Macro note – Central Government Budget Balance

In June, the budget recorded a deficit of TRY 330.2 billion and the non-interest balance recorded a deficit of TRY54.5 billion. While interest rates are putting increasing pressure on the budget balance, core indicators continue to show signs of recovery.

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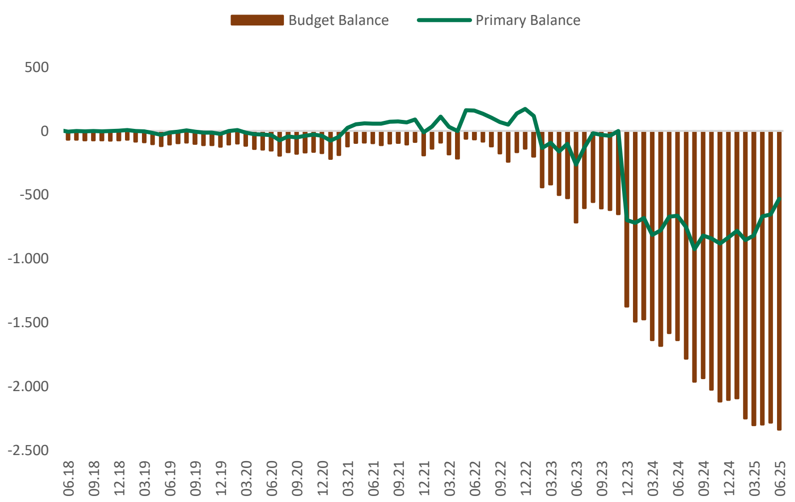
According to the central government budget data for June published by the Ministry of Treasury and Finance, budget revenues amounted to TRY909.4 billion, while budget expenditures reached TRY1,239.6 billion. During the same period, non-interest budget expenditures amounted to TRY 963.9 billion. With these figures, the budget deficit was TRY330.2 billion, while the non-interest balance showed a surplus of TRY54.5 billion. Basic expenditures (excluding interest) showed a parallel trend with revenues, and the budget continued to recover in annual indicators. However, when interest expenditures are included in the overall picture, we are far from the targeted budget deficit. Interest payments of TRY277 billion on government domestic debt securities in June created negative pressure on the budget balance. With the May effect of corporate tax also disappearing, the budget deficit rose again to TRY300 billion levels. In the first six months of the year, an average of TRY185 billion and a total of TRY1.1 trillion in interest expenses were paid. Current transfers and personnel expenses remained almost unchanged from the previous month. In June, TRY18.2 billion in current transfers were made to Electricity Generation Inc. In the first six months of the year, a total of TRY183.3 billion in transfers were made to BOTAŞ and Electricity Generation Inc. We see the disruptive effect of inflation on both monetary and fiscal policy in the budget figures. The high level of borrowing interest rates is increasing the interest burden on the budget. Even if all revenues cover non-interest expenditures and the budget breaks even, cumulative interest payments remain at a very high level. It seems very difficult to achieve fiscal discipline without price stability. A decline in funding and borrowing rates would alleviate the interest burden on the budget. Additionally, in line with the decline in inflation, personnel expenses and public expenditures will stabilize at a more moderate level. Considering the inflation figures for May and June, we will enter a cautious and inflation-focused interest rate reduction cycle starting in July. Although these reductions will be reflected in the 2026-2027 fiscal outlook, they are of critical importance in terms of expectation management. We believe that both public finances and monetary policy will enter a more stable phase by the end of 2025. Although it will take time to reach the 2010-2020 budget performance, we believe that the necessary measures will be taken on the fiscal policy side. During this period, any negative shocks from the economic or political front could impact on both monetary and fiscal policy beyond expectations. Market players who are expecting improvements in indicators such as production and investment are focused on a low inflation-low interest rate cycle supported by economic and political stability. We estimate that we will enter this period as of July.

Budget expenditures increased by 43.1% compared to the same period last year. The highest proportional increases were in interest expenditures (177.7%) and goods/services procurement expenditures (56.5%), while the highest expenditure items were current transfers (TRY462.1 billion) and personnel expenditures (TRY277.6 billion). Budget revenues have increased by an average of 53.8% annually. The highest increases were in income tax (92.4%) and fees (91%). The sub-items that contributed the most to budget revenues were income tax and special consumption tax (TRY204.3 billion and TRY163.8 billion, respectively). Although the proportional increase in revenue generation and budget collection balances expenditures, interest pressure negatively affects budget performance. We believe this will be overcome through price stability, low funding rates, and the normalization of financial indicators.

Graph 1: Budget and Primary Balance (12m rolling, Billion TL)



In summary, the budget recorded a deficit of TRY330.2 billion in June, and the primary balance recorded a deficit of TRY54.5 billion. Interest rates continue to exert increasing pressure on the budget balance. Achieving fiscal discipline without price stability appears to be quite challenging. Even if budget revenues recover and expenditures are reduced, interest payments alone will create an annual budget deficit of approximately 4.1%. This deficit has remained within the 1.5-2.5% range in terms of fiscal discipline. The recent increase in risks related to global debt burden and borrowing interest rates has once again highlighted the importance of fiscal discipline. We are currently experiencing a period in which past monetary policy choices have undermined fiscal discipline. A return to a tight fiscal policy in coordination with monetary policy will contribute to fiscal discipline and price stability in the medium term. Policies aimed at increasing the effectiveness of tax revenues and restricting expenditures will also ensure continuity in budgetary discipline. Our expectation that the budget outlook will gradually reach levels consistent with price stability starting in 2025 remains unchanged. We would like to emphasize that the transition to normalization in economic policies may bring additional shocks and updates to our forecasts.

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