Europe Flash

Portuguese 2013 budget enough to meet targets but tilted too much to higher taxes

- **The consolidation effort for 2013 amounts to 3,2% of GDP, enough in principle to reach the 4.5% deficit target**

  The government unveiled on Monday 15 the details of 2013 budget, which is now to be discussed in the Parliament. Total net consolidation measures amount to 5.3€bn (3.2% of GDP) so as to meet the 4.5% deficit target after the expected 5% in 2012. Those 3.2pp of GDP should cover the following: (a) an improvement of 0.5pp between 2012 and 2013; (b) compensation of some of the consolidation measures implemented in 2012, equivalent to 1% of GDP, which are one-offs, and therefore will be reversed in 2013; (c) the increase in the interest rate expenditure (+0.1pp of GDP) and (d) a worsening macroeconomic scenario, which under the government calculation translates into an additional cyclical deficit of +1.6pp. Some of the measures contained in this budget have already been announced in previous packages.

  The underlying macro assumption of the budget foresees a GDP decline of -1%, which we consider reasonable. However the elasticity of the deficit to the cycle might be somewhat optimistic, taking into account the recent evolution of public revenues. This poses an upward risk on deficit figures for next year.

- **On the spending side, there are cuts across the board, partly to compensate for the necessary reversal of the cut of one extra month's pay for public employees**

  On the spending side the government expects to save 2.7€bn (1.6% of GDP). The retirement age will be raised to 65 for civil servants so as to match that of the private sector. Temporary contracts will be cut and payments made for extra-hours and sick leave substantially reduced. The initial plan of the government to withdraw the two extra months of payment has been reduced to just one, as the measure was declared unconstitutional by the Constitutional Court (additional cost of 1.6 €bn). Hence, the net impact of spending measures will amount to just 1 €bn (0.6% of GDP).

- **The bulk of the adjustment comes from tax increases, mainly on the personal income tax**

  Total revenue measures account for 4.3€bn (2.6% of GDP), of which 2.8€bn will derive from the reduction in the number of personal income brackets**.** At the same time, additional charges will be implemented over capital gains, property, house rentals, car ownership and a tax for financial transactions. These measures come after a previous announcement to cut social security payments for firms, and raise it (by 7pp) for employees, which would have had a small positive net impact on the budget. That measure, which was mostly aimed at deepening the internal devaluation of the economy, was withdrawn after strong opposition from several parties.

- **Uncertainty remains, and it is likely that some of the measures will be modified**

  In spite of the current government majority in parliament, the reaction to the budget has been strong, with negative comments even within the governing coalition. We expect this budget to be subject to further changes, as the government has opened the door to discussing some of the measures included.

Table 1

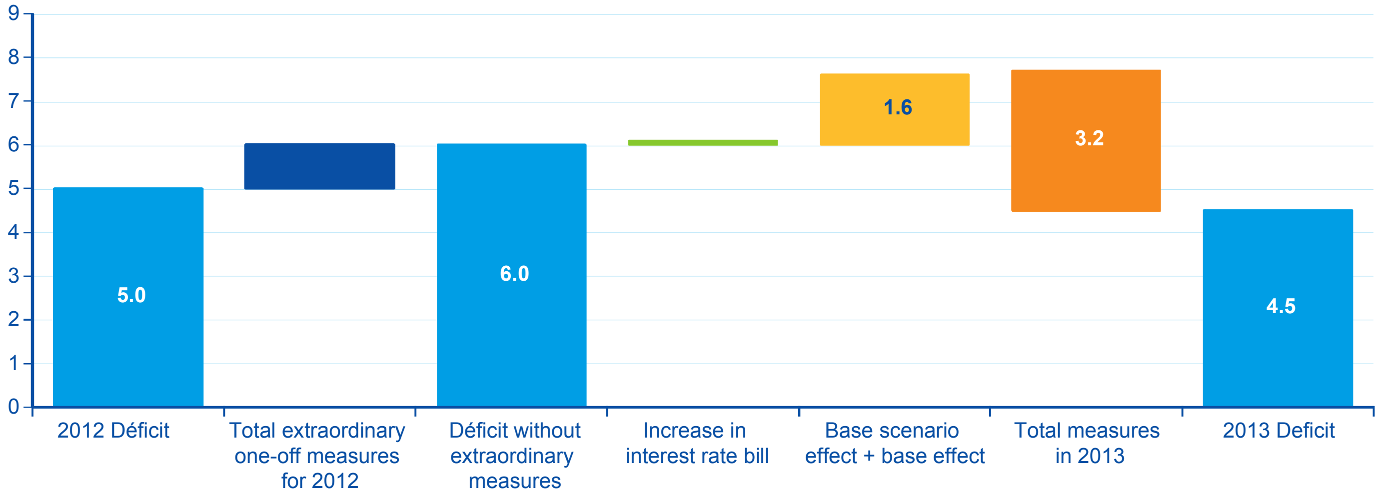
Detailed Measures

SPENDING MEASURES	% of GDP	€bn
Wages	0.4	0.73
Social benefits	0.6	1.04
Social benefits in kind	0.1	0.18
Intermediate consumption	0.2	0.37
Subsidies	0.1	0.12
Investment	0.2	0.25
Total	**1.6**	**2.70**
Subsidies to public servants and pensioneers	-1.0	-1.67
Total spending measures	**0.6**	**1.03**
REVENUE MEASURES		
Wealth and income tax	1.8	3.03
Tax on production	0.4	0.69
Social contributions	0.1	0.14
Other	0.1	0.09
Total	**2.4**	**3.94**
Due to the reposition of subsidies: IRS and Social contributions	0.2	0.37
Total revenue measures	**2.6**	**4.31**
TOTAL MEASURES	**3.2**	**5.34**

Source: OE 2013, Portuguese Ministry of Finance

Chart 1

Portugal. Consolidation required measures to meet targets



Source: OE 2013, Portuguese Ministry of Finance

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