6. Public Finance

In the first half of 2018, fiscal policy supported economic growth through not only measures and incentives, but also public consumption and particularly investment expenditures. Due to the expenditures caused by incentives to boost investment, employment and exports as well as the increase in current transfer expenditures, the budget deficit recorded a widening in the first half of the year. It is projected that the forecast slowdown in economic activity in the second half of the year will have possible downside effects on tax revenues and the uptrend in transfer expenditures will persist in the remainder of the year. Given these projections, the budget deficit is likely to increase further in the period ahead.

In the first half of 2018, despite the favorable performance of tax revenues, the rise in interest and primary expenditures accompanied by the slowdown in the growth rate of non-tax revenues led to a marked widening in the budget deficit compared to the same period last year. Meanwhile, restructuring of taxes and some other receivables coupled with the revenues to stem from the zoning amnesty as well as a possible rise in privatization revenues are estimated to curb the widening in the budget deficit.

In 2017, the public financing need that increased in tandem with the accommodative fiscal policy to boost economic activity was mostly met through domestic borrowing, and the domestic debt rollover ratio stood at 125.6 percent. In the first half of 2018, the cost effect induced by temporary measures and incentives adopted in 2017 on the budget waned partially, leading the domestic rollover ratio to recede notably with respect to last year, to 101.6 percent. On the other hand, due mainly to the rising of the financing need that increased owing to public transfer expenditures, the domestic rollover ratio is planned to be 122 percent in the July-September period, according to the Treasury's borrowing program.

6.1 Budget Developments

The central government budget deficit, which was 25.2 billion TL in the January-June period of 2017, increased to 46.1 billion TL in the same period of 2018 (Table 6.1.1). The budget deficit posted a year-on-year increase due to budget expenditures that proved higher than budget revenues.

In this period, tax revenues grew by 19.8 percent year-on-year. However, non-tax revenues restricted the increase in central government budget revenues rising to a limited extent of 10.6 percent. On the other hand, interest expenditures proved more notable owing to the rise in borrowing costs in this period. In the first half of 2018, the primary balance posted a deficit of 12.3 billion TL as primary expenditures increased at a faster rate than budget revenues.

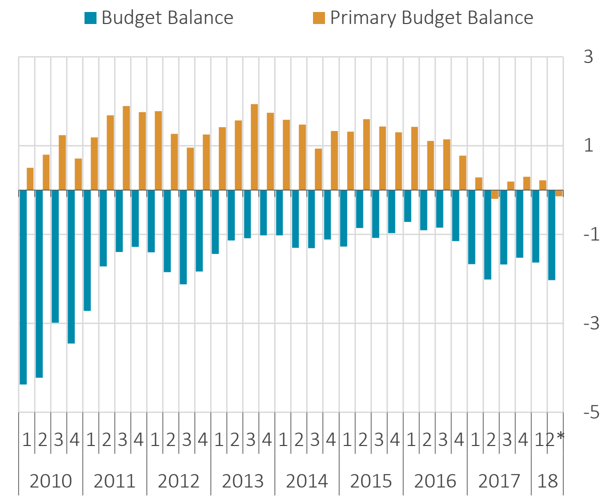
Table 6.1.1: Central Government Budget (Billion TL)

	January-June 2017	January-June 2018	Rate of Increase (%)	Realization/ Budget Target (%)
Central Government Budget Expenditures	324.4	399.7	23.2	52.4
Interest Expenditures	27.0	33.8	25.3	47.2
Primary Budget Expenditures	297.4	365.9	23.0	52.9
Central Government Budget Revenues	299.2	353.6	18.2	50.7
I. Tax Revenues	246.1	294.8	19.8	49.2
II. Non-Tax Revenues	53.1	58.8	10.6	60.3
Budget Balance	**-25.2**	**-46.1**	**82.6**	**69.9**
Primary Balance	**1.8**	**-12.3**	**-799.9**	**-212.7**

Source: Ministry of Finance.

In June 2018, it is estimated that the ratio of annualized budget deficit to GDP will be 2 percent; while the primary budget balance to GDP ratio will be -0.1 percent (Chart 6.1.1). These ratios indicate some deterioration in the budget balance compared to the previous quarter.

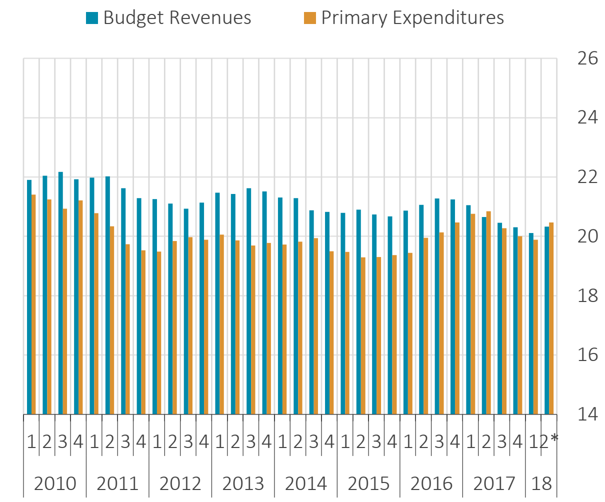
Chart 6.1.1: Central Government Budget Balances (Annualized, % of GDP)



Source: Ministry of Finance.

*Forecast.

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



Source: Ministry of Finance.

*Forecast.

The central government primary expenditures to GDP ratio is expected to display a year-on-year decline to 20.5 percent in the second 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 first half of the year (Chart 6.1.2).

Central government primary budget expenditures rose by 23 percent year-on-year to 365.9 billion TL in the first half of 2018 (Table 6.1.2). In this period, the upsurge in capital expenditures and capital transfers, indicative of public investments, remained as the leading factor to push expenditures upwards. Meanwhile, current transfers, the most significant item in primary expenditures, posted a rather limited rise of 14.5 percent in January-June 2018. Although grant payments to retirees made in June increased current transfers, the base effect stemming from the postponement of insurance premium payments for the first three months of 2017 to the last quarter of the year dampened health, pension and social benefit expenditures limiting the increase in current transfers. It should be noted that the contraction led by the base effect will last until the last quarter of the year, but the grant payments to retirees for the Eid al-Adha (Sacrifice Feast) will increase current transfers in the period ahead. On the other hand, in the second quarter of 2018, the borrowing item surged in June as the debts of university hospitals that accumulated due to medical equipment and medication were partially met by the Ministry of Finance.

Table 6.1.2: Central Government Primary Expenditures (Billion TL)

	January-June 2017	January-June 2018	Rate of Increase (%)	Realization/ Budget Target (%)
Primary Budget Expenditures	**297.4**	**365.9**	**23.0**	**52.9**
1. Personnel Expenditures	81.8	98.6	20.5	53.8
2. State Premium Payments to SSI	13.4	16.4	22.6	53.2
3. Purchase of Goods and Services	26.4	30.7	16.3	46.5
4. Current Transfers	143.8	164.7	14.5	55.0
a) Duty Losses	2.5	3.6	40.1	50.9
b) Health, Pension and Social Benefit Expenditures	76.0	75.0	-1.4	55.3
c) Agricultural Support Payment	8.2	10.6	28.7	72.9
d) Allocated Revenues	34.5	45.6	32.1	50.7
e) Household Transfers	8.3	13.5	61.9	63.7
5. Capital Expenditures	21.0	35.6	69.6	51.7
6. Capital Transfers	4.4	8.1	81.4	52.6
7. Lending	6.6	11.9	78.9	58.6

Source: Ministry of Finance.

Central government general budget revenues increased by 18.3 percent year-on-year to 339.5 billion TL in the January-June period of 2018 (Table 6.1.3). Revenues generated by the income tax, corporate tax and VAT on imports performed quite well, while the increase in domestic VAT revenues and SCT collection remained limited. The rise in income tax collection is affected by the favorable course of employment. The decision taken in May stating that if fuel prices increase due to oil prices and the exchange rate, the SCT collection would be lowered so that the final price can be kept unchanged, dampened the revenues from those taxes. The upsurge in VAT in imports is attributed to the rise in the exchange rate. Although enterprise and property revenues increased due to the Central Bank profit transfers, non-tax revenues performed weakly as privatization revenues posted a year-on-year decline. In the upcoming period, revenues to be generated by the restructuring of taxes and other receivables as well as the zoning amnesty are likely to affect budget revenues positively.

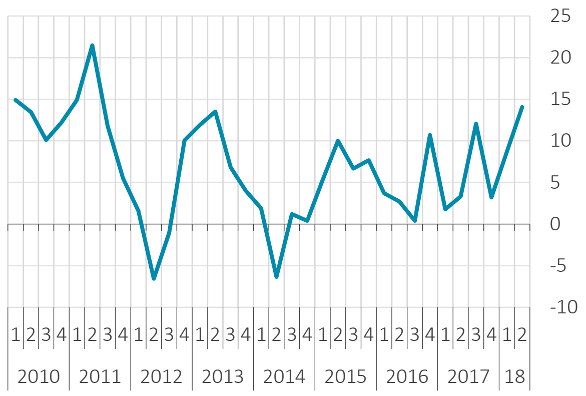
Table 6.1.3: Central Government General Budget Revenues (Billion TL)

	January-June 2017	January-June 2018	Rate of Increase (%)	Realization/ Budget Target (%)
Genel Budget Revenues	**287.1**	**339.5**	**18.3**	**49.8**
I-Tax Revenues	**246.1**	**294.8**	**19.8**	**49.2**
Income Tax	50.3	63.4	26.1	51.7
Corporate Tax	27.0	34.7	28.4	52.8
Domestic VAT	25.9	29.5	14.1	44.7
SCT	61.0	67.7	11.0	46.2
VAT on Imports	44.4	55.3	24.6	51.4
II-Non-Tax Revenues	**41.0**	**44.7**	**9.0**	**54.6**
Enterprise and Property Revenues	14.7	19.3	32.0	96.0
Interests. Shares and Fines	16.9	19.8	17.1	42.6
Capital Revenues	7.0	4.1	-40.5	34.3

Source: Ministry of Finance

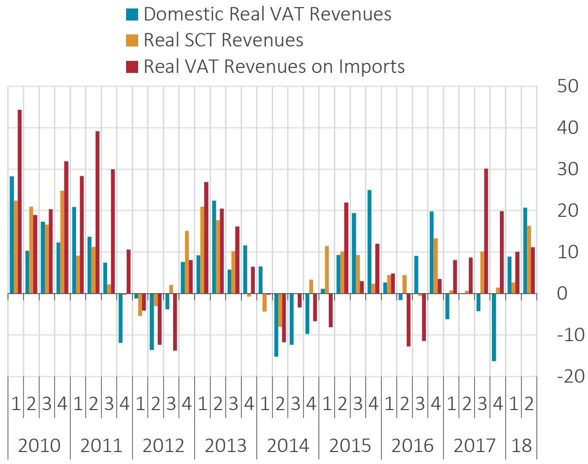
In the second quarter of 2018, real tax revenues recorded an annual uptick of 14.0 percent (Chart 6.1.3). Across sub-items, domestic VAT and SCT revenues increased remarkably in real terms, while the rise in VAT revenues on imports remained rather limited in the first half of 2018 (Chart 6.1.4).

Chart 6.1.3: Real Tax Revenues (Year-on-Year Percentage Change)



Source: Ministry of Finance

Chart 6.1.4: Real VAT and SCT Revenues (Year-on-Year Percentage Change)

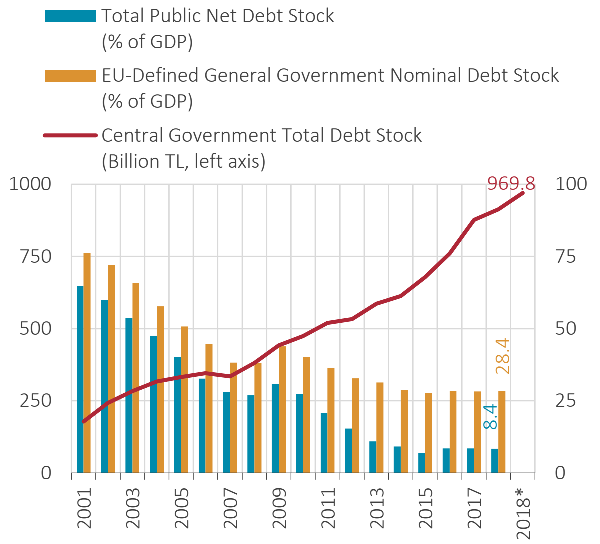


Source: Ministry of Finance

6.2 Developments in the Public Debt Stock

In the first quarter of 2018, 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 28.4 percent in the first quarter of 2018 (Chart 6.2.1).

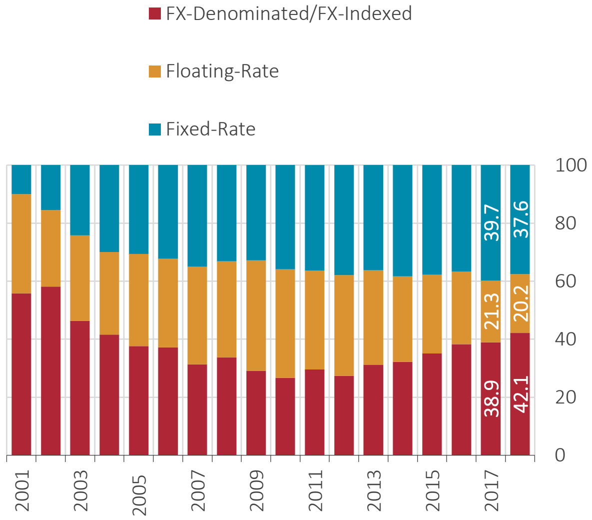
Chart 6.2.1: Public Debt Stock Indicators



Source: Treasury and the Ministry of Finance

* As of June

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

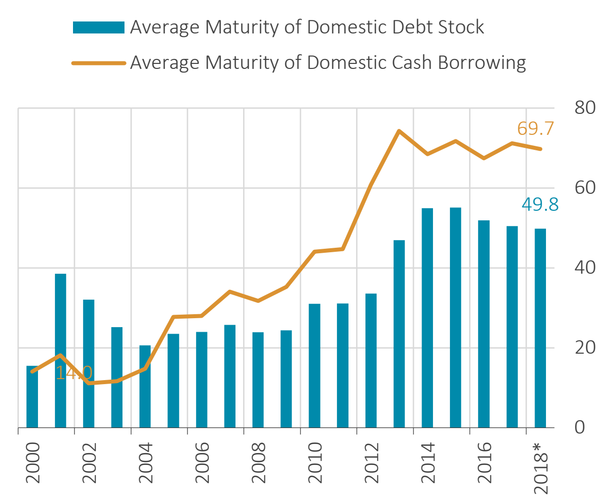


Source: Treasury and the Ministry of Finance

* As of June

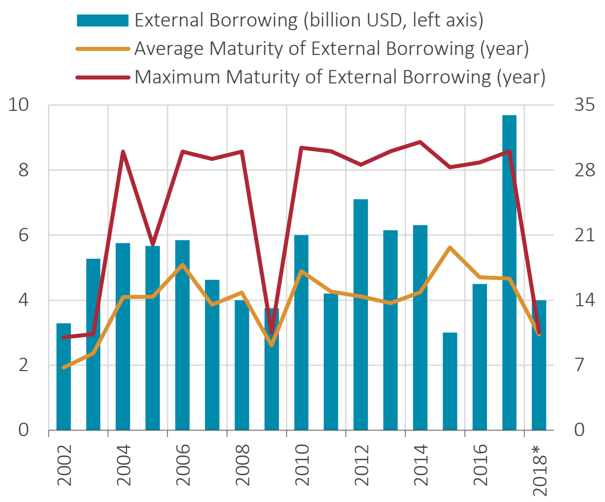
In the first half of 2018, the shares of fixed-rate and floating-rate securities in the total debt stock have decreased, while those of FX-denominated and FX-indexed securities have increased since 2017 (Chart 6.2.2). Domestic borrowing has been financed mostly by fixed-rate securities in this period.

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



Source: Treasury and the Ministry of Finance
* As of June

Chart 6.2.4: External Borrowing through Bond Issues

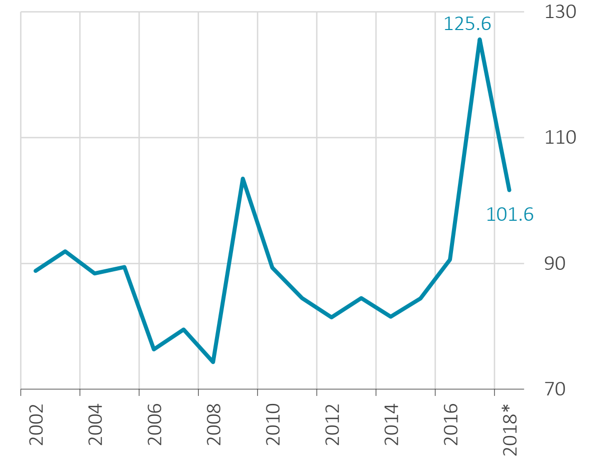


Source: Treasury and the Ministry of Finance
* As of June

The average term-to-maturity of the domestic debt stock stood at 49.8 months as of June 2018 (Chart 6.2.3). In the January-June period of 2018, external borrowing by bond issues amounted to 4 billion USD, with an average maturity of 10.3 years (Chart 6.2.4). The external debt rollover ratio receded to 56.5 percent year-on-year in June 2018.

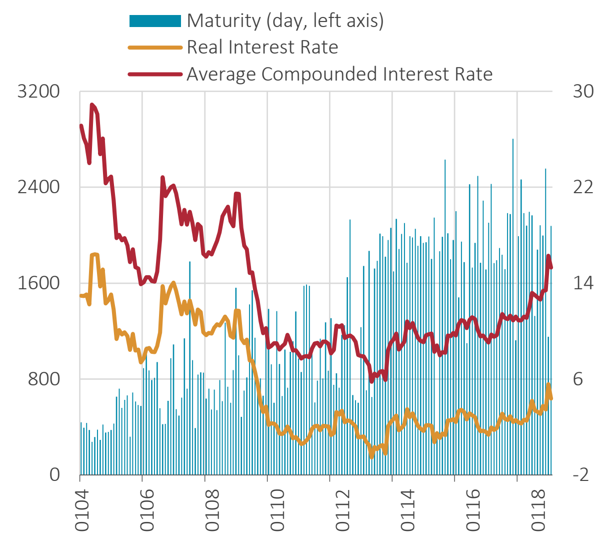
With a year-on-year decline, the domestic debt rollover ratio fell to 101.6 percent in the first half of 2018 (Chart 6.2.5). The average domestic borrowing real interest rate[1] has increased over the past few months (Chart 6.2.6).

Chart 6.2.5: Total Domestic Debt Rollover Ratio (%)



Source: Treasury and the Ministry of Finance
* As of June

Chart 6.2.6: Treasury Auctions Interest Rate and Maturity Structure*



Source: Treasury and the Ministry of Finance
* As of June

[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.