6. Public Finance

In 2017, fiscal policy supported economic growth through both public spending and temporary tax incentives and added 0.7 points to the growth rate through public consumption expenditures. Meanwhile, the contribution of administered prices to inflation hovered below past years' averages. In 2017, the upswing in economic activity bolstered collection of tax revenues. Yet, due mainly to the soaring primary expenditures and partly to the falling non-tax revenues, the budget deficit recorded a year-on-year widening. Accordingly, the budget deficit to GDP ratio picked up by 0.4 points to 1.5 percent. On the other hand, the budget deficit to GDP ratio in 2017 was 0.5 points lower than the MTP projection for 2017, which was 2.0 percent.

In the first quarter of 2018, despite the favorable performance of tax revenues, rising interest expenditures coupled with falling non-tax revenues resulted in a slight widening in the budget deficit. On the other hand, the high profit of the CBRT in addition to the uptick in privatization revenues are expected to contribute favorably to the budget performance in the upcoming period through higher non-tax revenues.

In 2017, the increases in public financing requirement owing to the expansionary fiscal policies to support economic activity were financed mostly by domestic borrowing. This resulted in an upsurge in the domestic debt rollover ratio compared to past years, amounting to 125.6 percent in 2017. Due also to the waning cost effect of temporary measures and incentives on the budget in the first quarter of 2018, the domestic debt rollover ratio declined compared to 2017 in line with the borrowing scheme of the Undersecreteriat of Treasury and stood at 95.7 percent.

6.1 Budget Developments

The central government budget deficit, which was 14.9 billion TL in the January-March period of 2017, increased to 20.4 billion TL in the same period of 2018 (Table 6.1.1). Despite higher budget revenues, the budget deficit posted a year-on-year increase due to the rise in budget expenditures and the fall in non-tax revenues.

In this period, tax revenues have grown by 19.9 percent year-on-year, while central government budget revenues rose by 15.7 percent. Non-tax revenues restricted the increase in budget revenues, dropping by 6.4 percent in this period. Meanwhile, soaring by 17.6 percent in the first three months of 2018, primary expenditures increased at a faster rate than budget revenues, leading to a slight year-on-year decline in the primary surplus.

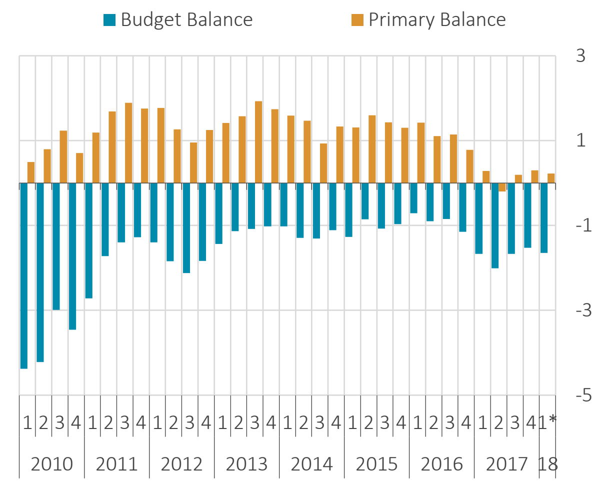
Table 6.1.1: Central Government Budget (Billion TL)

	January-March 2017	January-March 2018	Rate of Increase (%)	Actual/Target (%)
Central Government Budget Expenditures	159.7	187.9	17.7	24.6
Interest Expenditures	18.8	22.3	18.3	31.1
Primary Expenditures	140.8	165.6	17.6	24.0
Central Government Budget Revenues	144.7	167.4	15.7	24.0
I. Tax Revenues	121.6	145.8	19.9	24.3
II. Non-Tax Revenues	23.1	21.6	-6.4	22.2
Budget Balance	**-14.9**	**-20.4**	**36.9**	**31.0**
Primary Balance	**3.9**	**1.9**	**-52.5**	**32.1**

Source: Ministry of Finance.

As of March 2018, the budget deficit to GDP ratio is expected to be 1.6 percent, and the primary budget balance to GDP ratio is expected to stand at 0.2 percent (Chart 6.1.1). This indicates that budget balances remained stable year-on-year.

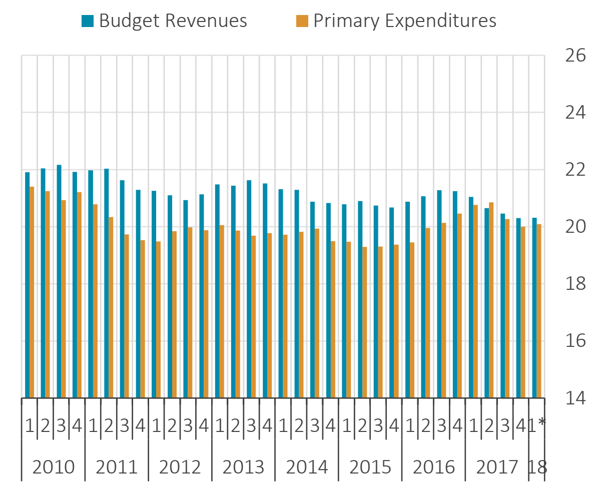
Chart 6.1.1: Central Government Budget Balance (Annualized, % of GDP)



Source: Ministry of Finance.

* Forecast.

Chart 6.1.2: Central Government Budget Revenues and Primary Expenditures (Annualized, % of GDP)



Source: Ministry of Finance.

* Forecast.

Mainly due to the slight uptick in current transfer expenditures, the central government primary expenditures to GDP ratio is expected to display a year-on-year decline to 20.1 percent in the first quarter of 2018. Likewise, the central government budget revenues to GDP ratio is estimated to exhibit a year-on-year decline to 20.3 percent because of lower non-tax revenues in the same period (Chart 6.1.2).

Current transfers, which constitute the largest portion of primary expenditures, increased at a considerably slower rate compared to the same period of the previous year and restricted the rise in primary expenditures. This was driven by the fall in health, pension and social benefit expenditures by 20 percent in the first quarter of 2018 due to the base effect generated by the postponement of insurance premium payments of the first three months of 2017 to the last quarter of 2017 (Table 6.1.2). On the other hand, other sub-items of current transfers such as agricultural subsidies, reserved share revenues and transfers to households exhibited high rates of increase. In the January-March period of 2018, the uptrend in public consumption expenditures coupled with high growth rates of capital expenditures and capital transfers, indicative of public investments, point out that the public sector backed economic growth mostly through investment expenditures in this period. In addition, the projected investment of 135 billion TL through the "Project-Based Incentive System" to be launched by the Ministry of Economy indicates that the fiscal policy will continue to support investments.

Table 6.1.2: Central Government Primary Expenditures (Billion TL)

	January-March 2017	January-March 2018	Rate of Increase (%)	Actual/Target (%)
Primary Expenditures	**140.8**	**165.6**	**17.6**	**24.0**
1. Personnel Expenditures	41.9	48.2	15.1	26.3
2. State Premium Payments to SSI	7.0	8.3	19.1	27.0
3. Purchase of Goods and Services	11.1	13.2	19.3	20.0
4. Current Transfers	71.4	74.3	4.1	24.8
a) Duty Losses	1.0	1.3	29.6	19.2
b) Health, Pension and Social Benefit Expenditures	38.2	30.5	-20.0	22.5
c) Agricultural Support Payment	4.9	7.1	44.1	48.7
d) Allocated Revenues	17.7	23.2	31.5	25.8
e) Household Transfers	2.8	4.6	62.6	21.8
5. Capital Expenditures	5.0	13.8	176.4	20.1
6. Capital Transfers	1.1	3.2	190.8	21.2
7. Lending	3.3	4.5	33.1	22.0

Source: Ministry of Finance.

In the January-March period of 2018, central government budget revenues increased by 15.7 percent year-on-year and reached 159.8 billion TL (Table 6.1.3). This surge in tax revenues was fueled by the tax adjustments such as the rise in corporate taxes from 20 percent to 22 percent effective from the start of 2018 and the hike in motor vehicles by 25 percent as well as the upswing in economic activity. Meanwhile, non-tax revenues declined by 15 percent in the first period of 2018 owing to the fall in privatization revenues. On the other hand, the income generated from the recent privatizations and the CBRT profit transfer are expected to increase non-tax revenues in the upcoming period.

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

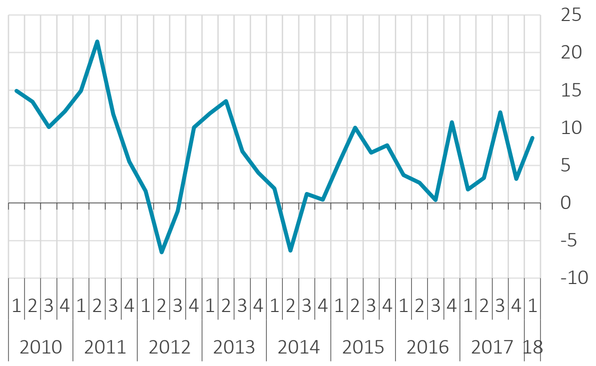
	January-March 2017	January-March 2018	Rate of Increase (%)	Actual/Target (%)
General Budget Revenues	**138.1**	**159.8**	**15.7**	**23.5**
I-Tax Revenues	**121.6**	**145.8**	**19.9**	**24.3**
Income Tax	25.0	30.5	22.3	24.9
Corporate Tax	12.6	16.8	33.0	25.5
Domestic VAT	13.5	16.2	20.3	24.6
SCT	28.1	31.8	13.4	21.7
VAT on Imports	21.4	26.0	21.4	24.1
II-Non-Tax Revenues	**16.4**	**14.0**	**-15.0**	**17.1**
Enterprise and Property Revenues	2.4	2.4	-1.0	12.0
Interests, Shares and Fines	8.0	10.0	23.9	21.5
Capital Revenues	4.8	0.6	-87.3	5.0

Source: Ministry of Finance.

Across tax types, corporate tax revenues performed well in the January-March period of 2018 due also to the tax increase effected from the beginning of the year; while income tax revenues, domestic VAT revenues and VAT revenues on imports recorded significant increases as well. Meanwhile, the rise in VAT revenues on imports was driven by the exchange rate as well as import dynamics. On the other hand, SCT revenues performed relatively milder with a 13.4 percent increase, whereas the SCT revenues on motor vehicles surged due to price hikes. In the meantime, the rise in collection of VAT revenues from petroleum, natural gas and tobacco products remained rather limited.

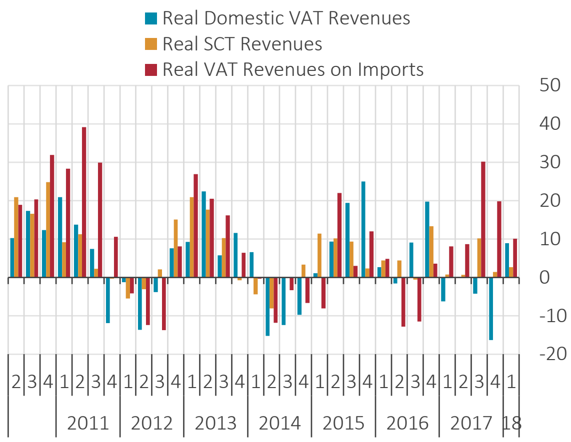
In the first quarter of 2018, real tax revenues recorded an annual uptick of 8.7 percent (Chart 6.1.3). Across sub-items, the collection of VAT revenues on imports displayed a relatively stronger performance in real terms, while the real increase in SCT revenues remained limited in the January-March period of 2018 (Chart 6.1.4).

Chart 6.1.3: Real Tax Revenues (Y-o-Y % Change)



Source: Ministry of Finance.

Chart 6.1.4: Real VAT and SCT Revenues (Y-o-Y % Change)

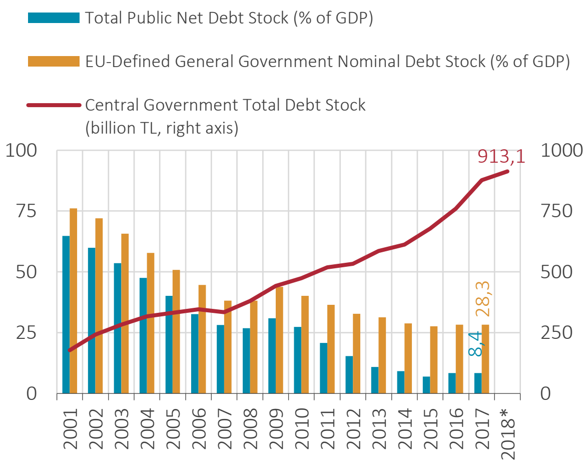


Source: Ministry of Finance.

6.2 Developments in the Public Debt Stock

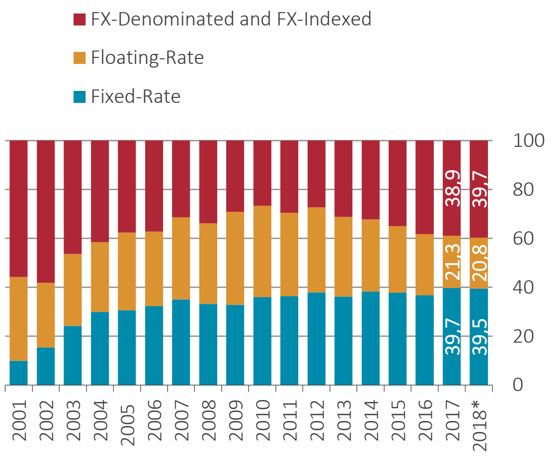
In 2017, both the total public net debt stock and the EU-defined general government nominal debt stock to GDP ratio remained unchanged in year-on-year terms. The EU-defined general government nominal debt stock to GDP ratio stood at 28.3 percent in 2017 (Chart 6.2.1).

Chart 6.2.1: Public Debt Stock Indicators



Source: Undersecreteriat of Treasury.

Chart 6.2.2: Composition of the Central Government Debt Stock (%)

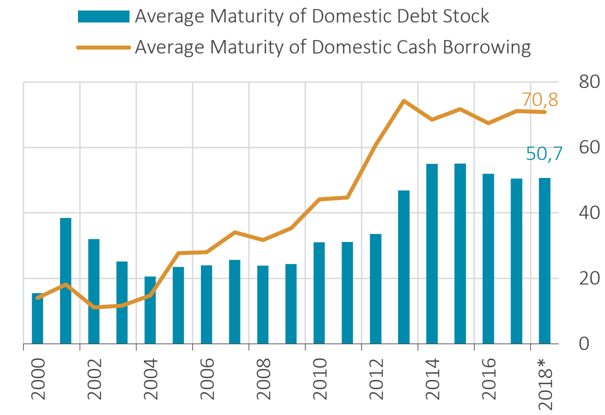


Source: Undersecreteriat of Treasury.

In the first quarter of 2018, the share of fixed-rate securities in the total debt stock has remained almost unchanged, while that of FX-denominated and FX-indexed securities has increased and the share of floating-rate securities has decreased slightly since 2017 (Chart 6.2.2). Domestic borrowing has been financed mostly by fixed-rate securities in this period.

The average term-to-maturity of the domestic debt stock stood at 50.7 months as of March 2018 (Chart 6.2.3). In the January-March period of 2018, external borrowing by bond issues amounted to 2 billion USD, with an average maturity of 10.1 years (Chart 6.2.4). The external debt rollover ratio decreased to 35.2 percent in the first quarter of 2018.

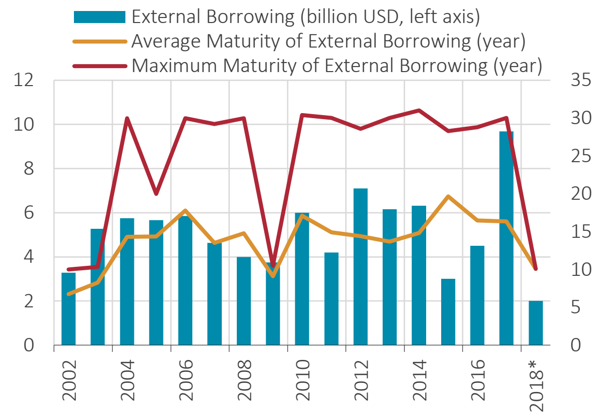
Chart 6.2.3: Average Term-to-Maturity of Domestic Debt Stock and Average Maturity of Domestic Cash Borrowing (Month)



Source: Undersecreteriat of Treasury.

* As of March.

Chart 6.2.4: External Borrowing

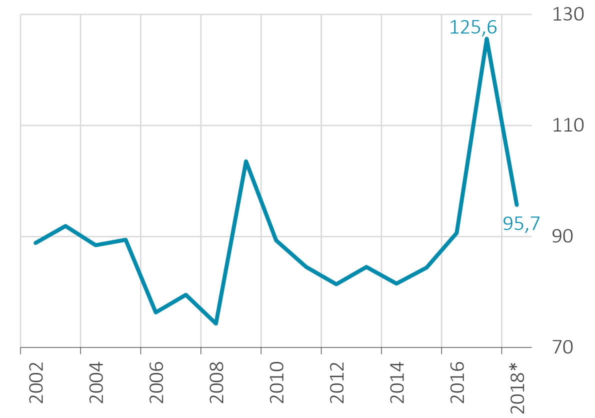


Source: Undersecreteriat of Treasury.

* As of March.

With a year-on-year decline, the domestic debt rollover ratio fell to 95.7 percent in the first three months of 2018 (Chart 6.2.5). The average domestic borrowing real interest rate[1] has increased slightly as of March (Chart 6.2.6).

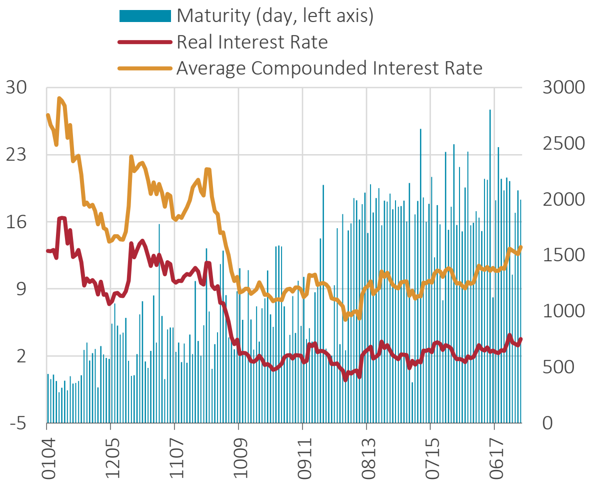
Chart 6.2.5: Total Domestic Debt Rollover Ratio (%)



Source: Undersecreteriat of Treasury, CBRT.

* As of March.

Chart 6.2.6: Average Maturity and Interest Rates at Treasury Auctions



Source: Undersecreteriat of Treasury, CBRT.

[1] Real interest rate is calculated by subtracting the 12-month-ahead inflation expectations of the CBRT Survey of Expectations from nominal interest rates at the Treasury's auction.