6. Public Finance

In the first quarter of 2019, fiscal policy contributed to economic growth through not only measures and incentives but also public expenditures. The contribution from the public sector, investments in particular, decreased in the following period. Primary expenditures and interest expenses were up in the first nine months while the growth of tax revenues slowed, with indirect taxes in the lead. Meanwhile, the high profit transfer as well as the transfer of reserve funds from the Bank helped buoy up non-tax revenues, putting a lid on the widening budget deficit.

In 2018, the widening in the budget deficit, along with the fall in net external borrowing, was mostly financed through domestic borrowing, while public deposits were used to meet the financing need to some extent. In 2018, the domestic debt rollover ratio was 98.1% and the external debt rollover ratio was 70.4%. In the January-September period of 2019, the public financing need was met by both domestic and external borrowing, with domestic borrowing having a larger share. In this period, domestic and external debt rollover ratios amounted to 125.4% and 112.5%, respectively.

The New Economy Program (NEP) covering the period 2020-2022 was announced on September 30, 2019. An assessment on the cyclically adjusted primary budget balance within the framework of the NEP is given in Box 6.1.

6.1 Budget Developments

The central government budget balance posted a deficit of TRY 85.8 billion in the January-September period of 2019. While the strong performance of non-tax revenues affected the budget balance positively, the rise in tax revenues lagged considerably behind the rise in expenditures due to the weak domestic demand. The primary balance, which posted a surplus of TRY 3.7 billion in the first nine months of 2018, ran a deficit of TRY 4.3 billion in the same period of 2019 (Table 6.1.1).

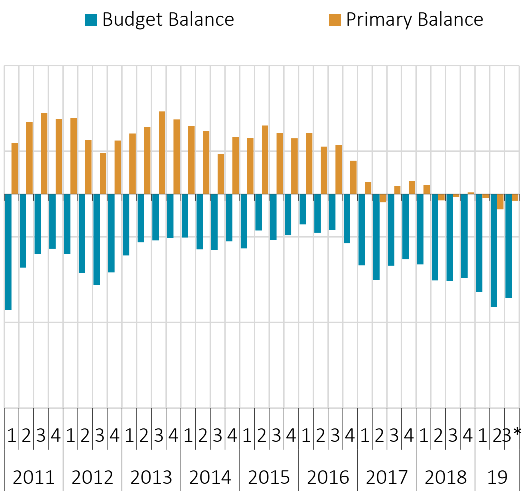
Table 6.1.1: Central Government Budget Aggregates (TRY Billion)

	January-September 2018	January-September 2019	Rate of Increase (%)	Actual/Target (%)
Central Government Budget Expenditures	603.5	739.6	22.5	77.0
I. Interest Expenses	60.4	81.5	34.9	69.5
II. Primary Budget Expenditures	543.1	658.1	21.2	78.0
Central Government Budget Revenues	546.8	653.8	19.6	74.3
I. Tax Revenues	459.4	485.3	5.6	64.2
II. Non-Tax Revenues	87.5	168.5	92.7	136.0
Budget Balance	**-56.7**	**-85.8**	**51.3**	**106.5**
Primary Balance	**3.7**	**-4.3**	**-217.3**	**-11.8**

Source: Ministry of Treasury and Finance.

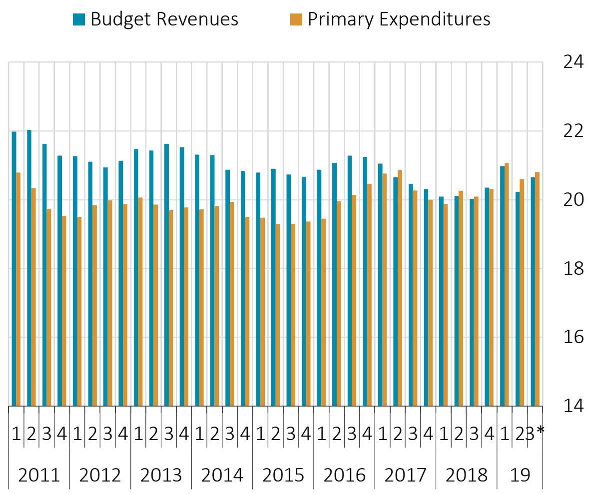
In the third quarter of 2019, it is estimated that the annualized budget deficit to GDP ratio will be 2.4%, while the primary budget deficit to GDP ratio will be 0.2% (Chart 6.1.1). The ratio of central government budget revenues to GDP is projected to increase by 0.6 points year-on-year to 20.6% in the third quarter of 2019. On the other hand, the central government primary budget expenditures to GDP ratio is estimated to rise by 0.7 points year-on-year to 20.8% (Chart 6.1.2).

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



Source: Ministry of Treasury and Finance.
*Forecast.

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



Source: Ministry of Treasury and Finance.
*Forecast.

Central government primary budget expenditures surged by 21.2% year-on-year to TRY 658.1 billion in the January-September period of 2019. This upsurge was mainly driven by the increases in current transfers and expenditures for personnel and SSI premiums while purchases of goods and services increased only slightly. In the first nine months, capital expenditures and the course of capital transfers, which are indicative of public investments, signal that the public sector made a smaller contribution to growth through investment compared to the same period last year (Table 6.1.2).

Table 6.1.2: Central Government Primary Expenditures (TRY Billion)

	January-September 2018	January-September 2019	Rate of Increase (%)	Actual/Target (%)
Primary Budget Expenditures	**543.1**	**658.1**	**21.2**	**78.0**
1. Personnel Expenditures	150.6	188.9	25.4	76.4
2. State Premium Payments to SSI	25.0	32.2	28.7	74.2
3. Purchase of Goods and Services	46.4	50.7	9.3	75.1
4. Current Transfers	242.6	306.1	26.2	78.2
a) Duty Losses	5.6	5.9	4.7	73.1
b) Health, Pension and Social Benefit Expenditures	114.9	156.0	35.8	84.2
c) Agricultural Support Payment	10.8	13.7	27.1	85.4
d) Allocated Revenues	69.9	73.4	4.9	64.2
e) Household Transfers	17.3	18.9	9.5	85.1
5. Capital Expenditures	52.2	50.8	-2.7	93.3
6. Capital Transfers	10.7	11.2	4.8	112.0
7. Lending	15.5	18.2	17.5	83.8

Source: Ministry of Treasury and Finance.

Central government general budget revenues increased by 20.3% year-on-year to TRY 633.9 billion in the January-September period of 2019 (Table 6.1.3). Making up a vast part of general budget revenues, tax revenues rose modestly by 5.6%, whereas non-tax revenues jumped by 119.7%. This was mainly driven by the Bank's transfer of its reserve funds totaling TRY 40.8 billion to the Treasury in July and August in addition to its transfer of profit amounting to TRY 37.5 billion. In addition, in the first nine months of the year, TRY 14.6 billion in the scope of the restructuring laws (no. 7143, 7020 and 6736) and another TRY 7.6 billion for the zoning amnesty are transferred to the budget. Among direct taxes, income taxes increased at a relatively faster pace while corporate taxes registered a slower growth. Among consumption-based indirect taxes, the collection of domestic VAT decreased while that of SCT only edged up. Despite a weaker Turkish lira, VAT on imports remained almost flat in response to the slowdown in import demand.

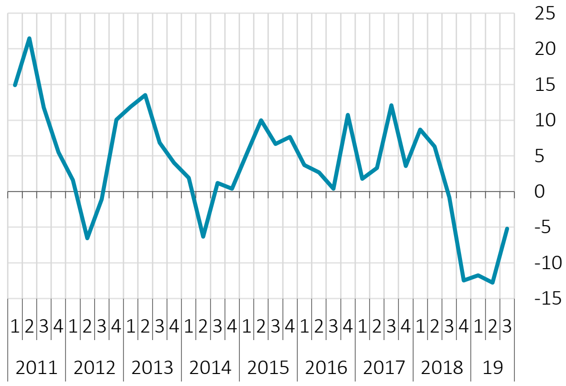
Table 6.1.3: Central Government General Budget Revenues (TRY Billion)

	January-September 2018	January-September 2019	Rate of Increase (%)	Actual/Target (%)
General Budget Revenues	**527.0**	**633.9**	**20.3**	**73.5**
I-Tax Revenues	459.4	485.3	5.6	64.2
Income Tax	99.8	116.9	17.2	68.0
Corporate Tax	52.9	55.4	4.9	74.7
Domestic VAT	45.7	41.2	-9.8	58.3
SCT	102.8	106.4	3.5	65.4
VAT on Imports	89.4	89.0	-0.4	53.7
II-Non-Tax Revenues	**67.6**	**148.6**	**119.7**	**139.9**
Enterprise and Property Revenues	22.3	89.7	301.3	263.9
Interests, Shares and Fines	37.8	45.2	19.4	82.7
Capital Revenues	5.8	4.6	-20.4	34.2

Source: Ministry of Treasury and Finance.

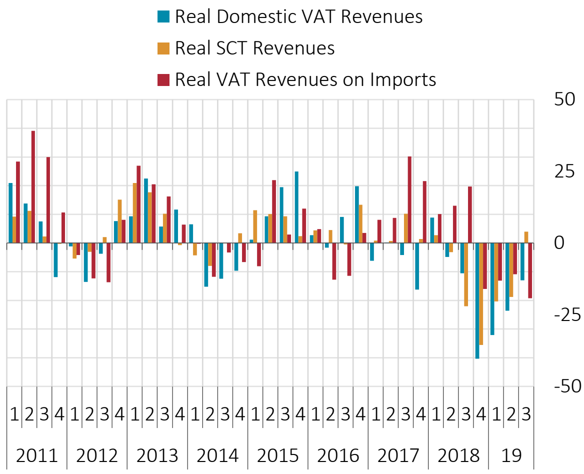
The contraction in real tax revenues slowed down slightly as of the third quarter of 2019 (Chart 6.1.3). In real terms, the deceleration in real domestic VAT revenues continued at a lesser pace, whereas SCT revenues posted a mild increase, due also to the price hike in tobacco products (Chart 6.1.4).

Chart 6.1.3: Real Tax Revenues (YoY % Change)*



Source: Ministry of Treasury and Finance.
* Deflated by the CPI.

Chart 6.1.4: Real VAT and SCT Revenues (YoY % Change)*

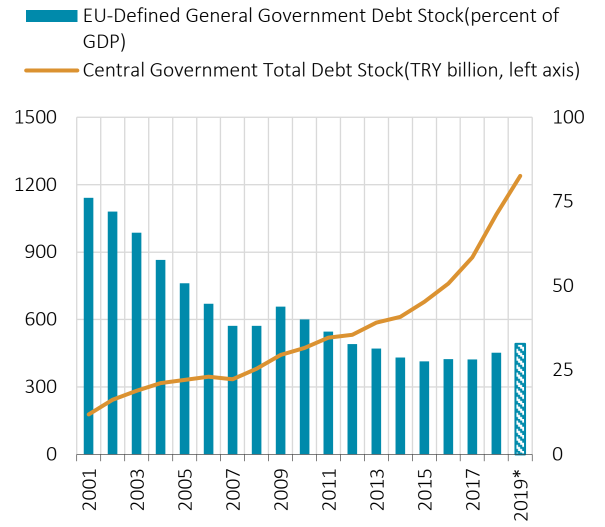


Source: Ministry of Treasury and Finance.
* Deflated by the CPI.

6.2 Developments in the Public Debt Stock

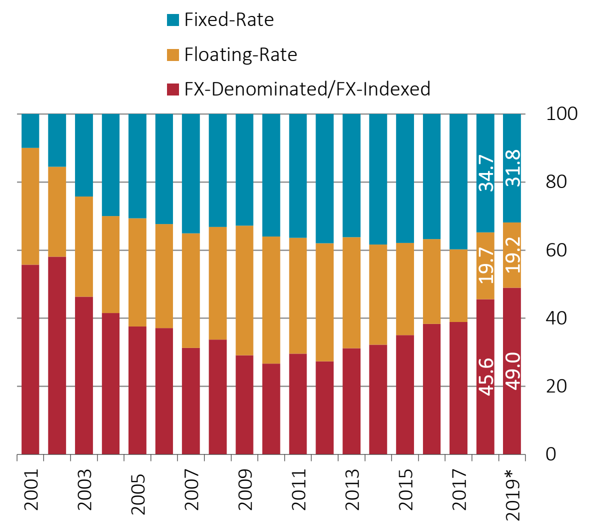
The EU-defined general government debt stock to GDP ratio, the 2019 realization estimate of which was set at 32.8% in the New Economic Program (NEP) announced on September 30, 2019, rose by 2.1 points year-on-year to 32.2% in the first half of 2019 (Chart 6.2.1).

Chart 6.2.1: Public Debt Stock Indicators



Source: Ministry of Treasury and Finance.
* Actual September 2019 figure for the central government total debt stock, and NEP 2019 estimate for the EU-defined general government debt stock.

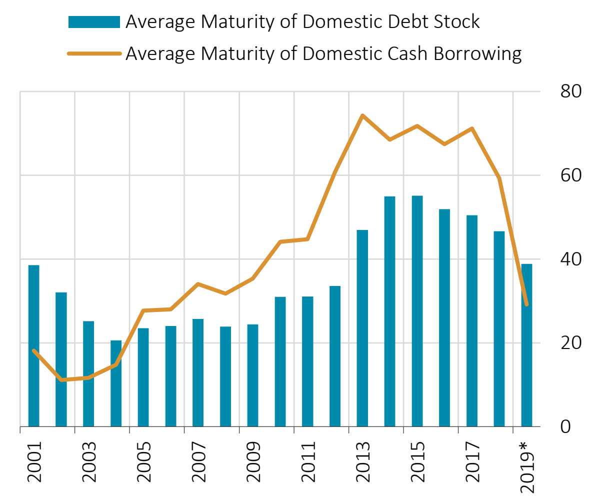
Chart 6.2.2: Composition of the Central Government Debt Stock (%)



Source: Ministry of Treasury and Finance.
* As of September.

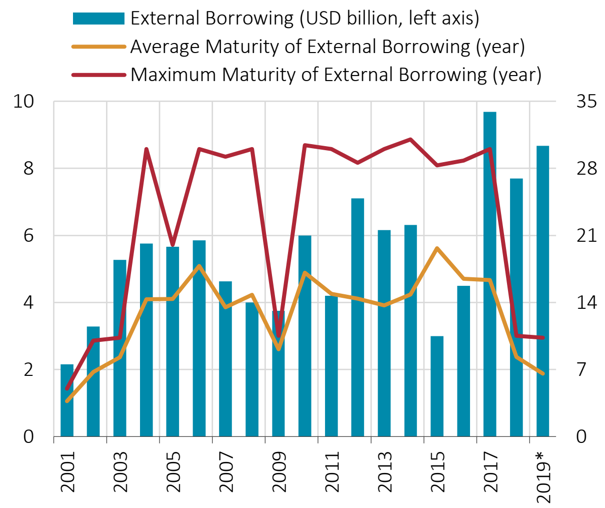
In September 2019, the shares of fixed-rate and floating-rate securities in the total debt stock were lower compared to 2018, while those of FX-denominated and FX-indexed securities increased (Chart 6.2.2). Domestic borrowing was mostly financed by fixed-rate securities in this period. While no foreign currency domestic borrowing was seen during the period January-August 2018, 24.1% of the total domestic borrowing made in the same period of 2019 was denominated in FX.

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



Source: Ministry of Treasury and Finance.
* As of September.

Chart 6.2.4: External Borrowing through Bond Issues

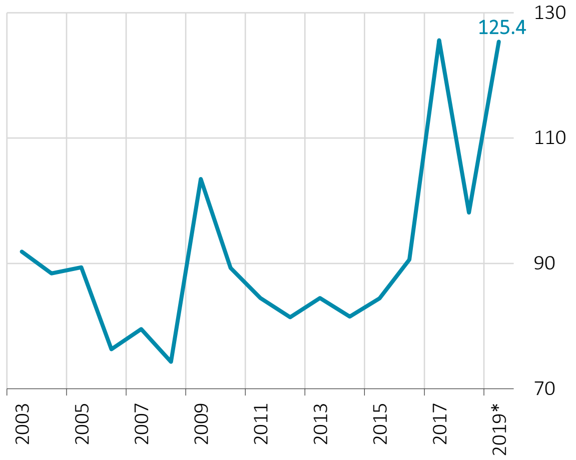


Source: Ministry of Treasury and Finance.
* As of September.

The average term-to-maturity of the domestic debt stock was 38.8 months as of September 2019 (Chart 6.2.3). In the first nine months of 2019, external borrowing through bond issues amounted to USD 8.7 billion, with an average maturity of 6.6 years (Chart 6.2.4). As of September 2019, the external debt rollover ratio was 112.5%.

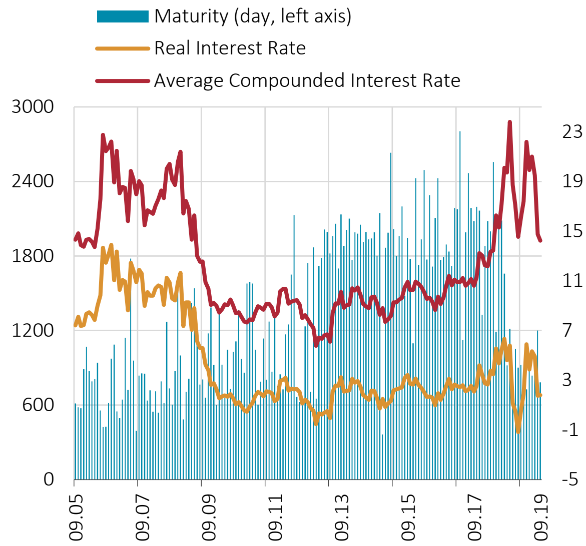
The domestic debt rollover ratio was 125.4% in the January-September period of 2019 (Chart 6.2.5). In this period, the public financing need was met through both domestic and external borrowing, with domestic borrowing having a larger weight. The average domestic borrowing real interest rate[1] was slightly down due to relatively lower borrowing costs in recent months (Chart 6.2.6).

Chart 6.2.5: Total Domestic Debt Rollover Ratio (%)



Source: Ministry of Treasury and Finance.
* As of September.

Chart 6.2.6: Treasury Auctions Interest Rate and Maturity Structure



Source: Ministry of Treasury and Finance.

[1] The 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 auctions.

Box 6.1

Fiscal Stance in the New Economic Program

The New Economy Program (NEP) covering the 2020-2022 period was announced on 30 September 2019. The main objective of the NEP is to maintain and enhance the gains achieved in price stability, financial stability and the current account balance. Moreover, the NEP aims to deliver economic change and transformation for sustainable growth and equal distribution with a focus on production and productivity. Over a period of three years, the program will make sure that fiscal discipline is maintained with determination, public sector indebtedness is kept at low levels and structural changes are implemented to ensure the efficient use of resources and to increase savings in designated areas. The aim of this box is to document the fiscal aggregates announced in the NEP and present the cyclically adjusted primary budget balance as implied by the NEP to have a better understanding of the future stance of fiscal policy.

The program envisages improvement in the budget balance and primary budget balance and a gradual decrease in the debt stock to GDP ratio. The declaration that fiscal adjustment will be maintained through decreasing primary expenditures rather than tax increases is important for fiscal and monetary policy coordination in bringing inflation down. The NEP forecasts the primary expenditures to GDP ratio to fall by 1.2 percentage points to 19.6% in 2020 and continue its downtrend thereafter, reaching 18.4% as of 2022 (Table 1, Chart 1). After the decline in 2019 due to weak economic activity and supportive tax reductions and incentives, tax revenues (as a ratio of GDP) are expected to increase in 2020 and hover around 16% in the program period (Table 1, Chart 1). In sum, the NEP aims to achieve a budget deficit to GDP ratio below 3% for the next three years and a gradual increase of 0.3% in the ratio of primary surplus to GDP by the end of 2022.

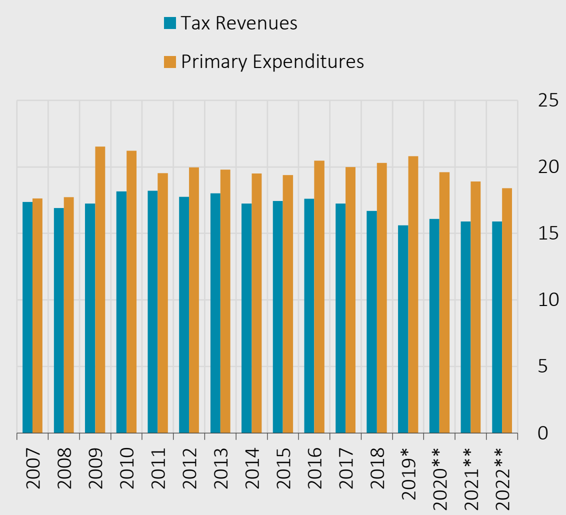
Table 1: Central Government Budget (% of GDP)

	2018	2019*	2020**	2021**	2022**
Expenditures	**22.3**	**23.2**	**22.5**	**21.8**	**21.3**
Primary Expenditures	20.3	20.8	19.6	18.9	18.4
Interest Payments	2.0	2.4	2.9	2.9	2.9
Revenues	**20.4**	**20.3**	**19.6**	**19.0**	**18.7**
Tax Revenues	16.7	15.6	16.1	15.9	15.9
Non-tax Revenues	3.7	4.7	3.5	3.0	2.8
Budget Balance	**-2.0**	**-2.9**	**-2.9**	**-2.9**	**-2.6**
Primary Budget Balance	**0.0**	**-0.5**	**0.0**	**0.0**	**0.3**
EU-Defined Debt Stock	**30.4**	**32.8**	**33.2**	**32.5**	**32.3**

Source: NEP (2020-2022).
* NEP (2020-2022) realization estimate.
** NEP (2020-2022) program.

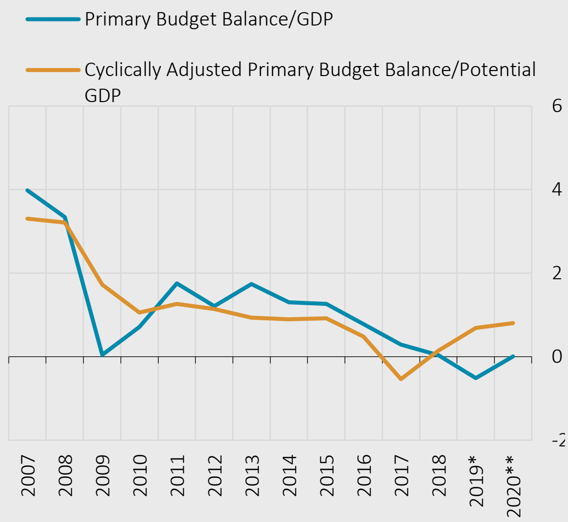
Some tax and expenditure items are highly sensitive to cyclical fluctuations. Thus, the information content of traditional measures such as the budget balance for the fiscal policy stance may be limited, especially in periods when the current production level differs significantly from the potential production level. Therefore, when assessing the fiscal policy stance, it is important to eliminate the cyclical effects that the fluctuations in economic activity have on the budget balance through automatic stabilizers. In this context, while the cyclically-adjusted primary budget balance displayed a relatively stable outlook during the post global financial crisis period (2010-2015), it started to decline in 2016 in line with the measures and incentives introduced and the expansionary fiscal policy implemented (Chart 2). The cyclically-adjusted primary budget balance began to recover as a result of the measures taken in the second half of 2018 and has retained this tendency in 2019 with the contribution of non-tax revenues. With non-tax revenues excluded, it is observed that fiscal policy pursuing a counter-cyclical stance in 2019, when economic activity has been weak, is slightly more expansionary compared to the previous year. On the other hand, fiscal discipline, which is considered as an important anchor for the Turkish economy, will be sustained in 2020. In this regard, the cyclically-adjusted primary budget balance is expected to improve with respect to 2019 (even if non-tax revenues are excluded), due to the decrease envisaged in the ratio of primary expenditures to GDP (Chart 2).

Chart 1: Primary Expenditures and Tax Revenues (% of GDP)



Source: Ministry of Treasury and Finance.
* NEP (2020-2022) realization estimate.
** NEP (2020-2022) program.

Chart 2: Primary Budget Balance and Cyclically-Adjusted Primary Budget Balance (%)



Source: Ministry of Treasury and Finance, CBRT calculations.
* NEP (2020-2022) realization estimate.
** NEP (2020-2022) program.

The coordinated conduct of monetary and fiscal policy prioritizing the decrease of inflation will contribute to leading the economy towards a healthy and sustainable growth path via an improvement in the risk premium. In this context, the cyclically-adjusted primary budget balance based on the framework presented in the NEP seems to support this coordination.