

Spanish Election Special

Nasty Surprises Unlikely

Anna MacDonald/Nicola Mann 0171 - 772 2470/2410 (London)
Juan Díez Nicolas (Madrid) - Consultant

Effective not absolute majority for PP

The results of the January opinion poll still give the PP a consistent lead over the incumbent PSOE administration. However, having played the theme of political change in Italy and France over recent years, we believe investors will be nervous of holding an overweight position in Spanish equities post the election on March 3rd. For, while investors do want a PP- rather than PSOE-led administration, the Partido Popular is untried and untested. Although they are certainly making the right noises - structural reforms on the supply side and a combination of demand-side monetary regulation and budgetary restraint to allow for lower interest rates - investors are unsure of what it will actually mean in practical terms. As a result, we would expect to see profit taking in the run up to the general election of March 3rd. However, given the results of the January polls, we are not expecting any nasty surprises in the short term:

1. The PP still have an effective 8.4% lead over the PSOE;
2. The abstention rate remains low, indicating that we are unlikely to see an evaporation of this lead, as happened in 1993;
3. The increasing support for the Communists should further split the PSOE vote and play into the hands of the PP; and
4. The PP is already making pre-election agreements with some of the smaller regional parties based in Aragon, Alava (Basque Country) and the Canary Islands.

Market likely to be dull in Q2

This should give investors additional time to play the Spanish market and means that - EMU concerns and US bonds aside - we believe the Spanish market should outperform at least until the latter part of February. After the election, we believe that investors will move underweight, sticking to the large blue-chips (overweighting banks rather than utilities) and probably staying that way until the summer when the release of details of the 1997 Budget will allow investors to take a view as to whether or not they buy the argument of political and economic change in Spain.

Spanish Politics

Background To The Spanish Political System

Spain's experience of modern political democracy dates from the death of Franco in November 1975 and the promotion of King Juan Carlos as his successor. The near unanimous approval of the Law for Political Reform which was carried by referendum in late 1976 created a new political order.

1. The electoral law approved for the 1977 elections established the 50 provinces in Spain and the 2 cities in North Africa, Ceuta and Melilla, as the electoral districts for which representatives would be elected.
2. It established a minimum 350 seats for the Lower House, or Congress of Deputies, each province having a minimum three seats, the two cities having one seat each, with the remaining 198 seats allocated on the basis of the population in each region.
3. The Spanish electorate votes for political parties, and not individuals, with each party presenting a list of candidates equal to the total number of seats in the province. As a result, a candidate's position on the list is key to the potential success or failure in any election.
4. The D'Hont method of proportional representation means that parties which fail to get at least 3% of the total valid votes in each province are automatically excluded. The winner of the first seat is the first candidate on the list of the party which gets the most votes. The second seat is then allocated to the party which has most votes either on the first count or once the original votes are divided in two (or by 3 for the third seat and so on).

Results Of The January Polls

Results of the January poll conducted by ASEP, of which Senor Juan Diez Nicolas is President, give the PP a 6.4% lead over the PSOE assuming a 76% turnout rate, or an effective lead of 8.4%. This is remarkably stable and compares to a lead of 6.8% and 6.2% in November and December 1995, respectively. At the same time, the turnout rate has increased a little from 73.5% in October to 76.1% in January.

Results Of ASEP Opinion Polls, Per 100 Electors And Per 100 Voters, October 95-January 96

	Est. Vote per 100 Electors (%)					Vote Per 100 Voters (%)*				
	1993 Election Result	Oct 95 Poll	Nov 95 Poll	Dec 95 Poll	Jan 96 Poll	1993 Election Result	Oct 95 Poll	Nov 95 Poll	Dec 95 Poll	Jan 96 Poll
PP (Partido Popular)	26.7	28.1	29.7	29.8	30.5	34.5	38.2	39.6	39.5	40.1
CDS (Centrists)	1.4	0.3	0.3	0.6	0.2	1.8	0.4	0.4	0.8	0.3
PSOE (Socialists)	29.7	21.5	22.9	23.6	24.1	38.4	29.3	30.6	31.2	31.7
IU (Communists)	7.4	11.2	9.1	9.5	9.3	9.6	15.2	12.2	12.6	12.2
Centre/Right Nationalists**	6.8	7.0	6.6	6.4	6.8	8.8	9.5	8.8	8.5	8.9
Left Nationalists	1.7	2.5	2.0	1.6	1.6	2.2	3.4	2.7	2.1	2.1
Other	3.6	2.9	4.3	4.0	3.6	4.7	4.0	5.7	5.3	4.7
Abstention Rate	22.7	26.5	25.1	24.5	-	-	-	-	-	-

* Adjusted to reflect zero abstention rate.

** Includes Catalan Nationalists.

Whilst the success of the PP appears fairly certain, the issue of whether they will rule with an absolute or effective majority remains in question. Although the PP may not achieve the 176 seats required for an absolute majority, most recent data indicates that the PP should achieve a 'comfortable' majority which will allow it to govern without being forced to seek parliamentary support from any other party. Unfortunately, we are unable to be more specific as to how many seats the PP will actually win, because of the way in which the d'Hont method of proportional representation works.

1. It is impossible to predict the number of seats that a party will win based on its showing in the polls, given that the number of seats in each province is fixed. The distribution of votes between provinces is therefore of key importance and it is not in a party's best interests for its votes to be concentrated in a small number of provinces as all votes above a certain level would effectively be wasted, implying no additional seats. On the other hand, a low showing elsewhere may mean that a party fails to win any seats in that province. Nevertheless, electoral returns from the 1993 European and regional elections have shown a significant increase in the PP's showing in regions where it has traditionally been weak (Andalucia, Cataluna, Basque Country).
2. Accurate estimates for the turnout/abstention rate are almost as important as the number of votes estimated for each party by the polls. For example, the UCD won the 1979 election with a 3.1% lead over the PSOE. This was very similar to the 3.0% lead achieved by the PSOE in 1993. While a 33% abstention rate in 1979 implied an effective lead of 4.6% for the UCD, compared to 3.9% for the PSOE in 1993 (based on a lower abstention rate of 23%), the difference in the number of seats won by the respective victors was far greater: The UCD achieved a 47 seat lead in 1979, compared to the PSOE's 18 seat lead in 1993, which clearly demonstrates the fact that the number of votes indicated by the polls is not a reliable guide to the number of seats that a party will actually win in an election.
3. The number of votes won by the third-largest party is another factor which determines the number of seats obtained by the two largest parties. In 1979, the PCE obtained 10.7% of the votes, which may help to explain the large lead achieved by the UCD. The most recent polls show that the IU would receive 12.2% of the votes, which should ultimately prove to be beneficial for the PP.

Results Of General Elections In Spain (Main National Parties, Lower House), 1977-93

Year	Abst. Rate (%)	% Over Electorate				% Over Voters*				Seats			
		PSOE	UCD/ CDS	AP/ PP	PCE/ IU	PSOE	UCD/ CDS	AP/ PP	PCE/ IU	PSOE	UCD/ CDS	AP/ PP	PCE/ IU
1977	22	22.8	26.8	6.2	7.2	29.4	34.6	8.0	9.3	118	165	16	20
1979	33	20.4	23.5	4.0	7.2	30.4	35.0	6.0	10.7	121	168	9	23
1982	22	37.6	5.3	20.7	3.2	48.3	6.8	26.6	4.1	230	13	115	3
1986	30	30.7	6.4	18.1	3.2	44.4	9.2	26.2	4.6	184	19	105	7
1989	31	27.4	5.5	17.9	6.3	39.7	8.0	25.9	9.1	175	14	107	17
1993	23	29.7	1.4	26.7	7.4	38.4	1.8	34.5	9.6	159	0	141	18
Jan 96 Poll	24	24.1	0.2	30.5	9.3	31.7	0.3	40.1	12.2	-	-	-	-

* Adjusted to reflect zero abstention rate.

Implications Of January Poll

A comparison of the results of the January 1996 poll and that conducted in April 1993 (2 months before the 1993 election) provides some interesting insights: The April 1993 polls gave the PP a 2.4% lead over the PSOE (compared to 6.4% currently), with an abstention rate of 33.2% (23.9% currently).

This lead had completely evaporated by May 1993 as the abstention rate decreased to 30%. As the turnout rate continued to improve, the PSOE increased its share of the votes, given that most of those who planned to abstain had voted for the PSOE in 1989 and when pressed, continued to vote to type. The final outcome was an abstention rate of only 22.7%, which benefited the PSOE and allowed them to win with a 3% lead over the PP. The 1996 turnout is, on the other hand, expected to be very high, with most of the electorate having already decided to vote and selected the party they will vote for. On that basis, the risk of a major change in voting patterns on the back of an increased turnout between now and the March 3rd election has been considerably reduced.

Since the 1993 elections, estimates of the abstention rate have been significantly lower than they were in the past, which may indicate that most of the electorate has decided well in advance how they will vote. This would seem to be borne out by the fact that the PP has consistently obtained more votes than the PSOE in polls conducted since 1993, indicating that voters have already made an active decision to change allegiance.

The January poll provides an insight into some of the key issues which are influencing voting intentions:

- ▶ The main socio-economic issues identified by voters are unemployment (80%), corruption/pensions (40%), taxes/drug trafficking (35%) and law and order. Social security benefits, regional problems, European integration and international conflicts appear to be less important, being mentioned by less than 20% of respondents.
- ▶ Polls still show a wide gap between Gonzalez' and Aznar's popularity (4.5 points versus 3.9 on a scale of 0-10). Whilst Gonzalez is generally seen as a more charismatic individual than Aznar, the difference may also reflect the benefit of being the incumbent in Gonzalez' case and the fact that both Aznar and the PP are untried and untested in government. It is interesting to note, however, that Aznar is considered more competent than either Gonzalez or Anguita (the leader of the IU) when it comes to solving problems linked to corruption, unemployment, economic slowdown, delinquency, terrorism etc.
- ▶ The calling of elections for March 3rd has boosted expectations for the national economy and increased the 'feel-good' factor, but does not appear to have had any impact on voters satisfaction with the government, which remains at very low levels.
- ▶ 59% of all respondents believe the PP will win the March 3 election, against only 23% who believe the PSOE will win.

Finally, the PP appears to be establishing pre-election coalitions including joint candidate lists with various regional parties, which should increase the power of the votes they obtain. So far, the PP has reached an agreement with the Aragon regional party (PAR, present in three provinces in Aragon), and is in the process of negotiating similar agreements with Union Alavesa (present in Alava in the Basque Country) and with Coalicion Canaria (present in both provinces in the Canary Islands).

Conclusions

Results of the January polls give the PP an effective 8.4% lead over the PSOE. This represents a small decline on the previous poll, but we do not believe it is a repetition of the trends seen in the run up to the 1993 elections. We believe the possibility of an unpleasant surprise in the results has been reduced by:

1. The low abstention rate;
2. The fact that the disaffected PSOE voters are moving both right and left, so splitting the opposition vote further; and
3. The development of pre-election coalitions with the Aragon, Alavesa and the Canary Island National parties, which further reduces the likelihood of the PP needing support from Convergencia i Unió.

The problem remains, of course, that although the market is looking for a PP victory, it still doesn't know what this will mean in real terms. Thus, to some extent the good news is already in the price. It is going to take the PP until early April to decide whose feet are actually going under the desks. As a result it is highly unlikely that they will be able to make any serious policy statements on which investors can make some assessment until the beginning of the summer at the earliest. As a result we are expecting profit taking in the run-up to the elections to be followed by a dull second quarter, following which investors can decide whether they really buy the argument of political change in Spain. At the moment, it's just too early to tell.