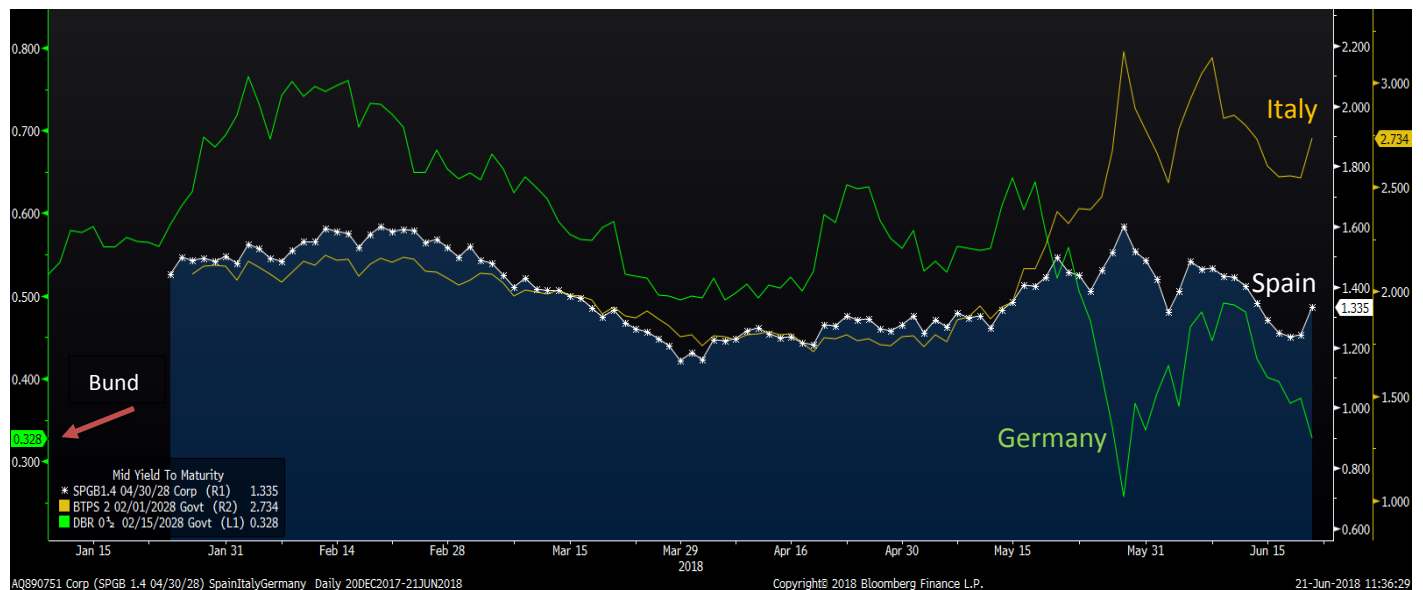


## Change in Spain

June 21, 2018

This month, Spain's Prime Minister Mariano Rajoy was replaced by socialist Pedro Sanchez after a parliamentary "vote of no confidence". Instrumental in leading Spain out of the European crisis, center-right Mr. Rajoy could not weather the Catalonia crisis and scandals within his party.

The success of the European periphery is crucial to the EU. So, it is concerning that Spain and Italy both have suffered political turmoil. But unlike Spain, Italian sovereign risk is acutely higher due to its euro-skeptic and anti-establishment populist government. Spain is neither anti-euro nor financially troubled. In the European recovery, Spain has mainly outperformed its euro peers with a higher rate of economic growth. And Spanish systemic risk has been markedly lower through successful reforms and a more consolidated, higher quality banking system.



The sovereign 10-year yield chart underscores expected political instability in Italy (Right Hand Side of chart, 2.73%). Not so with Spain (RHS, 1.34%). And "safe" German bunds (LHS, 0.33%) show little or no sovereign contagion, and no ill effects of the ECB's plan to cease asset purchases by the end of 2018. Notably, Mr. Draghi's dovish rhetoric includes keeping rates low through mid-2019, as well as leaving the door open for QE purchases beyond this year if incoming economic and other data are not supportive.

There is no guarantee that the pro-EU stance of Sanchez's minority government will have the backing of other parties for agenda items such as this year's budget and the social unrest in Catalonia. However, Spectrum believes the new government will not deviate from its path of social and economic progress. **The change in Spain should not materially elevate its sovereign or banking risk.**

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