GRAY/23/3501

January 13, 2023

Statement by Mr. Mozhin, Mr. Potapov, and Mr. Biriukov on Turkey
(Preliminary)
Executive Board Meeting
January 18, 2023

1. We thank staff for a well-focused set of papers on Türkiye. Our appreciation also goes to Mr. Mert and Mr. Akben for the additional clarifications provided in their helpful Buff statement. **We acknowledge the unprecedented divergence of views between the Turkish authorities and staff and would like to make the following comments for emphasis.**

2. **Türkiye experienced one of the strongest post-pandemic recoveries in the world.** Strong growth momentum carried over into 2022, outperforming the global trend. As a result, Türkiye probably ranked at the top among the OECD and the G-20 countries last year in terms of growth performance. Employment also recovered to the pre-pandemic levels supported by the rebound in economic activity.

3. **Reliance on the new growth model, however, amplified vulnerabilities.** Unorthodox monetary policy exacerbated macro-financial imbalances and impacted investor confidence, causing financial market turbulence, large Lira depreciation, higher inflation, and increased dollarization. Reserve buffers remain low or even negative if adjusted for external central bank swaps.

4. **Fiscal prudence has been one of Türkiye's key institutional strengths and we encourage the authorities to continue to adhere to fiscal discipline as the elections are approaching.** Debt burden remains low with some fiscal space, but the new policy initiatives (minimum wage hike, rise in public sector pay and pensions) point to a sharply wider shortfall in 2023. We commend the authorities for proactive policy stance to mitigate the negative effects of the pandemic, supply chain problems, and higher energy prices on the

most vulnerable households. Yet we see scope for better-targeted measures. *Did staff analyze the implications of the new early retirement option for fiscal sustainability?*

5. **On the monetary front, Türkiye could benefit from a reversal to orthodox monetary policy, reinstating interest rates as the primary policy instrument.** We welcome the CBRT's focus on ensuring affordable cost of financing to promote economic growth. High and persistent inflation, however, poses significant risks to long-term growth prospects. Recalibration of macro-prudential measures and monetary policy tightening with clear forward guidance could help tackle inflation and strengthen monetary policy credibility.

6. **We are reassured by Mr. Mert and Mr. Akben that the banking sector remains resilient, reflecting a strong capital structure, high asset quality, and liquidity buffers.** At the same time, we believe that the latest FSSA report draws important conclusions about potential financial stability risks. Increased level of restructured loans and regulatory changes that probably impaired the accuracy of key supervisory indicators could indeed test future capital adequacy. We are also concerned that the FATF placed Türkiye on its grey list.

7. **Türkiye's sizeable external financing requirements remain a source of concern.** The recent volatility in food and oil prices together with increased global yields have brought this risk into a sharper focus. Reliance on unidentified FX inflows (net errors and omissions) and bilateral swaps poses significant risks and can become unsustainable. Moreover, with inflation rapidly eroding purchasing power, a faster pace of dollarization could be another balance of payments risk.

8. With these comments, we wish the authorities of Türkiye every success in their future endeavors.