

High inflation: an uneven burden for Portuguese households?

After lying dormant for several years, inflation is back in the headlines as it surges to new heights: in April, inflation in Portugal climbed to 7.2%, the highest level since March 1993.

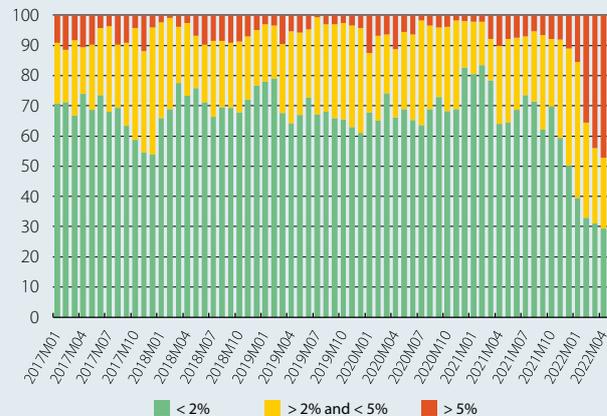
While the price rally was initially driven by the energy component, core inflation (which excludes energy and unprocessed food) is also rising, reflecting increasing contagion to the rest of the CPI categories. Thus, while in January 2021 only 19% of the categories that comprise the CPI basket registered price increases in excess of 2%, in April this year 71% had inflation above 2%, and in 47% of categories it was even above 5%. Similarly, inflation in food products, which stood at 1% in January last year, reached 10.25% in April. In other words, there has been a sharp rise in the price of essential goods and services – precisely the categories in which households struggle the most to adjust their spending. After all, we can postpone changing cars and we can opt not to go on holiday abroad or to go to a show, but it is difficult to reduce or postpone our consumption of food or heating.

Moreover, the rise in inflation does not affect all households alike, as the relative weight of household expenditure across the various categories of the consumer price index varies according to income level. Eurostat data¹ reveal that in Portugal, households with lower incomes (first quintile) allocate 18.3% of their expenditure to food products, while those with higher incomes (fifth quintile) spend only 11.6% on this category. This empirical confirmation of Engel’s law also applies to other essential goods and services, such as the category of expenses related to housing, which includes water, electricity, gas and other fuels. Households with lower incomes allocate 39.1% of their expenditure to these components, while for those with higher incomes they represent only 28.2%.

Thus, the impact of the rise in prices differs according to the consumption pattern, resulting in so-called inflation inequality. Using data from the NSI and Eurostat,² we have calculated two parameters for inflation inequality,³ distinguishing between headline inflation and that of essential goods and services (adding together the components of food and housing). According to our calculations, from the start of the pandemic to mid-2021,

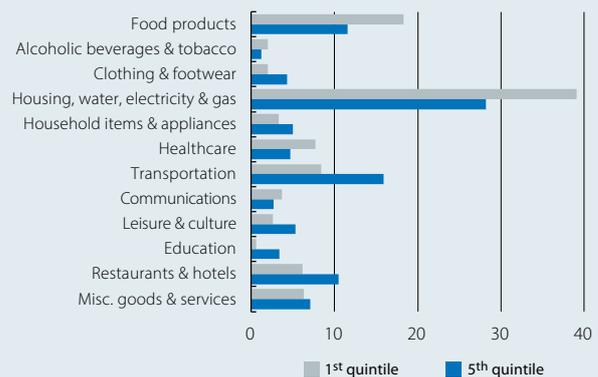
1. Data on consumption distribution by income quintile from the 2015 Household Budget Survey.
 2. From the National Statistics Institute, year-on-year inflation by component, measured using the CPI. From Eurostat, see footnote 1.
 3. The calculation method used is the same as that set out in the paper by G. Claeys and L. Guetta-Jeanrenaud (2022). «Who is suffering most from rising inflation?». Bruegel Blog, 1 February.

Portugal: inflation traffic light
(% of the CPI basket)



Source: CaixaBank Research, based on data from the National Statistics Institute of Portugal.

Portugal: structure of consumption expenditure by income quintile
(% of total expenditure)



Source: CaixaBank Research, based on data from Eurostat.

lower-income households were more affected, with inflation for their consumption patterns in November 2020 lying 0.6 pps above that of higher-income households. In fact, the average annual inflation in 2020 was -0.01%, but for lower-income households it was 0.3%, while for higher-income households it was -0.1%. This suggests that prices during that year fell in components where higher-income households spend a greater portion of their budget, such as clothing, footwear, leisure and culture, travel, education, etc.

From July 2021 to March 2022, inflation inequality in general terms fell, which could be due to the widespread rise in inflation across most components of the index. However, it increases in the case of essential goods and services, climbing to 1.8 pps in April 2022.

The inequality in the inflation of essential goods is the most worrying aspect of this phenomenon. Higher-

income households can soften the blow of rising prices, either by reducing and deferring their consumption of other goods or by resorting to savings. Lower-income households, however, could see their basic shortfalls exacerbated by the price rally and suffer a drastic reduction in their available resources after meeting their basic needs. It should be added that our calculations have been carried out based on the allocation of expenditure observed in 2015, so there is a possibility that the alteration of consumption patterns following the pandemic may have led to essential goods becoming an even larger part of lower-income households' expenditure.

It seems that this problem has not gone unnoticed among policymakers, and measures were included in the 2022 General Government Budget to alleviate the impact of the increase in the price of essential goods. These include a 60-euro aid voucher for the most vulnerable families to appease the increase in food prices (a measure with which the government expects to reach more than 800,000 households) and a 10-euro subsidy for the purchase of gas cylinders for three months. It is also expected that measures specifically targeted at agricultural activity, such as the VAT exemption for animal feed and fertilisers, will not only help producers but in some way will also help to ease the increase in the price of food products when they reach the consumer. If the current bout of inflation ends up being only transitory, as is expected, then these one-off or short-term measures could help mitigate the effects of the price rally.⁴

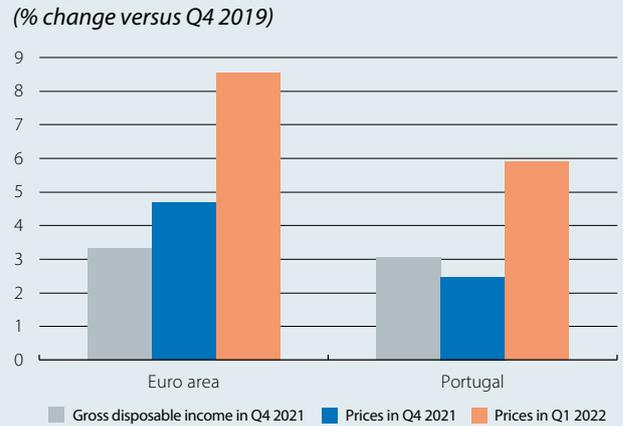
Tiago Belejo Correia

Portugal: inflation gap between low and high-income households (pps)



Source: CaixaBank Research, based on data from Eurostat and the National Statistics Institute of Portugal.

Portugal: household gross disposable income and prices (% change versus Q4 2019)



Source: CaixaBank Research, based on data from Eurostat.

4. According to Eurostat, the cut-off point for incomes in the 1st quintile in Portugal is 6,967 euros/year. The direct aid included in the Government Budget amounts to 90 euros per household. In practice, in annual terms, this would correspond to a monthly increase in income of 1.29%.