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Joint Statement by Mr. Bijani, Mr. Alhosani, Ms. Vumendlini, Mr. Abdullahi, Mr. Al-Kohlany, and Mr. Boostani on Turkey
(Preliminary)
Executive Board Meeting
January 18, 2023

We thank staff for the well-written set of papers and Mr. Mert and Mr. Akben for their insightful Buff statement. We commend the authorities for their swift response to the pandemic, saving lives and supporting livelihoods, and contributing to Türkiye recording one of the strongest recoveries among the emerging market economies. Although the growth momentum is expected to continue, we acknowledge the recent economic challenges and limitations of a demand-driven growth model. That said, we note the staff assessment that the current policy mix has exacerbated the pre-existing vulnerabilities and presented significant risks to macro-financial stability. **We broadly concur with the thrust of the staff appraisal** and offer the following points for emphasis.

We note the marked divergence between the authorities' and staff's views. This divergence is stemming from the different assessments of the Türkiye Economic Model (TEM) that relies on low-cost credit supply to selected sectors. We also note that there is no consensus between staff and the authorities on the medium-term forecasts of key macroeconomic variables with the authorities being far more optimistic than staff. *We would appreciate staff comments on the factors that account for the higher growth forecasted by the authorities.*

Monetary policy should be geared towards preserving price stability. We positively note that inflation is expected to drop markedly this year, but both the authorities and staff agree that inflation may remain higher than the target, at least over the medium term. *Could staff elaborate on the divergence between its inflation projections with those of the authorities'? Has the inflation target remained as the nominal anchor for monetary policy under the TEM? If not, what is the new anchor?* The authorities' decision not to cut the policy rate further is highly welcome. We tend to agree with staff that an independent central bank could bring the inflation down to the target, which is more aligned with the "liraization" strategy. A tighter monetary stance, relying on higher policy rates, will alleviate inflation by reigning in domestic demand and preserving the value of the local currency; moreover, it will help the central bank to rebuild its foreign reserves.

A tight Fiscal policy would be most helpful in supporting monetary policy to harness aggregate demand more effectively and alleviate inflationary pressure. We commend the authorities for their long standing prudent fiscal management and encourage them to be vigilant for potential fiscal risks associated with contingent liabilities. That said, the authorities should employ current fiscal buffers to provide targeted and temporary support to vulnerable households to protect them during the cost-of-living crisis. Moreover, to mitigate the risks of contingent liabilities, comprising the FX-deposit scheme and energy subsidies, fiscal buffers should be rebuilt through frontloaded consolidation measures.

Addressing vulnerabilities in line with the Financial System Stability Assessment (FSSA) findings is warranted to safeguard financial stability. The banking system firmly withstood the pandemic and continuously supplied credit to the economy. This sector is at the center of the new TEM that relies on channeling credit to selected sectors by implementing a complex set of macro-financial and regulatory measures. *Could staff explain the credit allocation mechanism in the new TEM?* We concur that over reliance on regulations can further distort capital allocation and increase banks' operational risks and urge the central bank to gradually unwind the macro-financial and regulatory measures. *Have the authorities declared a timeframe for ending these measures?* Commodity price increases, in addition to the pandemic, exacerbated the pre-existing vulnerabilities, including FX liquidity risks and FX mismatches, in the system. Going forward, the authorities should enhance transparency by unwinding the supportive measures from the pandemic period and gradually implementing the regulatory measures according to international standards. We welcome the authorities' intention to implement an effective regulatory framework for crypto assets.

Advancing structural reforms in support of the supply side of the economy is paramount to preserving sustainable and inclusive growth. These reforms should improve the business environment, encourage investment and strengthen the labor market, including by increasing female participation. Capital inflows can be directed to finance investment in infrastructure and physical capital, while associated volatility can be effectively managed by building buffers and implementing CFM-MPM measures. *Staff's comments are welcome.* Climate adaptation measures could be part of a new growth strategy, which bolsters job creation in new sectors, heightens investment in new technology, and retains green and sustainable growth.

We wish the Türkiye's authorities and people all the success in their future endeavors.