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January 13, 2023

**Statement by Mr. Jennings, Mr. O'Brolchain, and Ms. Ahmed on Turkey  
(Preliminary)  
Executive Board Meeting  
January 18, 2023**

We thank staff for their report and Mr. Mert and Mr. Akben for the insightful Buff statement. Despite Türkiye's strong recovery from the pandemic, rising risks and vulnerabilities, including high inflation, current account deficit, low foreign reserves, are worrisome. These vulnerabilities are further exacerbated by global economic uncertainty stemming from Russia's war in Ukraine. **Against this backdrop, we fully support staff's appraisal and recommendation for a shift towards tighter monetary and fiscal policies, along with targeted structural policies to promote more inclusive and sustainable growth.**

**Significant monetary policy tightening is urgently needed to rein in inflation and reduce vulnerabilities.** It is alarming that inflation has increased to a 24-year high of 85 percent and is among the highest across large emerging economies. While supply constraints may account for a share of the recent increase in inflation, these high levels of inflation also reflect excess demand. In this context, we share staff's view that prompt and sizeable policy rate hikes are urgently needed to durably lower inflation, underpin the lira and rebuild reserve buffers, while supporting more sustainable long-term growth and competitiveness. Although macroprudential and regulatory measures may have helped contain credit risk, we emphasize that these are not a substitute for interest rate hikes, especially in the absence of well-anchored inflation expectations. We thus strongly encourage authorities to shift away from reliance on such measures towards using the interest rate as the primary monetary policy instrument to achieve price stability. We underscore the importance of ensuring that this shift is carefully sequenced to minimize market and financial stability risks. This will require authorities to clearly communicate their monetary policy stance going forward to help anchor expectations.

**At the same time, we stress the importance of increasing the central bank independence to restore credibility.** In this regard, we support staff's recommendations to reinstate

previous qualification criteria for appointments and adherence to well-specified procedures for dismissing central bank board members.

**We strongly agree that Türkiye should rebuild high-quality foreign reserves as a buffer against global financial market uncertainty and to safeguard against domestic vulnerabilities.** The reduction and quality deterioration of foreign reserves is concerning. We agree with staff that reserves replenished as soon as conditions allow, and FX intervention should be only used in cases of extreme exchange rate volatility.

**We support the findings of the FSSA and agree with the recommendation to realign fundamental financial incentives and rationalize policy measures to achieve financial stability.** The high and growing financial stability risks, including rising FX liquidity risks and uncertainty over banks' asset quality and capital, as noted in the FSSA, are concerning. While the recent slowdown in credit growth is welcome, we share staff's concern that heavy reliance on complex macrofinancial practices is distorting price formation and capital allocation as well as creating risks for banks. We thus fully support the 2022 FSSA recommendations to phase-out idiosyncratic measures in favour of tighter macroprudential tools and banking regulations, aligned with international standards. We also agree with staff's recommendation to unwind regulatory forbearance measures and to strengthen regulatory and supervisory frameworks. We encourage continued efforts to address weaknesses in the AML/CFT framework through implementation of the FATF action plan. Given the increasing adoption of crypto assets, we emphasize the importance of enhancing oversight, risk management and regulation of these assets. We positively note the authorities' commitment and recent progress in this regard.

**We share staff's view that a tight fiscal stance, with targeted support to the vulnerable, is warranted to preserve fiscal space to deal with future shocks, while containing domestic demand.** In this respect, we support staff's recommended medium-term consolidation measures, particularly replacing energy subsidies with better targeted mechanisms. Fiscal consolidation should be complemented by improved debt management practices and fiscal governance to increase transparency and limit risks.

**Targeted structural reforms are necessary to foster more inclusive and sustainable growth and build resiliency to shocks.** We encourage the authorities to boost competitiveness by reducing labor market rigidities, stimulating private investment by improving the business climate, and increasing labor force participation and human capital, particularly among females. We note with concern that Türkiye's labor force participation gender gap is amongst the largest in the G20 and much bigger than many other emerging markets. While we positively note the authorities' efforts towards gender budgeting and to improve the capacity of early-school education centers, improving childcare affordability should also be considered, particularly for low-income households. *Staff comments welcome on whether such measures have been contemplated by the authorities.* Given Türkiye's vulnerability to climate change, we also strongly support measures to strengthen resilience to climate change and facilitate a transition to a low-carbon economy. In this respect, we

welcome the authorities' commitment to reach net zero emissions by 2053 and recent investments in renewable energy projects.