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May 25, 2021

**Statement by Mr. Odonye and Mr. Ismail on Turkey  
(Preliminary)  
Executive Board Meeting  
May 27, 2021**

We thank staff for the informative report and Mr. Azal and Mr. Dogan for their insightful Buff statement.

The COVID-19 pandemic has exerted severe human and economic tolls on Turkey, amplifying pre-existing macroeconomic challenges, including external and internal imbalances. The authorities' decisive and sizable policy response helped mitigate the negative impact of the pandemic on vulnerable households and businesses. This led to exceptionally strong recovery in second half of the year, putting Turkey among the few countries with positive growth in 2020. This notwithstanding, rapid monetary and credit expansion also exacerbated pre-pandemic economic and financial vulnerabilities, fueling inflation and pressures on the exchange rate and reserves. Against this background, we broadly agree with staff analysis and policy recommendations and urge the authorities to accelerate their reforms to restore policy credibility and rebuild buffers while continuing to respond to the human and economic needs precipitated by the pandemic. We welcome the mass vaccination program started by the authorities to support the normalization of activity and look forward to a more inclusive economic recovery.

Using the available fiscal space to provide additional support to households and workers most affected by the pandemic and minimize scarring is warranted. In this context, we welcome that the support measures would extend beyond the formal sector workers to cover those in informal sector. In the same vein, we note that financing some of the pandemic-related spending through the assets of the Unemployment Insurance Fund has been helpful in limiting the impact of the fiscal response on gross public debt. *Could staff elaborate on the rationale for limited the use of Unemployment Insurance Fund in financing pandemic support measures?* Once the recovery is firmly established, we encourage the authorities to start a medium-term consolidation measures to place the debt on a downward trajectory and strengthen the fiscal anchor. Further, fiscal consolidation could be supported by fiscal

structural reforms aimed at improving fiscal governance and mitigating fiscal risks, including by improving the oversight and management of PPPs and SOEs, enhancing the transparency of the quasi-fiscal operations, and strengthening the budget execution. We also see room for improving debt management and fiscal sustainability by building on earlier reforms aimed at addressing rollover and currency risks through lengthening borrowing maturities and reducing reliance on domestic FX debt.

Strengthening central bank independence and financial autonomy remains critical to achieve price stability and restore monetary policy credibility. To this end, we see merit in reinstating previous qualification criteria for appointments and adoption of well-specified procedures for dismissing central bank governors to avoid policy uncertainty and de-anchoring inflation expectations associated with the recent governors' turnover. At the same time, given the deteriorating inflation-output tradeoff, pursuing upfront commitment to a firm monetary policy stance would be crucial to bring inflation below target and rebuild reserve buffers and policy credibility. The central bank should stand ready to timely tighten monetary policy if inflation expectations increase further. This should be complemented with further simplification in the monetary policy framework and operations and improvement in communications of monetary policy decisions. Looking forward, we welcome the commitment of the Central Bank of the Republic of Turkey (CBRT) to the principles of transparency, predictability, and accountability while continuing to strengthen its policy communication and data dissemination. We also urge the authorities to gradually phase out administrative measures aimed at supporting the exchange rate to address policy distortions and encourage inward investment.

We support gradual reversal of regulatory flexibility and containment of credit expansion as the pandemic subsides. Focusing on state-owned bank and Credit Guarantee Fund lending would be essential to preserve financial stability. It is important to provide level the playing field for state-owned and private banks to ensure prudent risk pricing and efficient credit allocation, with all subsidies to state-owned banks being transparently reflected in the budget. Concurrently, close monitoring and addressing risks stemming from bank FX liabilities is warranted, including through stress testing, enforcement of foreign exchange limits, and strengthening bank resolution frameworks. We also see merit in completing the ongoing asset quality review and look forward to a speedy resolution of elevated risks emanating from bank exposure to sectors facing financial difficulties, rapid credit growth in recent years, and high NPL levels. Further, addressing weaknesses in the AML/CFT framework identified in the 2019 FATF report would be key to dissipating potential pressures on corresponding banking relationships that could result from entering the FATF's grey list.

Finally, we encourage the authorities to intensify structural reforms to support the recovery, mitigate pandemic related scarring, and boost sustainable and inclusive growth. The authorities need to prioritize supporting female labor force participation and youth employment to minimize scarring and foster job creation. They also need to shift their focus from preserving existing jobs to facilitating workers transition more flexibly across firms and sectors once restrictions on movement are removed. We underscore the need to direct support and facilitate restructuring of viable but temporary-insolvent firms while winding down unviable firms. We welcome the authorities' plan to continue improving judicial

transparency and independence, as well as putting in place measures to ease resolution of disputes in businesses and the administration, which will help improve the business environment and bolster confidence.

With these comments we wish the Turkish authorities success in their reform endeavors.