BOX 2.3: BENEFITS AND COSTS OF THE CASH POSITION IN 2013 AND 2014

Since 2006, along with its duties of managing the direct government debt, *IGCP* took on the task of managing the cash balances of the Central government, thus promoting an integrated management of the risks of assets (cash) and liabilities (debt). The integrated management of cash balances, financing and government debt allows greater efficiency gains by minimising the financial burden of government debt and lower the State's direct debt in circulation in exchange for reduced cash surpluses.

However, since 2010 the goal of maintaining cash balances at tendentially low levels was dependent on the need to establish liquidity reserves, given the uncertainty of accessing financing in the market in an environment of high volatility, which affected euro area peripheral countries in particular. The new challenges posed in obtaining financing in a context of global economic and financial crisis and the fact that Portugal was under an assistance programme justified the adoption of a more conservative attitude by *IGCP* in terms of its cash position. It should be noted that the adoption of more prudent behaviour was repeatedly suggested by the technical mission of the EU and the IMF in order to facilitate the recovery of the Portuguese government debt investor base, thus contributing to reduce the Republic's financing cost in the medium term. This is essentially due to the fact that Portugal has not yet recovered the investment grade status – in the rating awarded by the three major rating agencies,[13] which it had before the sovereign debt crisis in the euro area.

In this framework, cash balances have remained relatively high in recent years. In 2013, the average daily cash balance of cash deposits amounted to EUR 16.6 billion and in 2014 it stood at around EUR 17.4 billion (including deposits held for the recapitalisation of the banking system in a dedicated account with *Banco de Portugal* – the Bank Solvency Support Facility[14] – in an average daily amount of EUR 4.1 billion in both years). Excluding the BSSF deposits, the average excess funding in relation to overall financing needs stood at EUR 12.5 billion and EUR 13.2 billion in 2013 and 2014, respectively. Considering the average cost of financing in the market during this period, excluding the applications of cash surpluses and the cost associated with deposits held for the recapitalisation of the banking system, the net cost of the cash position amounted to EUR 230 million and EUR 246 million in these two years respectively.

Table 12– Estimated cost of the cash position

Estimated cost of the Treasury cash position						
	Implicit rate total stock [1]		Average cost (*BT*+*OT*) [2]		Average cost (*BT*) [3]	
(EUR million)	2013	2014	2013	2014	2013	2014
Average balance of deposits	16.621	17.377	16.621	17.377	16.621	17.377
Funding cost (%)	3,6%	3,6%	3,1%	2,3%	1,6%	0,5%
Average cost of funding of the Treasury cash balance	602	628	517	403	258	82
Interest received from Treasury applications	-152	-61	-152	-61	-152	-61
Net cost of the Treasury cash balance	**450**	**566**	**364**	**342**	**106**	**20**
p.m.						
Average balance of deposits held in BSSF account	*4.103*	4.132	*4.103*	4.132	*4.103*	4.132
Average cost of funding of deposits in BSSF account	*149*	*149*	*128*	*96*	*64*	*19*
Net cost of the Treasury cash balance, excluding BSSF deposits	***301***	***417***	***237***	***246***	***42***	***1***

(1) Implicit interest rate is computed as the ratio between interest of the State's direct debt paid on an accrual basis and the average debt stock in a given year (see section 4.2).
(2) Funding cost of *BT* and *OT* corresponds to the average interest rate of new financing of *BT* (with maturity in forthcoming years) and *OT* obtained over the given year.
(3) Funding cost of *BT* corresponds to the average interest rate of new financing of *BT* (with maturity in forthcoming years) obtained over the given year.

Source: *IGCP*

However, as we can observe in the table above, the negative carry related with the excess funding may present rather different estimates, depending on the assumptions used to

[13] At the end of June 2015, the rating of the Republic of Portugal given by the three major rating agencies was: BB+ in the case of Fitch, Ba1 in the case of Moody's and BB in the case of S&P, one notch below below investment grade in the first two cases, and two notches below investment grade in the case of S&P.
[14] As agreed with international institutions supporting the EFAP.

compute the funding cost: the estimate is significantly higher if we consider the implicit interest rate on the overall debt stock (which includes all the funding obtained over in the past for the current outstanding debt, and not only the marginal cost of new funding in the year), but is significantly lower if we only consider the marginal cost of the *BT* funding.

Even though in an ex-post analysis maintaining high cash surpluses may result in an increase of the Republic's financial burden, this increase cannot be dissociated from the potential cost of delaying the execution of funding operations to a moment where financial conditions could be even worse. It should be noted that the prudent strategy of pre-financing and establishment of liquid reserves was also adopted by other sovereigns given the uncertainty and volatility of the international debt market.