Portugal: budgetary risks return for 2023

Next year will be a major challenge for Portugal's public finances due to the context of high inflation, worsening financial conditions and a sharp slowdown in the economy. In this environment, in addition to the likely reduced growth of tax revenues in the face of a slowdown in household and business incomes, there are risks surrounding the pattern of expenditures. In this article, we focus on estimating the impact of higher interest payments on public expenditure and that of inflation on staff and pension costs.

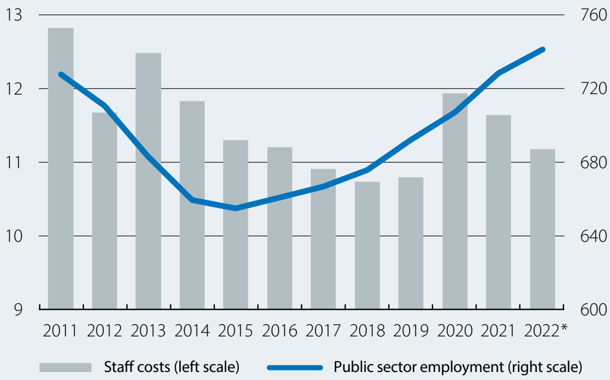
With regards to staff costs, it must be borne in mind that the decision on updating public sector wages lies with the government, as part of its preparation of the General Government Budget. It has already confirmed that such an update will depend on its payment capacity and on the wage negotiations with the unions. In this exercise, we assume a wage increase of 2% in 2023, in line with the target for the medium-term inflation rate (2%). In this context, and assuming 1% growth in the number of public sector workers,[1] staff costs would increase by 3% and the impact on expenditure would amount to around 0.3 pps of GDP (this calculation does not take into account the impact of career progress or other increases in the overall remuneration package). It should be noted that, should the government choose to update wages at the average inflation rate registered in the 12 months to November 2022,[2] as it has done in recent years, staff costs would increase by more than 8% compared to the forecast for 2022 and the impact on the public accounts could amount to 0.9 pps of GDP.

With regards to retirement pensions, taking into consideration the recently announced formula that will be applied in 2023,[3] we estimate that the impact on public expenditure will reach 0.6 pps of GDP (i.e. an increase of more than 1.4 billion euros).[4]

Finally, and in view of the ECB's expectations of additional interest rate hikes of at least 100 bps by 2023, it is reasonable to assume that sovereign interest rates will accompany this move, at least in part. Incorporating this increase in financing costs, we estimate an increase in public debt interest expenditure of between 0.2 and 0.3 pps, which would bring interest payments to 2.4%-2.5% of GDP. Also, the rise in rates will be felt gradually over the next few years, as the stock of debt is renewed and maturities are replaced with new, more expensive debt. Thus, it appears inevitable that interest charges on public debt will increase as a proportion of GDP and public expenditure over time, and this will act as an increasingly difficult restriction for fiscal policy and should be taken into account when designing future policies.

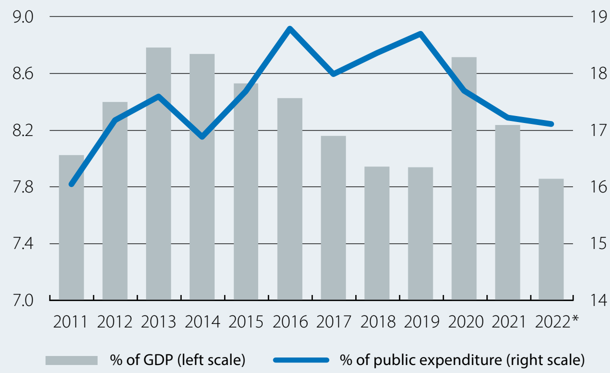
There are other factors that are likely to also push up public spending. These include the impact of inflation on new contracts for the supply of goods and services to government, the potential need to prolong and/or implement new measures to support households and businesses in mitigating the effects of the energy crisis, and the increase in food prices in their budgets and the

Portugal: staff costs



*Notes: * Government forecast for staff costs according to the 2022 General Government Budget. Average public sector employment registered in Q1 2022.*
Source: CaixaBank Research, based on data from the DGAEP, the 2022 General Government Budget and the National Statistics Institute of Portugal.

Portugal: Social Security pension expenditure



*Note: * Government forecast per the 2022 General Government Budget.*
Source: CaixaBank Research, based on data from the 2022 General Government Budget and the National Statistics Institute of Portugal.

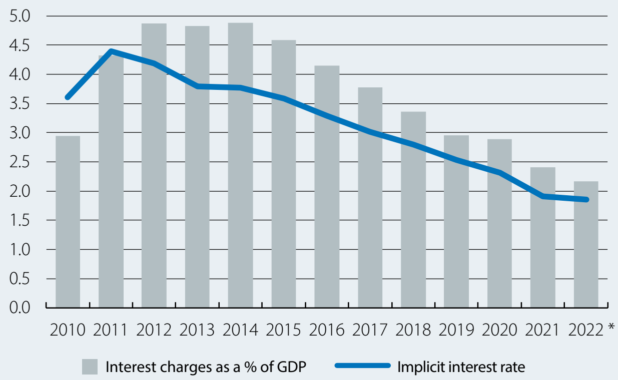
1. We assume that the number of public sector workers will grow at the average rate recorded between 2015 and 2019.
2. Based on CaixaBank Research forecasts for the monthly CPI.
3. For pensions up to 886 euros per month, the update is 4.4%; for pensions between 886 and 2,659 euros, the update is reduced to 4.1%; and for pensions over 2,659 euros, the update amounts to 3.5%.
4. It is assumed that the number of pensioners increases by the same proportion as that registered in the first half of 2022, i.e. by 0.6%.

updating of the social aid index, which would have the knock-on effect of driving up other social benefits such as that of unemployment.[5]

Despite these impacts and the residual effect that the «Families First» package will still have next year, the deficit in 2023 could be reduced from the 1.9% of GDP estimated by the government for 2022 to somewhere around 1.3% of GDP, supported by nominal GDP growth and the effect of inflation boosting revenues through higher tax bases. However, beyond other effects, it should be mentioned that our assessment does not consider the possibility of discretionary measures that may end up being included in the 2023 budget proposal, which will be made public in mid-October, or the possibility of better than expected results in the 2022 budget implementation.[6]

Vânia Duarte

Portugal: interest payments on public debt
(%)



Note: ** Government forecast per the 2022 General Government Budget.*
Source: *CaixaBank Research, based on data from the 2022 General Government Budget and the National Statistics Institute of Portugal.*

5. The update of the social support index (IAS) depends on real GDP growth and the average change in the CPI over the last 12 months, excluding housing.
6. For example, the Portuguese Public Finance Council (CFP) estimates a deficit of 1.3% in 2022, taking into consideration the impact of the measures included in the «Families First» package. Assuming that the deficit in 2022 is that stated by the CFP, and based on the impacts estimated in this article, the deficit would remain at around 0.7% of GDP in 2023.