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January 13, 2023

**Statement by Ms. Marcussen and Ms. Allika on Turkey
(Preliminary)
Executive Board Meeting
January 18, 2023**

We thank Staff for insightful reports in the context of Türkiye's Article IV consultation and Financial Stability Assessment Program (FSAP). We also thank Mr. Mert and Mr. Akben for their informative Buff statement. **We broadly agree with staff's appraisal and offer the following comments for emphasis.**

While the economy recovered strongly from the COVID-19-crisis, excessively loose monetary policy and spillovers from Russia's war in Ukraine exacerbated pre-existing vulnerabilities contributing to record high inflation in Türkiye last year. Widened external imbalances is a major vulnerability in a situation of increased uncertainty and low international reserve buffers. We appreciate staff's candid assessment of the authorities' TEM model and their clear recommendation for a pivot in the overall policy approach. We agree with staff that **switching from demand-driven to a productivity-led growth model is urgently needed** to ensure strong and sustainable growth increasing the economy's resilience to shocks. Given Türkiye's very high dependence on imported gas and oil with a high share coming from Russia, the economy is very exposed to energy supply disruptions and price volatilities. *Could staff comment on contingency measures in this regard and the impact from the additional natural gas reserves recently discovered in the Black Sea.*

It is essential to deliver a tight fiscal stance, while providing targeted support to the most vulnerable. We welcome that the authorities are committed to fiscal discipline, but more efforts are needed to enhance fiscal governance reforms improving transparency and containing fiscal risks especially related with SOEs, PPPs and FX-protected deposit schemes. We concur with staff that costly and inefficient energy subsidies should be gradually phased out, supporting vulnerable households with better-targeted measures. This would help contain domestic demand and preserve fiscal space to deal with future shocks.

Prompt monetary policy tightening is needed to reduce inflation durably and lower external financing risks. While the slowdown in credit growth is welcome, we concur with staff that macrofinancial and regulatory measures have been distortionary and are no substitute for

necessary interest rate hikes. It is important to restore a credible commitment to the central bank's price stability target with policy rates as the main monetary policy instrument. Going forward it is also essential to continue rebuilding FX reserves and use FX interventions only to tackle extreme cases of exchange rate volatility. We are concerned that the central bank remains under significant pressure and its independence needs to be strengthened.

To safeguard financial stability, prudential standards should be strengthened and systemic FX liquidity risks closely monitored. As recommended by the 2022 FSAP, we concur that complex macrofinancial and regulatory measures need to be carefully phased out. More efforts are needed to deal with crypto and AML/CFT risks. In this regard we welcome the authorities' high-level commitment to strengthen the effectiveness of the AML/CFT framework and we encourage the authorities to fully implement the FATF action plan addressing the grey listing. We positively note that the authorities are seeking Fund CD to strengthen their climate stress testing methodologies.

Structural reforms are key to unlock the economy's full potential and increase resilience to shocks. We positively note that the 2022 Article IV consultation focused on female labor force participation and climate change which are macro-critical structural issues for Türkiye. We particularly appreciate staff's detailed analysis and advice in the Selected Issues Paper. Despite improvements achieved in recent years, Türkiye's low female labor force participation and high share of informal female workers still stand out internationally, lowering potential GDP by about 25 percent. We welcome the authorities' efforts to develop a gender budgeting framework and encourage them to continue their work, focusing on the policy priorities to reduce labor market gender gaps recommended by staff. *Is staff planning to assist the authorities in this area including on suggested future analytical work to help inform policy design and trade-offs?*

Since Türkiye faces high climate risks and vulnerabilities it is essential to strengthen the economy's resilience to climate change and facilitate the transition to a low-carbon economy by reducing high dependency on fossil fuels. As it has been concluded by the recent WB Country Climate and Development Report (CCDR), Türkiye could reap \$146 billion in savings over 20 years if it takes effective and appropriate actions to boost resilience and adaptation against the impact of climate change and to mitigate economy-wide emissions. In this regard we welcome that the authorities announced more ambitious emission reduction targets at COP27. To achieve these targets, a mitigation strategy based on a progressively increasing carbon price would be efficient. We encourage the authorities to continue efforts to design a long-term strategy that is integrated into development and economic plans and policies as suggested by the CCDR.