6. Public Finance

In 2015, the central government budget deficit to the GDP ratio was slightly down year-on-year, moving closer to the initial target (Chart 6.1). Although the growth of primary expenditures failed to decelerate as expected at first, tax revenues performed better than initial targets. Meanwhile, having trended downward since 2010, the EU-defined nominal debt stock to the GDP ratio continued to decline in 2015 (Chart 6.2). This favorable course in public debt helps to alleviate the concerns over the sustainability of public finances driven by soaring public spending.

Chart 6.1.
Central Government Budget Deficit
(Percent of GDP)

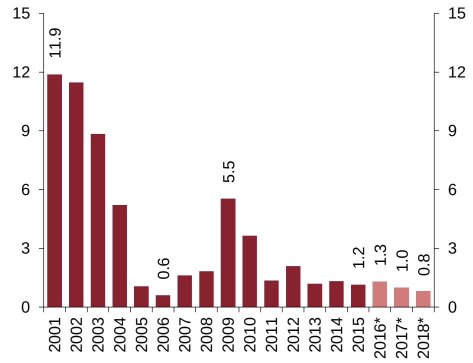
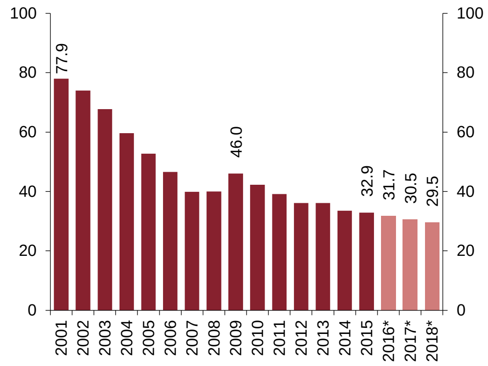


Chart 6.2.
EU-Defined Public Debt Stock
(Percent of GDP)



* MTP (2016-2018) Targets.
Source: Ministry of Finance, MTP (2016-2018).

The MTP covering the 2016-2018 period states that the public savings-investment gap will be gradually narrowed by curbing the rate of increase in public spending and the public sector borrowing requirement. The MTP also emphasizes that the quality of public revenues will be improved and therefore non-recurring revenues will no longer be used to finance policies that permanently raise the level of public spending in the medium to long term. Thus, fiscal discipline will be maintained and the public debt stock to the GDP ratio will be reduced further in a gradual way during the MTP period.

The central government budget developments of the first quarter of 2016 reveal that the primary expenditures have continued to increase at a stronger pace. Public consumption posted a notable upsurge while public investment spending declined substantially. The seasonal fall in interest expenditures and the sharp year-on-year growth in privatization revenues helped to reach a balanced budget as of the first quarter of 2016.

6.1. Budget Developments

In the first quarter of 2016, the central government budget achieved a balance, while the primary budget balance had 16.5 billion TL in surplus (Table 6.1.1). The robust tax revenue collection of 2015 continued into the first quarter of 2016. Due to the quarterly fall in interest expenditures and the marked upsurge in non-tax revenues, the central government budget balance registered a substantial year-on-year improvement in the first three months of 2016.

Table 6.1.1.
Central Government Budget Aggregates
(Billion TL)

	2015 January-March	2016 January-March	Rate of Increase (Percent)	Actual/Target (Percent)	Target Rate of Increase (Percent)
Central Government Budget Expenditures	118.6	131.7	11.0	23.1	12.8
Interest Expenditures	18.1	16.5	-9.0	29.4	5.6
Primary Expenditures	100.5	115.2	14.6	22.4	13.6
Central Government Budget Revenues	113.2	131.7	16.4	24.4	11.9
I. Tax Revenues	96.3	108.5	12.7	23.6	12.7
II. Non-Tax Revenues	12.4	17.7	42.6	25.6	20.7
Budget Balance	**-5.4**	**0.0**	**-**	**-**	**-**
Primary Balance	**12.7**	**16.5**	**30.4**	**62.8**	**-**

Source: Ministry of Finance.

After rising slightly to 1.3 percent in 2014 on an annual basis, the central government budget deficit to the GDP ratio dropped to 1.2 percent in 2015. This ratio is estimated to fall further to 0.9 percent in the first quarter of 2016 (Chart 6.1.1). Meanwhile, having declined to 1.1 percent in the third quarter of 2012, the primary budget surplus to the GDP ratio assumed an upward course in 2013, ending the year at 2 percent. Dropping to 1.6 percent in 2014 and 2015, this ratio is estimated to rise slightly to 1.7 percent in the first quarter of 2016.

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

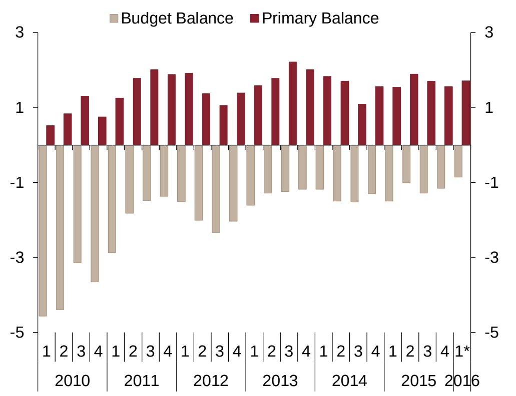
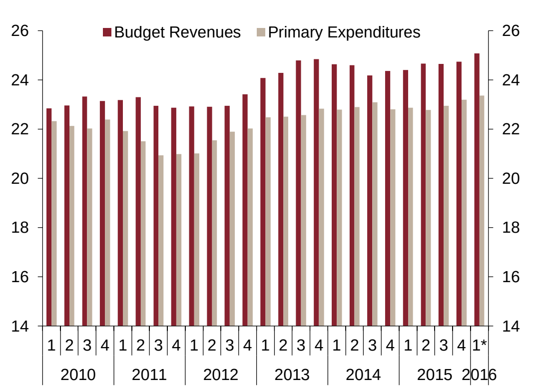


Chart 6.1.2.
Central Government Budget Revenues and Primary Expenditures
(Annualized, Percent of GDP)



* Forecast.
Source: Ministry of Finance.

Having surged notably since 2012, the central government primary expenditures to the GDP ratio hit 23.2 percent in 2015, which is the highest level recorded since 2008. This ratio is expected to inch higher to 23.4 percent in the first quarter of 2016 (Chart 6.1.2). On the other hand, the central government budget revenues to the GDP ratio increased upon the relatively robust economic activity as well as the tax adjustments in September 2012 and January 2013, reaching 24.8 percent at end-2013. After dropping to 24.4 percent in 2014 mainly due to slowing tax revenues based on domestic demand, this ratio rose to 24.7 percent in 2015, and is estimated to climb to 25.1 in the first quarter of 2016.

Trending upwards since the second half of 2012, the central government primary budget expenditures remained on the rise in the first quarter of 2016. Accordingly, the central government primary budget expenditures posted a year-on-year increase of 14.6 percent in the first three months of 2016 (Table 6.1.2).

Table 6.1.2.
Central Government Primary Expenditures (Billion TL)

	2015 January-March	2016 January-March	Rate of Increase (Percent)	Actual/Target (Percent)
Primary Expenditures	**100.5**	**115.2**	**14.6**	**22.4**
1. Personnel Expenditures	32.3	38.7	19.6	26.2
2. Government Premiums to SSI	5.5	6.6	20.2	26.3
3. Purchases of Goods and Services	7.3	9.2	25.8	19.7
4. Current Transfers	41.7	54.2	29.9	24.9
a) Duty Losses	0.8	1.2	50.9	22.5
b) Health, Pension and Social Benefits	17.1	26.7	55.9	26.1
c) Agricultural Support	2.4	3.1	25.5	26.2
d) Reserved Share Revenues	14.2	15.7	10.9	25.0
5. Capital Expenditures	7.3	3.3	-55.0	6.3
6. Capital Transfers	1.8	0.7	-62.7	8.9
7. Lending	4.6	2.6	-43.8	19.9

Source: Ministry of Finance.

Across primary expenditures, current transfers, purchases of goods and services, and personnel expenditures were up 29.9, 25.8 and 19.6 percent, respectively, in the first quarter of 2016. Health, pension and social benefit expenditures under current transfers, which also include social security deficit financing, soared by 55.9 percent. Transfers for the financing of the social security deficit amounted to 6.4 billion TL in the first quarter of 2016 from 0.4 billion TL during the same period of the previous year, thus driving health, pension and social benefit expenditures higher. As for public investment expenditures, the slump in capital expenditures and capital transfers curbed the rise of primary budget expenditures. Excluding these two items, the rate of increase in primary expenditures is 21.6 percent. Even though it is too early to make an overall assessment, the upswings in current expenditures and transfers appear to be initial signs that primary expenditures will put pressure on budget targets in 2016.

Central government general budget revenues increased by 16.1 percent year-on-year in the first quarter of 2016 (Table 6.1.3). Meanwhile, tax revenues surged by 12.7 percent, while non-tax revenues grew by a massive 42.6 percent.

Across tax revenues, the collection of income tax, which makes up the largest share of direct taxes, recorded a year-on-year growth of 14.1 percent in the first quarter of 2016. Income tax collection is mostly driven by deductions from wages. In this regard, the large minimum wage hike of 2016 had a favorable impact on income tax revenues. Among consumption-based indirect taxes, the SCT and the domestic VAT rose by 13.5 and 11.8 percent, respectively. The details of SCT revenues show a jump of 20.6, 14.7 and 9.1 percent in tax revenues from tobacco products, motor vehicles and petroleum and natural gas products, respectively, with the last accounting for the largest share of total SCT revenues. Meanwhile, the VAT on imports soared by 13.7 percent due to BOTAŞ payments. This sharp rise in non-tax revenues was mostly driven by the inclusion of an additional 6.1 billion TL of privatization revenues into the budget in the first quarter of 2016.

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

	2015 January-March	2016 January-March	Rate of Increase (Percent)	Actual/Target (Percent)
General Budget Revenues	**108.7**	**126.2**	**16.1**	**23.9**
I-Tax Revenues	**96.3**	**108.5**	**12.7**	**23.6**
Income Tax	20.0	22.9	14.1	23.1
Corporate Tax	9.5	10.3	8.0	27.9
Domestic VAT	11.7	13.1	11.8	25.6
SCT	22.3	25.3	13.5	21.8
VAT on Imports	15.8	17.9	13.7	20.6
II-Non-Tax Revenues	**12.4**	**17.7**	**42.6**	**25.6**
Enterprise and Property Revenues	2.0	2.2	8.4	11.5
Interests, Shares and Fines	7.4	7.8	5.2	22.9
Capital Revenues	2.0	6.5	224.7	52.9

Source: Ministry of Finance.

Having turned positive amid tax rate hikes in September 2012 as well as the base effect, the annual rate of increase in real tax revenues started to slacken in the third quarter of 2013. Real tax revenues remained unchanged year-on-year in the last quarter of 2014, but increased by 7.7 percent in the last quarter of 2015. In the first quarter of 2016, however, real tax revenues rose by 3.7 percent year-on-year (Chart 6.1.3). The analysis of this increase by sub-items suggests that revenues from the VAT on imports, SCT and the domestic VAT, which are among consumption-based taxes, surged by 4.8, 4.5 and 2.7 percent in real terms, respectively (Chart 6.1.4).

Chart 6.1.3.
Real Tax Revenues
(Annual Percent Change)

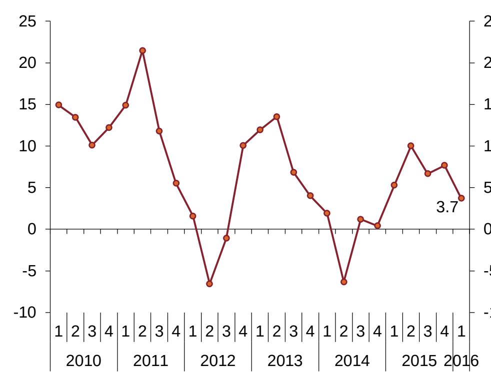
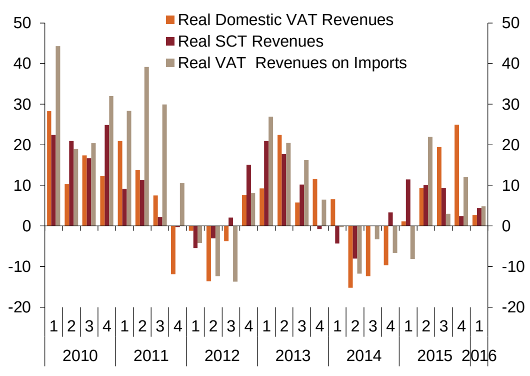


Chart 6.1.4.
Real VAT and SCT Revenues
(Annual Percent Change)

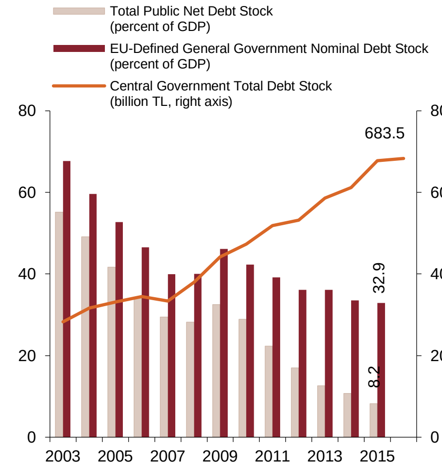


Source: Ministry of Finance.

6.2. Developments in the Public Debt Stock

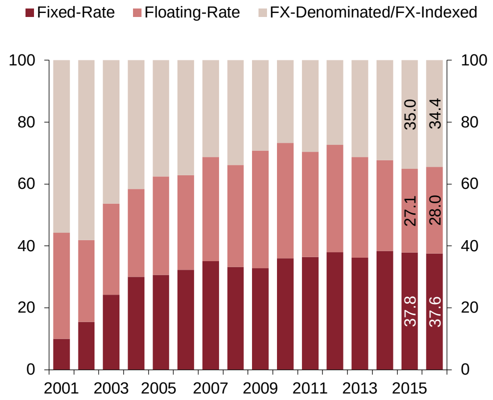
The central government debt stock reached 683.5 billion TL in the first quarter of 2016. Total public net debt stock to the GDP and the EU-defined general government nominal debt stock to the GDP posted a year-on-year drop of 2.5 and 0.6 points, respectively, in 2015 (Chart 6.2.1).

Chart 6.2.1.
Public Debt Stock Indicators



Source: Treasury.

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



* FX-Denominated/FX-Indexed debt stock includes external debt stock and FX-denominated and FX-indexed domestic debt stock.
Source: Treasury.

As of March 2016, the share of fixed-rate securities in the total debt stock remained almost unchanged from 2015 (Chart 6.2.2). As for the interest rate and currency structure of domestic borrowing, the share of fixed-rate borrowing registered a modest year-on-year growth during January-February 2016. Meanwhile, the ratio of public deposits to the average monthly debt service stood at 275.1 percent. The average term-to-maturity of the domestic debt stock reached 56.2 months (Chart 6.2.3). External borrowing by bond issues amounted to 1.5 billion USD in the first three months of the year, with an average maturity of 10.6 years (Chart 6.2.4).

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

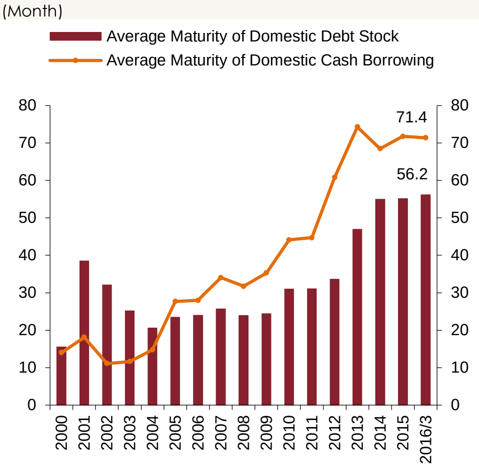
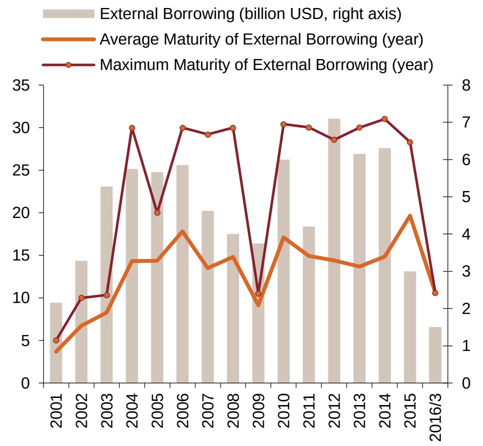


Chart 6.2.4.
Borrowing By Bond Issue



Source: Treasury.

The domestic debt rollover ratio was realized at 88.2 percent by the end of February 2016 (Chart 6.2.5). The average real interest rate[1] has been on the rise since early 2015 (Chart 6.2.6).

Chart 6.2.5.
Total Domestic Debt Rollover Ratio
(Percent)

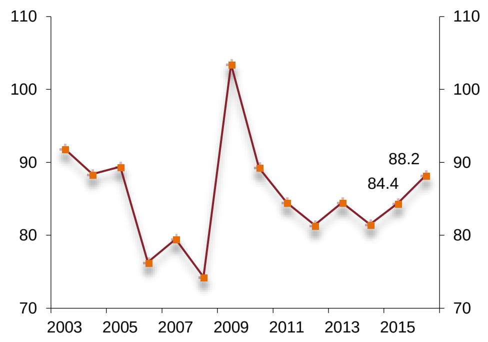
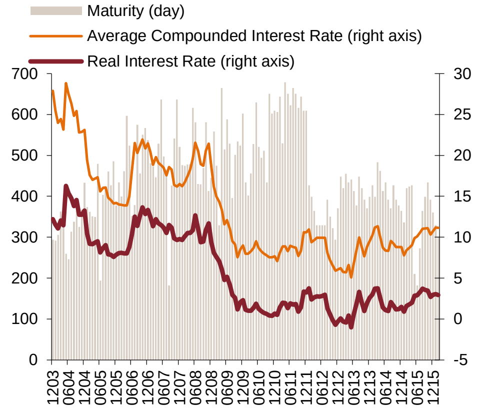


Chart 6.2.6.
Average Maturity and Interest Rates of Borrowing at Discount Auctions



Source: Treasury, CBRT.

[1] Real interest rates are 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).