

## Spain: Political tensions set to increase while the economy decelerates

Approving the 2019 budget and the Catalan situation will prove difficult for the minority government. Meanwhile, weak retail sales in July give further evidence of the deceleration of the Spanish economy



Source: Shutterstock

The next few weeks promise to be stressful for Pedro Sánchez, the Socialist leader of the minority government, as his government will be confronted with a number of thorny issues.

In a few days, there will be a second parliamentary vote for the 2019 budget. At the end of June, parliament rejected the draft 2019 budget, which was the first serious blow for the minority government. Only 88 members of parliament (out of 350) voted in favour of the plan. The Spanish far-left party Podemos, which has 67 seats, did not support the draft budget as it wanted softer deficit targets. Sánchez, on the other hand, repeated the importance of fiscal discipline and to continue to pursue the deficit target of 2.2% of GDP. Finding a compromise will be difficult, and as the draft budget should be submitted to Brussels by 15 October, the pressure will rise.

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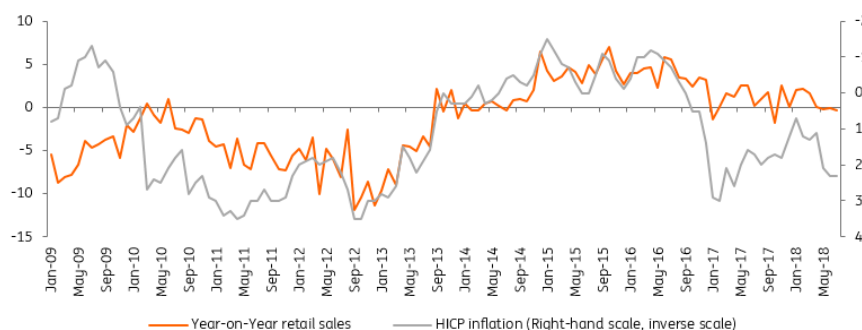
*We still expect the Spanish economy to grow by 2.6% in 2018,*

*compared to 3.1% in 2017*

The second important political point is the situation in Catalonia. On 11 September, Catalans celebrate the National Day. Quim Torra, Catalonia’s President, has already called for street protests to call for the region’s independence. A few weeks later, on 1 October, there is the first anniversary of the referendum. Sánchez will have to tread carefully, as he needs the support of the nationalist parties in parliament.

Meanwhile, evidence of the deceleration of the economy is mounting. The first hard data for the third quarter doesn't show much movement compared to the second quarter. Retail sales in July fell by 0.4% year-on-year, compared with -0.1% in June. The uptick in inflation, from around 1.0% to above 2.0% in recent months, explains the weak performance.

## The pick-up in inflation hampers the upward potential of retail sales



Source: Thomson Reuters

The dampened retail sales are one of the reasons why we don't expect an acceleration of the economy in the coming months. Another is the continued decline of the PMIs in July for both the manufacturing and services sectors.

A slowdown, however, doesn't mean the economy is doing badly. The past growth rates were just extremely high. We still expect the Spanish economy to grow by 2.6% in 2018, compared with 3.1% in 2017.

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