

Spanish elections cast a shadow over the economic outlook

Spanish elections show a divided political landscape with no clear winner, raising the possibility of new elections. Ongoing political uncertainty is casting a shadow over the economic outlook, hampering fiscal and other necessary economic reforms



Popular Party leader Alberto Nunez Feijoo addresses supporters in Madrid after election day on 23 July, 2023

Last night the Spanish elections ended in a thriller. The margin between the left and right blocs proved much smaller than expected, revealing a fragmented political landscape with no clear winner. The centre-right People's Party emerged as the largest party in the polls but failed to achieve an absolute majority. Even with their preferred far-right coalition partner Vox, they did not get enough seats to form a right-wing government. As a result, Alberto Feijóo, the leader of the People's Party, might try to form a minority government, although the chances seem slim.

While the course of events in the coming weeks remains highly uncertain, it is not out of the question that Socialist prime minister Pedro Sánchez will retain his position in La Moncloa. A plausible scenario could be that Sánchez once again forms a left-wing government, together with the far-left Sumar. However, this would mean that he would have to count on the support of regional parties that have already declared their intention to demand significant concessions in exchange for their support.

In the coming days, all political leaders should meet with King Felipe VI, who will ultimately decide which party or coalition has the best chance of forming a viable government. The current election result indicates a strong likelihood that neither Feijóo nor Sánchez will be able to establish a government, leaving weeks of political uncertainty ahead, leading to new early elections in the country.

Impact on Spain's economy and EU presidency

Ongoing political uncertainty and the prospect of new elections may introduce an element of instability to the Spanish economy. This situation could hamper the country's long-term growth prospects through delays in implementing essential economic reforms. Moreover, it risks hampering efforts to improve Spain's public finances through necessary fiscal measures. One advantage is that the process of government formation in Spain has a time limit. If no prime ministerial candidate gains the support of a majority in parliament within 60 days, new elections are triggered.

This scenario could also be detrimental to the European Union as Spain currently holds the EU presidency. Several important reforms are on the agenda in the coming months. For instance, reforms to the Stability and Growth Pact must be approved before the end of the year. Otherwise, the old system will come back into force, forcing countries to adopt stricter austerity measures. In addition, one of the spearheads of the Spanish presidency was finalising the Mercosur deal. This also risks being delayed if the political impasse persists for long. While a caretaker Spanish government will surely still manage the EU presidency, the prospect of new elections could jeopardise its effectiveness.

While ongoing political uncertainty and the possibility of another snap election could cast a shadow over the economic outlook, we should not overestimate the short-term impact either. Political uncertainties aside, the Spanish economy is expected to slow down in the coming months on the back of a slowdown of the world economy and the interest rate hikes of the European Central Bank. The ongoing recovery of the tourism sector is the main growth driver this year. However, its positive impact will fade later this year and next.

For this year, we assume average GDP growth of 1.9% for 2023, implying a slowdown in the second half of this year.

Author

Wouter Thierie

Economist

wouter.thierie@ing.com

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