Macro note – Central Government Budget Balance

In July, the budget records a deficit of TRY378.1 billion and the non-interest balance a deficit of TRY51.3 billion. Despite the recovery in tax revenues, the sharp rise in interest expenditure and current transfers increases pressure on the budget deficit.

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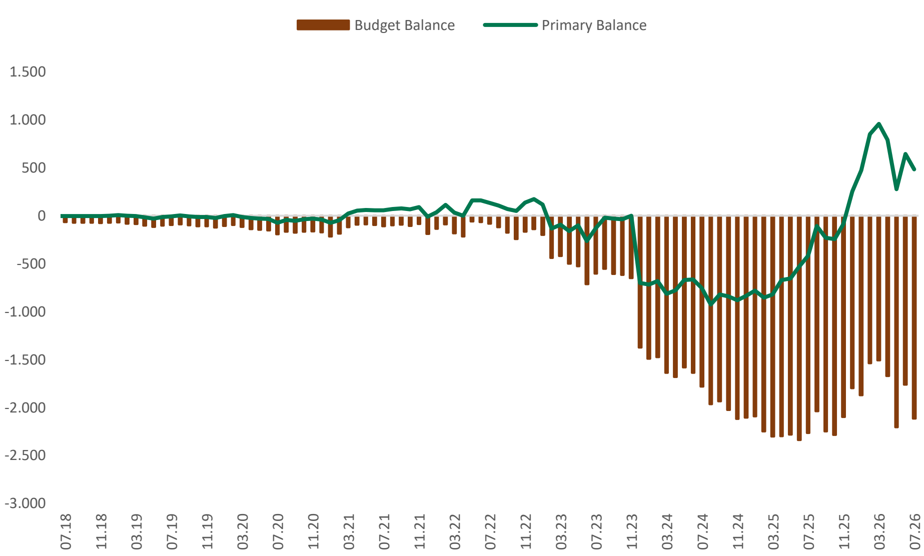
According to the central government budget figures for July published by the Ministry of Treasury and Finance, budget revenue stood at TRY1,412.4 billion, whilst budget expenditure amounted to TRY1,790.5 billion. During the same period, non-interest budget expenditure totaled TRY1,463.7 billion. Based on these figures, the budget deficit stood at TRY378.1 billion, whilst the non-interest balance recorded a deficit of TRY51.3 billion. The impact of adjustments made on both the revenue and expenditure sides in July is noteworthy. The increase in staff costs resulting from the inflation adjustment was an expected effect. Following this adjustment, we can say that staff costs are set to stabilize at around TRY450 billion. However, whilst interest expenditure averaged around TRY200 billion, excluding January, it rose to TRY326 billion in July. Furthermore, current transfers, which had stabilized at around TRY500 billion in the first six months of the year, rose to TRY611 billion in July. Finally, capital transfers have doubled from the average level in the first half of the year, rising to approximately TRY150 billion. Owing to this July figure, personnel costs (TRY55 billion), current transfers (TRY110 billion), interest (TRY125 billion) and capital transfers (TRY75 billion) experienced an additional increase totaling TRY365 billion. When adjusted for these effects, we can say that core budget indicators remain in good shape. The point to emphasize here is that there has been no deterioration in fiscal policy, either in tax collection or expenditure policies. However, the inflationary impact created by monetary policy is triggering the budget deficit, both by increasing expenditure at least as much as inflation and by generating high interest expenditure due to borrowing costs. Therefore, as we have highlighted in our previous reports, positive developments in monetary policy and the disinflation process will also bring about improvements in fiscal policy. Revenue policy and collection continue to trend sideways. Despite a limited decline in tax revenues, there has been an improvement in revenue performance spread across the year as a whole. Consequently, the fundamental improvement that will restore fiscal discipline to the budget will result from improvements in expenditure items. We believe this will be achieved not so much through fiscal policy as through improvements in monetary policy and inflation expectations. Assuming the disinflation process continues resolutely in the second half of the year, several possibilities come to the fore. Foremost among these are the adjustments to administered/guided prices, as highlighted in the latest inflation report. Regulations in revenue-generating sectors such as healthcare, transport and fuel – which reflect the lagged effects of inflation – are at issue. It is clear that this will have a positive impact on budget performance. The second possibility is that inflation will remain within the 28–30 per cent range by year-end, with no significant improvement from current levels. This scenario would necessitate the continuation of a tight stance in both monetary and fiscal policy for some time to come. The final, and least likely, scenario is a shift towards an 'election economy' and a one-off easing of fiscal policy. In this scenario, a marked rise in personnel and pension expenditure would be observed. To finance this, price increases and tax adjustments across expenditure categories may be introduced. Once these temporary effects are factored out, we maintain our base scenario that the budget will converge towards the fiscal discipline benchmark during the 2027–2028 period, in line with the decline in inflation.

Looking at the details of the changes in the budget's revenue-expenditure balance, budget expenditure in July rose by 59.8 per cent compared with the same period of the previous year. The highest proportional increases were observed in capital transfers (134 per cent) and interest expenditure (142.8 per cent), whilst the largest expenditure items were current transfers (TRY611 billion) and staff costs (TRY461 billion). The average annual increase in budget revenue stands at 28.8 per cent. The highest increases were seen in income tax (47.9 per cent) and stamp duty (49.5 per cent). The sub-categories contributing most significantly to budget revenue were income tax and VAT on imports (TRY432 billion and TRY192 billion respectively).

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



In summary, the budget recorded a deficit of TRY378.1 billion in July, whilst the non-interest balance showed a deficit of TRY51.3 billion. Seasonal increases in current transfers, interest payments and staff costs triggered the budget deficit. On the other hand, the persistently high level of borrowing costs is exerting a significant negative pressure on budget performance beyond 2023. Any falls in nominal interest rates will have a markedly positive impact on fiscal discipline in the 2027–2028 period. As monetary policy works to achieve disinflation, falling interest rates will also contribute to fiscal discipline. The increased risks surrounding the global debt burden and borrowing costs in recent times have once again highlighted the importance of fiscal efficiency. A shift in fiscal policy towards a tightening stance, in coordination with monetary policy, will contribute to fiscal discipline and price stability in the medium term. Policies aimed at enhancing the efficiency of tax revenues and restricting expenditure will also ensure the continuity of budgetary discipline. We would like to emphasize that the transitions involved in the normalization process of economic policies may bring about additional shocks and necessitate updates to our forecasts.

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