6. Public Finance

During January-September 2017, fiscal policy supported growth through both public spending as well as fiscal measures and incentives. Meanwhile, tax adjustments within the year proved less inflationary compared to previous years. Accordingly, due mainly to the soaring primary expenditures and partly to the falling non-tax revenues, the budget deficit widened notably in this period. On the other hand, in September 2017, primary expenditures grew more slowly while tax revenues witnessed a noticeable recovery on the back of the rebound in economic activity stimulated by the CGF-backed loans besides growth-boosting measures and incentives. In the last quarter of 2017, fiscal policy is expected to provide higher support to growth through investment allowances.

In the first three quarters of 2017, the sizeable widening in the budget deficit stemming from rising public spending and temporary measures was financed mostly by domestic borrowing. Having risen notably compared to previous years, the domestic debt rollover ratio climbed to 126.6 percent during this period. Yet, the domestic borrowing rate increased only slightly thanks to the growing global risk appetite and the increased share of foreign investors in the domestic debt stock.

The MTP covering the 2018-2020 period was announced to the public at the end of September. The objectives of the new MTP are reducing the share of public revenues and expenditures in GDP, obtaining public revenues from reliable and sustainable resources by increasing the share of tax revenues in public revenues, enhancing efficiency and controlling the public sector borrowing requirement. In addition, it is stated in the MTP that the fiscal policy will be implemented in line with the monetary policy targets to boost growth potential, maintain economic stability, keep current account deficit at sustainable levels and stimulate domestic savings and investments. In this respect, it is projected that fiscal discipline will be maintained and the public debt stock to the GDP ratio will continue to decline gradually throughout the MTP period (Table 6.1). The fiscal harmonization envisaged in the MTP suggests that the ratio of primary expenditures to GDP will be reduced gradually and the ratio of tax revenues to GDP will be kept unchanged.

According to the new MTP, the ratio of the central government budget deficit to GDP is estimated to display a notable year-on-year rise to -2 percent in 2017 (Table 6.1). The new MTP projections for 2017 suggest that primary expenditures are envisioned to remain considerably above the target in 2017. Moreover, tax revenues are expected to be largely consistent with the target, while non-tax revenues are likely to reduce the budget deficit, albeit at a slower pace compared to the previous year.

Table 6.1.
Central Government and General Budget Balance
(Percent of GDP)

	2016	2017*	2018**	2019**	2020**
Expenditures	22.4	22.2	22.1	21.7	21.1
Primary Expenditures	20.5	20.3	20.1	19.5	18.9
Interest Expenditures	1.9	1.9	2.1	2.2	2.2
Revenues	21.2	20.2	20.2	19.8	19.5
Tax Revenues	17.6	17.1	17.4	17.1	16.9
Other Revenues	3.6	3.0	2.8	2.6	2.6
Budget Balance	**-1.1**	**-2.0**	**-1.9**	**-1.9**	**-1.6**
Primary Balance	**0.8**	**-0.1**	**0.2**	**0.3**	**0.6**
General Budget Balance	**-1.3**	**-2.4**	**-1.9**	**-1.9**	**-1.3**
Primary Budget Balance	**0.7**	**-0.4**	**0.2**	**0.5**	**1.1**
EU-Defined Nominal Debt Stock	**28.1**	**28.5**	**28.5**	**28.0**	**27.5**

* Forecast.
** MTP (2018-2020).
Source: MTP (2018-2020).

6.1. Budget Developments

In January-September 2017, the central government budget balance posted a deficit of 31.6 billion TL, while the primary budget balance recorded a surplus of 15 billion TL (Table 6.1.1). In this period, the budget deficit exhibited a notable year-on-year deterioration due to accelerated primary budget expenditures and the restricted rise in total budget revenues owing to the decline in non-tax revenues.

In this period, tax revenues increased by 17.1 percent year-on-year, while non-tax revenues dropped by 9.7 percent, which led central government budget revenues to rise by only 12.9 percent. Meanwhile, soaring by 17.8 percent in the first nine months of 2017, primary expenditures exceeded budget revenues, leading to a dramatic year-on-year decline in the primary surplus.

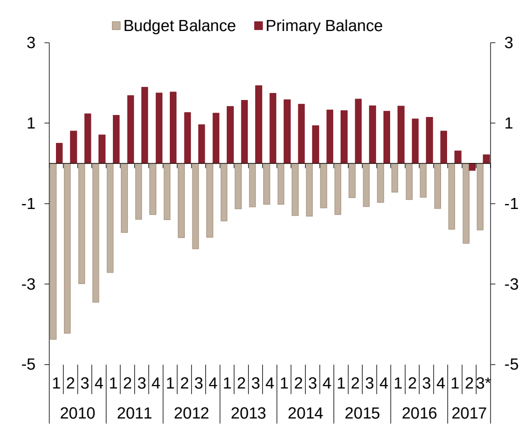
Table 6.1.1.
Central Government Budget Aggregates
(Billion TL)

	January-September 2016	January-September 2017	Rate of Increase (Percent)	Actual/Target (Percent)
Central Government Budget Expenditures	416.5	488.2	17.2	75.7
Interest Expenditures	41.7	46.6	11.8	81.0
Primary Expenditures	374.8	441.6	17.8	75.2
Central Government Budget Revenues	404.5	456.6	12.9	76.3
I. Tax Revenues	329.0	385.3	17.1	75.4
II. Non-Tax Revenues	60.4	54.6	-9.7	74.5
Budget Balance	**-12.0**	**-31.6**	**-**	**-**
Primary Balance	**29.6**	**15.0**	**-49.5**	**140.5**

Source: Ministry of Finance.

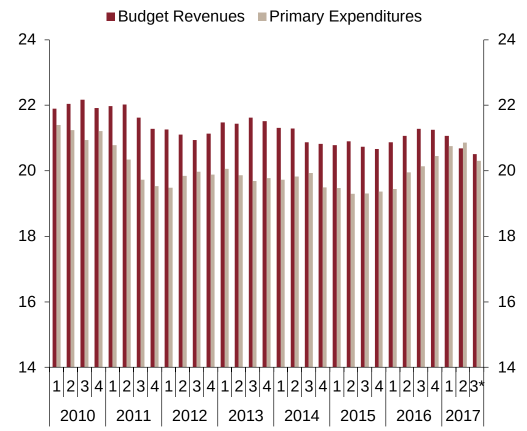
In the third quarter of 2017, the central government budget deficit to GDP ratio is expected to inch up by around 0.9 points year-on-year to 1.7 percent (Chart 6.1.1). In the same period, the primary budget balance to GDP ratio may fall by 0.9 points to 0.2 percent.

Chart 6.1.1.
Central Government Budget Balance
(Annualized, Percent of GDP)



* Forecast.
Source: Ministry of Finance.

Chart 6.1.2.
Central Government Budget Revenues and Primary Expenditures
(Annualized, Percent of GDP)



* Forecast.
Source: Ministry of Finance.

Having accelerated since 2016, the central government primary expenditures to GDP ratio continued to climb in the first half of 2017, but lost pace in the third quarter. In fact, up only by 0.2 points year-on-year, this ratio is projected to reach 20.3 percent in the third quarter of 2017, mainly due to the ongoing uptrend in current transfer expenditures (Chart 6.1.2). In the same period, the central government budget revenues to GDP ratio is estimated to hit 20.5 percent with a year-on-year decline of 0.8 points because of slowing non-tax revenues and temporary tax reductions at end-2016 as well as the effects of VAT returns on tax revenues.

Data for the January-September 2017 period suggest that central government primary expenditures jumped by 17.8 percent year-on-year. This was particularly due to current transfers, capital expenditures and the uptick in purchases of goods and services stemming from defense expenditures amid the geopolitical turmoil (Table 6.1.2). The significant rise in current transfers was fueled by social security deficit financing, transfers to households entailing incentives extended to firms and the 5-point reduction in the employer's insurance premium. On the other hand, personnel expenditures, the key item of primary expenditures, stood relatively low. Among investment expenditures, capital expenditures and capital transfers surged by 29.5 and 75.5 percent year-on-year, respectively. In the remainder of the year, fiscal policy is expected to spur economic growth especially through investments by the use of investment allowances that were not utilized in the first nine months of 2017.

Table 6.1.2.
Central Government Primary Expenditures
(Billion TL))

	January-September 2016	January-September 2017	Rate of Increase (Percent)	Actual/Target (Percent)
Primary Expenditures	**374.8**	**441.6**	**17.8**	**75.2**
1. Personnel Expenditures	113.6	122.7	8.0	75.5
2. Government Premiums to SSI	18.6	20.2	8.7	74.4
3. Purchases of Goods and Services	33.6	40.6	20.8	77.8
4. Current Transfers	167.5	204.1	21.8	81.9
a) Duty Losses	4.2	4.7	12.5	65.4
b) Health, Pension and Social Benefits	82.4	103.9	26.0	89.0
c) Agricultural Support	9.3	10.0	7.3	77.9
d) Reserved Share Revenues	46.1	52.8	14.4	75.3
e) Transfers to Households	7.4	11.7	58.3	86.7
5. Capital Expenditures	28.9	37.4	29.5	56.5
6. Capital Transfers	4.2	7.4	75.5	68.0
7. Lending	8.5	9.3	9.9	72.2

Source: Ministry of Finance.

During January-September 2017, central government budget revenues increased by 13.0 percent year-on-year (Table 6.1.3). In the same period, tax revenues recorded a sizeable upturn of 17.1 percent. This rise was led by the growth-boosting measures along with the SCT adjustments and tax revenues generated by Law No. 6736. Meanwhile, non-tax revenues slumped by 9.7 percent due to the year-on-year decline in privatization revenues.

Table 6.1.3.
Central Government General Budget Revenues
(Billion TL)

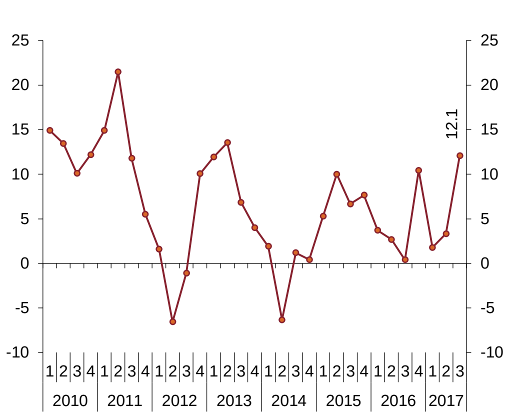
	January-September 2016	January-September 2017	Rate of Increase (Percent)	Actual/Target (Percent)
General Budget Revenues	**389.4**	**439.9**	**13.0**	**75.3**
I-Tax Revenues	**329.0**	**385.3**	**17.1**	**75.4**
Income Tax	69.4	79.5	14.6	73.0
Corporate Tax	31.0	39.9	28.8	86.5
Domestic VAT	38.6	41.1	6.5	72.0
SCT	85.7	98.8	15.3	72.4
VAT on Imports	53.5	68.2	27.6	81.5
II-Non-Tax Revenues	**60.4**	**54.6**	**-9.7**	**74.5**
Enterprise and Property Revenues	19.4	16.7	-13.7	97.8
Interests, Shares and Fines	26.2	25.8	-1.6	68.7
Capital Revenues	12.1	9.0	-25.1	58.7

Source: Ministry of Finance.

Across sub-items, the upsurge in tax revenues was driven by higher VAT revenues on imports in indirect taxes and increased corporate tax revenues in direct taxes. In the meantime, SCT revenues, an indirect tax item, and the income tax revenues, a direct tax item, posted a rather modest rise. On the other hand, the rebounding economy notwithstanding, the domestic VAT displayed a limited increase due to temporary tax incentives and VAT reductions, which were put into effect to stimulate the economy, as well as the decline in the collection and accrual ratio. Meanwhile, VAT on imports recorded a sizeable year-on-year upturn of 27.6 percent in the first nine months of 2017 largely due to the rise in the exchange rate.

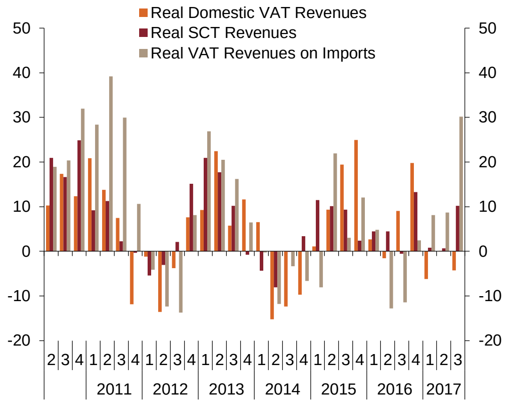
In terms of annual percentage changes, having picked up in the last quarter of 2016, real tax revenues lost momentum in the first quarter of 2017 but steered back to recovery in the second quarter and accelerated in the third quarter growing by 12.1 percent (Chart 6.1.3). This increase is mainly attributed to the rebounding economic activity fueled by CGF-backed loans and other growth-boosting measures as well as the adjustments[1] to certain tax rates in late 2016 and tax revenues generated by the Law No. 6736. Across sub-items, the collection of VAT on imports displayed a strong performance in real terms over the third quarter of 2017 (Chart 6.1.4).

Chart 6.1.3.
Real Tax Revenues
(Annual Percent Change)



Source: Ministry of Finance.

Chart 6.1.4.
Real VAT and SCT Revenues
(Annual Percent Change)

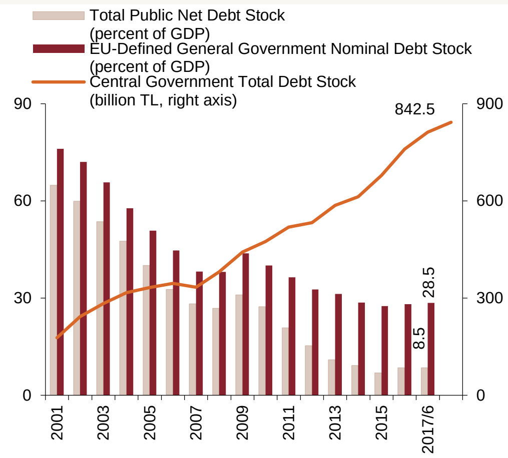


Source: Ministry of Finance.

6.2. Developments in the Public Debt Stock

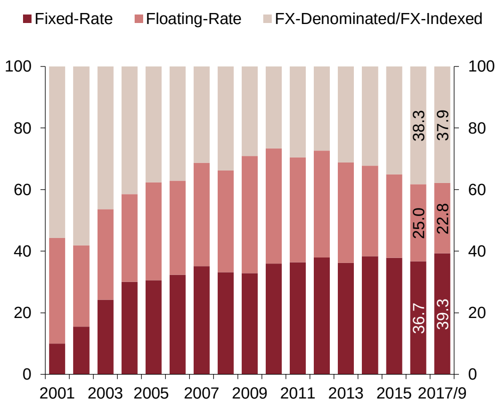
In the first half of 2017, the total public net debt stock to GDP ratio and the EU-defined general government nominal debt stock to GDP ratio remained flat in year-on-year terms (Chart 6.2.1). The EU-defined general government nominal debt stock to GDP ratio was 28.5 percent in the first half of 2017.

Chart 6.2.1.
Public Debt Stock Indicators



Source: Treasury.

Chart 6.2.2.
Composition of the Central Government Debt Stock
(Percent)



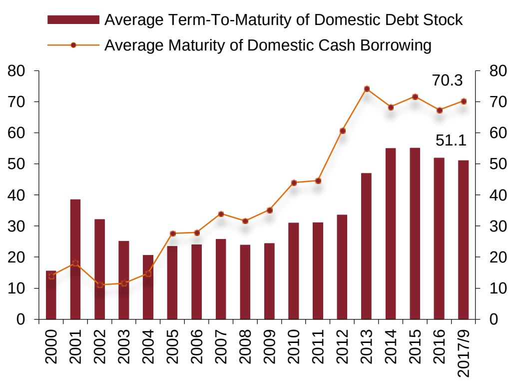
Source: Treasury.

[1] Tax adjustments were applied to fuel, automobiles and tobacco products in September, November and December, respectively.

In September 2017, the share of fixed-rate securities in the total debt stock increased from 2016, while that of FX-denominated, FX-indexed and floating-rate securities inched down as domestic borrowing was mostly financed by fixed-rate securities in this period. In addition, the central government debt stock was mostly composed of domestic borrowing in this period.

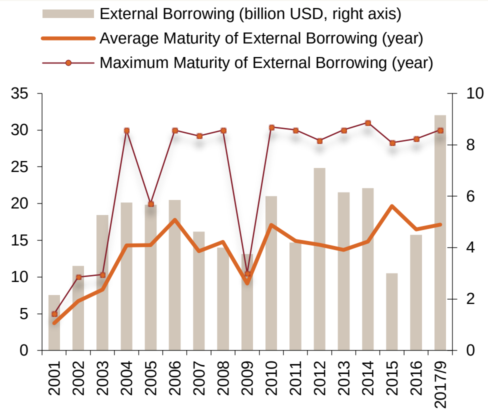
The average term-to-maturity of the domestic debt stock has been flat since 2016 at 51.1 months (Chart 6.2.3). In January-September 2017, external borrowing by bond issues climbed to 9.2 billion USD, with its average maturity rising to 17.1 years (Chart 6.2.4).

Chart 6.2.3.
Average Term-to-Maturity of Domestic Debt Stock and Average Maturity of Domestic Cash Borrowing
(Month)



Source: Treasury.

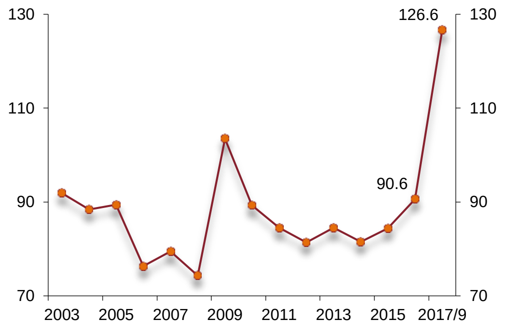
Chart 6.2.4.
External Borrowing



Source: Treasury.

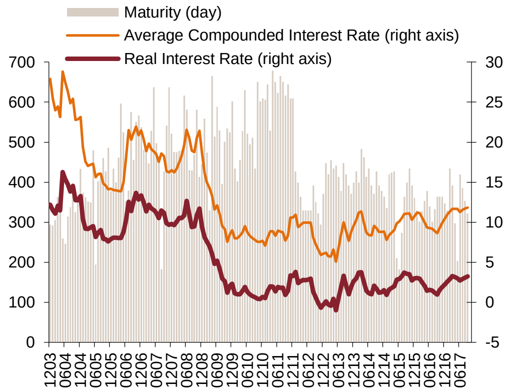
Having accelerated since 2016, the domestic debt rollover ratio reached 126.6 percent at the end of September 2017, while the external debt rollover ratio stood at 101 percent (Chart 6.2.5). As of September 2017, the average compounded interest rate and real interest rate recorded an uptick (Chart 6.2.6).

Chart 6.2.5.
Total Domestic Debt Rollover Ratio
(Percent)



Source: Treasury, CBRT.

Chart 6.2.6.
Average Maturity and Interest Rates of Borrowing at Discount Auctions*



* Real interest rate is calculated by subtracting the 12-month-ahead inflation expectations of the CBRT Survey of Expectations from nominal interest rates (average annual compounded interest rate at the Treasury's TL-denominated zero-coupon securities auction).
Source: Treasury, CBRT.