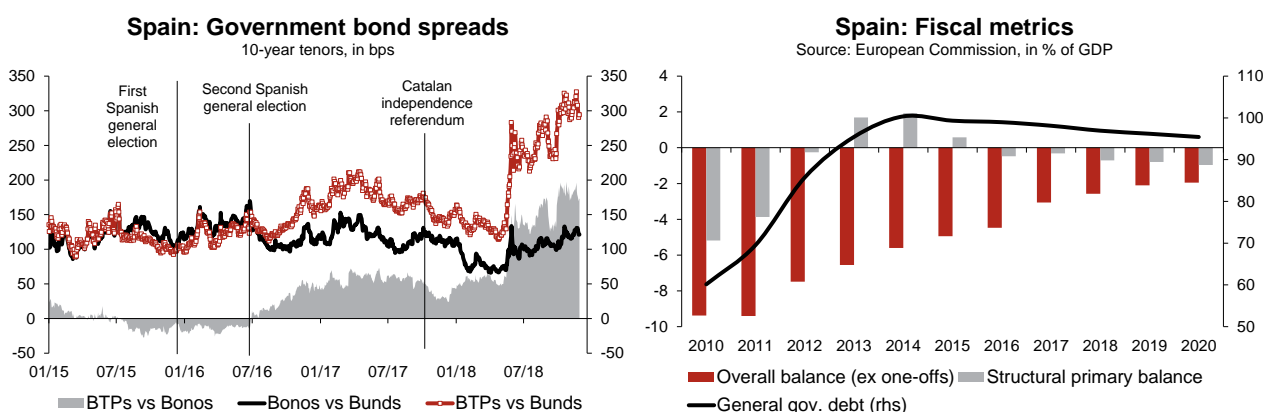


The results in Andalusia have **profound implications for national politics**.

- **The vote further weakens PM Sánchez.** The PSOE-led minority government has already shown its inability to pursue active policies amid the lack of sufficient support in the parliament. In particular, PM Sánchez has been unable so far to pass his revised budget for 2019 as the Catalan separatist parties denied their support.
- On the other hand, it also makes a **national snap election in 2019 less likely.** PM Sánchez had hoped to post a large victory in the Andalusian regional election and leverage on it, benefitting at national level by gaining at the expense of the PP and to agree on a political alliance with the left-wing Unidos Podemos. The poor performance of both the PSOE and Unidos Podemos makes such an electoral project less likely. As a result, **PM Sánchez could try to extend his mandate until 2020** even though he will likely become a lame duck.
- Finally, it will be interesting to see the reaction of the Catalan separatist parties. Political commentators affirmed that the **surge of Vox can be attributed to its harsh stance against Catalan separatism** (though also its anti-immigration rhetoric likely played a role). In his electoral manifesto, Vox pledges to suspend the autonomy of Catalonia, but it also considers a stronger central state at the expense of Autonomous Communities, something the regionalist parties of the Basque Country and Catalonia would firmly oppose to. As a result, regional parties – and Catalan ones in particular – could decide to soften the stance towards PM Sánchez’s government, allowing him to remain in charge until the next general election in 2020.

Markets reacted quietly to the news. The 10-year spread between the Spanish Bonos and the German Bunds declined by one basis point this morning to 118 bps. In our view, **investors are likely balancing the fading risk of a national snap election in 2019 with the risks posed by a future larger role of the right-wing Vox in Spanish politics.**

Looking further down the road, however, both a longer-lasting cabinet held by PM Sánchez or a 3-way alliance among the PP, C’s and Vox could pose risks to public finance. Vox has a fiscal agenda similar to the one of the League in Italy, i.e. a flat personal income tax and, more in general, lower taxation. Spain could struggle to reduce its structural deficit, exposing the country to more risks in the longer run.



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