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January 13, 2023

**Statement by Mr. Mizuguchi, Ms. Kashima, and Ms. Fukuda on Turkey
(Preliminary)
Executive Board Meeting
January 18, 2023**

We thank staff for the informative report and Mr. Mert and Mr. Akben for their helpful Buff statement.

While the economy has continued to grow on the back of significant demand stimulus, mounting macro-economic vulnerabilities are seriously concerning. We see the policies under the new TEM to have been running counter to the objective of ‘liralization’ and eroding the medium-term economic stability in return for near-term growth. The social implications are also problematic as high inflation has unproportionally affected the vulnerable. In order to achieve sustainable and inclusive growth in the medium-term to its maximum potential of the Turkish economy, we support staff’s recommendation that a policy pivot to policy tightening with supply side reforms is warranted.

Decisive monetary tightening needs to be pursued before high inflation gets entrenched. We note with concern that the sustained excessively loose monetary policy, in addition to other external factors, has been accelerating Türkiye’s high inflation through acute lira depreciation. This is also resulting in deepening the economy’s de-lirarization. We support the staff view that macro-financial and regulatory measures cannot replace tight monetary policy to bring inflation down. We strongly encourage the CBRT to start prompt and sizeable rate hikes in a data-dependent manner with clear communication and strong commitment to price stability. The CBRT should also consider rebuilding the ‘core’ FX reserves when the conditions allow. These policy shifts should be in parallel with measures to re-enhance the CBRT’s governance and independence.

Fiscal policy should be consistent with the primary purpose of disinflation. It is advised to preserve fiscal space as much as feasible to contain domestic demand and to build up buffers for future adverse shocks. We encourage the authorities to gradually shift away from high energy subsidies to more cost-effective support measures targeted to vulnerable households. Fiscal risks stemming from FX-protected deposit schemes warrant close attention, and the authorities should consider phasing out when the circumstances stabilize.

We are interested in the staff assessment of adequacy of the budget allocation for possible contingent liabilities arising from the schemes. Staff comments are welcome. While acknowledging the authorities' progress in enhancing fiscal governance, especially on PPPs and SOEs, further transparency efforts are highly recommended to facilitate monitoring and assessment of quasi-fiscal risks.

We encourage the authorities to gradually reduce the role of the state in credit allocation. While positively noting the recent slowdown of credit growth, we are concerned that potential risks mounting in the financial sector could be blurred due to the complex macro-financial and regulatory measures. Phasing out these policy measure could also facilitate more efficient resource allocation in the economy through the provision of bank credit on a fully commercial basis. We encourage the authorities to steadfastly implement the 2022 FSAP recommendations, and above all, strengthening monitoring of systemic FX liquidity risks backed by sound operational autonomy of the relevant agencies. We share the staff advice to bolster financial supervision of crypto assets and to put further efforts on implementing the FATF action plan in order to urgently exit the grey list.

On top of pursuing macro-economic stability, the authorities should increase their focus on boosting productivity. The three reform priority areas of improving the business and regulatory environment, labor market flexibility and the quality of human capital identified in the 2019 Article IV consultation remain critical. As for the gender gap in the labor market, we welcome the current collaboration with UN-Women on gender budgeting and we agree with the other policy priorities to encourage female labor participation and facilitating a shift to the formal sector. We positively note the completion of the CCDR last year and expect the report to feed into Türkiye's climate agenda going forward.