

**EXECUTIVE
BOARD
MEETING**

SM/21/70
Correction 2

May 17, 2021

To: Members of the Executive Board

From: The Secretary

Subject: **Turkey—Staff Report for the 2021 Article IV Consultation**

Board Action: The attached correction to SM/21/70 (5/14/21) has been provided by the staff:

Factual Errors Not Affecting the Presentation of Staff's Analysis or Views

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Questions: Mr. McGettigan, EUR (ext. 36407)
Ms. Domit, EUR (ext. 34174)



TURKEY

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

May 13, 2021

KEY ISSUES

Context: In Turkey, as in other countries, the human and economic toll of the COVID-19 pandemic has been severe. Thousands of lives have been tragically lost and many livelihoods compromised. The initial policy response to the pandemic—and subsequent sharp growth rebound—set Turkey apart from its peers. Rapid monetary and credit expansion and large liquidity support meant that Turkey was among the few countries to experience positive economic growth in 2020. But these policies also aggravated pre-existing economic and financial vulnerabilities. Higher inflation, increased dollarization, and a large shift in the current account position increased pressure on the lira and gave rise to heavy foreign exchange sales, which led in turn to steep reserve declines from already-low levels. A policy shift in late 2020—mainly towards tighter and more transparent monetary policy and slower credit growth—was both welcome and necessary. But the durability and depth of the shift were called into question in March 2021, following the change in central bank leadership, as the lira weakened markedly and interest rate spreads widened.

Policies: Although policy uncertainty and vulnerabilities have increased, Turkey's challenges are not insurmountable. Delivering a firm monetary policy stance will be necessary to rebuild credibility and buffers, while also responding to the human and economic needs arising from the pandemic, including through:

- Strongly committing to, and delivering, a firm monetary stance—with no premature easing and with further timely and well-calibrated tightening if inflation expectations rise further, to, at a minimum, keep the ex-ante real policy rate unchanged—and transparent and predictable reserve accumulation once conditions allow;
- targeted and temporary fiscal support to address pandemic-related needs, alongside pre-announced and credible medium-term consolidation;
- close monitoring of bank FX liabilities, continued reining in and refocusing of lending by state-owned banks, gradual unwinding of regulatory flexibility and loan deferrals, and, once the pandemic subsides, a rigorous third-party assessment of bank assets; and
- focused reforms to minimize long-term scarring in the labor market and in the non-financial corporate sector.