

Spain: Snap elections likely to be called

After months of trying to convince Catalan lawmakers to support the 2019 budget, Prime Minister Sanchez is likely to throw the towel in the ring and call snap elections. We see a right-wing government or political gridlock as the most likely outcomes



Spanish Premier, Pedro Sanchez

What happened?

As expected, the 2019 budget was voted down today in parliament. The 17 Catalan lawmakers did not vote in favour of the budget. Sanchez tried to win their support by offering an increase in money earmarked to the region, which would make Catalonia the biggest recipient of central government funding. He also wanted to start negotiations with the Catalans. But the Catalans said they only want to talk if a new independence referendum is discussed, something that Sanchez was unwilling to do.

As there is no 2019 budget, the 2018 budget rolls over. But this implies that the current PSOE-led minority government is very much limited in what it can do. The probability of snap elections has therefore increased. More specifically, Sanchez could call snap elections in April or May this Friday, after the weekly cabinet meeting. It would be the third general election in less than four years.

All this comes at a sensitive time as the Catalan independence trial started yesterday, where 12 leading politicians and activists are on trial for calling an independence referendum and declaring independence in October 2017.

Possible scenarios in case of snap elections

Recent polls still show that the PSOE is the leading party with about 24% of the votes. The two large right-wing parties, the PP and Ciudadanos, follow with about 20% and 18%, respectively, of the votes. Podemos is fourth with about 14%. A new factor in the political equation is VOX. In recent polls, the party achieves about 10% of the votes.

The political fragmentation in Spain is therefore here to stay and forming a coalition will be necessary. What are the likely outcomes of a potential snap election?

- Right-wing government (PP and Ciudadanos, with the support of VOX): Likely

A coalition between the PP and Ciudadanos, with the support of VOX, as is already the case in Andalucía, is quite likely based on current polls. This coalition would be much harder on the Catalans. Tensions between the central government and Catalonia are likely to increase in this scenario.

- Left-wing government (PSOE and Podemos, with the support of smaller parties): Less likely

The PSOE is still the largest party in the polls and so could be in the lead to form a coalition. This support could grow further in the coming months as Sanchez was quite generous to voters. He was able to significantly increase the minimum wage, which affects 1.2 million workers. An increase of PSOE votes, however, does not mean that a left-wing government is automatically more likely. Indeed, voters could switch from Podemos to PSOE, making the sum of the two constant. Given the tensions in Catalonia, the support of regional parties is questionable, which make chances for this government setup less likely.

- Political gridlock: Likely

If the right-wing bloc does not get enough votes to form a government, then they also would need support from smaller, notably, regional parties. As this is questionable, political gridlock is also among the possible scenarios.

All in all, political uncertainty is bound to remain high in Spain, hurting investment and hiring decisions. The economy is still growing at a fast pace, although annual growth slowed from 3.1% in 2017 to about 2.5% in 2018. Given the weaker external environment, we also see the Spanish economy slowing further in 2019 to about 2% annual growth. Political gridlock could further hamper the economy, though the better state of the economy should make political tensions less dangerous than a few years ago. We don't exclude some widening in Spanish bond spreads, but this is unlikely to go very far.