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January 13, 2023

**Statement by Mr. Guerra and Mr. Lopez on Turkey
(Preliminary)
Executive Board Meeting
January 18, 2023**

We thank staff for their comprehensive set of reports and Mr. Mert and Mr. Akben for their insightful Buff statement. We note the strong difference in views between the authorities and staff on critical policy issues. The IMF should continue closely engaging with the authorities in a constructive and effective policy dialogue. We broadly concur with the staff's assessment and would like to make the following comments for emphasis.

Despite the resilience of Türkiye's economy after the pandemic in a context of strong policy support, macroeconomic imbalances have risen and downside risks dominate.

The new Türkiye Economic Model, aimed at supporting growth and addressing chronic external financing dependence, will have to address additional and increasing challenges. During 2022, the lira has sharply depreciated, inflation has mounted to historic highs, the external deficit has widened, dollarization has increased, and financial stability risks have risen. The authorities should consider adapting the economic policy model to better confront these challenges and preserve the impressive gains in poverty reduction. Specifically, a comprehensive and consistent policy mix with a tightening stance would help to stabilize Türkiye's economy and increase its resilience to shocks and volatile capital flows.

The authorities' strong commitment to fiscal discipline should be preserved as a critical macroeconomic anchor.

A prudent fiscal stance, while providing targeted support to the most vulnerable groups to confront the cost-of-living crisis, would help to contain domestic demand and ease inflationary pressures. The implementation of wide-ranging public sector reforms, including in SOEs, governance, and public debt management, will also support the

consolidation efforts, strengthen transparency, and limit contingent liabilities and quasi-fiscal risks.

The CBT should decisively raise its policy rate, provide clear and credible forward guidance, and simplify the monetary policy operationalization framework. The authorities should reinstate the policy rate at the core of the policy toolkit, while non-distortionary regulatory and macroprudential measures enacted to protect the lira and contain credit growth could serve as complementary tools if needed. These actions will help provide the right market incentives for credit allocation and reduce bank-sovereign linkages.

Strengthening central bank independence and governance—establishing a clear mandate and ensuring institutional, budgetary, and operational autonomy—should also be a priority to rebuild credibility and re-anchor expectations.

We welcome the 2022 FSAP analysis and policy recommendations, especially those related to the crypto asset market. The authorities should continue tackling the rising systemic FX liquidity risks, ensuring adequate banks' capital buffers, improving oversight and resolution frameworks, and advancing the AML/CFT agenda. Given the uprising activity in crypto markets, we welcome the authorities' work on the design of a comprehensive regulatory framework to mitigate risks and enhance data, oversight, risk management, and consumer protection for crypto platforms. We note that current regulation bans these assets for payment purposes, although exploring other digitalization options could draw benefits and facilitate financial inclusion. *Could staff comment on any plans to provide technical assistance on this issue?*

We support the FSAP's assessment that a tightening and simplification of macroprudential policies is critical. To reach this objective, banking supervisory activities should be adequately resourced. The authorities should continue to enhance the financial supervisory capabilities. While noting the point of view of the authorities that non-performing loan ratios (NPL) have declined to historically low levels, the stress tests results point to increased vulnerabilities in the banking system even under the baseline scenario. Additionally, the liquidity stress test analysis indicates the existence of a scenario of a perverse feedback loop between the bank's FX liabilities and pressures on the CBRT international reserve position. We note that the authorities have committed to follow closely the developments related to FX risks in the overall financial system.

Finally, the structural reform agenda should promote an inclusive and sustainable growth model. Long-standing challenges in the labor market related to informality, gender gaps, employability, or precarity should be addressed. We commend the authorities for their commitment to net zero emissions by 2053. The climate strategy should be comprehensive,

including carbon pricing mechanisms to reinforce decarbonizing incentives, while providing a distributional tool to support the transition.