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**Statement by Mr. Lushin and Mr. Palei on Turkey
(Preliminary)
Executive Board Meeting
November 20, 2013**

1. Despite high output in Turkey, country's economic performance is impressive, particularly in light of large and persistent external shocks from the euro area crisis, a complex situation in the MENA region, and high energy prices. The monetary policy framework with the authorities' strong commitment to flexible exchange rate serves as a shock absorber. Public debt is low and the desirable fiscal consolidation appears to be manageable under a variety of scenarios. Households, the corporate sector and banks also have very strong balance sheets with limited exposure to foreign exchange and liquidity risks. The Turkish authorities consistently pay close attention to the banking sector, which is well-capitalized and resilient to severe stress tests. In order to mitigate external risks, the authorities have substantially increased gross foreign exchange reserves through innovative mechanisms. Overall, the Turkish economy exhibits strong fundamentals.
2. At the same time, we welcome the ongoing frank and comprehensive policy discussions between the authorities and staff, as the global economic and financial environment continues to pose challenges and there is substantial uncertainty with respect to domestic vulnerabilities in Turkey. We are pleased to note that the quality of Fund's surveillance in Turkey is high, as staff strive to support their policy recommendations with well-focused analytical work and useful cross-country comparisons. Many substantial disagreements between the Turkish authorities and staff, in our opinion, should be attributed to the genuine complexity of the economic and financial situation in Turkey.
3. Relatively large current account deficits certainly call for caution and close monitoring for the signs of further deterioration or improvements. While staff find a relatively large deviation from the current account norm and a pronounced exchange rate misalignment, the authorities disagree with much of this analysis. Staff themselves admit the EBA analysis is of limited use in Turkey, similar to the situation in many other emerging market and developing countries.

4. It would be a grave mistake to ignore possible vulnerabilities associated with large current account deficits, as the global financial crisis had already provided ample evidence of the huge risks involved in such circumstances. Still, we believe that large and persistent capital flows into economies with strong growth prospects and a predictable policy environment could be sufficiently robust. In Europe, the experience of the Baltic states, which recovered from the crisis rapidly and strongly, offers a lot of food for thought. Hence, we are prepared to be less categorical than staff in the diagnosis of external vulnerabilities in Turkey and give the authorities more benefit of the doubt. Admittedly, Turkey's net asset position has deteriorated, but it still is close to - 50 percent of GDP, well below that in many countries affected by severe balance of payments pressures. As stated in Box 8 and a special chapter in the Selected Issues paper, market shares in traditional export markets point to strong competitiveness of the Turkish exports, and the evidence of successful diversifications provides further comfort in the prospects for export growth. We are also sympathetic to the authorities' argument about the cyclical underperformance of exports. Even under very stressful conditions the rollover rates for external financing remain high, providing further evidence in investors' confidence in the Turkish economy.

5. However, it is better to be safe than sorry, and, from this point of view, we encourage the Turkish authorities to further accumulate foreign exchange reserves and to put more efforts into arranging ample contingent external financing, similar to what is being done by the authorities in other EMDCs.

6. We agree with the authorities and staff that savings in the Turkish economy are low, and that it would be very desirable to increase them. More ambitious and frontloaded fiscal consolidation, as staff proposed in the report, is one sufficiently reliable way to achieve this goal, and we support staff's recommendations in this area. A private pension reform may also contribute to the improvements in this area. However, from our point of view, even more aggressive moves could be considered. For example, the authorities could explore the possible benefits of a higher mandatory savings scheme, as it was done in several other countries.

7. In the monetary area, we note the differences in views on the costs and benefits of the authorities' less orthodox approach to policy implementation. It is true that, for an extended period of time, inflation in Turkey remained higher than the official target. However, if we are not mistaken, similar performance of inflation targeting could be detected in other EMDCs. We ask staff to compare Turkey's performance with the developments in its peers. Staff's criticism of the CBTR having multiple goals and many instruments may be fair, as their call for more clarity in the monetary authorities' communication policy. Yet, many EMDCs' central banks are currently searching for an appropriate balance between their traditional focus on low and stable inflation and the need to assure financial stability. They are also experimenting with a variety of macro- and micro-prudential tools, the effectiveness of which remains to be tested. In any case, similar to the CBTR, we appreciate the

challenges related to volatile, powerful and unpredictable capital flows driven by the developments in global liquidity.

With these remarks, we wish the Turkish authorities success in their endeavors.