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May 25, 2021

**Statement by Mr. Buissé, Mr. Rozan, and Ms. de Waziers on Turkey
(Preliminary)
Executive Board Meeting
May 27, 2021**

We thank staff for the clear and comprehensive report and Mr. Azal and Mr. Dogan for their insightful buff statement. We broadly share staff's analysis and recommendations and would like to offer the following comments.

We welcome the rapid rebound of the Turkish economy in 2020 and the encouraging outlook for 2021, but we share staff's assessment that pre-pandemic vulnerabilities have been exacerbated, with large current account deficits leading to high external financing needs, rapid credit growth and high inflation, all leading to large reserves losses. Linked with the pandemic response, Turkey is among the few economies to have recorded a positive GDP growth in 2020. We agree that the strong outlook in 2021 is surrounded by uncertainties and domestic and global downsides risks regarding the pace of vaccination, monetary policy stance, global risk aversion and geopolitical developments. We would have appreciated further analysis of the contribution of the large-scale policy response, mainly monetary and credit expansions, to economic growth. An accommodative domestic environment drove demand up, including investments. Staff mentions that the export composition has diversified. It would be interesting to have more details on the exports diversification and insights on which regions and sectors increased their demand for Turkish goods despite the pandemic.

We strongly agree that monetary policy is one of the key factors in rebuilding the necessary credibility domestically and for international investors. We agree with staff on the vulnerabilities and risks emerging mainly from large external financing needs, high deposit dollarization, losses in reserves, decreased inflows as well as the adverse implications of these developments for bank and non-financial corporate balance sheet. The sudden change of the central bank governor in mid-March 2021 triggered a downward trend in the currency's value as well as lost credibility in the policy stance. We encourage the authorities to implement as quickly as possible an orthodox monetary policy to slow down the price drift and reassure foreign investors. Markets will be thoroughly following the decisions and communication of the new governor in the coming months; in particular, premature easing

could weaken the monetary stance. Preserving clear and forward-looking communication of monetary policy decision, and more transparency on FX interventions and the mechanism put in place to achieve them would be essential. In addition, we notice that the composition of reserves by the central bank reflects a higher share of gold and non-SDR-basket currencies (60% of total CBRT reserve assets) from 2019 to 2020, rather than more traditional reserve assets. *Staff's explanation for this uncommon development would be welcome.*

We concur with staff on the use of the fiscal space to provide temporary and targeted fiscal support to address pandemic-related needs with a commitment to a medium-term fiscal consolidation. The rise in interest rates is weighing on the financing costs despite an increase in alternative borrowing instruments, and the shift in the debt structure has increased currency and rollover risks. We encourage further strengthening of debt management to control the financing costs and mitigate fiscal risks. Reform of the legal framework for PPPs and better monitoring and data consolidation of extra-budgetary funds and public guarantees used to finance infrastructure program will also be needed to strengthen fiscal risk management. We encourage control of quasi-fiscal activity of all state-owned enterprises and monitoring contingent liabilities related to the financial sector, PPPs, and non-financial state-owned enterprises. *Does staff intend to review the State's off-balance sheet to estimate its amount?*

We generally agree with staff's analysis on the financial sector, and call for vigilance regarding recent development in the banking sector. A review of the quality of bank assets is desirable in order to measure the impact of the very aggressive credit distribution policy set up last year. The withdrawal of regulatory flexibility and of state guarantees or an adverse scenario could lead to a significant increase in banks' vulnerabilities. In this context, we very much support the authorities' request to advance the FSAP review to 2021.

We concur with staff on the need to carry out structural reforms in order to correct imbalances in Turkey's growth model and diversify the economy into value-added tradable sectors and we support staff's recommendations. Strengthening the business environment and governance and judicial reforms will be essential to increasing productivity and encourage FDI. We also highlight the need for additional labor market support, labor market reforms and human capital investments to reduce long-term scarring. The Covid-19 crisis has significantly exacerbated income disparities and weighed on vulnerable populations, resulting in a reversal of the progress made during the last decade. Beyond the reduction of the labor market slack, targeted policy support and active labor market policies will be necessary to improve skill-building and help labor reallocation and support female labor force participation and youth employment.

We welcome staff's focus on the cryptocurrency market. Although it still represents a small share of GDP, cryptocurrency trading is growing rapidly. Due to more limited regulations in this field, authorities banned cryptocurrency payments after severe market disruptions in April. In addition, we noticed media coverage on the current experiments undertaken by the Central bank regarding central bank digital currencies and *we would welcome staff comments on these developments.* We look forward further analysis on these, including in the upcoming FSAP.

Finally given the macro-criticality of climate change and climate resilience building, we regret the absence of coverage of climate change adaptation and mitigation policies and

we encourage the authorities and staff to include it in future bilateral surveillance, including the FSAP. We encourage the authorities to seize the opportunities of a green recovery for job creation.