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January 13, 2023

**Statement by Mr. Chodos and Ms. Bustillo on Turkey
(Preliminary)
Executive Board Meeting
January 18, 2023**

We thank staff for their insightful set of reports and Mr. Mert and Mr. Akben for their informative Buff statement.

After a remarkable recovery from the pandemic, whereby the economy grew more than 11 percent in 2021, external shocks and domestic policy challenges have shaped a complex economic scenario. As assessed by staff, risks have increased and inflation, while expected to decline, will remain much higher than the target. In this context, reigning in macro-financial vulnerabilities and continuing structural reforms are critical to achieve sustainable and inclusive growth.

Strong commitment to a firm monetary policy is necessary to bring inflation down to target. Considering the country's chronic high inflation, a tight monetary stance is critical in order to lower price pressures and anchor inflation expectations. We echo staff's concerns on inflation risks becoming entrenched and thus welcome the Central Bank of the Republic of Türkiye (CBRT) ending the easing cycle in November. Forward guidance and clear communication would help reinforce policy credibility. We note the divergence of views between the central bank and staff on the merits of interest rate increases as a demand management tool and on the need for institutional reforms and thus encourage continued efforts to find common ground.

We commend the authorities for their longstanding commitment to fiscal discipline. Despite proactive fiscal policies, including support to the most vulnerable, budget targets have been attained. Going forward, we concur with staff on the need to preserve fiscal space to deal with future shocks. In this regard, we positively note, as mentioned in the Buff

statement, that the authorities will continue with a prudent stance and efforts to restrain spending and improve its composition. We acknowledge that the decline in global energy prices in late 2022 have diminished budget pressures. At the same time, the deployment of medium-term consolidation measures based on efforts to improve the progressivity and collection of taxes, rationalize VAT exemptions, strengthen spending efficiency, and streamline subsidies would strengthen the fiscal position. In this connect, we welcome the authorities' ongoing efforts to improve the monitoring and managing of SOEs and PPPs. Finally, we agree that debt management should be strengthened by lengthening borrowing maturities and lowering reliance on domestic FX by borrowing through more durable means.

On the financial sector, an extensive array of macroprudential measures were deployed to strengthen its resilience and effectiveness of monetary policy. Staff assesses that the measures have achieved some of their intended objectives, including slowing credit growth and reducing dollarization of deposits but have introduced inefficiencies. We thus highlight the need for vigilance on the health of the financial system and concur that the sequencing and modalities of unwinding this complex regulatory framework would merit careful consideration. Moreover, efforts to enhance the resilience and soundness of the financial sector should continue. To this end, we encourage the authorities to consider the recommendations of the Financial Sector Assessment Program and strengthen regulatory, supervisory, resolution, and AML/CFT frameworks.

Accelerating reforms remains essential to improve resilience and achieve inclusive and sustainable growth. We encourage the authorities to boost growth through higher productivity, increased investment and greater labor force participation. Recent amendments, including in the areas of rule of law, labor markets, and education to improve the business environment are welcome. Likewise, we positively note the improvements in female labor force participation and important steps taken to improve gender outcomes, including gender-equality initiatives. Moreover, we welcome the ongoing rapid green transformation and efforts towards achieving a low-carbon, resource-efficient and competitive economy. In this regard, we welcome that the first domestically developed electric car will be mass-produced this year, as noted in the Buff statement.