

BUFF/ED/23/9

January 12, 2023

**Statement by Mr. Mert and Mr. Akben on Turkey  
Executive Board Meeting  
January 18, 2023**

On behalf of the Turkish authorities, we would like to thank Mr. McGettigan and Mr. Nelmes for their leadership and their teams for their hard work on the Article IV and FSSA reports.

**Macroeconomic Context**

**Risks to global economic activity have increased in the context of a sharper-than-expected slowdown, with the highest global inflation in almost half a century.** The war in Ukraine, the tightening financial conditions, increased recession expectations and the scarring effects of the pandemic are weighing heavily on the outlook for many countries. The Turkish authorities have faced similar challenges in finding the optimal policy set.

**Thanks to its increasing production and employment capacity, the Turkish economy was the fastest growing among the G20 countries with GDP growth of 11.4 percent in 2021.** Despite the mentioned challenges, Türkiye's strong growth performance continued in 2022 as explained in the staff report in-depth. In the first three quarters of the year, the economy grew by 6.2 percent, performing well above the world average. In a period when the world is struggling with difficult conditions, Türkiye has managed to grow steadily for 9 quarters and increase its machinery-equipment investments continuously for 12 quarters. With the expected growth performance at around 5 percent in 2022, Türkiye will continue to rank at the top among the OECD and G-20 countries.

**Considering chronic high inflation and current account deficit problems together with reliance on volatile short-term capital flows, Türkiye introduced a new model** to achieve sustainable and inclusive economic development. "Türkiye Economy Model - TEM" aims to achieve a healthy current account balance and reduce the need for short-term capital flows in order to attain sustainable price and financial stability. The model prioritizes, investment, employment, production and export by providing low-cost accessible loans to the aggregate supply and by controlling inflationary demand pressures through macro-prudential policies. The Central Bank of the Republic of Türkiye (CBRT) views interest rate increases as a demand management tool, which would be ineffective for lowering inflation in an environment where large external supply shocks account for most of the inflation. Past rate

hikes had only attracted volatile capital inflows and amplified exchange rate volatility which, in turn, led to high inflation. Thus, the authorities expect that all these aspects and country-specific circumstances are considered in policy proposals. The authorities are committed to continue fighting against inflation, protecting the vulnerable, and implementing country-focused policies with an enhanced perspective to diverge from the “exchange rate, interest, and inflation” spiral faced in the last decades.

## **Recent Developments and Outlook**

**The authorities expect solid growth beyond 2023 as Türkiye Economy Model with its targeted loan policy bolsters economic activity.** The government is expected to adjust policies to make sure that the growth potential of the economy remains strong in this period of extreme events.

**Recognizing the difficulties associated with high inflation, Türkiye makes fighting against inflation one of its top priorities.** The global supply chain disruptions, increase in food prices and FX market dysfunction led to a depreciation of the lira and thus contributed to CPI inflation reaching 36.1 percent at the end of 2021 before peaking at 85.5 percent in October 2022. Inflation has moderated to 64.27 percent at the end of 2022, reflecting the stabilization of the exchange rate, lower credit growth as well as favorable base effects. Inflation is expected to decline further by next year.

**The current account deficit is projected to shrink in the upcoming period.** Commodity and energy prices and gold imports are the main factors affecting the current account deficit. The current account deficit was USD 7.2 billion in 2021. As of November 2022, the 12-month cumulative deficit increased to USD 45 billion. On the other hand, the 12-month rolling current account balance, excluding gold and energy, recorded a surplus of USD 51.3 billion. Despite the slowdown in global economic activity and other challenges, exports, which increased to US\$ 254.2 billion in 2022, continue to support the current account balance. The stronger-than-expected contribution of tourism revenues to the current account balance continues. Tourism revenues in the first three quarters of 2022 reached USD 35 billion, 68 percent higher than last year and the number of visitors increased by 94 percent to 39.4 million in the same period. The current account deficit to GDP is expected to significantly recover in 2023 thanks to a decreasing energy bill and increasing tourism revenues.

**Job creation has accompanied the ongoing strong growth performance.** As of the third quarter of 2022, Türkiye continues to rank at the top of OECD countries in terms of employment generation compared to pre-pandemic levels, while the unemployment rate declined to 10.2 percent in November 2022, from 11.2 percent at the end of 2021. To mitigate the burden of inflation on the households, the minimum wage was raised by 54.7 percent starting in January 2023, and public workers’ wages are also increased by 30 percent for the first half of 2023.

**As the centennial anniversary year of the Republic, 2023 will mark important developments for Türkiye.** At the end of December, President Erdoğan announced that

additional natural gas reserves were found in the Black Sea. The country's first domestically developed electric car (TOGG) will be mass-produced in the first quarter of 2023. The inauguration of both the TOGG and natural gas production will decrease Türkiye's import bill.

## **Policies**

### **Monetary Policy**

**The Liraization Strategy is based on a comprehensive approach that places the Turkish lira at the center of the financial system and** refers to an integrated policy framework including liraization tools, targeted loans, liquidity and collateral policy and diversified reserve management. The CBRT assesses that in order to achieve permanent price stability, a sustainable current account surplus together with a structural decline in currency substitution are necessary.

**The CBRT views that policy rates ensure affordable cost of financing in order to promote production and current account surplus capacity** of the economy while macroprudential tools are used within the framework of targeted loans to ensure that financial resources are used as intended. Together with the collateral policy, two objectives are achieved. First, prudent monetary growth is ensured. Second, interest rates of credit and long-term yields are in line with the policy rate—hence monetary policy transmission is strengthened. Liraization measures both incentivize households, non-financial and financial sectors to reduce currency substitution and together with other elements of a diversified reserve policy contribute to the stability in the foreign currency market. Thanks to the strength of the policy framework, important progress has been achieved in accordance with the policy objectives with respect to the composition of credit, policy and loan rates as well as long-term bond yields, collateral structure of the CBRT funding, reverse currency substitution, FX market stability and the CBRT's international reserves. By the end of 2022, the dollarization rate dropped to below 50 percent as a result of liraization measures, with a significant decrease in both households' and corporates' FX deposit shares. As a consequence, headline, core as well as underlying inflation expectations significantly slowed down. Inflation is projected to decline to below 25 percent in 2023 and to single-digit levels in 2025 according to the Medium-Term Program (MTP).

**The authorities concur with staff on the need to accumulate international reserves as economic and financial conditions permit** and note the success of the current policy on reserve accumulation and FX market stability in a period where many central banks opting for rate hikes suffered large losses in their reserves and have been subject to high volatility in the FX market. The effective management of international reserves is important for ensuring confidence in monetary and exchange rate policies and maintaining financial stability. In this context, the CBRT has implemented a pro-active and diversified reserve management strategy that diversifies reserve sources from various channels and consistent FX inflows have been recorded to the FX reserves in 2022. As of December 30, 2022, gross reserves amount to USD 128.8 billion.

**The Monetary Policy Committee is taking its decisions in a data-driven manner and implementing a strong monetary program, which is transparently communicated to the public.** The CBRT's independence is guaranteed by law and should not be regarded as a potential subject of debate. Moreover, one key indicator of central bank independence is the absence of debt monetization and government financing. The CBRT assures that they do not finance the government through debt monetization and has the lowest percentage of government bonds in the balance sheet compared to peer central banks. Therefore, the CBRT disagrees with the statements in the report on central bank independence and the need for institutional reforms.

## **Fiscal Policy**

**The authorities will continue to adhere to fiscal discipline.** A prudent fiscal policy stance has been the strongest pillar of the economy for many years. Despite the proactive fiscal policies implemented by the government in order to mitigate the negative effects of the pandemic, supply chain problems and high energy prices, Türkiye has succeeded to attain its budget targets. Fiscal policy tools were also used to support the most vulnerable segments of society through tax cuts and social transfers. Although the fiscal measures such as tax cuts and increased subsidies were used to complement the monetary policy efforts to tame inflation, the central government deficit to GDP ratio was 2.8 percent in 2021. Similar to the budget execution results of last year, for 2022, this figure is expected to be significantly below the 2023-2025 MTP target of 3.4 percent. Going forward, the authorities do not intend to introduce new tax cuts ahead of the elections. In addition, efforts to restrain expenditure growth as well as to improve the composition of the spending envelope will continue. The target for the central government deficit is 3.5 percent in 2023. The authorities had foreseen the share of interest expenditure at 13.7 percent of the central government budget expenditure in 2022, but it was revised to 10.5 percent in the MTP.

**Debt sustainability is not a source of concern as the general government debt declined to 34.8 percent as of third quarter of 2022,** which is lower than many of its peers (the EU average is around 86 percent). The share of domestic borrowing in foreign currency, which was 30 percent in 2021, decreased to 10 percent as of December 2022. At a time when access to international capital markets became difficult, the authorities reached the financing in the amount of 11 billion dollars (the highest amount among emerging market countries in 2022), which was also the target for 2022. The average maturity of domestic borrowing, which was 53.5 months in 2021, increased to 70.0 months in 2022, thus reducing the refinancing risk. The share of fixed-rate bonds (in terms of TRY) in total domestic borrowing, which was 35 percent in 2021, increased significantly to 60 percent in January-December 2022. The authorities are confident to preserve sustainable levels of debt management going forward.

**The authorities do not envisage high risks from contingent liabilities as the resources allocated in the 2023 budget cover possible costs** associated with state-owned enterprises (SOE), public-private partnerships (PPP), and FX-protected deposit schemes. The government implemented substantial energy subsidies both to support households and curb inflation in 2022. However, fiscal risks have diminished following the decline in global energy prices in late 2022. PPP-related contingent liabilities are closely monitored to

correctly reflect their potential impacts on the budget. Budget transfers for the FX-protected deposit scheme have shown a downward trend each month due to the attained stability in exchange rate.

## **Financial Sector**

**Financial sector risks are limited and well contained although the financial sector has been exposed to various shocks.** In the last year, the authorities have implemented a set of policy tools in an integrated framework to support both price and financial stability. To strengthen the resilience of the financial system and the effectiveness of monetary policy, macroprudential measures have been timely deployed. These measures largely aim to manage credit growth and direct it to priority economic activities that incentivize production capacity, limit dollarization, support healthy price formation in the foreign exchange market, and increase the effectiveness of monetary transmission. These measures not only improve policy predictability, but also help promote efficiency in capital allocation and reduce price volatility to support durable financial development. Despite its multiple objectives, the policy framework still prioritizes price stability. However, in particular the FSSA report misses this perspective in articulating measures addressing financial risks.

**Despite the severe challenges following the pandemic, the banking sector remains resilient, reflecting a strong capital structure, high asset quality, and liquidity buffers.** The authorities noted the concern of staff on forbearance measures. These measures were to limit the undesirable financial effects of the pandemic on households and businesses and are not needed anymore. It is important to note that, even excluding their positive impact, banks' capital ratios are well above the regulatory minima. Profit performance has also supported capital accumulation recently. The non-performing loan ratios (NPL) have declined to historically low levels. Firms and households show strong debt payment performance, which is also observed in the NPL collections. The share of restructured loans in total loans has been on a declining trend at below 6 percent. The majority of these loans have been classified under the stage 2 category and a significant number of provisions have been set aside. There is no forbearance measure that is effective in allowing banks to postpone recognition of loan losses. Banks classify their loans and set aside provisions for them in line with the IFRS-9. Their coverage ratios are well above peer countries' ratios, which is an indication of the banks' prudent provisioning policies.

**The authorities have also taken several steps to deepen the non-bank financial sector and capital markets in recent years.** To increase the share of pension funds in the financial sector, in January 2022, the government contribution to the private pension system was increased to 30 percent from 25 percent of individual contributions and the scope of the system was expanded to cover the population under the age of 18. As a result, 1.1 million new members (an increase of almost 9 percent) were enrolled in the system in the period January-November. There has been a significant increase in the interest in capital markets, especially in the past two years, both from companies and investors. The number of initial public offerings and the number of domestic investors has grown substantially, and the Borsa İstanbul equity market has provided significant growth in both TL and USD terms. Debt markets and institutional investors have also been growing in this period. Apart from the

regulatory efforts, supervision and monitoring is conducted with high efficiency with respect to markets, instruments, and market participants to avoid any market disruption or loss to investors.

**The authorities are committed to addressing the deficiencies in the AML/CFT framework and continue taking steps to implement the Financial Action Task Force (FATF) action plan.** Türkiye's Financial Crimes Investigation Agency (MASAK) maintains its efforts to prevent the laundering proceeds from crime and financing of terrorism. In 2022, almost 20,000 people were analyzed for money laundering and/or associated predicate offences. In addition, the assets of 66 real persons and 14 organizations were frozen within the scope of implementation of United Nations Security Council Resolution (UNSCR) no 1373(2001) on targeted financial sanctions for financing of terrorism. All steps are taken decisively to implement the FATF recommendations and to end the grey list process. In October, FATF already declared that Türkiye has taken additional and positive steps in this direction and the authorities applied for a re-rating in relation to 6 FATF recommendations, including Recommendation 12 which is about Politically Exposed Persons (PEPs) and Recommendation 15 on New Technologies, in December 2022. In advance of the application, MASAK designated Crypto Asset Service Providers as obliged parties thanks to an amendment to the Regulation on Measures in May 2021. Moreover, in November 2022 MASAK issued a General Communiqué No 21 on enhanced due diligence measures related to PEPs. The authorities believe that these will help Türkiye to upgrade the level of compliance with the FATF Recommendations 12 and 15. Moreover, the authorities also concur with staff on integrating crypto assets into the supervisory framework and the Capital Markets Board (CMB) is working on a new legislation for crypto assets.

### **Structural Reforms**

**Türkiye Economy Model, prioritizes investment, employment, production, and exports and is based on structural reforms to achieve sustainable and inclusive growth.** To improve the business environment and investor confidence, several amendments in wide-ranging areas have been made recently, including in the areas of rule of law, labor markets, education, and climate change. Under the implementation process of the Judicial Reform Strategy and the Human Rights Action Plan, legislation packages on a variety of issues have entered into force recently. These activities range from strengthening the independence of the judiciary to taking technical measures to expedite judicial proceedings.

**The authorities welcome the fiscal policy suggestions provided by staff on the labor market gender gap.** They also stress that the opening and closing regulation has been amended to reduce the minimum required enrollment number for establishing a new early-school education center, from 10 to 5 in rural areas. In addition, the physical infrastructure capacity has been increased and new teachers have been hired to raise the early-school education enrollment rate and thus support women's employment.

**Türkiye sets an inclusive, resilient, and sustainable course making rapid progress in green transformation policies in order to achieve a low-carbon, resource-efficient and competitive economy.** Ratification of the Paris Agreement, net zero emission target by 2053,

doubling the emission reduction target by 2030 and holistic measures to achieve these targets show Türkiye's determination towards a low carbon economy. Renewable energy investments have taken an important place in Türkiye's energy policies for many years. Thanks to the incentives provided, significant increases have been achieved in renewable installed power capacity and its share in electricity generation. On the other hand, green transformation in industry has been vital for all countries. Türkiye provides significant support and gives priority to scientific and technological projects to accelerate green transformation in manufacturing. For instance, thermal insulation loans with long-term and favorable terms are provided in order to improve energy efficiency in the construction sector.

### **Final Remarks**

The Turkish authorities are grateful for the Article IV and FSSA consultations and associated policy advice, to which they are paying careful attention. The authorities will continue to work closely with the Fund.