INTERNATIONAL MONETARY FUND

IMF Country Report No. 23/303

REPUBLIC OF TÜRKİYE

2022 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

January 2023

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2022 Article IV consultation with the Republic of Türkiye, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its January 18, 2023 consideration of the staff report that concluded the Article IV consultation with the Republic of Türkiye.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 18, 2023, following discussions that ended October 26, 2022, with the officials of the Republic of Türkiye on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 21, 2022.
- An **Informational Annex** prepared by the IMF staff.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

On January 18, 2023, the IMF Executive Board Concluded the 2022 Article IV Consultation with the Republic of Türkiye

Washington, DC – August 18, 2023: On January 18, 2023, the Executive Board of the International Monetary Fund concluded the 2022 Article IV Consultation with the Republic of Türkiye.[1] This press release summarizes the views of the Executive Board as expressed during its January 18, 2023 consideration of the 2022 Article IV and the 2022 Financial System Stability Assessment staff reports.

Türkiye made impressive economic gains over the past two decades. In the early 2000s, broad-based macroeconomic and structural reforms supported income catch-up towards advanced economies, poverty reduction, and marked disinflation. This moved Türkiye firmly into the upper middle-income bracket, while lifting nearly 30 percent of the population out of poverty. In recent years, however, as reforms waned, productivity gains slowed, and growth became increasingly dependent on externally-funded credit and demand stimulus. The newly-adopted Türkiye Economic Model—comprising low interest rates as well as a complex set of regulatory measures to direct credit to selected sectors and promote greater use of the lira in the economy—has exacerbated vulnerabilities.

Driven by the lagged effects of an outsized credit impulse in 2020, the relaxation of mobility restrictions, and robust external demand, Türkiye's output rebounded by more than 11 percent in 2021—a much stronger recovery from the pandemic than in most countries—and robust growth carried over into the first half of 2022. GDP is now significantly above its pre-pandemic trend and the rates of unemployment and labor force participation have more than fully recovered.

Despite strong growth and inflation four times above target, policy rates were cut aggressively in late 2021, leading to significant pressure on the lira, which was relieved only through large foreign exchange intervention and the introduction of an FX-protected deposit scheme. These moves were followed by an increasingly distortionary and complex set of macrofinancial measures to encourage the holding of lira assets. Inflation has accelerated sharply, reaching a 24-year high of 85 percent in October, among the highest in large EMs. External imbalances have widened, aggravated by the war in Ukraine, and reserve buffers remain low, despite increasing somewhat in recent months. Public debt declined to under 40 percent of GDP, but spending pressures and fiscal risks, including from contingent liabilities from Turkish Lira FX-protected deposits and exposure of public debt to FX shocks, are rising. Financial risks are also high and rising owing, among other things, to a strong FX liquidity nexus between the central bank and the banks, while the recent credit slowdown is driven by increasingly distortionary measures. Non-financial corporations showed resilience through the pandemic, but leverage and FX mismatches remain large.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Reflecting lower growth carryover, weaker external demand, especially in Europe, binding external financing constraints, and squeezed real incomes, growth is expected to decline to 3 percent in 2023 from about 5.5 percent this year. Inflation is expected to fall to about 70 percent by end-2022, and to fall further, to 36 percent, by end-2023—driven by fading exchange rate passthrough, favorable base effects, and expected lower commodity price pressures. But inflation is expected to remain much higher than the target and than in peer countries, given loose policies, inflation inertia, and un-anchored inflation expectations. Near-term growth may surprise on the upside, as unexpected sources of external financing could allow the continuation of pro-growth policies and a wider current account deficit, but, overall, risks are skewed to the downside and, with limited buffers, vulnerabilities remain acute. On the domestic front, doubling down on pro-growth policies without enough external financing could weigh on confidence and fuel pressures on the lira, hurting bank and corporate balance sheets, with spillovers to the public sector. Meanwhile, external risks have also intensified, including from larger- or faster-than-expected tightening by advanced market central banks, escalating geopolitical tensions, higher commodity prices, higher global risk aversion, and weaker global growth.

Türkiye's FSSA found that financial stability risks are high and growing. In particular, FX liquidity risks have risen given the tightening bank-central bank nexus and scarce readily available central bank FX reserves. Also, banks could face capital adequacy pressure should rapid credit growth resume, and uncertainty over banks' asset quality and capital adequacy remains. The authorities' idiosyncratic macrofinancial policy mix has introduced distortions in financial price formation, with some measures working at cross purposes or diverging from international standards. Operational autonomy has been eroded in key agencies, while policy and resource pressures have resulted in banking supervisory practices and a regulatory framework that require critical enhancement. Several gaps in the crisis management framework identified in the last FSAP remain.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They commended Türkiye for its remarkable recovery from the pandemic, noting the contribution of stimulative policies and a dynamic private sector. However, the policies that buoyed growth also exacerbated vulnerabilities. Directors noted that the policy rate cuts in late 2021 led to significant pressure on the lira, and measures to relieve those pressures, while helping, did not address the root causes of Türkiye's economic problems, with the lira remaining under pressure for much of 2022, inflation reaching multi-year highs, and core reserves remaining deeply negative. The spillovers from Russia's invasion of Ukraine also exacerbated Türkiye's external imbalances and added to inflation pressures.

With high inflation at risk of becoming entrenched, Directors stressed that prompt and sizable interest rate hikes are needed, complemented with steps to strengthen central bank independence. They also emphasized the importance of carefully phasing out regulatory

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

measures, allowing the policy interest rate to act as the primary monetary policy instrument. Directors welcomed the authorities' aim to replenish international reserves as conditions allow.

Directors acknowledged that Türkiye's public debt burden remains low and commended the authorities' commitment to fiscal discipline. Nonetheless, Directors cautioned against rising fiscal risks from growing spending pressures and contingent liabilities, including from FX-protected schemes. They recommended maintaining a tight fiscal stance to preserve buffers and contain domestic demand, while focusing on targeted measures to support the most vulnerable. Directors welcomed the authorities' progress in enhancing fiscal governance but encouraged further steps to increase transparency and strengthen debt management more durably.

In the financial sector, Directors underscored the importance of phasing out regulatory measures to minimize distortions to price formation and capital allocation, while reducing the role of the state in credit provision. They shared the emphasis on strengthening prudential standards and encouraged reversing regulatory forbearance measures to improve asset quality and capital adequacy transparency. Directors recommended integrating crypto assets into the supervisory framework, while taking any further required steps to fully implement the FATF action plans. Directors also broadly supported recommendations in the FSSA, in particular, the importance of increasing attention to FX liquidity monitoring and contingency planning. They underscored the need to strengthen banking supervision, including by adequately resourcing supervision activities. Directors also encouraged reforming the emergency liquidity assistance framework and strengthening the crisis management framework.

Directors called for targeted structural reforms to foster stronger sustainable growth and increase the economy's resilience to shocks. They welcomed the focus of the consultation on female labor force participation and climate change. Improving the business and regulatory environment, labor market flexibility, and the quality of human capital will be important, as well as closing labor market gender gaps. A comprehensive strategy would help meet Türkiye's climate goals.

Background: IMF Executive Board Concluded the 2022 Article IV Consultation with Türkiye on January 18, 2023.

Table 1. Türkiye: Selected Economic Indicators, 2021–27

Population (2021): 84.7 million
Per capita GDP (2021): US$9,654
Quota: SDR 4,658.6 million

	2021	2022	2023	2024	2025	2026	2027
		Proj.					
Real sector				(Percent)			
Real GDP growth rate	11.4	5.5	3.0	3.0	3.0	3.0	3.0
Contributions to real GDP growth							
Private consumption	8.7	8.4	2.0	2.0	2.1	2.1	2.0
Public consumption	0.4	0.4	1.6	0.4	0.4	0.4	0.5
Investment (incl. inventories)	-4.1	-4.8	0.9	0.2	0.5	0.5	0.6
Net exports	6.4	1.5	-1.4	0.3	0.1	-0.1	-0.1
Output gap	1.5	2.2	1.7	1.2	0.6	0.1	0.0
GDP deflator growth rate	29.0	83.3	51.7	24.1	19.3	18.5	18.2
Inflation (period-average)	19.6	72.1	50.6	24.0	20.2	20.0	20.0
Inflation (end-year)	36.1	70.0	36.0	21.3	20.0	20.0	20.0
Unemployment rate	12.0	10.8	10.5	10.5	10.5	10.5	10.5
				(Percent of GDP)			
Fiscal sector							
Nonfinancial public sector overall balance	-2.5	-4.4	-5.3	-5.0	-4.9	-4.8	-5.0
General government overall balance (headline) 1/	-2.6	-3.9	-4.7	-4.5	-4.5	-4.4	-4.6
General government gross debt (EU definition)	41.8	35.6	35.4	36.6	38.4	39.8	39.6
External sector							
Current account balance	-0.9	-6.0	-3.4	-2.5	-2.2	-2.2	-2.2
Gross external debt	54.8	57.8	48.6	47.7	46.9	46.1	45.6
Gross financing requirement	21.2	26.2	24.7	23.4	23.2	23.4	23.3

Sources: Turkish authorities; and IMF staff estimates and projections.
1/ Headline (or authorities' definition), which includes items excluded from the IMF 'program' definition.

INTERNATIONAL MONETARY FUND

REPUBLIC OF TÜRKİYE

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION

December 21, 2022

KEY ISSUES

Context. Türkiye's recovery from the pandemic has been remarkable and reflects outsized stimulative policies and a dynamic private sector. But the same policies that buoyed growth also exacerbated vulnerabilities by lowering reserve buffers and increasing dollarization. A new policy model, introduced in the Fall of 2021, aims at further supporting growth and at lowering inflation by eliminating Türkiye's current account deficit. The model relies on low interest rates and on measures to reduce dollarization, financial volatility, and overall credit growth, while directing lending to selected sectors. Successive policy rate cuts led to a run on the lira in December 2021, which was only relieved by large FX intervention and a new FX-protected deposit scheme. Since then, increasingly distortionary and complex macrofinancial and regulatory measures have been put in place to limit the lira decline. Meanwhile, inflation reached multi-decade highs, at 85 percent in October 2022. While Türkiye's public debt burden is low compared to peers, fiscal risks have grown—notably from quasi-fiscal operations, contingent liabilities, and the exposure of public debt to FX shocks—and spending is expected to rise ahead of the upcoming elections. Spillovers from Russia's war in Ukraine have added to Türkiye's economic strains and have exacerbated external vulnerabilities, notably through a wider current account deficit.

Outlook. Growth is expected to fall and inflation to remain high—and much higher than in peer countries—in 2023. Although near-term upside risks to growth are non-negligible, medium-term downside risks have increased because of rising economic distortions and vulnerabilities. Near-term risks to inflation are on the upside.

Policies. While risks and vulnerabilities have increased, and buffers have fallen further, Türkiye's challenges are not insurmountable. Addressing them requires a policy shift that should include:

- First and foremost, prompt, sizeable, and credible policy rate hikes combined with moves to strengthen central bank independence, as well as transparent and predictable reserve accumulation as conditions allow;

- Close monitoring of systemic FX liquidity risks, careful unwinding of the distortionary and complex set of regulatory measures, strengthening of prudential standards and phasing out of regulatory forbearance;

- Tight fiscal policy combined with targeted assistance to the most vulnerable and fiscal governance reforms to limit quasi-fiscal risks; and

- Targeted structural policies to promote more inclusive and sustainable growth through higher productivity and labor force participation, and through well-targeted investment.

Approved By
Laura Papi (EUR) and Maria Gonzalez (SPR)

Discussions took place in Istanbul and Ankara during October 14–26, 2022. The team consisted of Messrs. McGettigan (Head), Guzzo, Pienkowski and Ms. Domit (all EUR), Mr. Di Vittorio (SPR), Ms. Hong (FAD), Mr. Piontek (MCM), and Messrs. Sadikov, Çeçen and Ms. Kesimal (Senior Resident Representative Office). Ms. Fernando (LEG), Mr. Nelmes (MCM), and Mr. Parry and Ms. Zhunussova (both FAD), and Messrs. Azal and Akben (OED) also participated in the mission. The mission met with Deputy Minister of Treasury and Finance Zaman, Deputy Central Bank Governor Duman, other senior officials, and private sector representatives. Mses. Kumar, Lee, and Mengüç assisted with the mission and with the preparation of the staff report.

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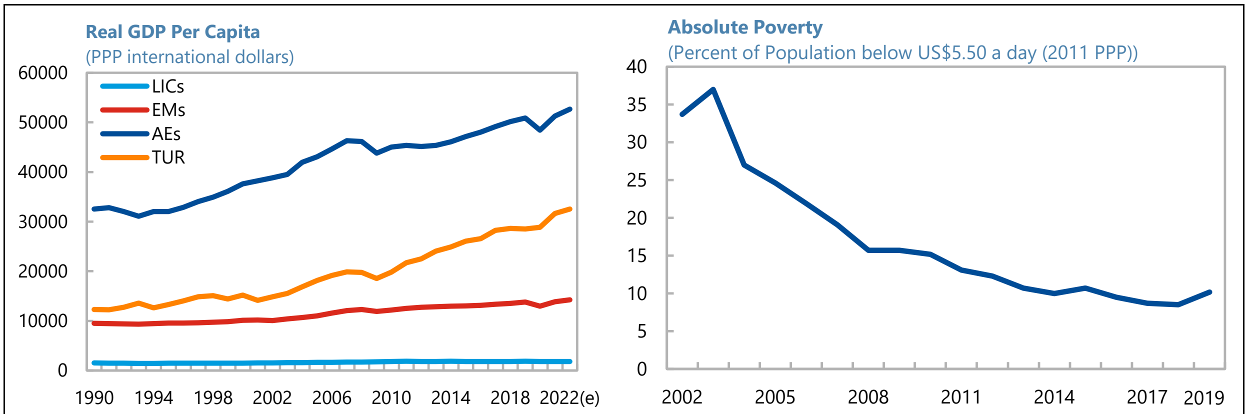
CONTEXT—A NEW ECONOMIC MODEL

1. Türkiye made impressive economic gains over the past two decades. In the early 2000s, broad-based macroeconomic and structural reforms supported income catch-up towards advanced economies, poverty reduction, and marked disinflation, following decades of inflation around 70–80 percent. This moved Türkiye firmly into the upper middle-income bracket, while lifting many households out of poverty.

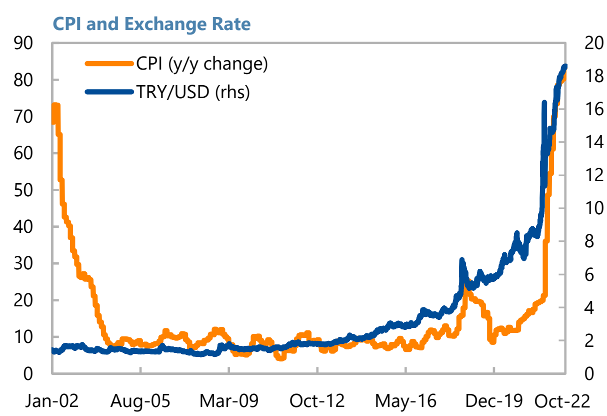


Sources: IMF World Economic Outlook and IMF staff calculations.

Source: World Bank.

2. In recent years, including through the pandemic, Türkiye's growth model increasingly relied on demand stimulus, exacerbating vulnerabilities. As reforms waned, productivity gains slowed and growth became increasingly dependent on externally-funded credit and demand stimulus. Progress on reducing poverty also stalled (Figure 1). As a result of outsized stimulative monetary policy and rapid credit expansion, Türkiye was among the few countries to record positive growth in 2020 and, unlike most peers, its output gap closed rapidly following the pandemic. But the same policies that buoyed growth also exacerbated already-large vulnerabilities, notably in the form of low and falling reserves and increased dollarization.

3. The new Türkiye Economic Model (TEM), adopted in late 2021, introduced a new policy approach. The TEM identified Türkiye's current account deficit—and the resulting dependence on capital flows needed to finance it—as a major impediment to sustainable growth and low inflation. The model comprises low interest rates as well as a complex set of regulatory measures to direct credit to selected sectors (notably exporters) and to promote greater use of the lira in the economy—the "liraization" strategy. The TEM policies instead led to significant market pressure on the lira in late 2021. This was followed by the war in Ukraine, which added to pre-existing vulnerabilities.



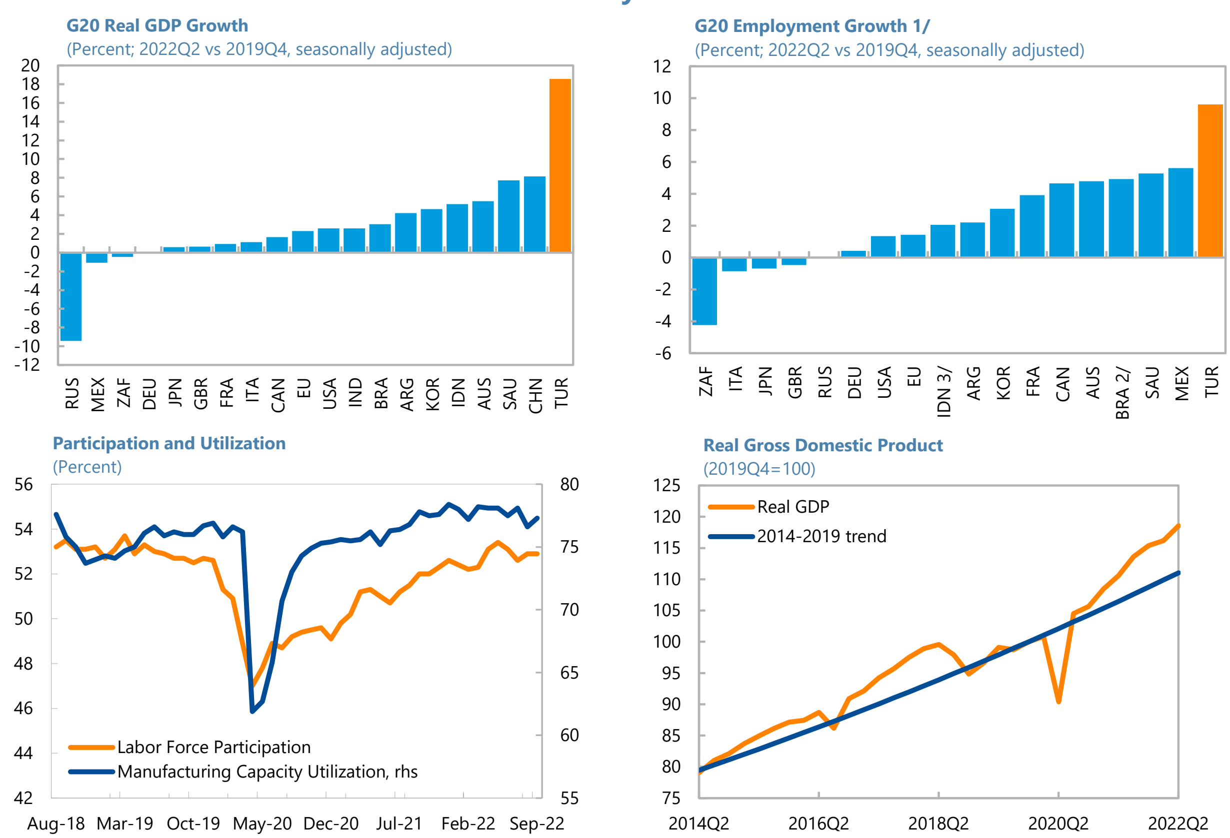
Sources: Bloomberg Finance L.P. and CBRT.

4. The authorities have since doubled down on TEM policies. As growth started to slow, interest rates were cut further in the second half of 2022, in contrast with the ongoing global tightening cycle, while the set of macrofinancial and regulatory measures has grown in size and complexity.

RECENT DEVELOPMENTS—RECOVERY, INFLATION, AND RISING GLOBAL TENSIONS

5. Türkiye's recovery from the pandemic has been remarkable. Driven by the lagged effects of an outsized credit impulse in 2020, the relaxation of mobility restrictions, and robust external demand, output rebounded by more than 11 percent in 2021—a much stronger recovery than in most countries. This growth momentum carried over into the first half of 2022, driven mainly by strong consumption and net exports. As a result, the output gap turned positive in 2021 and has since widened, while capacity utilization and the rates of unemployment and labor force participation have more than fully recovered (including in the most affected segments of the population, notably among female and young workers). And, unlike in most countries, GDP is significantly above its pre-pandemic trend.

Remarkable Recovery from the Pandemic

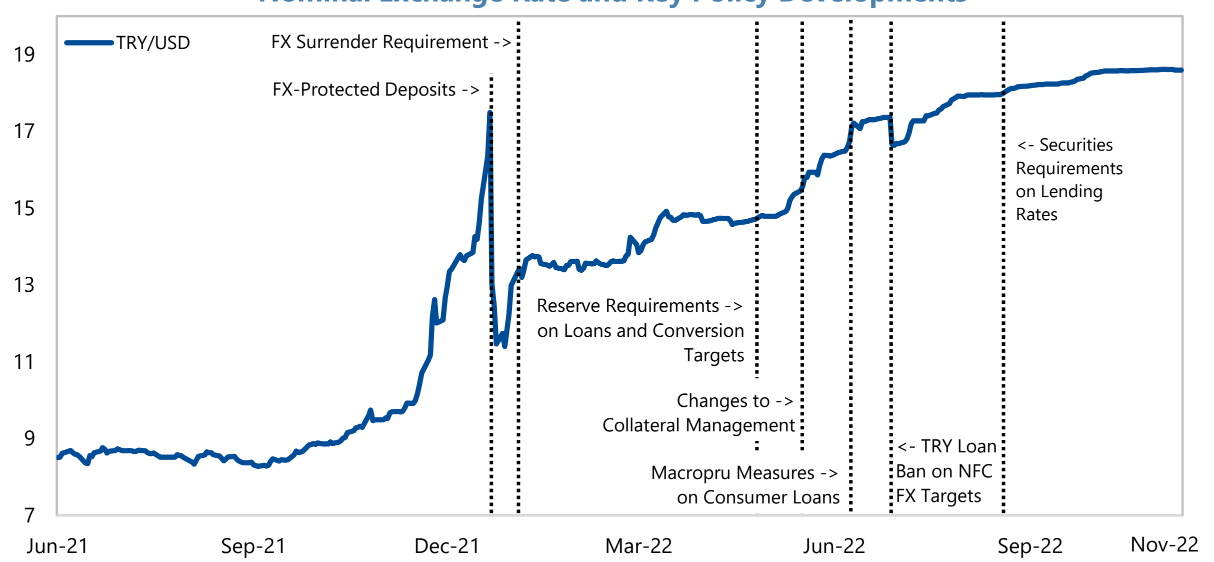


Sources: Turkstat; Haver Analytics; World Economic Outlook; and IMF staff calculations.
1/ China and India are omitted due to lack of data availability.
2/ Based on 3-month moving average.
3/ 2022Q1 vs 2019Q3.

6. Under the TEM, the Central Bank of the Republic of Türkiye (CBRT) cut rates aggressively in late 2021, which led to significant pressure on the lira. The CBRT cut the policy rate from 19 to 14 percent between September and December 2021, despite strong growth and inflation of 20 percent, well above the central bank's 5 percent target. Following the loosening of monetary policy, the conversion of lira deposits into foreign exchange deposits accelerated sharply, putting severe pressure on the lira, which lost half its value against the dollar in a matter of weeks.

7. Large foreign exchange intervention and macrofinancial and regulatory measures relieved market pressures. Pressures on the lira were relieved by large foreign exchange interventions and the introduction of a scheme protecting lira term deposits against currency depreciation (Box 1). These moves were followed by an increasingly distortionary and complex set of macrofinancial measures to encourage the holding of lira assets (overleaf text table).

Nominal Exchange Rate and Key Policy Developments



Sources: Bloomberg Finance L.P.; CBRT; and Haver Analytics.

Selected Macro-Prudential and Regulatory Measures

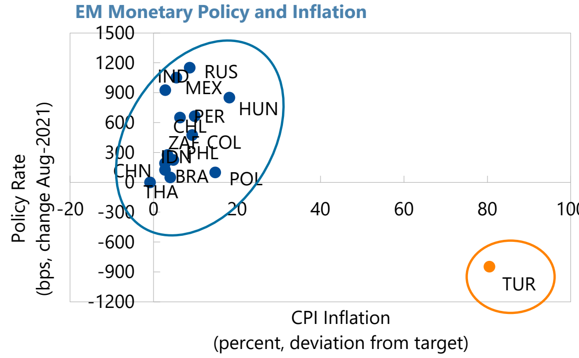
Reserve Requirements/ Securities Maintenance	Collateral Management	Macroprudential Policies	Capital Adequacy	Other
• 10% RR imposed on newly issued TRY commercial loans; later increased to 20% RR; and, finally, to 30% SM • 20% RR imposed on stock loan growth above 20% during Dec 21-May 22 • 100% SM imposed on stock loan growth above 10% during Jul-Dec 22 • Additional 500 bp RR for banks with a conversion rate from FX to TRY deposits below 5%; 300 bp RR for banks with a 5-10% conversion rate • 1.5% commission fee imposed on RR for FX deposits with conversion rates below target; later increased to 5% • 5% SM on FX deposits. 700 bp SM for banks with TRY deposit share below 50%; 300 bp SM between 50-60%	• Weight of TRY fixed-rate securities in collateral pool increased • 30% floor imposed on TRY-denominated collateral for interbank money markets and swap transactions • Floor later increased to 45% and then 50% • Haircut on inflation-linked, gold-backed and FX-denominated collateral raised progressively from 5% to 60%	• Reduced maturity cap for general purpose loans over TRY 50,000 from 36 to 24 months • Reduced maturity cap for general purpose loans over TRY 100,000 to 12 months • Increased minimum monthly payment for credit cards over TRY 25,000 from 20% to 40% • Differentiated LTV ratios introduced for housing loans according to energy class and value	• USD/TRY exchange rate used in FX risk-weighted assets fixed at 2021 year-end level • Risk weight applied to selected commercial TL loans and corporate cards raised from 20-150% to 200% • Risk weight applied to loans from NFC engaging in derivatives with offshore counterparts raised to 500%	• One-week repo rate cut by 1,000 bps cumulatively • TRY FX-protected deposits introduced/NFC tax exempt • FX surrender requirements for exporters set at 25%; later increased to 40% • Export rediscount credit linked to FX surrender requirements • Loan ban for corporates with FX cash assets above TRY 15m or 10% of total assets; later 10m or 5% of assets • 90% SM for TRY loans with rates 1.8 times compound reference rate; 20% for loans with rates between 1.4-1.8 times • Lower mortgage rates if 50% of purchase through FX sale • Tax for banking and insurance transactions on consumer loans increased from 5% to 10%

Sources: CBRT; BRSA; MoTF; and Official Gazette. Notes: RR = reserve requirement; SM = securities maintenance; LTV = loan-to-value.

8. **Spillovers from the war in Ukraine exacerbated existing vulnerabilities.** Higher energy import prices significantly widened the current account deficit and increased pressure on Türkiye's already-limited reserves, adding to lira weakness. Rising energy and food import prices also fueled inflation, while spillovers through other channels were more limited (Figure 2).

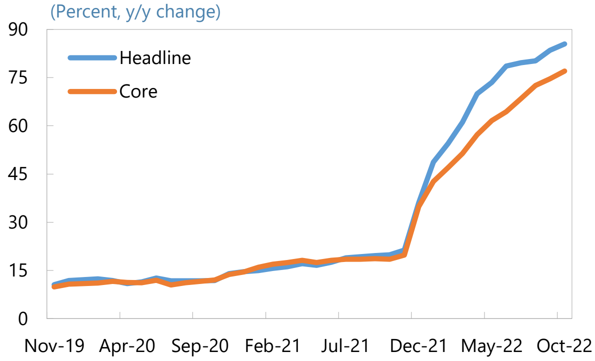
9. **Inflation has accelerated sharply, reaching a 24-year high of 85 percent, among the highest across large EMs.** While commodity price increases and supply-chain disruptions have added to inflation, as in other countries, Türkiye's idiosyncratically high inflation is driven by excessively loose monetary policy and the resulting exchange rate depreciation and shifting of inflation expectations (Figure 3). High inflation has imposed large economic costs on the country, particularly on the poor (Box 2). Despite rising headline and core inflation, the CBRT cut the policy rate further to 9 percent in November, in the latest of a succession of cuts, setting it further apart from peer central banks, which have raised rates aggressively over the past year.

EM Monetary Policy and Inflation



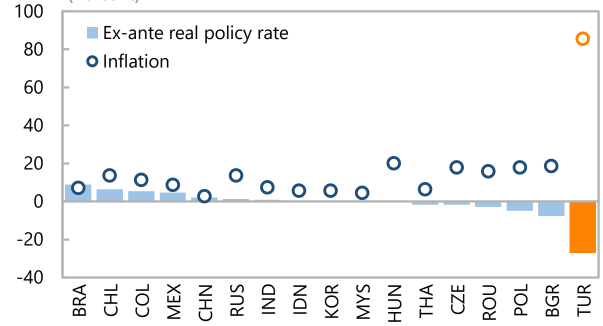
Sources: Haver Analytics and IMF staff calculations.
Note: Excludes Argentina.

CPI Inflation
(Percent, y/y change)



Source: Turkstat.

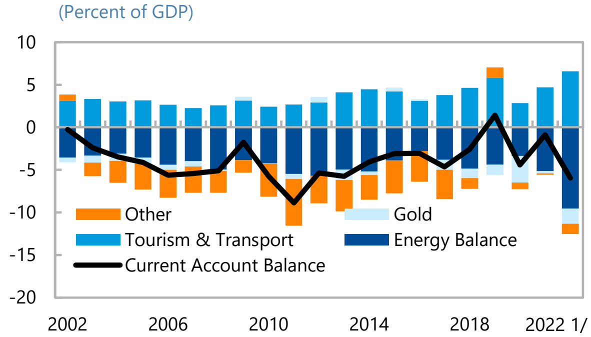
Ex-Ante Real Policy Rate and Inflation 1/
(Percent)



1/ Ex-ante rates based on one year-ahead inflation expectations.
Sources: Haver Analytics and IMF staff calculations.

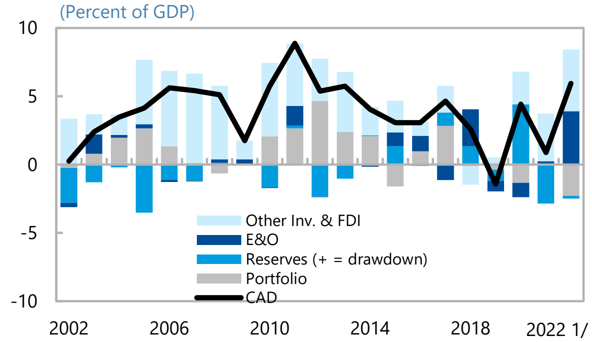
10. External imbalances have widened, aggravated by the war in Ukraine. The spillovers from the war in Ukraine doubled Türkiye's 2022 energy import bill to a projected 10 percent of GDP and contributed to a widening of the current account deficit to a projected 6 percent of GDP. The higher deficit was financed mostly by unidentified inflows (errors and omissions), which have become more persistent but remain an unreliable financing source (Box 3), as well as by large foreign FX deposits relating to the Rosatom nuclear power project. Competitiveness gains from the sharp lira depreciation have been, and continue to be, steadily eroded by rising inflation, particularly at the producer level, such that the non-energy goods current account balance has not improved. Tourism exports surpassed pre-pandemic levels, while gold imports have also increased.[1] On a preliminary basis, Türkiye's external position in 2022 is assessed to be weaker than the level implied by fundamentals and desirable policies. Much of this gap would close if desired policies—the staff recommended policy pivot, with an interest rate increase at its core—were implemented. While there are large uncertainties over energy prices and the drivers of large net errors and omissions and their impact on Türkiye's external imbalances, the assessment is also supported by other components such as the low level of reserves, large external financing needs, and the size and composition of the NIIP, all of which contribute to external vulnerabilities (Annex I).

Current Account
(Percent of GDP)



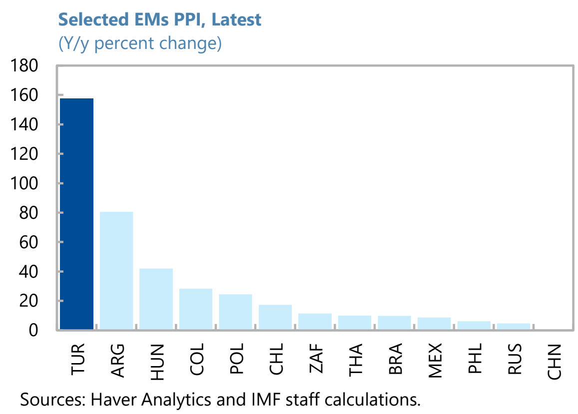
Sources: Haver Analytics and IMF staff calculations.
1/ Based on available data through Q3.

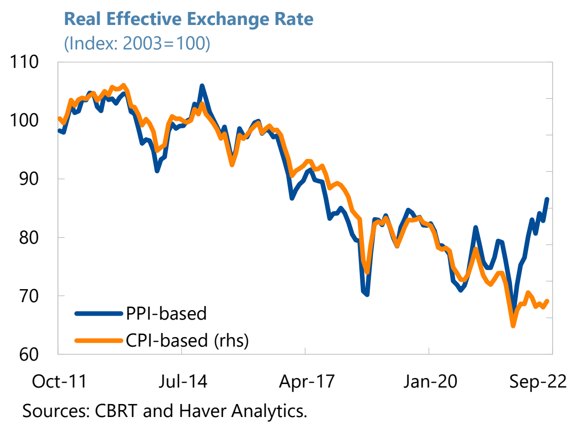
Current Account Deficit Financing
(Percent of GDP)



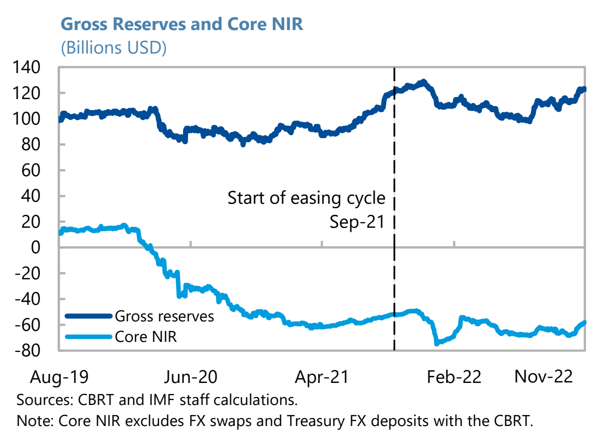
Sources: Haver Analytics and IMF staff calculations.
1/ Based on available data through Q3.

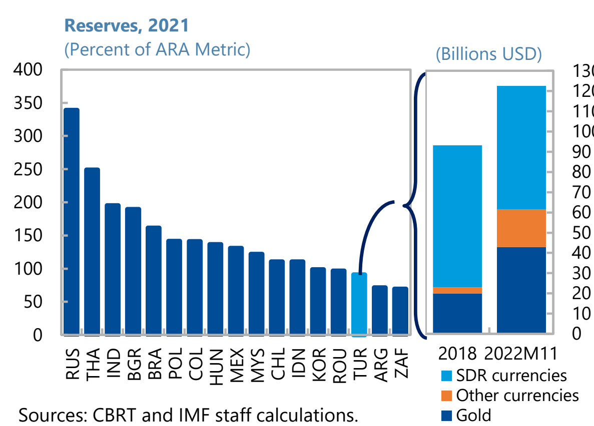
[1] Revisions to tourism exports, published in November 2022, decreased the current account deficit (and net errors and omissions) by about 0.8 percent of GDP in 2022.





11. Reserve buffers remain low. Despite increasing in recent months, gross reserves remained low at end-November, at around USD 123 billion or 88 percent of the Fund's ARA metric, with the CBRT's "immediately available" hard currency reserves (i.e., gross reserves minus gold, non-hard currencies, SDR holdings, and Treasury FX deposits) standing at around USD 37 billion. Moreover, a measure of "core" reserves that excludes all central bank foreign exchange liabilities (including external central bank swaps) remains deeply negative. While the private sector has reduced its foreign exchange exposure, exchange rate risk has shifted from private to public sector balance sheets.



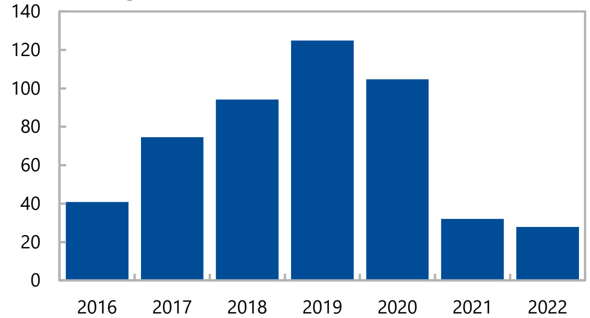


12. Under-execution of the central government deficit contributed to a tightening of fiscal policy for most of 2022.[2] The central government registered a 1 percent of GDP deficit through October, much lower than the Medium-Term Plan full-year deficit target of 3.4 percent of GDP; this resembles the execution profile observed in 2021, supporting staff's projection of an expansionary

[2] The assessment considers both cyclical factors (fiscal impulse of -1.9 percent of GDP, comparing the cyclically-adjusted primary balance in 2022 up to October to the cyclically-adjusted primary balance in 2021) and a comparison to the budget target for the full-year 2022. However, this assessment does not consider wider measures of the fiscal stance, including the non-financial public sector and/or quasi-fiscal activities beyond this perimeter.

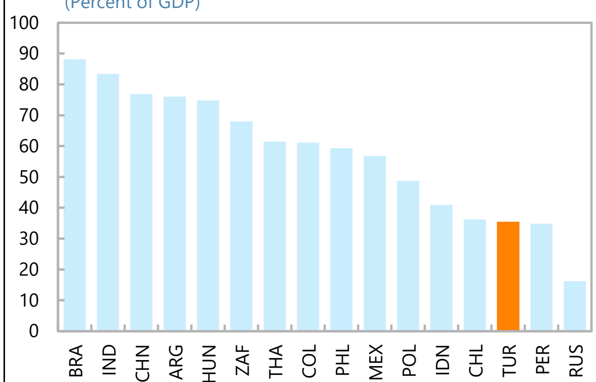
fiscal stance for 2022 as a whole (¶38, Table 4). This strong performance was driven by contained spending and still-strong revenues. Public debt remains low and sustainable under the scenarios considered in staff's Debt Sustainability Analysis (see Annex II). The general government debt ratio declined to under 40 percent of GDP by the second quarter of 2022, assisted by higher inflation, while the composition of debt improved as various macrofinancial and regulatory measures led to longer debt maturities and to a lower reliance on domestic FX borrowing. Meanwhile, foreign holdings of public domestic debt fell to an all-time low of under 1 percent of overall holdings, with domestic banks picking up the slack. Risks have increased, however, from rising contingent liabilities, quasi-fiscal operations, and the large exposure of public debt to FX risks—notably from high external financing requirements and the large share of FX in public debt—against the backdrop of a weak external position.

Central Government Overall Balance Execution Through October
(Cumulative Jan-Oct Balance as a percent of Original or Revised Annual Target)

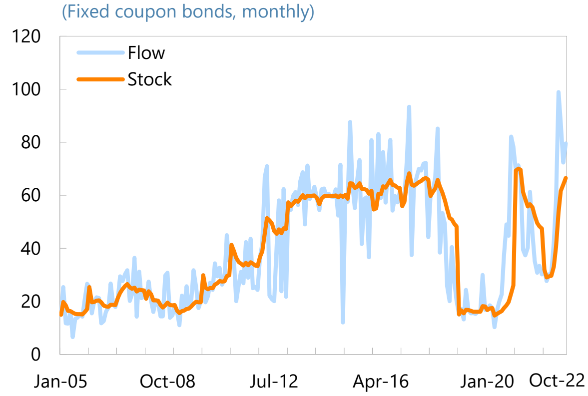


Sources: Ministry of Treasury and Finance and IMF staff calculations.

EMs General Government Gross Debt, 2022 Forecast
(Percent of GDP)



Average Maturity of Domestic Borrowing 1/
(Fixed coupon bonds, monthly)



Sources: World Economic Outlook; MOTF; and IMF staff calculations.
1/ Total domestic fixed interest borrowing, cumulative average to date (latest observation, October 2022).

13. But spending pressures and fiscal risks are rising. Government spending is expected to pick up sharply in the coming months, driven by shovel-ready investment projects and the financing of energy state-owned enterprise (SOE) losses.[3] While some risks are recognized in the budget, broader fiscal risks have grown, including through contingent liabilities from FX-protected deposits, public private partnerships (PPPs), and state-owned banks.[4] However, the main near-term risk to fiscal space relates to possible financing constraints.

[3] State gas company BOTAS heavily subsidizes gas prices to households and SMEs. By the time the report was prepared, BOTAS had received a capital injection of 120 billion TL in 2022, equivalent to 0.8 percent of GDP, reflected in the budget.

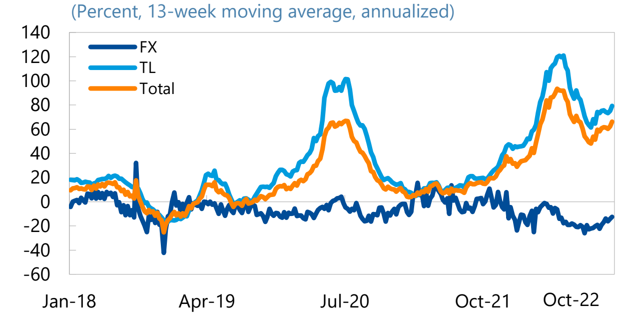
[4] For FX-protected deposits, staff estimates that every extra 10 percent depreciation would lead to an additional 0.4 percent of GDP cost in 2023 (see Box 1).

14. Financial stability risks are high and rising, mainly stemming from a strong FX liquidity nexus between the CBRT and banks. Deposit dollarization and limited demand for domestic FX loans have led to a large currency mismatch on banks' balance sheets. The mismatch has been closed through FX swaps with the CBRT and through sizable bank FX deposits at the CBRT. As a result, more than half of banks' FX liquid assets are held at the CBRT, and more than three quarters of the central bank's reserve liabilities are now owed to domestic banks, a claim larger than the CBRT's total reserve assets.

15. The recent credit slowdown is welcome, but it is driven by increasingly distortionary and costly measures. Despite sizeable interest rate cuts, credit growth slowed in the second half of 2022, although it has picked up more recently and it remains positive in real terms for most segments, notably credit card and export loans (Figure 12). The slowdown in credit growth has been driven by an increasingly distortionary and complex set of regulatory measures, leading to an inefficient allocation of capital along with heightened financial and fiscal risks. The measures, for instance, include requirements for banks to hold long-dated fixed-rate government securities when lending growth exceeds certain thresholds. As a result, government bond yields fell sharply and the share of short-term loans in total new lending increased as banks sought to address the increasing maturity mismatch, with adverse implications for longer-term investment. Although new securities are mostly classified as "held to maturity," fixed-rate long-dated securities at artificially compressed yields would, over time, other things equal, erode profits and weigh adversely on capital should interest rates increase materially. By weakening the link between interest rates and credit provision, these measures have also seriously undermined the role of the policy rate as the main monetary policy instrument.

Total Credit Growth

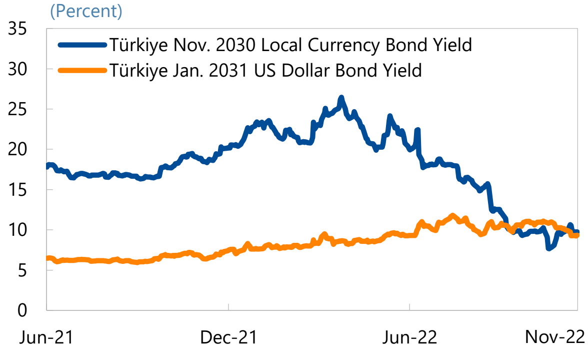
(Percent, 13-week moving average, annualized)



Sources: BRSA; Haver Analytics; and IMF staff calculations.
Note: Weekly EOP. FX adjusted by converting FX credit to currency basket (2017 base) before calculating the rate of change.

Turkish Local Currency and US Dollar Sovereign Bond Yields

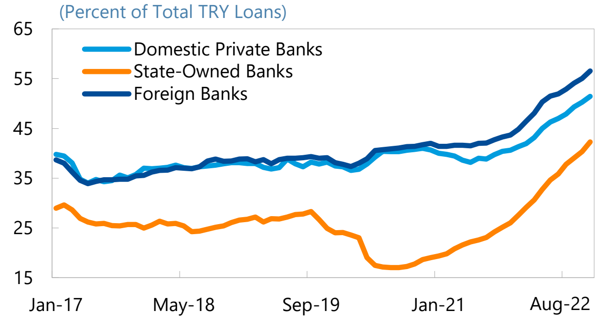
(Percent)



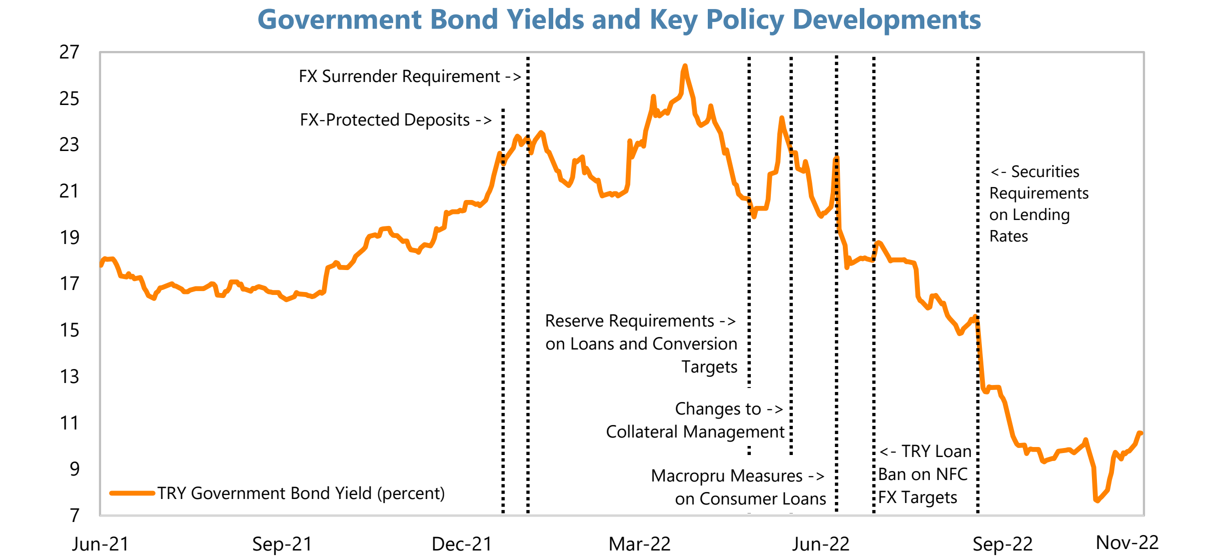
Source: Bloomberg Finance L.P.

TRY Short-Term Loans 1/

(Percent of Total TRY Loans)



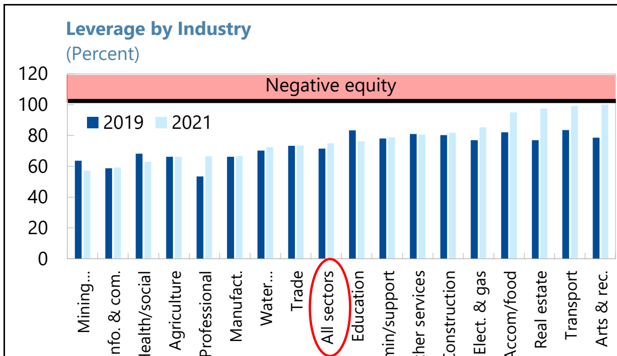
Sources: BRSA; CBRT; and IMF staff calculations.
1/ Short-term loans are defined as loans with maturity of less than one year.



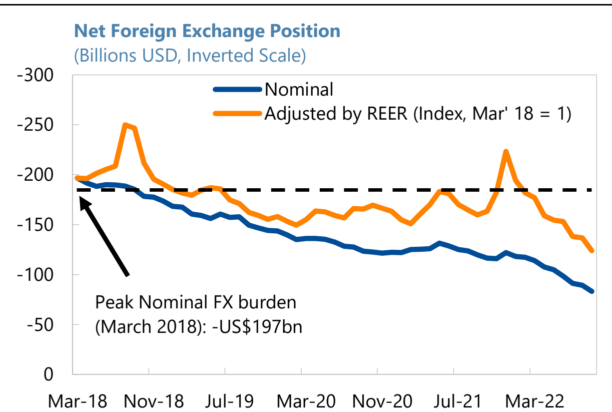
Sources: Bloomberg Finance L.P.; CBRT; and Haver Analytics.

16. Regulatory forbearance continues to mask underlying asset quality problems. Reported non-performing loan (NPL) ratios have fallen. At the same time, capital ratios have increased, reflecting private bank profits and capital injections in state-owned banks. As noted in the FSSA, however, capital would be materially lower, and much closer to regulatory limits without legacy regulatory forbearance, which includes a fixed exchange rate in risk-weighted asset calculations. Moreover, loans that have been refinanced and recorded as performing after benefiting from regulatory forbearance have a higher default risk than regular performing loans.

17. Non-financial corporations showed resilience through the pandemic, but leverage and FX mismatches remain large. A strong rebound in economic activity, a steady real wage bill, and government pandemic support all helped with NFC profitability during the pandemic (Annex III). But Turkish NFCs remain highly levered, and pockets of vulnerability are acute, including in the accommodation and food, transportation, and real estate/construction sectors. While NFC FX-denominated debt has halved in nominal terms since its 2018 peak, it remains high relative to emerging market peers, while the real exchange rate depreciation in recent years increased the real burden of this debt on NFCs.



Sources: CBRT and IMF staff calculations.
Note: Leverage = non-equity liabilities/total assets using the CBRT company accounts database.



Sources: Haver Analytics and IMF staff calculations.

OUTLOOK AND RISKS—A FRAGILE BALANCE

18. Policy settings are expected to remain too loose. The near-term outlook for Türkiye will continue to be characterized by a tug of war between boosting growth ahead of the elections and the constraints imposed by the large current account deficit, unfavorable external financing conditions, and low reserves. Under the baseline, staff assumes that policy rates remain low.[5] Credit growth is expected to remain positive in real terms, especially for targeted sectors. And while fiscal policy remained tight through most of 2022, the fiscal impulse, based on the cyclically-adjusted primary balance, is expected to turn expansionary, as spending pressures from high energy prices and the electoral cycle increase.

19. Growth and inflation are expected to fall, but inflation is expected to remain high, and much higher than in peer countries. Growth likely reached 5.5 percent in 2022, supported by a large positive carryover from 2021 and strong first-half growth. Reflecting lower growth carryover and staff's assumptions about weaker external demand, especially in Europe, binding external financing constraints, and squeezed real incomes, headline growth is expected to fall to 3 percent in 2023. That growth remains high, despite lower carryover and the constraints just noted, reflects expected stimulus policies, including recent policy rate cuts (and still-positive real credit growth), and an expected loosening of fiscal policy. Following recent declines in energy prices, the current account deficit is expected to narrow to around 3.5 percent of GDP, but to remain high, reflecting slower trading partner growth and domestic policy stimulus. Inflation is expected to fall sharply to 47 percent on average over the coming year—driven by fading exchange rate passthrough, favorable base effects, and expected lower commodity price pressures—but to remain high, and much higher than in peer countries, given loose policies, inflation inertia, and un-anchored inflation expectations.

Selected Economic Indicators, 2020–27

	2020	2021	2022	2023	2024	2025	2026	2027
			(Percent change)					
GDP Growth	1.9	11.4	5.5	3.0	3.0	3.0	3.0	3.0
Inflation (end year)	15	36	70	36	21	20	20	20
			(Percent of GDP)					
Current account balance	-4.4	-0.9	-6.0	-3.4	-2.5	-2.2	-2.2	-2.2
Fiscal balance 1/	-3.5	-2.7	-3.4	-4.2	-4.1	-4.1	-4.1	-4.3
Public debt	39.7	41.8	35.6	35.4	36.6	38.4	39.8	39.6

Source: IMF staff calculations.
1/Central government overall balance, headline or authorities' definition, which includes items excluded from the IMF 'program' definition.

20. Inflation could well exceed staff's inflation forecast. The exchange rate is the critical monetary transmission channel in Türkiye and the projected decline in inflation under the baseline hinges on the assumption that lira depreciation will be moderate. Inflation would be significantly higher if the lira were to depreciate sharply—for example, because of the diminishing effectiveness of macrofinancial and regulatory measures in curbing depreciation pressures—or if inflation became

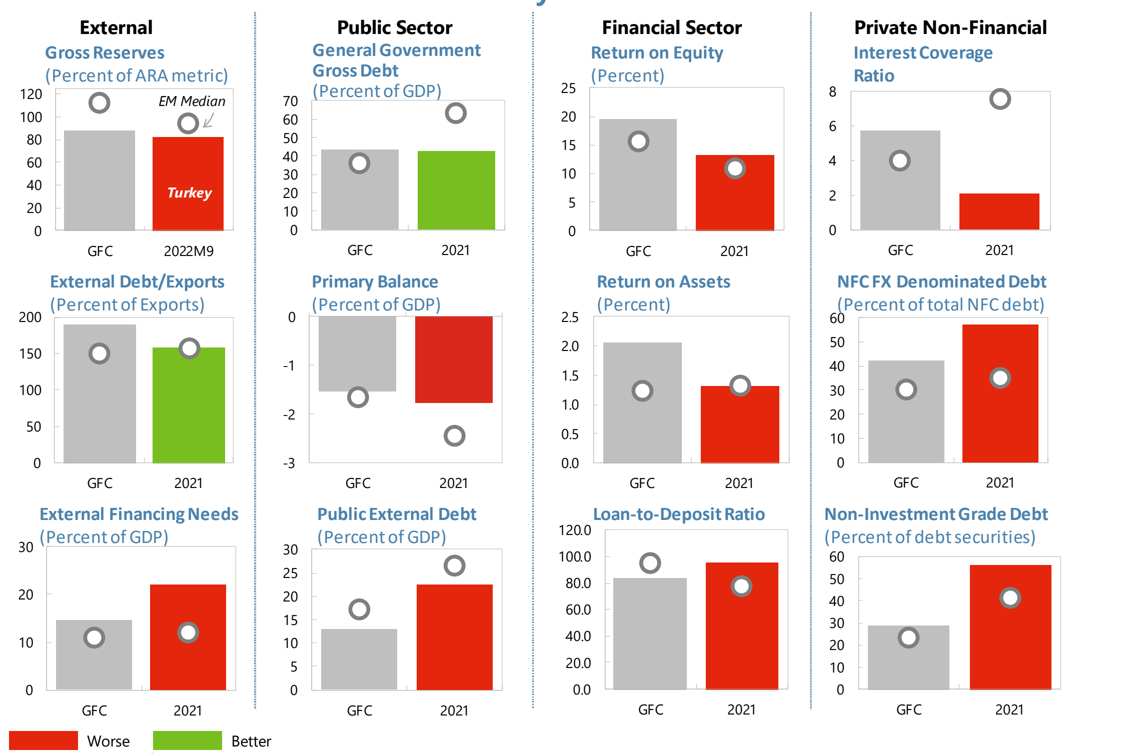
5 This is in line with market expectations at the time this report was prepared in early November.

more entrenched as expectations shift and contract-setting adjusts.[6]

21. Near-term growth may surprise on the upside. As in recent episodes, unexpected sources of external financing (e.g., in the form of new swaps with neighboring countries) could once again allow the continuation of pro-growth policies and a wider current account deficit. Under such a scenario, the real policy rate could remain deeply negative for longer, while credit and fiscal policies would have room to turn decisively looser. While this would boost growth in the near term, it would exacerbate vulnerabilities.

22. But, overall, risks are skewed to the downside and, with limited buffers, vulnerabilities remain acute. Given the extent of vulnerabilities, the economy is susceptible to various shocks. On the domestic front, doubling down on pro-growth policies given high and rising financial risks and without enough external financing could weigh on confidence and fuel pressures on the lira, hurting bank and corporate balance sheets, with spillovers to the public sector. Meanwhile, external risks have intensified, including from larger- or faster-than-expected tightening by advanced market central banks, escalating geopolitical tensions, higher commodity prices, higher global risk aversion, and weaker global growth. Another COVID-19 wave at home or abroad is another risk (Annex IV). Should these risks materialize, they could expose Türkiye's vulnerabilities, notably its low reserve buffers and domestic banks' large claims on CBRT's FX reserves.

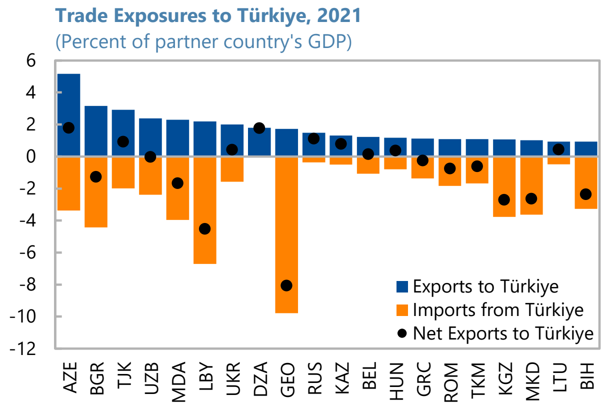
Selected Vulnerability Indicators: GFC vs. Latest



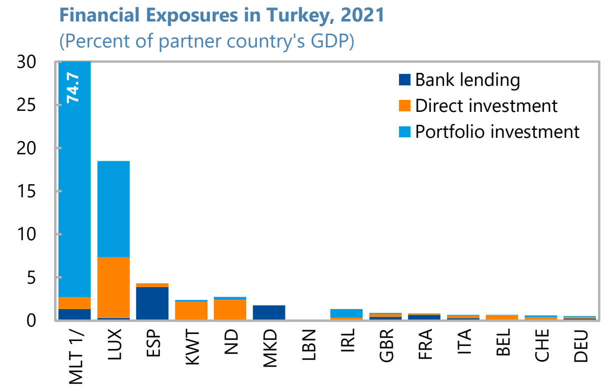
Sources: World Economic Outlook; Financial Soundness Indicators; and IMF staff estimates.
Note: GFC denotes 2008 or 2009 (whichever is worse).

[6] Reduced effectiveness of macrofinancial and regulatory measures in curbing depreciation pressures could surface from regulatory loopholes or reflect the tight FX demand-supply equilibrium under which the corporate sector is operating.

23. Any marked worsening of the situation in Türkiye could have some regional spillovers. Channels include trade links with neighbors (Azerbaijan), remittances (Bulgaria, Montenegro),



Sources: IMF DOTS; IMF WEO; and IMF staff calculations.



Sources: BIS; IMF CDIS; IMF CPIS; and IMF staff calculations.
1/ Portfolio investment as of 2016.

financial exposures through portfolio flows (Bahrain, Luxembourg, Malta) and direct investment (Azerbaijan). Exposure through bank lending is mostly linked to euro area financial institutions holding equity stakes in Turkish banks (Spain), but these risks are seen as manageable. Overall, the impact on other emerging markets will likely remain contained as Türkiye's situation is largely perceived as idiosyncratic.

POLICIES—A U-TURN IS NEEDED

24. The policy stance is too loose. Despite the recent slowdown in credit growth, the overall policy mix remains stimulative. Real policy rates are deeply negative, credit growth remains high, and the fiscal impulse is expected to turn more expansionary. Such an accommodative policy stance is at odds with the large positive output gap, multi-year high inflation, and the large current account deficit alongside external financing constraints and low buffers.[7]

25. Tight policies are needed to rein in inflation and to reduce vulnerabilities. A decisive tightening, with a higher monetary policy rate at its center—which should move towards achieving firmly positive real rates—would help reduce inflation more durably, lower external financing risks, underpin the lira and encourage more sustained "liraization," as well as allow reserve buffers to be rebuilt over time. Coordination across all policy levers—monetary, fiscal, and financial policies—will be crucial.

26. Prompt tightening would also contain adjustment costs and support competitiveness and medium-term growth. The longer inflation remains so high, the more it risks becoming entrenched, raising the economic cost of future disinflation efforts. In contrast, durably lower inflation would benefit medium-term growth by helping re-anchor inflation expectations, thus

[7] Consistent with the positive output gap, capacity utilization in the manufacturing sector and labor force participation have recovered to pre-pandemic levels, while the unemployment rate and broader measures of labor market slack have fallen sharply, back to historical averages (Figure 8).

reducing the sacrifice ratio of monetary policy.[8] By durably lowering inflation and curbing ongoing competitiveness losses, the recommended set of policies would also help strengthen Türkiye's external position. Similarly, prompt policy tightening would allow for a subsequent careful unwinding of the complex set of existing macrofinancial and regulatory measures. The longer such measures are allowed to persist and to evolve, the more costly it will be to unwind them, and the greater the costs to medium-term growth.

27. A shift away from demand stimulus towards supply-side reforms would support the authorities' policy goals more durably and would reduce vulnerabilities. Following the pandemic, efforts should now focus on carefully-sequenced structural reforms to increase growth potential rather than on continued demand stimulus. The benefits of such a move—which would have prompt and sizeable interest rate hikes at its center—would include achieving low interest rates in a more sustainable manner, a stronger lira, faster and more durable disinflation, higher reserves, and, ultimately, stronger, more sustainable, and more inclusive longer-term growth. Structural reforms, rather than cheap credit, would also be a more sustainable way of achieving the TEM's goal of promoting exports. Priorities should include reforms to improve the business and regulatory environment, labor market flexibility, the quality of human capital, and increase the size of Türkiye's labor force through higher female participation.[9] Reforms could also help strengthen Türkiye's resilience to climate change and facilitate its transition to a low-carbon economy.

28. This policy shift would involve near-term trade-offs, highlighting the need for targeted support to the most vulnerable. Tighter monetary, fiscal, and credit policies would sacrifice some near-term growth in favor of stronger and more resilient growth over the medium term. Some structural reforms may also involve near-term costs as resources are reallocated across sectors, calling for careful reform sequencing. But the medium- and long-term benefits of a policy shift from demand-driven to supply-driven growth would greatly outweigh its near-term costs. By addressing vulnerabilities, these policies would also greatly reduce Türkiye's exposure to downside risks and bolster the country's resilience.

Authorities' Views

29. The authorities argued that policies were on the right track and were more sanguine than staff on Türkiye's economic outlook. They highlighted that the TEM's primary objective was to support growth while reducing the current account deficit and Türkiye's resulting reliance on volatile foreign capital inflows. They argued that monetary policy tightening had been implemented through a set of tools in an integrated framework and that focusing on interest rates as a measure of the policy stance was misleading, especially in an environment of volatile external conditions. They noted that macrofinancial and regulatory measures had been effective in slowing down overall credit growth, while directing affordable lending towards selected net exporting sectors. The authorities stressed that fiscal discipline was a key pillar of Türkiye's economy and they did not

[8] Defined as the ratio of the total output loss to the associated reduction in trend inflation.

[9] See also discussion in *IMF Country Report No. 19/395, Türkiye, 2019 Article IV Consultation.*

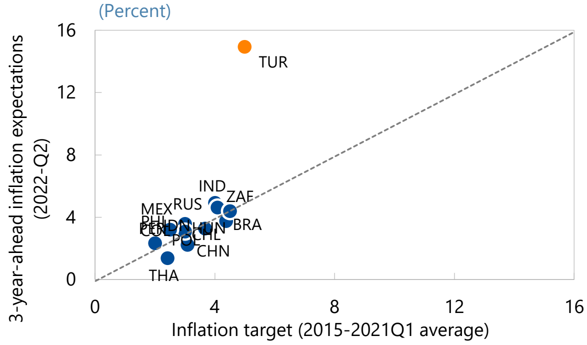
expect fiscal policy to turn expansionary ahead of the elections. They also disputed the need for reducing the role of the state in credit allocation and the need for strengthening central bank independence, which they saw as adequate. Finally, the authorities project materially higher growth and lower inflation than in staff's baseline and a smaller current acccount deficit (Box 4).

A. Monetary Policy—A Credible Regime Switch is Needed

Prompt, sizeable, and credible policy rate hikes are needed to lower inflation sustainably, stop high inflation from becoming entrenched, underpin the lira, and allow reserves to be rebuilt over time. This tightening should be accompanied by moves to reinstate interest rates as the primary monetary policy instrument and to strengthen central bank independence.

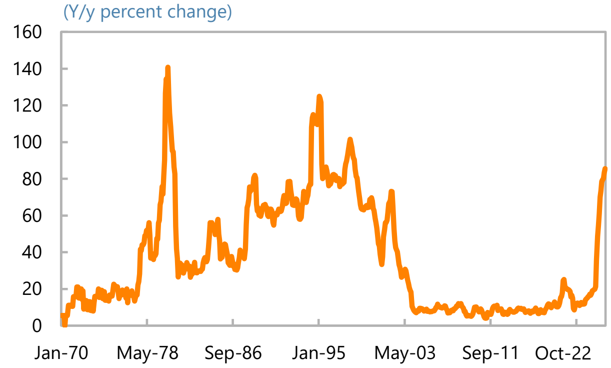
30. High inflation is in danger of becoming entrenched. While inflation is expected to fall, it is projected to remain high, and inflation expectations are expected to remain far more de-anchored than in peer countries (Figure 3). Inflation inertia in Türkiye is high and the longer inflation remains elevated, the more it risks becoming entrenched through more extensive indexation and shorter gaps between wage agreements. This risk is aggravated by Türkiye's long history of high inflation which was brought to single digits only in the mid-2000s and only for a brief period.[10] The sooner inflation expectations are re-anchored, therefore, the lower the output and employment costs of future disinflation are likely to be.

EMs 3-year-ahead Inflation Expectations vs Target 1/
(Percent)



Sources: Haver Analytics; Consensus Forecast; and IMF staff calculations.
1/ Excludes Argentina.

CPI Inflation
(Y/y percent change)



Source: Turkstat.

31. Prompt, sizeable, and credible interest rate hikes are needed to lower inflation sustainably. Integrated Policy Framework (IPF) policies are not suitable to achieve disinflation when the monetary policy stance is not consistent with well-anchored inflation expectations. Hence, while macrofinancial and regulatory measures have helped contain credit growth, they are no substitute for interest rate hikes. Türkiye's deeply negative real interest rates discourage savings, especially in lira, and encourage moves towards FX, equity markets, and real assets (gold, real estate), and work against durable disinflation. Türkiye's deeply negative real interest rates also stand out

[10] See *IMF Country Report No. 19/395, Türkiye, 2019 Article IV Consultation* for staff analysis on the degree of inflation inertia in Türkiye.

internationally, adding to pressures on the lira and fueling inflation. A prompt and sizeable increase in interest rates, accompanied by a well-communicated and credible re-commitment to the central bank's price stability target, would increase incentives to hold the lira and would have a powerful effect on inflation dynamics, especially through inflation expectations and the exchange rate channel. The more credible and prompt the tightening, the less sizeable it would need to be.

32. Rate hikes should be complemented with policies to strengthen central bank independence. The CBRT would benefit from measures to strengthen its independence, including by restoring earlier arrangements for senior appointments (including minimum qualifications) and introducing transparent procedures for dismissal, backed by law. Steps should also be taken to strengthen the CBRT's financial autonomy, by reviewing the rules governing profit transfers to the budget.

33. Higher interest rates should also be accompanied by moves to carefully phase out macrofinancial and regulatory measures, reinstating interest rates as the primary monetary policy instrument. Should policy rates be increased credibly, the various FX-protected deposit schemes could be phased out carefully, as could the many restrictions on banks' balance sheets and operations. The tightening of the export surrender requirements, an existing capital flow measure (CFM), has served as a substitute for warranted macroeconomic adjustment and should also be discontinued over time. Recent measures aimed at increasing bank holdings of government securities should also be phased out to minimize risks to bank balance sheets and to minimize distortions that weigh on long-term investment. Such phasing out should be carefully sequenced to minimize market dislocation and financial stability risks.

34. Scarce FX reserves should be preserved and gradually rebuilt over time. FX intervention to support the lira should be limited to the most extreme cases of exchange rate volatility, undertaken only by the central bank itself (not state-owned banks). Once monetary policy tightening is firmly underway, and as conditions allow, policies should aim at replenishing reserves over time, preferably through preannounced FX purchase auctions.

Authorities' Views

35. The authorities were more sanguine than staff on the inflation outlook and on reserve adequacy. They shared staff's view that high inflation was being primarily driven by the sharp lira depreciation, but argued that supply shocks and FX market dysfunction—rather than interest rate cuts—were behind the exchange rate depreciation in late 2021. They also highlighted the role of global inflationary pressures, which had been driven by global supply disruptions, and by energy and commodity price spikes. The authorities argued that FX market dysfunction had amplified exchange rate volatility in late 2021, but that it had been contained under the TEM, as evidenced by the fact that more recent interest rate cuts had not led to pressures on the lira. The authorities' inflation forecasts were more sanguine than staff's, relying on inflation expectations falling sharply as inflation falls. The authorities also took comfort from the recent moderation in monthly core inflation. Separately, the authorities argued that FX needs could be covered in any downside scenario with existing gross reserves and that the concept of negative net reserves was irrelevant for assessing reserve adequacy. They planned to support the deepening of Türkiye's FX market and to strengthen reserves over time from higher exports and FX-protected receipts, rather than through volatile portfolio inflows.

36. The authorities disputed the need for interest rate hikes. They argued that, despite interest rate cuts, broader financial conditions had been tightened through macroprudential and regulatory measures, while also allowing for directed credit to selected sectors at lower rates. In their view, directing credit and keeping it under control was preferable to raising policy rates. The authorities also deemed their policy framework to be consistent with the Fund's Integrated Policy Framework (IPF), stressing that the traditional approach where disinflation was achieved through interest rate hikes had been tried extensively in the past, but that it had only attracted volatile capital inflows, which amplified exchange rate volatility and, ultimately, fueled inflation. In their view, interest rate hikes were a demand-management tool and would therefore be ineffective in lowering inflation in an environment where Türkiye's inflation was driven by large external supply shocks. They also noted the adverse output and balance sheet implications of rate hikes. Finally, they stressed that fiscal policy was also being used to support the disinflation process. Looking ahead, the authorities stressed that the November CBRT monetary policy decision marked the end of the recent rate-cutting cycle and that future decisions would continue to be data-driven. Because they assessed macroprudential and regulatory measures to have been effective, the authorities did not expect to unwind these policies in the short term.

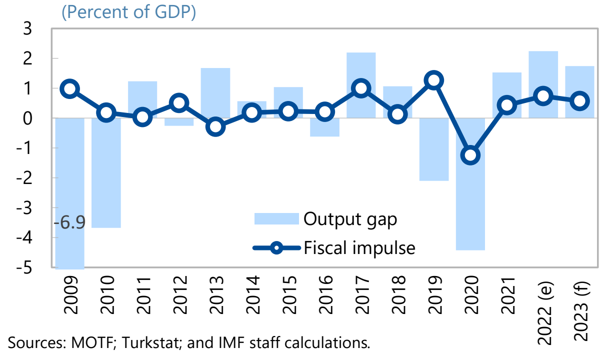
37. They also disputed the need for central bank reforms. The authorities strongly disagreed with the need for institutional reforms to enhance central bank independence, arguing that tightening was being achieved (albeit through different tools), that neither debt monetization nor central bank financing of the fiscal deficit were features of Türkiye's economy, and that policy rates were high compared to peers. They also argued that government bonds are only a small share of the CBRT's balance sheet and that this was another indicator of central bank independence.

B. Fiscal Policy—Tight Fiscal Policy, with Support for the Most Vulnerable

While Türkiye's public debt burden remains low with some fiscal space (Annex II), rising spending pressures and higher contingent liability, debt exposure to FX shocks, and quasi-fiscal risks—including new liabilities from FX-protected deposit schemes—are eroding fiscal space and could undermine investor confidence. A tight fiscal stance, combined with targeted measures to support the vulnerable, would preserve fiscal space to deal with future shocks, while also containing domestic demand. Other priorities include enacting fiscal governance reforms, achieving public debt management goals through more durable means, and gradually replacing natural gas subsidies with better-targeted mechanisms.

38. A tight fiscal stance is needed. Staff expects a modestly higher central government overall deficit (4 percent of GDP) than the MTP's 3.5 percent of GDP target for 2023, driven by spending pressures from higher energy prices, lagged inflation adjustments (e.g., to civil servant wages), and broader election-related spending pressures, as well as staff's more conservative revenue assumptions. Staff's projections imply a modestly positive fiscal impulse. Given the positive output gap, high inflation, and rising quasi-fiscal risks, staff recommends capping the fiscal deficit at 3 percent of GDP in 2023, which would imply a modestly negative impulse, help contain domestic demand, and preserve investor confidence.

Fiscal Impulse[1/] and Output Gap
(Percent of GDP)



Sources: MOTF; Turkstat; and IMF staff calculations.
1/ Negative change in central government primary cyclically-adjusted balance, excluding one-off CBRT revenues.

39. Several options are available to deliver a tight fiscal stance, while providing targeted support to the most vulnerable. First and foremost, better-targeted energy support measures would provide an estimated fiscal saving of about 1 percent of GDP. A range of medium-term consolidation measures could also be deployed to strengthen Türkiye's fiscal position, notably streamlining VAT exemptions and rationalizing ad-hoc subsidies (see text table).

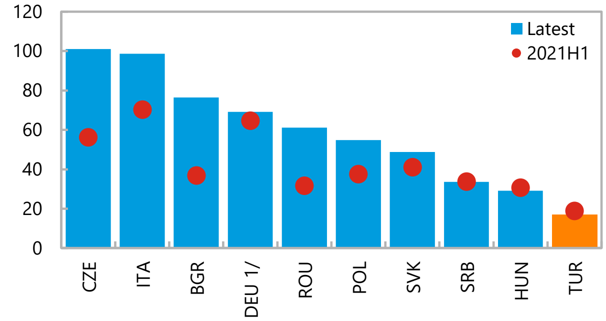
Recommended Medium-Term Consolidation Measures
(Percent of GDP)

Consolidation Measures	Estimated Yield
Revenue options	
(i) Personal Income Tax reform (collection, progressivity)	0.1
(ii) Streamline VAT exemptions, raise and unify reduced rates	1.1
Expenditure options	
(i) Eliminate backward-looking wage indexation	0.3
(ii) Contain net lending to public entities	0.2
(iii) Rationalization of ad-hoc transfers/subsidies	0.5
(iv) Rationalize investment incentives	0.3

Source: IMF staff estimates.

40. Energy subsidies should be replaced with better-targeted measures. Natural gas prices for households are heavily subsidized in Türkiye. Soaring energy prices have therefore led to a significant increase in fiscal costs, with the draft 2023 budget allocating around 2.5 percent of GDP to energy subsidies.[11] These subsidies are expensive, inequitable (most benefits accrue to wealthier households who consume more energy), and inefficient (since price signals needed to spur energy savings are blunted). Such subsidies should therefore be phased out and replaced with measures such as block pricing (where consumption is subsidized only up to a certain subsistence level).[12]

Natural Gas Prices for Household Consumers, 2022H1
(Euro/MWh; all taxes and levies included)



Sources: Eurostat and IMF staff calculations.
1/ Latest data refers to 2021H2 due to lack of availability.

41. Public debt management should remain focused on lengthening borrowing maturities and limiting domestic FX borrowing, but through more durable means. Macrofinancial and regulatory measures have helped artificially extend debt maturities and lower borrowing costs. Going forward, debt management should aim to achieve these same goals in a more durable manner: sustainably lower inflation would contribute greatly to this.

42. Fiscal risks should be mitigated and carefully managed. Phasing out FX-protected deposit schemes should be a priority, given potentially unbounded fiscal liabilities in the event of a sharp lira depreciation. But such phasing out needs to proceed carefully and only once policy and other conditions allow. Energy-related spending is also an important source of contingent liabilities in the event energy prices increase materially. PPP-related contingent liabilities should also continue to be carefully monitored. Finally, the risk of another recapitalization of state-owned banks has increased as their lending practices are increasingly being driven by non-commercial objectives.

43. Fiscal governance reforms would increase transparency and help limit quasi-fiscal risks. The oversight and management of PPPs should be strengthened, including through: (i) publishing regular PPP monitoring reports, and (ii) finalizing the long-overdue draft 2019 PPP legislation to manage PPP risks centrally. SOE financial statements are published regularly, but regular timely publication of fiscal risk statements and of comprehensive and consolidated information on the quasi-fiscal operations of all SOEs (including state-owned banks and BOTAS) would improve the monitoring and assessment of fiscal risks. It is also important to integrate investment and borrowing by the Türkiye Wealth Fund into the budget and to have its financial statements audited by the Court of Accounts. Finally, continuing to strengthen budget execution, including by introducing supplementary budgets when needed (as opposed to bypassing budget targets) would enhance public financial management.

[11] Budgeted energy subsidies include (i) duty losses and subsidies to energy SOEs, and (ii) payments of arrears accrued by energy SOEs.

[12] See IMF Note "Fiscal Measures to Help Households and Firms Cope with the Energy Crisis in Europe: First Principles and Policy Recommendations."

Authorities' Views

44. The authorities reiterated their continued strong commitment to fiscal discipline. They noted that such discipline was a longstanding strength in Türkiye, that the MTP targets were consistent with preserving the fiscal anchor, and that spending pressures were unlikely to materialize before the elections. They argued that various income and expenditure policy instruments were in place to protect vulnerable households, and agreed with staff's recommendation to increase targeted support as needed. They also agreed that existing energy subsidies were costly, but they did not envisage phasing them out in the near term.

45. The authorities also argued that fiscal risks were covered in the budget. The authorities assessed fiscal risks to be contained given that the draft 2023 budget already made allocations for possible contingent liabilities arising from SOEs, PPPs, and FX-protected deposit schemes and that those provisions were unlikely to be spent. They also noted that fiscal risks had diminished following the decline in global energy prices in late 2022, which could even lead to an overperformance relative to budget targets.

46. The authorities agreed with the importance of prudent debt management and monitoring of fiscal risks from SOEs and PPPs. The authorities noted that their upcoming 2023 debt strategy would allow them to adapt as needed to changing market conditions and regulatory environments. The authorities agreed there was room to improve the monitoring and managing of fiscal risks from SOEs and PPPs, while noting their progress on integrating PPPs with the public investment management framework and on publishing financial and non-financial information on SOEs.

C. Financial Policies—Allowing Market Forces to Drive Credit Allocation

Complex macrofinancial and regulatory measures should be phased out as this would help minimize price formation and capital allocation distortions. Priority should also be given to strengthening prudential standards and to phasing out regulatory forbearance, closely monitoring systemic FX liquidity risks at an economy-wide level, and implementing an effective regulatory framework for crypto assets. The authorities should also continue to improve Türkiye's AML/CFT governance framework to address the FATF grey listing.

47. The recent slowdown in credit growth from recent peaks is welcome, but it is driven by increasingly distortionary policies. Despite deeply negative real policy rates, the authorities have curtailed credit growth through a complex and growing set of measures, including macroprudential policies, banking regulations, and systemic liquidity-management measures. These measures have distorted price formation and capital allocation, while also increasing risks for banks, notably operational, compliance, governance, and interest rate risks. In addition, the requirements to hold government securities on bank balance sheets are leading to a significant shortening in the maturity of new loans as banks try to minimize maturity mismatch as a result of increased holdings of longer-term fixed rate government securities.

48. The state should reduce its outsized role in credit provision. The complex and growing set of measures impairs banks' ability to allocate credit on a fully commercial basis and should be phased out carefully, as conditions allow. In addition, any non-commercial operations of state-owned banks should be better defined and limited to areas of clear market failure. This should be accompanied by strengthening risk management to mitigate contingent liabilities to the state. State-owned banks should also be compensated directly from the budget for any losses incurred in performing these non-market operations. Finally, the provision of state guarantees through the Credit Guarantee Fund should be limited to clear cases of market failure, such as small firms that do not have the collateral needed to access needed credit.

49. As recommended by the 2022 FSAP, prudential standards need to be strengthened and regulatory forbearance measures phased out to improve asset quality transparency. Regulatory decisions, often pre-dating the policy response to the pandemic, have contributed to Turkish banks' low non-performing loan and high capital adequacy ratios in recent years. In particular, restructured stage 2 loans can still be reclassified as performing after a short 3-month probation period, and loans were refinanced including through the Credit Guarantee Fund or state-owned banks' facilities while retaining their performing status. Despite the large stock of restructured loans, there is limited information on the types of restructuring and the performance of these loans. Finally, the use of a fixed exchange rate in risk weighted assets, along with zero-risk weights for FX-denominated government exposures, result in overstated capital adequacy ratios. Re-aligning regulatory and accounting practices with Basel and other international standards is critical, alongside timely recognition of loan losses by drawing on capital buffers as needed. Strengthening the operational autonomy and resources of the BRSA, as recommended by the FSAP, would be instrumental in achieving these objectives. The monitoring of restructured loans needs to be enhanced, while an independent third-party asset quality review would be an important way of assessing, and improving confidence in, bank asset quality.

Türkiye: Main 2022 FSAP Recommendations		
Recommendations	**Agency**	**Time***
Systemic Risk and Macroprudential Policies		
Rationalize heterodox and idiosyncratic policy measures while realigning financial incentives to reduce distortions; activate countercyclical capital buffer.	CBRT, BRSA	ST
Refocus the systemic risk monitoring framework to ensure clarity of financial stability as the primary objective of the Financial Stability Committee (FSC)	FSC	ST
Strengthen FX systemic liquidity analysis incorporating systemic FX availability, contingency planning, and consider interlinkages when discussing macroprudential policy options	FSC (SRMG)	ST
Banking and Insurance Supervision and Regulation		
Amend the Banking Law to confirm financial stability as the primary objective of the BRSA and enshrine policy independence, operational autonomy and adequacy of resources to provide a stable cadre of experienced staff and modern tools.	MOTF, BRSA	MT
Restore and/or enhance, as applicable, the standards for intrusive, effective supervision for all banks, notably for liquidity, FX, sovereign and concentration risk, credit risk, including problem assets and provisions, and interest rate risk in the banking book. Revisions must include aligning regulations with international minimum standards, or higher.	BRSA	ST
Intensify supervisory engagement and monitoring using meaningful reporting practices, accompanied by robust, timely intervention and follow up with banks.	BRSA	ST
Enhance the risk-based, forward-looking perspective of CAMELS process, integrating Pillar 2 assessments (ICAAP and SRP), off-site work, stress-testing and ICT/Cyber dimensions.	BRSA	MT
Set financial stability as the legal objective of insurance supervision, ensure transparency of the nomination, appointment and dismissal processes of IPRSA's board members; and introduce a formal Own Risk and Solvency Assessment process.	Presidency, IPRSA	MT
Systemic Liquidity		
Strengthen the CBRT's operational autonomy, focus interest rate policy on inflation. Implement the interest rate corridor through monetary operations on the interbank money market solely.	CBRT	ST
Limit FX interventions to the most extreme cases of exchange rate volatility. Define a volatility-based FX rule. Build FX reserves over time.	CBRT	MT
Finalize review of the ELA framework.	CBRT	ST
Cyber Resilience		
Ensure FSC discusses ICT/cyber risks regularly and facilitates coordination among member agencies. Integrate ICT/cyber risk supervision within overall supervisory process	MOTF, BRSA, CBRT, CMB	ST
Factor ICT/ cyber risks in the financial stability analysis, develop a crisis management plan to address potential large-scale cyber-attack.	BRSA, CBRT	MT
Financial Integrity		
Take steps to exit the FATF grey list by demonstrating effectiveness and addressing all areas identified in the FATF's action plan, including with respect to politically exposed persons.	MASAK BRSA, CBRT	ST
Monitor key financial integrity risks stemming from the grey listing, and other cross-border regulatory actions.	MASAK, MoTF, BRSA, CBRT	MT
Implement FATF Recommendation 15 to address virtual asset risks.	MASAK, CMB	ST
Crisis Management and Resolution		
Introduce resolution planning and consider extending recovery planning to all banks; extend recovery requirements to entire groups and foreign affiliates.	SDIF, BRSA	ST
Enhance SDIF resolution powers in line with the FSB Key Attributes and empower SDIF to start preparations in the run up to resolution. Introduce a full P&A concept beyond insured deposits for all banks regardless of SDIF shareholdership status.	SDIF, MOTF	ST
End the use of SDIF funds for all loss coverage, liquidity, and recapitalization purposes and introduce loss absorbance principles in line with the liquidation hierarchy. Introduce resolution funding and the least-cost concept for SDIF funds.	SDIF, MOTF	ST
* Immediate (I) = within one quarter; short-term (ST) = within one year; medium-term (MT) = over one year		

50. Close monitoring of systemic FX liquidity risks remains critically important. As in the past, staff recommends focusing on the economy-wide interconnectedness of FX liquidity when formulating policies, designing bank liquidity stress tests, and assessing liquidity coverage ratios, with the Financial Stability Committee (FSC) playing a coordinating role. Given the potential systemic implications, staff also recommends enhanced crisis management frameworks and contingency planning across regulatory agencies.

51. Integrating crypto assets into the supervisory framework and closing data gaps are a priority. The adoption of crypto assets has gained pace in Türkiye, raising consumer protection, capital flow measure circumvention, and AML/CFT concerns (Box 5). Although regulations prohibit banks from directly holding crypto assets, improved policies could help enhance oversight, risk-management, regulation, and supervision of these assets, while also reducing their overall attractiveness. Priorities include enhanced prudential standards, tackling data gaps and standardization issues, and more effective legal and regulatory frameworks.[13]

52. The authorities should continue to take steps to fully implement the Financial Action Task Force (FATF) action plan. Türkiye's grey listing by the FATF in October 2021 identified serious weaknesses in the AML/CFT framework and exposes Türkiye to reputational and other risks. While progress has been made in addressing the FATF action plan, continued efforts are required to introduce enforceable legal measures and guidance for politically exposed persons and approving the law on crypto assets. Continuing to implement targeted financial sanctions without delay is critical. The authorities should also closely monitor the impact of bilateral foreign sanctions against third countries (even if not legally applicable in Türkiye), to help mitigate any reputational risk.

Authorities' Views

53. The authorities were confident in their credit allocation strategy and in the health of the banking and broader financial system. They disagreed that macrofinancial and regulatory measures were distortionary, while stressing that the role of the state in directing credit and supporting the transition to a more "liraized" economy was a key pillar of the TEM. The authorities expected capital buffers and prudent loan-loss provisioning to be sufficient even under a potential deterioration in asset quality and they did not see the need for a third-party asset quality review. They were confident in the banking system's ability to withstand a liquidity shock, but agreed fully with the importance of monitoring FX liquidity closely on an economy-wide basis.

54. The authorities highlighted their progress in dealing with crypto and AML/CFT risks. They noted the ongoing collaboration among supervisory agencies, the implementation of international prudential standards, and the recent inclusion of crypto asset service providers in the obliged parties list for AML/CFT purposes. They also highlighted ongoing work by the Capital Markets Board on a new regulation for crypto investment platforms that would strengthen investor protection. The authorities also stressed that Türkiye has made a high-level commitment to strengthen the effectiveness of its AML/CFT system and has taken further steps in this direction, which was also acknowledged by the FATF.

[13] For example, the recently issued Basel Committee second consultation on the regulatory capital treatment of direct bank holdings of crypto assets highlights the importance of risk management and indirect risk channels generated by crypto asset activity. https://www.bis.org/press/p220630.htm

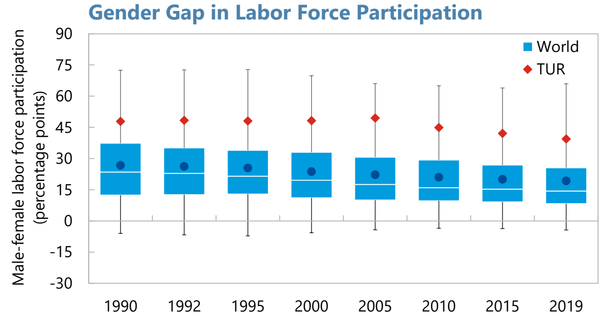
D. Structural Policies—Promoting More Inclusive and Sustainable Growth

Targeted reforms are critical to promote the necessary shift from demand stimulus to supply-side policies. This shift would help achieve the authorities' goals more durably, while also reducing vulnerabilities and Türkiye's exposure to downside risks. The 2019 Article IV consultation undertook a broad diagnostic of structural reform needs, while the 2021 consultation focused on policies to avoid pandemic-related scarring. This consultation focused on two other macro-critical structural themes: female labor force participation and climate change.

55. Focused structural and governance reforms would help foster stronger, sustainable growth and increase the economy's resilience to shocks. Switching to a productivity-led growth model calls for focused and carefully-sequenced structural reforms to improve the business and regulatory environment, labor market flexibility, and the quality of human capital.[14]

56. Closing Türkiye's labor market gender gaps would boost medium-term growth and make it more inclusive. Despite recent improvements, Türkiye's low female labor force participation and its high share of informal female workers stand out internationally. Policy priorities to close these gaps include improving the supply, targeting, and affordability of childcare services; increasing public spending on childcare and pre-primary education (following a cost-benefit analysis); optimizing targeted childcare subsidies, transfers, and tax allowances/credits for low-skilled mothers; assessing the impact of existing personal income tax brackets on female labor force participation; and ongoing efforts to enhance Türkiye's gender-budgeting framework. Measures to reduce the cost of employment would also benefit women by supporting job creation in the formal sector.

Gender Gap in Labor Force Participation



Sources: World Development Indicators and IMF staff calculations.
Note: The lower and upper lines of the box represent the first and the third quartiles respectively; the upper and lower whiskers represent the highest and the lowest points, respectively; the line inside the box represents the median and the dot represents the average. There are 187 countries included in these charts.

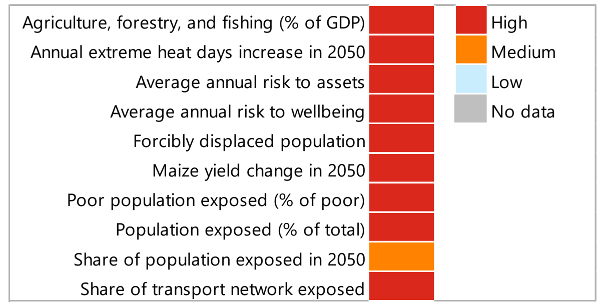
57. A comprehensive strategy, with carbon pricing at its center, would help Türkiye meet its climate goals. The 2022 Country Climate and Development Report (CCDR) for Türkiye—the World Bank's first such diagnostic report—showed that the country is vulnerable to the impact of climate change—and more so than most other OECD countries—and identified policy priorities to reduce emissions and improve resilience.[15] In addition to challenges from its own transition to a

[14] These three areas, as well as raising female labor force participation, were identified as reform priorities, in *IMF Country Report* No. 19/395, *Türkiye*, 2019 *Article IV* Consultation.

[15] See *World Bank Group. 2022. Türkiye Country Climate and Development Report.*

low-carbon economy (e.g., decarbonizing carbon-intensive industries), Türkiye needs to adapt to the carbon border adjustment mechanism planned by the European Union, Türkiye's main trading partner. Staff welcomed the authorities' commitment to reach net zero emissions by 2053 and presented a mitigation strategy with a carbon price rising progressively to USD 75 a ton by 2030 to make progress towards the net zero target. Revenues from the carbon price could be used to address its distributional effects, including through targeted support to low-income families, lower labor taxes, and higher public investment.

Climate Risk and Vulnerability in Türkiye



Source: World Bank CCDR (2022).
Note: Countries are rated using a benchmark approach: those rated at high risk (red) are in the top third, medium risk (orange) are in the middle third, and low risk (blue) are in the lowest third.

Authorities' Views

58. The authorities welcomed the discussions on gender and climate issues. On gender, they highlighted improvements made in recent years, as well as the fast recovery from the pandemic, and hoped to make further progress in order to boost medium-term growth and make it more inclusive. They noted their ongoing cooperation with UN-Women to enhance Türkiye's gender budgeting framework and expressed an interest in continuing discussions with Fund experts. On climate, the authorities highlighted their goal to achieve net zero emissions by 2053, while leaning towards an Emissions Trading System (ETS) to achieve their climate mitigation goals. They took note of staff's recommendation to combine the ETS with a robust price floor to encourage private investment and to auction emissions to raise revenue. Since the conclusion of the Article IV discussions, the authorities announced at COP27 Türkiye's updated Nationally Determined Contribution, pledging to reduce emissions growth between 2020 and 2030 from around 70 percent, under the business-as-usual scenario, to roughly 30 percent. This is a bigger commitment than under the previous target, which aimed at reducing emissions growth to 50 percent.

STAFF APPRAISAL

59. Türkiye's recovery from the pandemic has been remarkable. Türkiye was among the few countries to achieve positive growth in 2020, followed by growth of more than 11 percent in 2021 and strong growth momentum in 2022, setting it apart from most countries, thanks to outsized stimulative policies and a dynamic private sector.

60. But the same policies that buoyed growth also exacerbated pre-existing vulnerabilities. These vulnerabilities included low and falling reserve buffers and an increase in already-high dollarization.

61. A new policy model, introduced in late 2021, aimed at supporting growth and lowering inflation by eliminating Türkiye's current account deficit. The new Türkiye Economic Model (TEM) relied on interest rate cuts (despite high inflation and above-trend growth) and a complex set of macrofinancial and regulatory measures to reduce dollarization and credit growth, while directing lending to selected sectors. This new model represented a major departure from prevailing economic orthodoxy.

62. **But TEM policies, notably interest rate cuts, led instead to significant depreciation pressure on the lira, as inflation reached multi-year highs.** As conversion from lira to foreign currency accelerated, the lira depreciated sharply in late 2021, falling by half against the US dollar in a matter of weeks. These pressures were relieved by heavy FX intervention and a new FX-protected deposit scheme that protected lira deposits against excessive currency depreciation. While these measures helped initially, they failed to address the root causes of Türkiye's economic problems. The currency remained under pressure in 2022 and, as a result, inflation reached multi-year highs, at 85 percent in October, among the highest in large emerging markets. Despite increasing somewhat in recent weeks, gross reserves remain below the IMF's recommended range. And "core" reserves are deeply negative, after all central bank FX liabilities, including swaps, are factored in.

63. **The war in Ukraine delivered a large negative terms-of-trade shock and exacerbated already-high vulnerabilities.** Spillovers from the war led to a wider current account deficit and added to inflation, with the poor affected the most. Current policies and diminished buffers, especially low international reserves, leave Türkiye vulnerable to shocks and changes in sentiment, both at home and overseas, especially in the face of ongoing large gross external financing needs. Meanwhile, preliminary estimates suggest that Türkiye's external position was weaker than the level implied by medium-term fundamentals and desirable policies in 2022.

64. **Growth is expected to fall and inflation to remain high in 2023.** Reflecting lower growth carryover and lower external demand, growth is projected to fall to around 3 percent in 2023, despite low interest rates, still-positive real credit growth, and an expected loosening of fiscal policy. This forecast also assumes still-binding external financing constraints that limit the authorities' ability to continue stimulating growth. Inflation is expected to fall, mostly driven by fading exchange rate passthrough. But inflation is also expected to remain high, and much higher than in peers, given loose policies, inflation inertia, limited policy credibility, and un-anchored inflation expectations.

65. **While near term upside risks to growth are non-negligible, downside risks to medium-term growth have increased due to rising economic distortions and vulnerabilities.** While containing volatility and credit growth, increasingly distortionary and complex macrofinancial and regulatory policies have blurred market signals, led to a misallocation of resources, constrained private credit, weakened bank balance sheets, and increased bank compliance costs, all of which undermine long-term growth prospects. Other downside risks include a doubling down of pro-growth policies in the lead up to the elections given FX liquidity risks and absent sufficient external financing, faster-than-expected tightening by advanced market central banks, escalating geopolitical tensions, higher global risk aversion, weaker global growth, and another COVID-19 wave at home or abroad. Upside risks to near-term growth are non-negligle—notably from unexpected sources of external financing that allow for more aggressive pro-growth policies—while upside risks to inflation from a weaker-than-expected lira remain high.

66. The risk of high inflation becoming entrenched has also increased. Türkiye has a history of high inflation and, with no effective monetary anchor and limited central bank credibility, inflation risks becoming entrenched at higher levels and increasing further over time. The longer inflation remains so high, the more it risks becoming entrenched, including through more frequent and automatic indexation of wages and prices, and the more difficult it will be to re-anchor inflation expectations, raising the growth and employment costs of any future disinflation efforts.

67. Risks and vulnerabilities are rising and buffers remain low, but Türkiye's challenges are not insurmountable. Tight monetary and fiscal policies, along with the careful normalization of macrofinancial and regulatory policies would help promote macroeconomic and financial stability, key pre-requisites for sustainable medium-term growth. Building on these policies, targeted structural reforms would support a shift in focus on supply-side policies to boost potential growth. Taken together, these policy shifts would help achieve the authorities' goals more durably, while also reducing vulnerabilities and exposure to downside risks.

68. Prompt, sizeable and credible interest rate hikes are needed to lower inflation and should be combined with reforms to strengthen central bank independence. Türkiye's deeply negative real interest rates stand out internationally, adding to pressure on the lira and fueling inflation. A prompt and sizeable increase in interest rates, accompanied by a credible commitment to the central bank's price stability target, would help the disinflation process through the exchange rate and inflation expectations channels. It is important that monetary tightening be complemented with policies to strengthen central bank independence. FX intervention should be kept to a minimum and reserves replenished in a transparent manner, as conditions allow.

69. Macrofinancial and regulatory measures should be phased out carefully, prudential standards strengthened, and systemic FX liquidity risks closely monitored. The slowdown in credit growth is welcome and should continue, but, as noted by the 2022 FSAP, heavy reliance on increasingly complex macrofinancial and regulatory measures to manage credit provision needs to be curtailed. This would help minimize price formation and capital allocation distortions, reduce the role of the state in credit allocation, and reinstate interest rates as the primary monetary policy instrument. The longer existing macrofinancial and regulatory measures are allowed to persist and to evolve, the greater the economic distortions and the more costly it will be to unwind them. The role of the Credit Guarantee Fund and the scope of non-commercial activities of state-owned banks should be scaled back. Close monitoring of systemic FX liquidity at an economy-wide level remains critically important. These policies should be accompanied by tighter prudential standards and an unwinding of regulatory forbearance, as well as efforts to further strengthen regulatory, supervisory, resolution, and AML/CFT frameworks.

70. A tight fiscal stance, with targeted assistance to the vulnerable, as well as fiscal governance reforms, would help preserve fiscal space and limit quasi-fiscal risks. While Türkiye's public debt burden remains low, fiscal space is being eroded—notably by rising spending pressures and higher contingent liability, and quasi-fiscal risks, as well as the large debt exposure to FX shocks in an environment of a weak external position—which could undermine investor confidence. A tight fiscal stance, with targeted measures to support the vulnerable, would preserve fiscal space, while also containing domestic demand. Other priorities include enacting fiscal governance reforms to improve transparency and expand oversight and management of quasi-fiscal activities and contingent liabilities, achieving public debt management goals through more durable means, and gradually replacing natural gas subsidies with better-targeted mechanisms.

71. Focused structural reforms would help foster stronger sustainable growth and increase the economy's resilience to shocks. Targeted supply-side policies could help boost long-term growth through higher productivity, greater labor force participation, and higher investment. Priorities include reforms to improve the business and regulatory environment, greater labor market flexibility, raising the quality of human capital, and increasing female labor force participation. Reforms can also help strengthen Türkiye's resilience to climate change and facilitate its transition to a low-carbon economy that is less dependent on imported fossil fuel and based on a more sustainable growth model.

72. It is recommended that the next Article IV consultation with Türkiye be held on the standard 12-month cycle.

Box 1. FX-Protected Deposit Scheme

FX-protected deposit schemes were introduced in December 2021 to stem lira pressure and support depositor confidence. Supported by large central bank FX interventions, these proved effective in helping to stabilize the lira, and reversed some of its earlier losses.

By compensating for exchange rate risk, the schemes aim to encourage "liraization." To qualify for the scheme, deposits must have a fixed maturity of up to a year and earn interest, paid by banks, set at up to 300 basis points above the CBRT policy rate. Should the lira depreciate over the deposit term by more than the set interest rate, the depositor receives compensation—namely the margin between the depreciation rate and the interest rate—paid by either the MoTF or CBRT. The MoTF covers the FX-protected deposits funded by lira deposits, while the CBRT covers FX-protected deposits funded by FX deposit conversion. The schemes also benefit from attractive tax treatment.

FX-protected lira deposits have grown substantially. They rose to almost 1.5 trillion Turkish lira (original face value) by end-October, accounting for 37 percent of lira deposits and 17 percent of total bank deposits. Since the start of the schemes, the share of lira deposits (inclusive of FX-protected lira deposits) in total bank deposits rose from 36 percent at end-2021 to 47 percent, pointing to significant deposit liraization, thanks to the rise in FX-protected deposits.

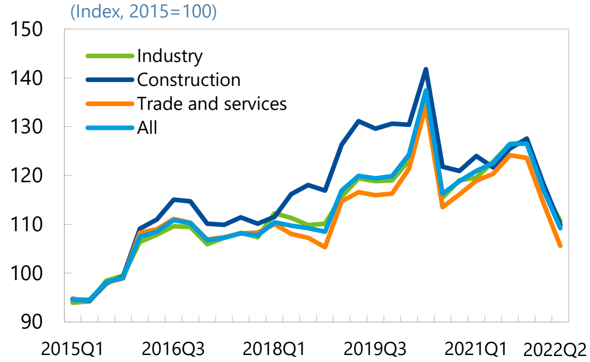
FX-protected schemes present a significant fiscal risk and will be a challenge to unwind. Under the scheme, the state has assumed most of the exchange rate risk, taking over from depositors. Staff estimates its annual cost, total for the Treasury and CBRT, at 0.8 percent and 0.3 percent of GDP in 2022 and 2023 under baseline assumptions. The cost is subject to major uncertainty and could rise significantly if the lira were to depreciate by more than expected, with every extra 10 percent depreciation leading to an estimated additional 0.4 percent of GDP cost in 2023, everything else equal. To improve transparency and allow more accurate assessment of contingent liabilities, staff recommends disseminating all relevant data (stock, flows, costs) with a breakdown between household and corporate deposits split by MoTF and CBRT deposit schemes.

Box 2. The Economic Costs of High Inflation

High inflation can create significant economic distortions, especially when macrofinancial and regulatory measures inhibit full market adjustment. This box looks at how high inflation in Türkiye is affecting real incomes and poverty and how it is distorting valuable price signals.

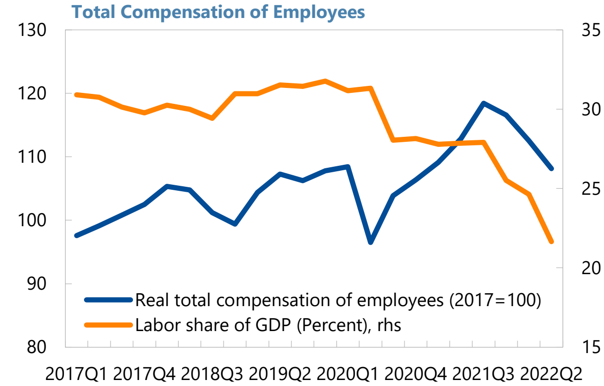
Real Income. Real wages, across all broad industrial sectors, have fallen steeply in 2022H1 as inflation has eroded workers' pay. Real wages are likely to recover with a lag, as workers demand higher nominal pay rises, but this will only further entrench inflation persistence, increasing the cost of inflation normalization. This lower real wage bill, as well as deeply negative borrowing costs and stimulus-induced growth, has boosted private sector profits. And has had the effect of significantly reducing the labor share of GDP.

Average Hourly Real Wages
(Index, 2015=100)



Sources: Turkstat; Haver Analytics; and IMF staff calculations.

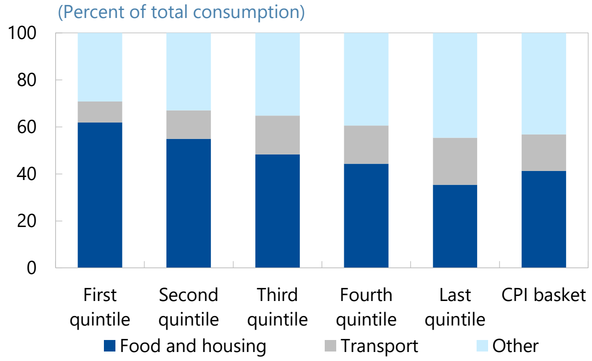
Total Compensation of Employees



Source:s: CBRT; Haver Analytics; and IMF staff calculations.

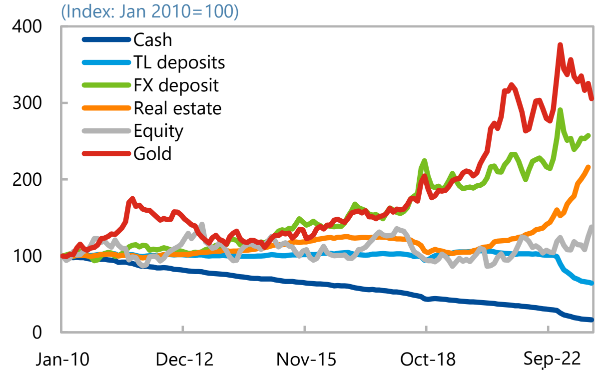
Poverty. The poor are hit hard by inflation through two channels. First, a relatively rigid consumption basket dominated by essential goods—such as food and housing—reduces the scope for expenditure switching as prices rise. As these essential goods are difficult to substitute away from, any increase in prices can lead to large welfare losses. Second, the poor are often less able to hedge any wealth they hold against price rises, leading to the erosion of economic buffers in times of inflation. This is especially the case when macrofinancial and regulatory measures constrain savers from switching to assets that have a better inflation hedge. In Türkiye there is no data on the size or composition of wealth by income group. But beyond the inference that low-income households are likely to hold less wealth, the composition of assets held is also likely to vary. Low-income households are more likely to hold the limited wealth that they have in cash or lira deposits, which historically have performed poorly in real terms. In contrast, the real return on gold and FX deposits has been much stronger in Türkiye. More recently, real house prices have also risen dramatically, increasing the net wealth of property owners, but generating affordability problems for new buyers.

Household Consumption by Income, 2019
(Percent of total consumption)



Sources: Turkstat and IMF staff calculations.

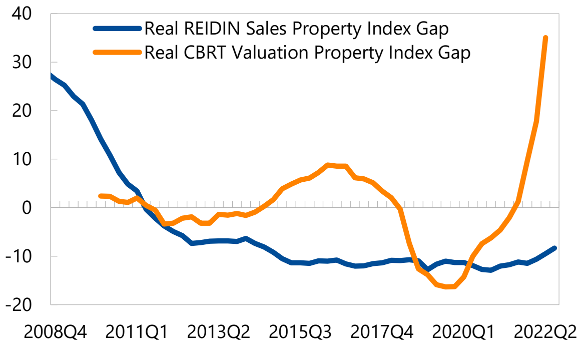
Real Lira Return On Assets
(Index: Jan 2010=100)



Sources: CBRT; Haver Analytics; and IMF staff calculations.

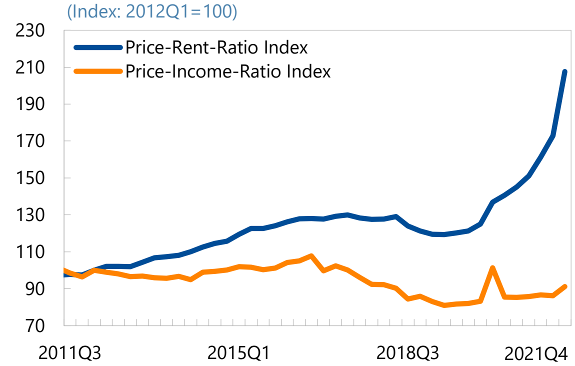
Box 2. The Economic Costs of High Inflation (concluded)

Real House Price Gaps
(Percent)



Sources: CBRT and IMF staff calculations.

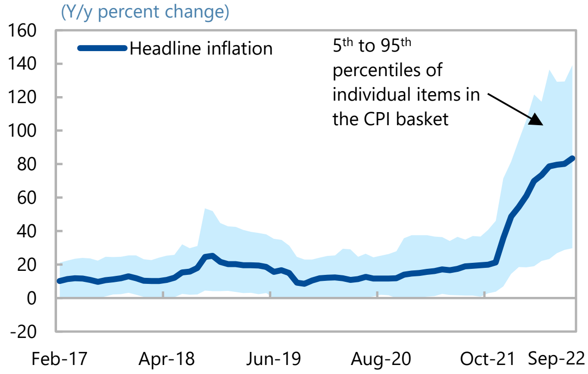
Residential Housing Price Misalignment Indices
(Index: 2012Q1=100)



Sources: CBRT and IMF staff calculations.

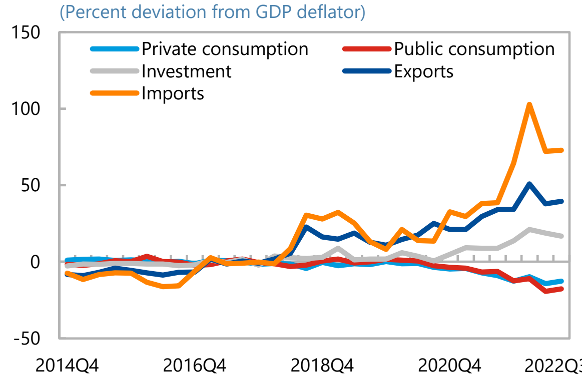
Distorted Price Signals. Important business decisions, including on capital investment, hiring staff and negotiating contracts, are also distorted by high inflation. Since late 2021, the dispersion of consumer prices has grown significantly, making it more difficult for businesses to distinguish between relative and general price changes, and making the allocation of resources across products more difficult. The price of investment goods has also grown by significantly more than consumer goods, complicating investment decisions.

Inflation Dispersion
(Y/y percent change)



Sources: Turkstat and IMF staff calculations.

Deflator by Component
(Percent deviation from GDP deflator)



Sources: Haver Analytics and IMF staff calculations.

Box 3. Net Errors and Omissions

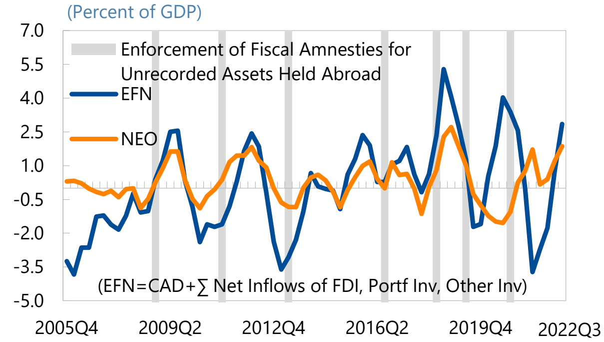
Net errors and omissions (NEO) have surged to all-time highs. Inflows reached around USD 25 billion, or 2.9 percent of GDP, year-to-date through September 2022. These inflows helped finance more than 65 percent of the current account deficit over the same period, alleviating pressures on foreign reserves and the lira.

NEO inflows have provided financing during recent episodes of external pressure. While NEO have historically fluctuated around zero, inflows have tended to outstrip outflows on a more persistent basis in recent years, reaching a cumulative USD 60 billion since 2008. A pattern has also emerged, where periods of NEO inflows coincide with episodes of wider external financing needs (the pandemic being a notable exception), helping relax external financing constraints, thereby limiting the drawdown of central bank reserves.

Cumulative Net Errors and Omissions
(Billions USD)

Sources: CBRT and IMF staff calculations.

4-Quarter Rolling EFN and NEOs
(Percent of GDP)



Sources: CBRT and IMF staff calculations.
Note: 2022Q3 GDP is IMF forecasted GDP.

Various factors could explain the particularly large NEO inflows in 2022. These include deposit withdrawals and repatriation by non-bank residents from foreign banks not covered by the BIS data, as well as broader repatriation of unrecorded foreign assets by Turkish companies and households, including in response to tax amnesties. Anecdotal evidence also suggests that Türkiye experienced a higher-than-usual inflow of physical cash in 2022, reportedly driven by Russian or neighboring citizens paying for real estate in cash. Finally, Turkish companies and households withdrew sizeable amounts of foreign currency cash from banks during the sharp lira depreciation in December 2021, resulting in a record NEO outflow of USD 10 billion that month. Restrictions on lending introduced in 2022, combined with a more depreciated lira, could have encouraged the return of this foreign currency into the banking system.

Box 4. The Authorities' Medium-Term Projections

On September 4, 2022, the authorities published their "Medium-Term Economic Programme (2023–2025)," which laid out key economic projections for the medium term. These included growth of 5–5½ percent, in line with the average over the last two decades, but significantly above staff's estimate of potential growth (closer to 3 percent). Despite strong growth, the authorities expected inflation to fall to single digits by 2025 and the current account deficit to shrink to 1 percent of GDP by 2025. This is consistent with the logic of the TEM: that a lower current account will stimulate growth, stabilize the lira and bring down inflation. The authorities also envisaged a strong improvement in the fiscal balance, with the debt-to-GDP ratio 5 percentage points lower than staff's projection by 2025. However, measures to achieve this fiscal consolidation were not articulated.

	2022	2023	2024	2025	2022	2023	2024	2025
	IMF Proj.				MTP			
Real GDP growth rate (Y/Y)	5.5	3.0	3.0	3.0	5.0	5.0	5.5	5.5
Inflation (EOP, Y/Y)	70.0	36.0	21.3	20.0	65.0	24.9	13.8	9.9
Current account balance (percent of GDP)	-6.0	-3.4	-2.5	-2.2	-5.9	-2.5	-1.4	-0.9
Central government primary balance (percent of GDP)	-1.0	-1.7	-1.0	-0.7	-1.0	-0.5	0.5	1.3
General government gross debt (percent of GDP)	35.6	35.4	36.6	38.4	36.7	35.2	33.6	32.1

Sources: Turkish authorities and IMF staff estimates.

Box 5. Crypto Assets in Türkiye

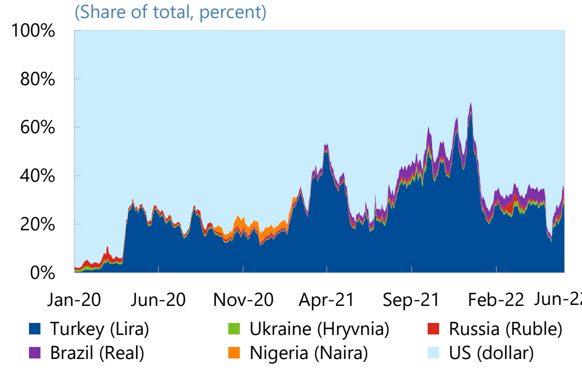
Crypto asset activity has increased in recent years in Türkiye, raising risks, and warranting continued close monitoring.

Crypto asset activity has increased in Türkiye. Türkiye has 37 active centralized crypto exchanges, with an estimated 15 million client accounts, and the largest share of crypto asset trading application adoption across advanced and emerging economies.[1] Outside of the period of market stress in December 2021, where crypto trading escalated, daily transaction volumes have averaged close to USD 1-2 billion a day, compared to the USD 3-4 billion average in Turkish lira FX volumes. Following the recent failure of crypto asset exchange FTX, Türkiye's Financial Crimes Investigation Agency (MASAK) initiated an investigation into the institutions related to FTX's regional subsidiary. It also noted that it had been monitoring FTX's activities in accordance with the country's AML laws.

Some assets have seen outsized trading against the lira. Tether—the largest stablecoin—has seen especially strong demand, with outsized trading against the lira compared to other EM currency trading. This likely reflects Turkish lira volatility in recent years.

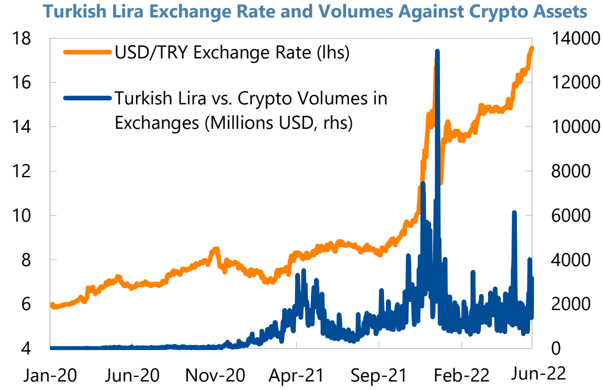
The increased role of crypto raises risks that warrant careful monitoring. These include the possible entrance of new entities with weak controls; the potential for crypto to circumvent capital flow measures; and possible AML/CFT risks.[2]

Tether Trading Volumes Against Select Currencies
(Share of total, percent)



Sources: Bloomberg L.P.; CryptoCompare; and IMF staff calculations.

Turkish Lira Exchange Rate and Volumes Against Crypto Assets



Sources: Bloomberg L.P.; CryptoCompare; and IMF staff calculations.

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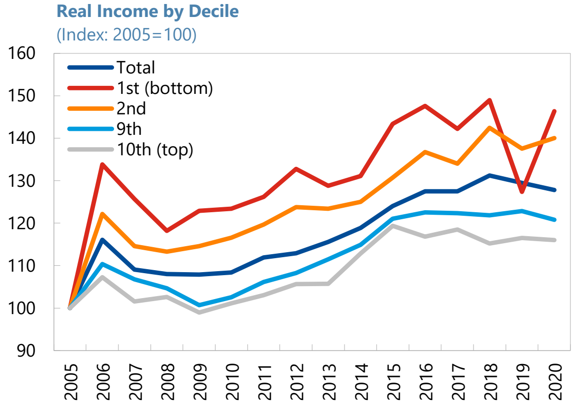
[1] See November 2022 BIS Working Paper, Crypto trading and Bitcoin prices, evidence from a new database of retail adoption.

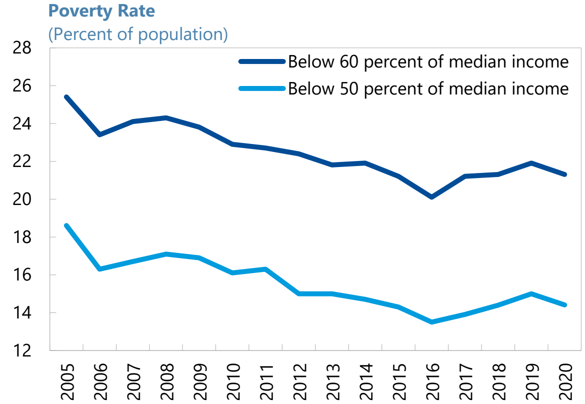
[2] See 2022 IMF Fintech Note on Capital Flow Management Measures in the Digital Age: Challenges of Crypto Assets and October 2021 IMF GFSR Chapter 2: The Crypto Ecosystem and Financial Stability Challenges.

Figure 1. Türkiye: Poverty and Inequality

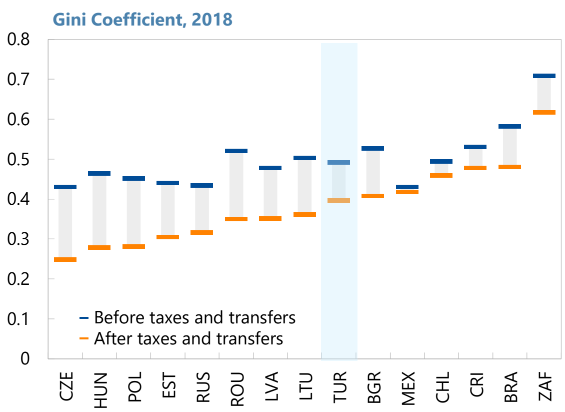
Average real income declined in recent years, with the bottom decile especially volatile.



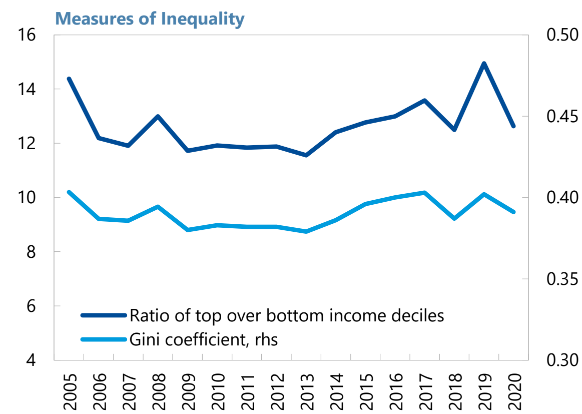
While relative poverty fell from the early 2000s, progress has stalled more recently.



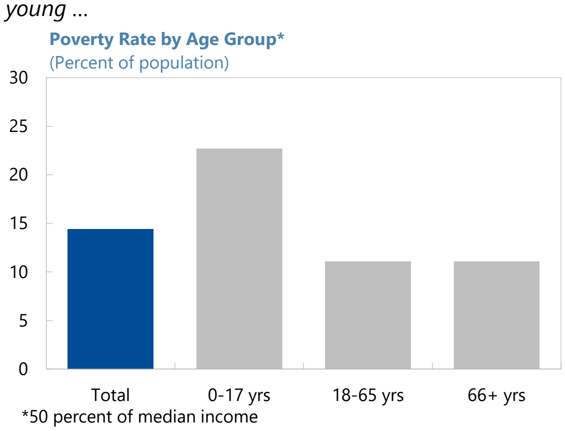
Inequality is similar to EM peers when taxes and transfers are controlled for...



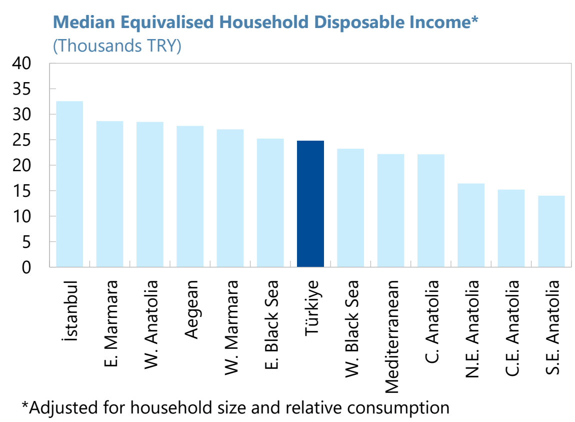
...but it has increased of late.



Poverty rates are particularly concentrated among the young ...

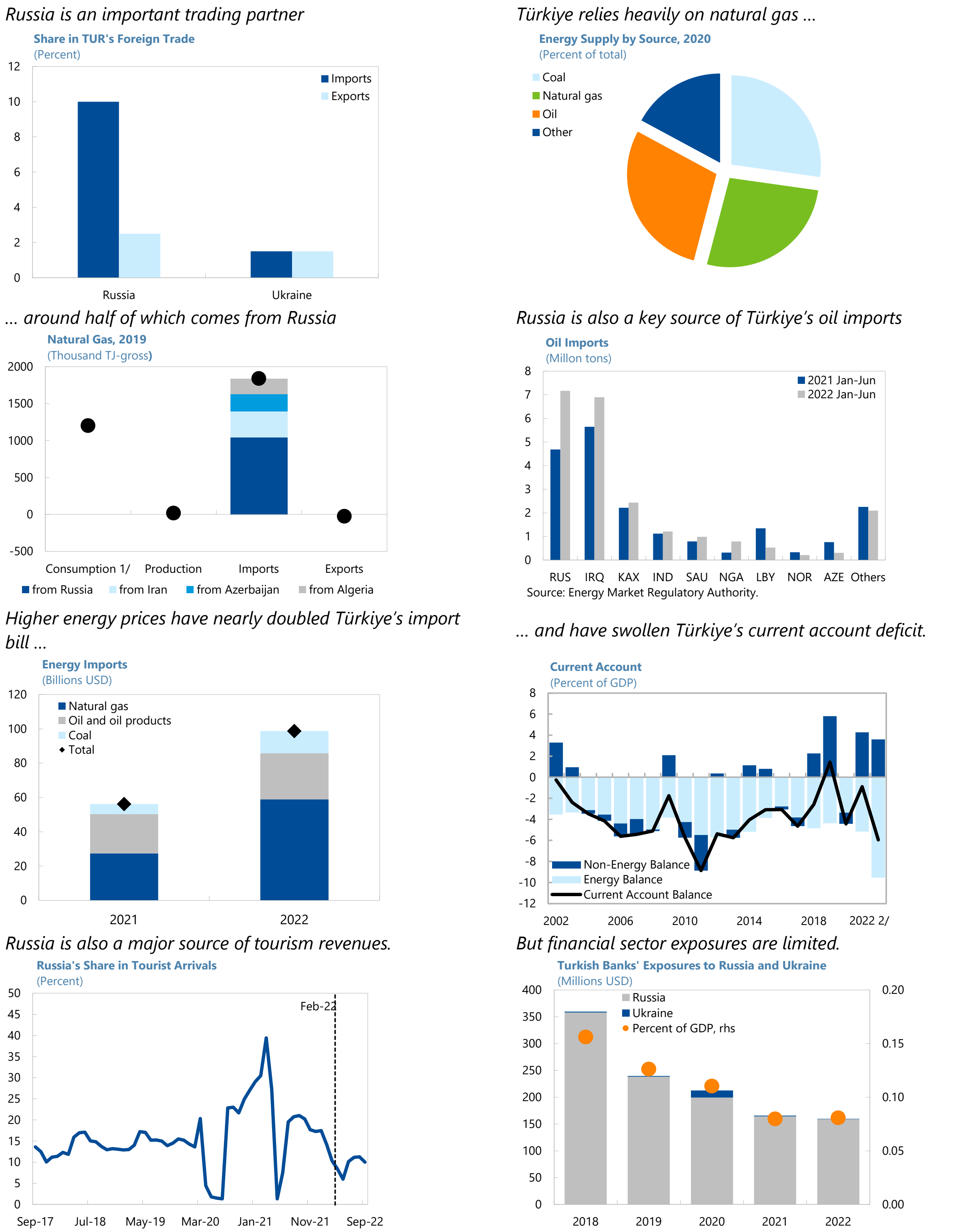


... and in the eastern regions of Türkiye.



Sources: Turkstat; Haver; OECD and IMF staff calculations.

Figure 2. Türkiye: Key Spillovers from the War in Ukraine



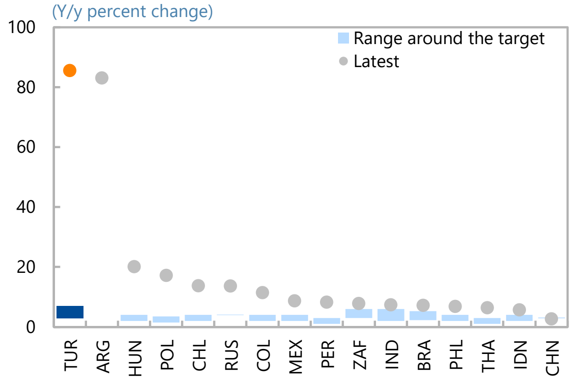
Sources: Turkstat; Haver; Bank for International Settlements; IEA, and IMF staff calculations.

1/ Excludes deliveries for transformation and/or own use of the energy producing industries. 2/Cumulative sum of available data (Jan-Sep) divided by IMF forecasted 2022Q3 GDP.

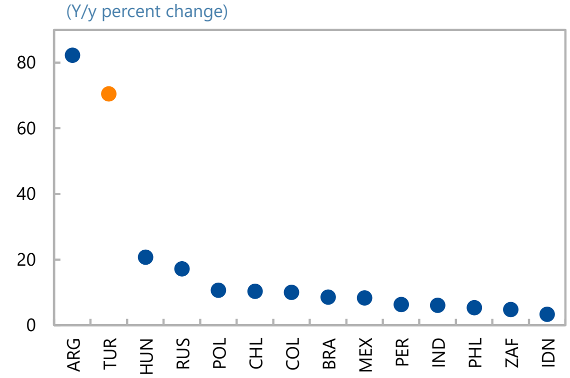
Figure 3. Türkiye: Inflation Developments in an International Context

Türkiye's high inflation rates stand out.

Selected EMs CPI Inflation, Latest
(Y/y percent change)

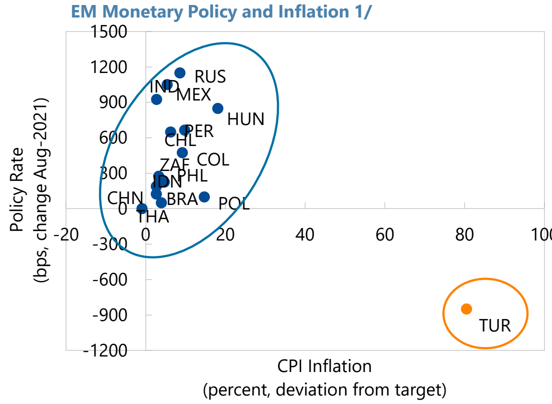


Selected EMs Core CPI Inflation, Latest
(Y/y percent change)



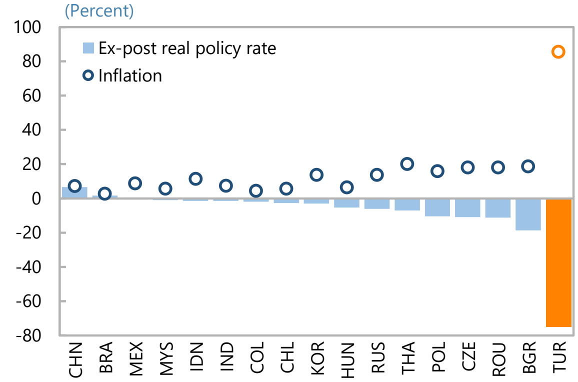
Unlike Türkiye, other EMs have tightened monetary policy aggressively …

EM Monetary Policy and Inflation 1/



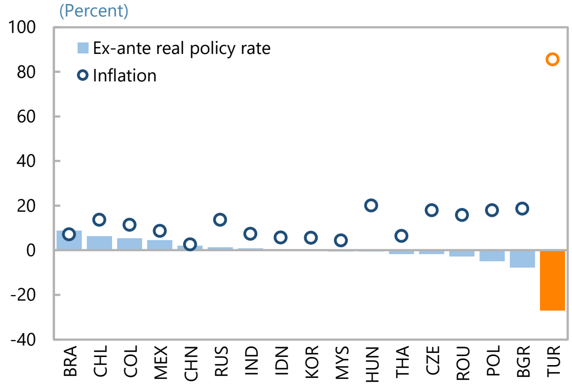
… such that Türkiye's deeply negative real rates stand out ex-post …

Ex-Post Real Policy Rate and Inflation
(Percent)



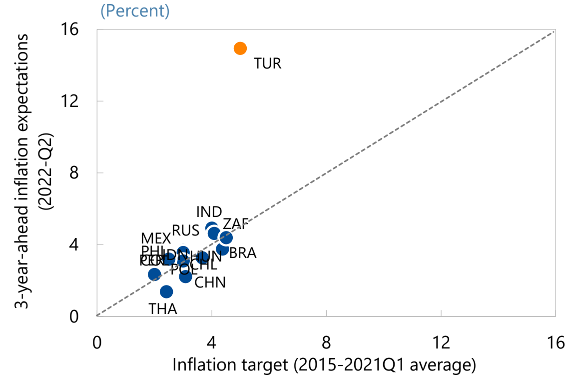
… and ex-ante…

Ex-Ante Real Policy Rate and Inflation
(Percent)



… as inflation expectations have de-anchored more than in most EMs

EMs 3-year-ahead Inflation Expectations vs Target 1/
(Percent)

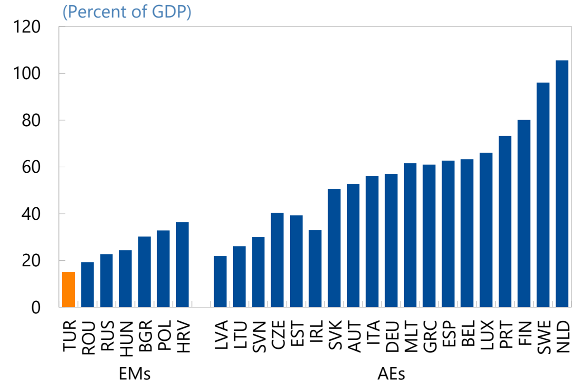


Sources: Central Bank of the Republic of Türkiye; Consensus Forecasts; Country authorities; Eurostat; Haver Analytics; Turkstat; and IMF staff calculations.
1/ Excludes Argentina.

Figure 4. Türkiye: Household Balance Sheets

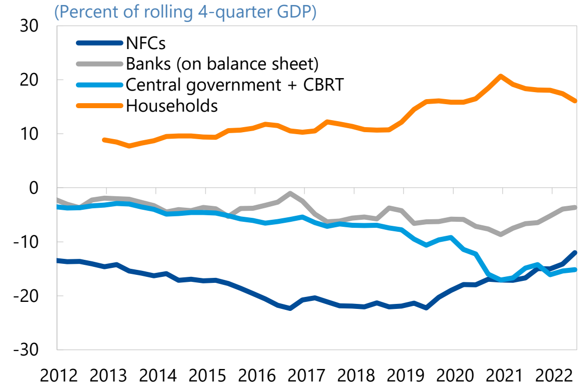
Turkish households have very low debt levels relative to emerging market peers.

Household Debt, 2021
(Percent of GDP)



And they are the only sector to have a positive net FX balance sheet position.

Net FX Position
(Percent of rolling 4-quarter GDP)

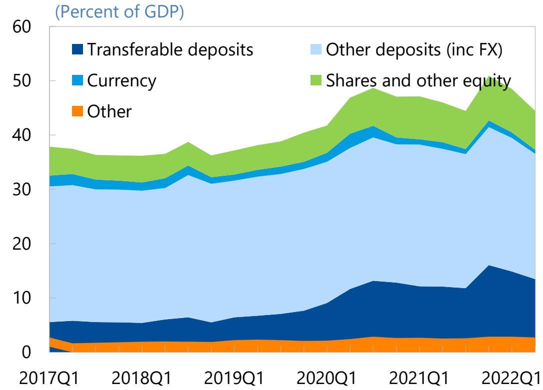


Real incomes recovered strongly after the pandemic but have since been eroded by high inflation.

Real Total Compensation of Employees
(MIllions TRY, 2017 prices)

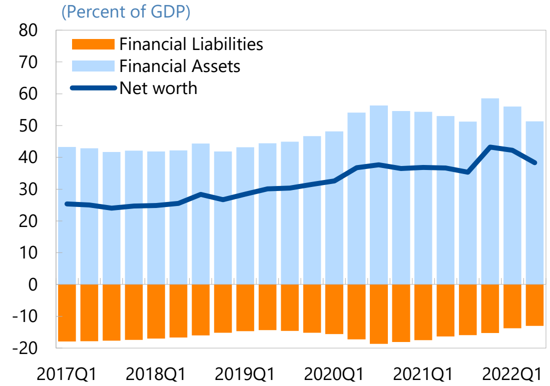
Financial assets are dominated by FX deposits.

Financial Assets
(Percent of GDP)



Nevertheless, net financial wealth has still been eroded by high inflation…

Household Financial Net Worth
(Percent of GDP)



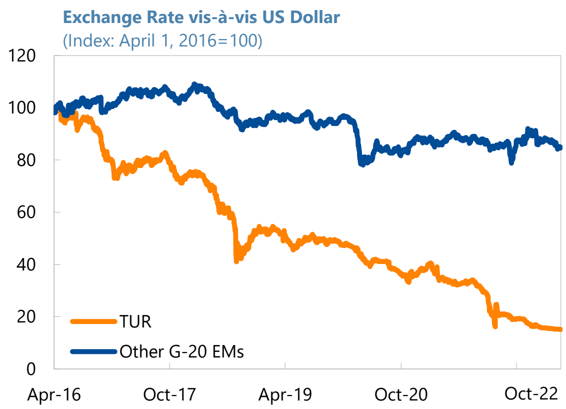
… shifting resources to non-financial assets., such as housing, which has caused a steep increase in house prices.

Real House Prices
(Index: 2017=100)

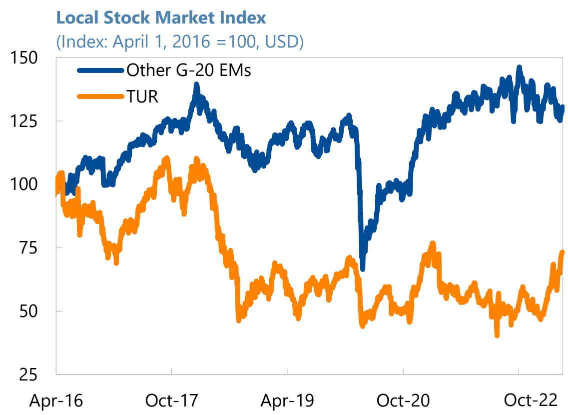
Sources: CBRT; Haver Analytics; and IMF staff calculations.

Figure 5. Türkiye: Financial Markets

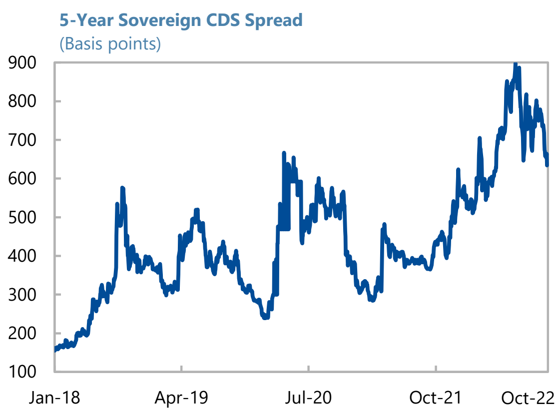
The Turkish lira has depreciated sharply in the last few years …



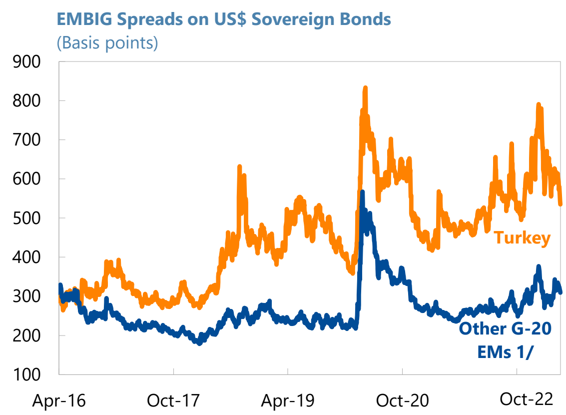
… muting local stock market gains.



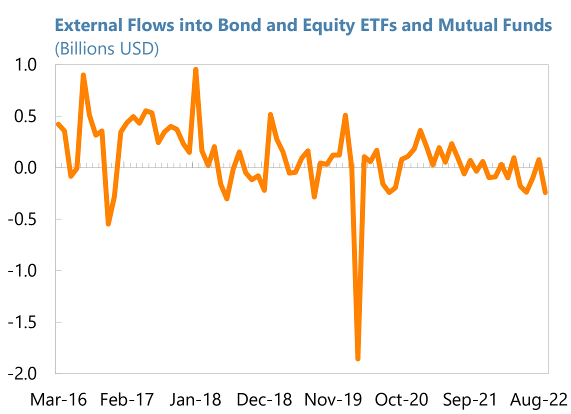
Türkiye's CDS spread has widened significantly …



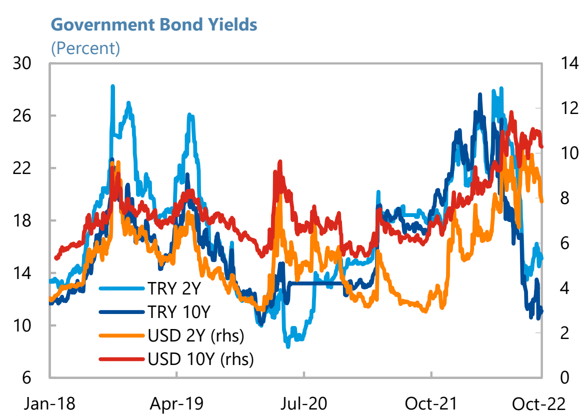
… and so have its bond spreads…



… as light portfolio outflows have continued.



In contrast, local currency government bond yields have dropped sharply on regulations forcing banks to hold securities.



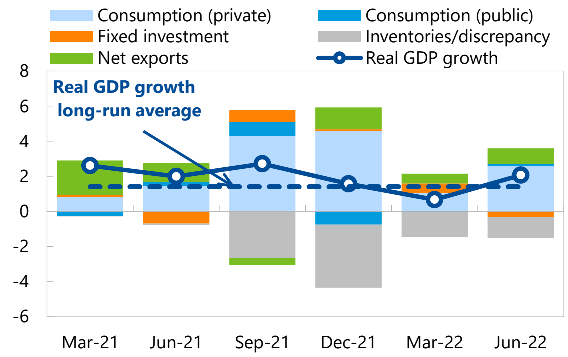
Sources: Bloomberg Finance L.P.; Haver Analytics; and IMF staff estimates.

1/ Excludes Russia.

Figure 6. Türkiye: Real Sector Developments

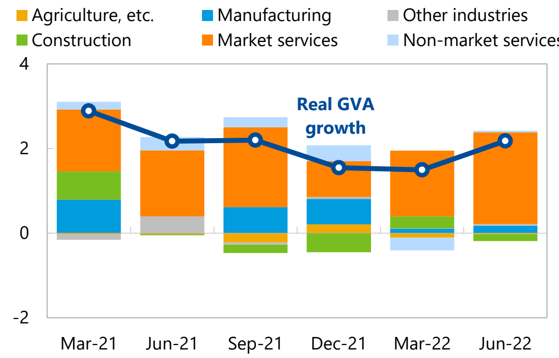
Growth has remained robust, driven by private consumption …

Contributions to Real GDP Growth
(Percent, quarter-on-quarter)



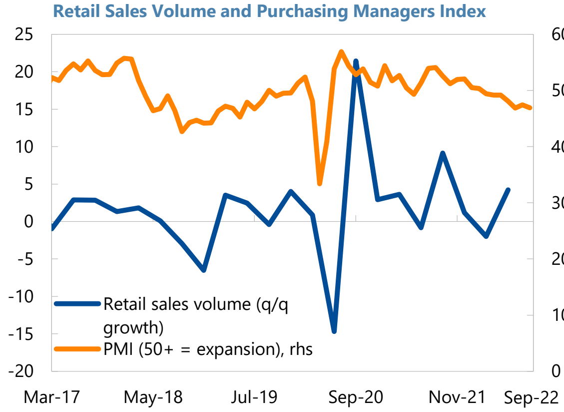
… and, on a sectoral basis, by services.

Contributions to Real GVA Growth
(Percent, quarter-on-quarter)



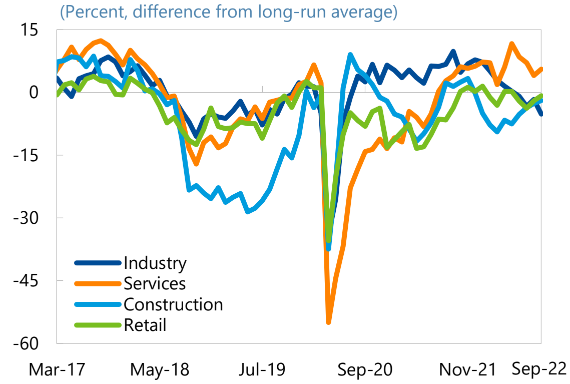
Recent indicators have softened …

Retail Sales Volume and Purchasing Managers Index



… as has confidence among business in key sectors.

Sectoral Confidence Indicators
(Percent, difference from long-run average)

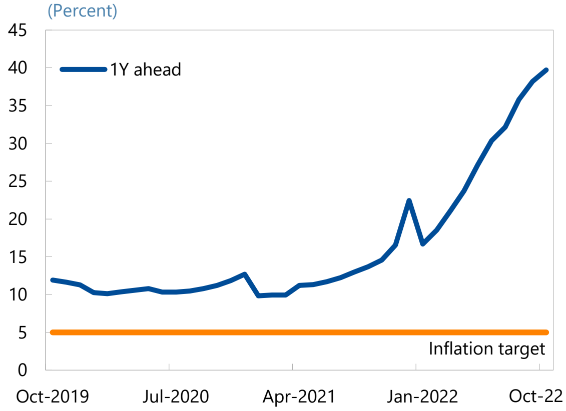


Loose monetary policy and higher commodity prices brought inflation to multi-year highs …

Consumer Price Index
(Percent, y/y change)

… and further dislodged inflation expectations.

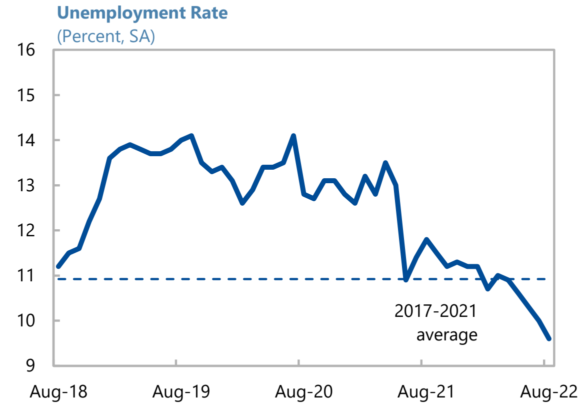
Inflation Expectations
(Percent)



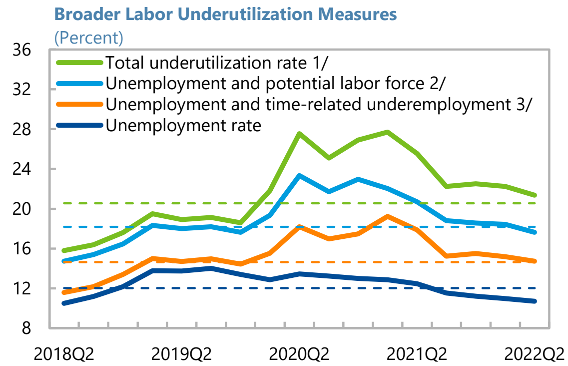
Sources: Bloomberg Financial Markets L.P.; CBRT; Consensus Forecast; European Commission; Turkstat; and IMF staff calculations.

Figure 7. Türkiye: Labor Market Developments

The unemployment rate has fallen sharply …

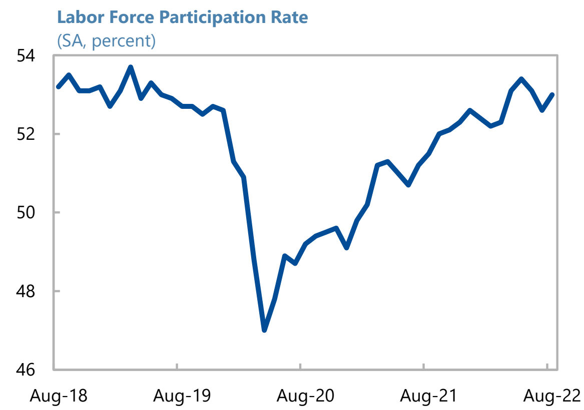


… as have broader slack measures.

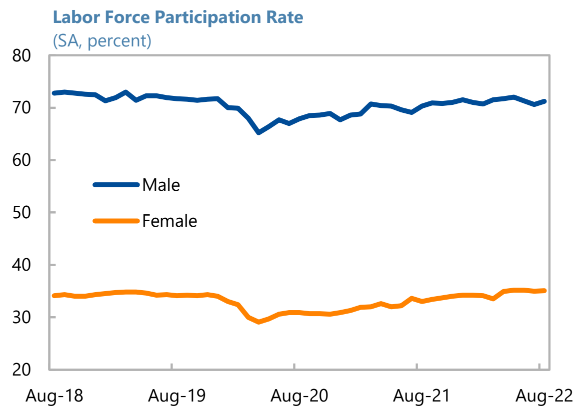


Note: Dashed lines are 2017-2021 average.

Labor force participation has broadly recovered …



… across both male and female labor force participants.



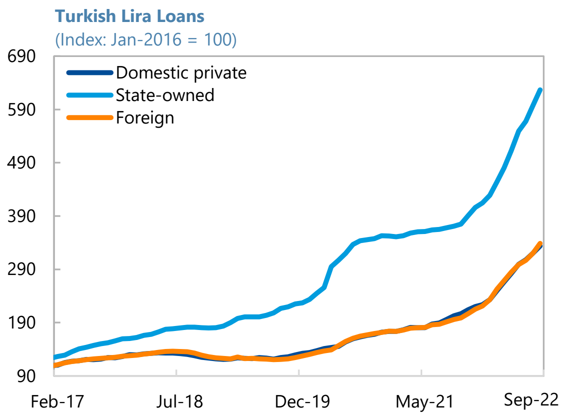
Nominal wage growth has picked up sharply…

… although real wages have been eroded

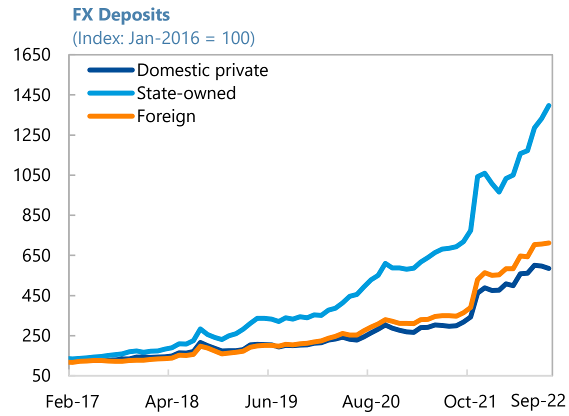
Sources: Turkstat; Haver Analytics; and IMF staff calculations.
1/ Ratio of the sum of unemployed, time-related underemployment, and potential labor force to the sum of labor force and potential labor force.
2/ Ratio of the sum of unemployed and potential labor force to the sum of labor force and potential labor force.
3/ Ratio of the sum of time-related underemployment and unemployed people to the labor force.4/ Gross wages and salaries are defined as the total remuneration, in cash or in kind, payable to all persons counted on the payroll (including home workers), in return for work done during the accounting period, regardless of whether it is paid on the basis of working time, output or piecework and whether it is paid regularly.
4/ Gross wages and salaries are defined as the total remuneration, in cash or in kind, payable to all persons counted on the payroll (including home workers), in return for work done during the accounting period, regardless of whether it is paid on the basis of working time, output or piecework and whether it is paid regularly.

Figure 8. Türkiye: Financial Sector

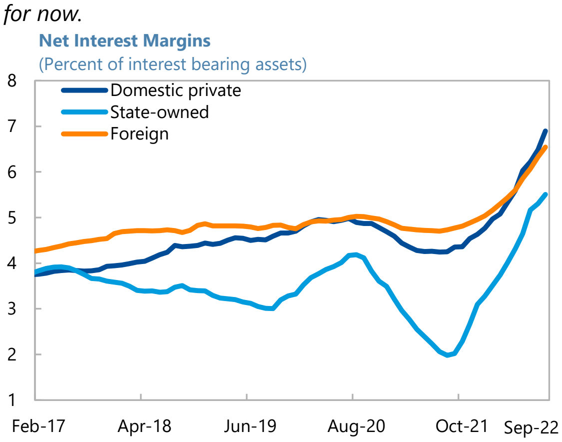
Bank credit growth decelerated at the margin, but remains strong …



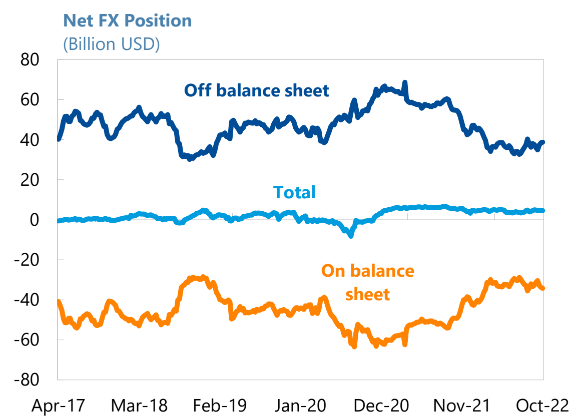
… while headline deposit dollarization has slowed down, especially for private banks, following the introduction of TL FX-protected deposits.



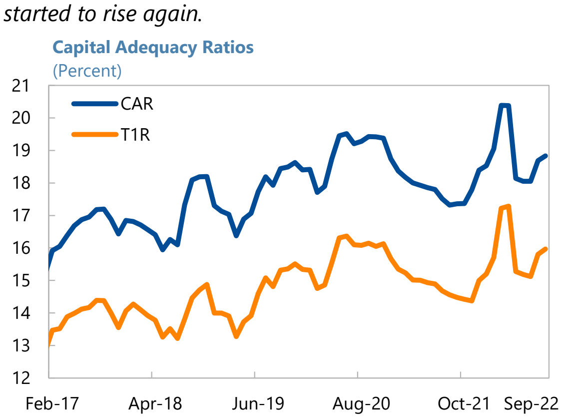
Higher securities' income from inflation-linked and FX-denominated bonds have contributed to wider margins, for now.



The net FX position of the banking system has remained broadly balanced.

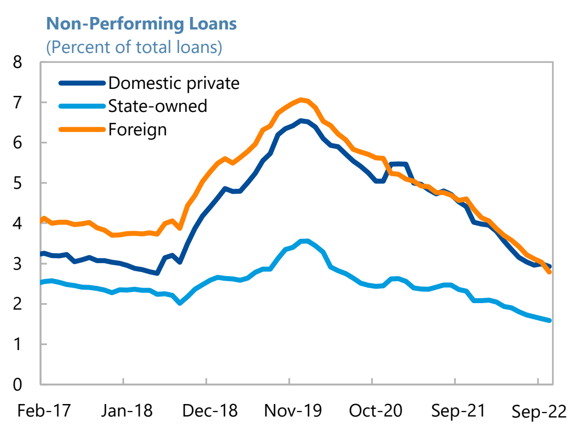


After rebounding on private bank profits and SOB capital injections, capital ratios have fallen from their peaks on adjustments in regulatory forbearance, but have since started to rise again.



Notes: Monthly EOP NSA. CAR= Regulatory Capital/RWA. T1R= T1 Capital/ RWA.

Non-performing loan ratios have declined steadily on strong loan growth and regulatory forbearance.

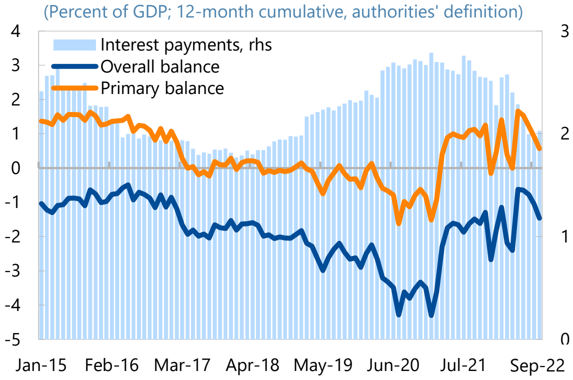


Sources: BRSA; CBRT; and IMF staff calculations.

Figure 9. Türkiye: Fiscal Stance

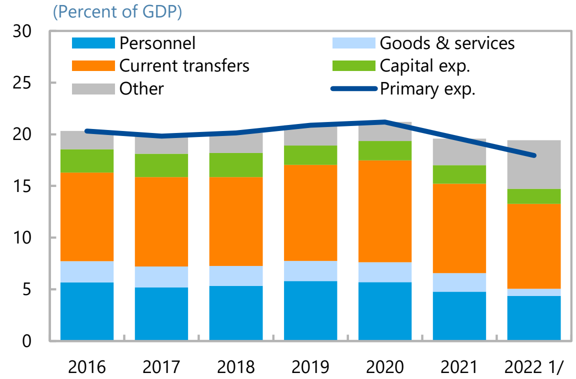
The central government budget overperformed in the first three quarters of 2022…

Central Government Fiscal Balance
(Percent of GDP; 12-month cumulative, authorities' definition)



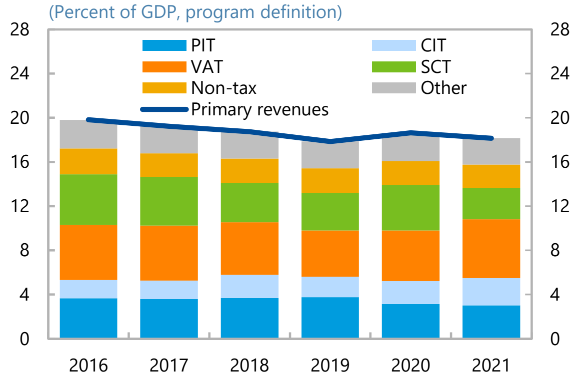
…as spending execution is expected only in late 2022…

Central Government: Primary Expenditure Components
(Percent of GDP)



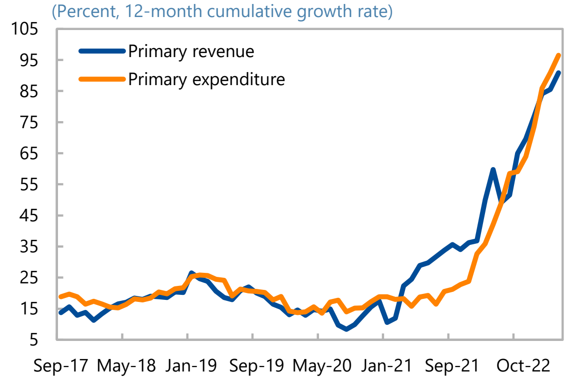
…while revenues held up as a share of GDP.

Central Government: Primary Revenue Components
(Percent of GDP, program definition)



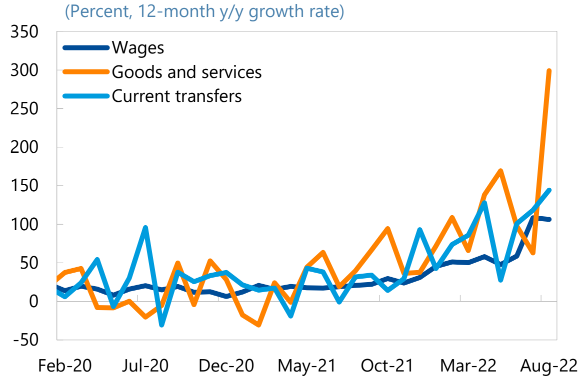
But, lately, expenditure growth has overtaken revenue growth.

Central Government: Primary Revenue/Expenditure
(Percent, 12-month cumulative growth rate)



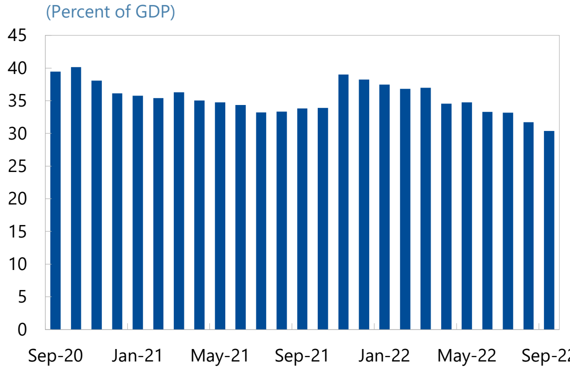
Spending on goods and services has increased especially sharply.

Central Government: Current Expenditure
(Percent, 12-month y/y growth rate)



With strong nominal GDP growth, the central government debt stock has fallen.

Central Government Debt Stock
(Percent of GDP)

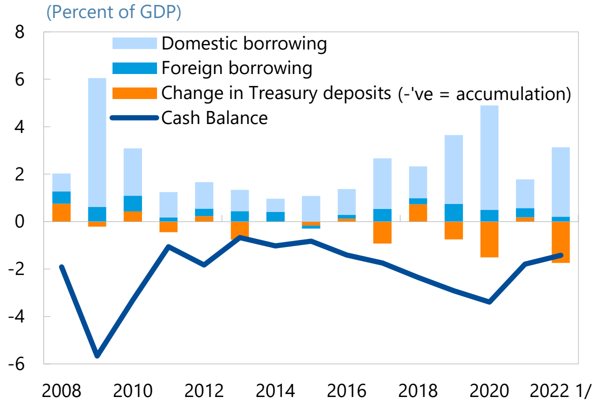


Sources: Ministry of Treasury and Finance and IMF staff calculations.
1/ Entry for 2022 includes data through Q3.

Figure 10. Türkiye: Fiscal Financing

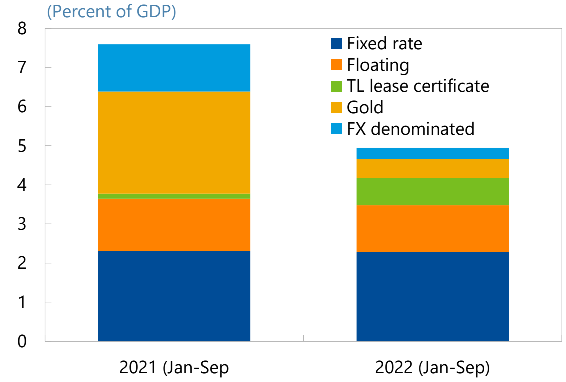
Domestic borrowing exceeded the cash balance, allowing the accumulation of Treasury deposits.

Deficit Financing Sources
(Percent of GDP)



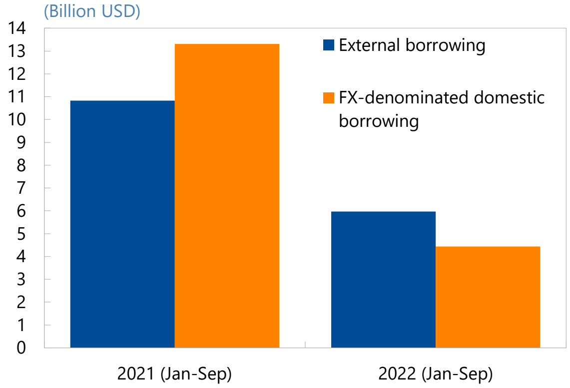
Domestic borrowing has become less reliant on FX-denominated debt and gold.

Domestic Borrowing
(Percent of GDP)



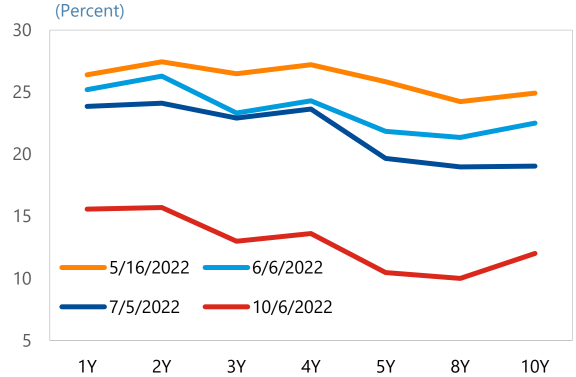
External borrowing declined sharply compared to 2021.

FX Gross Issuance
(Billion USD)



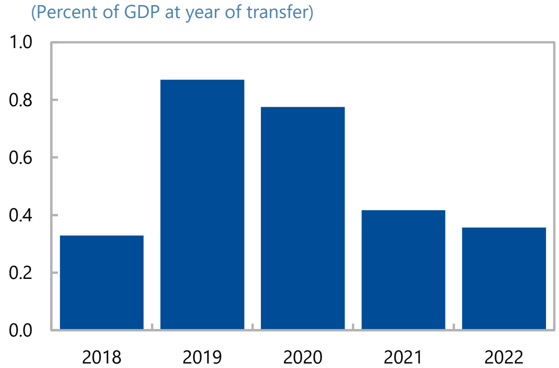
Government borrowing rates have fallen for all tenors due to macrofinancial and regulatory measures.

TRY Government Bond Yield Curve
(Percent)



CBRT profit transfers to the MoTF remain small[2/]

Profit Transfers from the CBRT to the MoTF
(Percent of GDP at year of transfer)

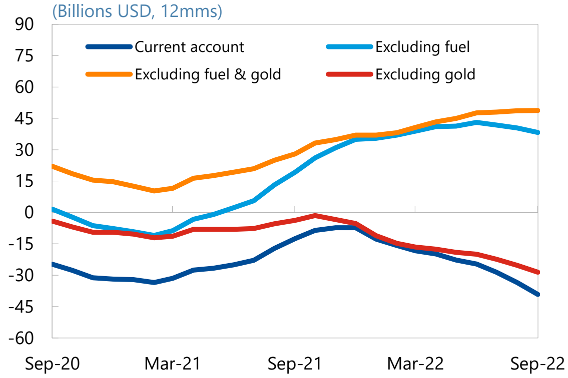


Sources: CBRT; MOTF; and IMF staff calculations.
1/ Cumulative sum of available months (January – September).
2/ The CBRT's exposure to the central government is limited. The central bank's balance sheet currently comprises, on the asset side, only a small Treasury securities portfolio of around TL 140 billion (just 4.7 percent of total CBRT assets or 1 percent of GDP) while, on the liability side, public sector deposits amounting to around TL 420 billion.

Figure 11. Türkiye: External Sector

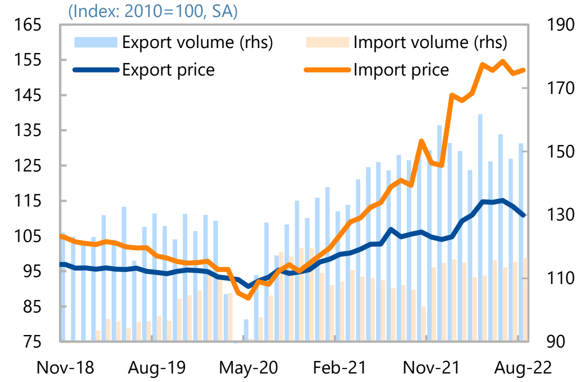
The current account deteriorated sharply …

Current Account
(Billions USD, 12mms)



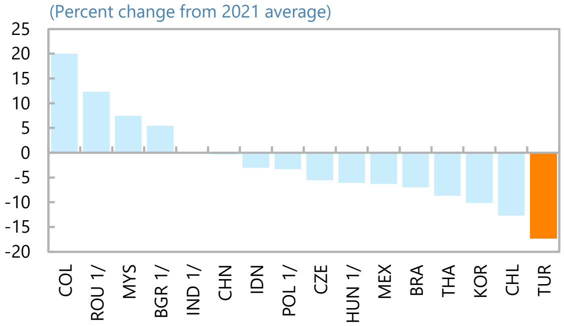
… driven by higher import prices…

Trade Volume and Price Index
(Index: 2010=100, SA)



,,,that caused a large deterioration in the terms of trade.

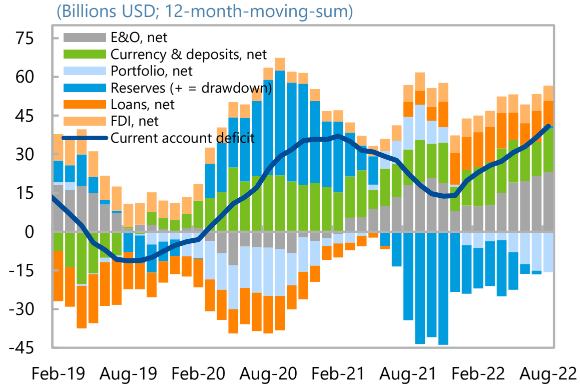
Terms of Trade Shock, 2022Q3
(Percent change from 2021 average)



Sources: Haver Analytics and IMF staff calculations.
1/ Data refers to 2022Q2.

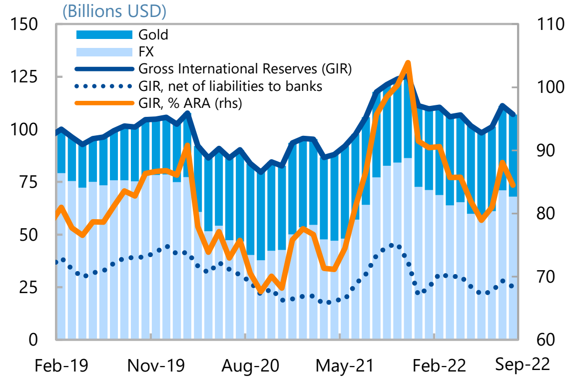
Net errors and omissions are a significant component of the current account financing…

Current Account and Financing
(Billions USD; 12-month-moving-sum)



… while gross reserves remain below the ARA metric lower bound …

Gross International Reserves
(Billions USD)



Sources: CBRT; MOTF; and IMF staff calculations.

… and external financing needs continue to be high due to high short-term debt and a large current account deficit.

External Financing Needs
(Percent of rolling 4-quarter GDP)

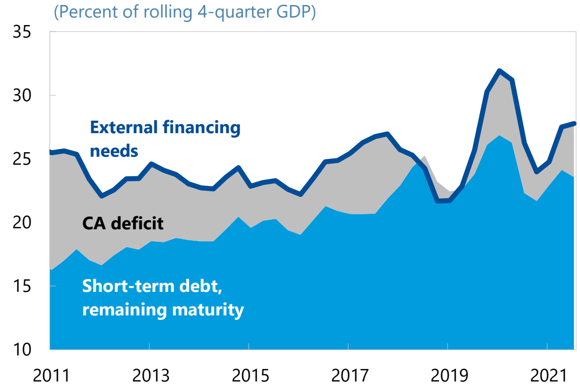
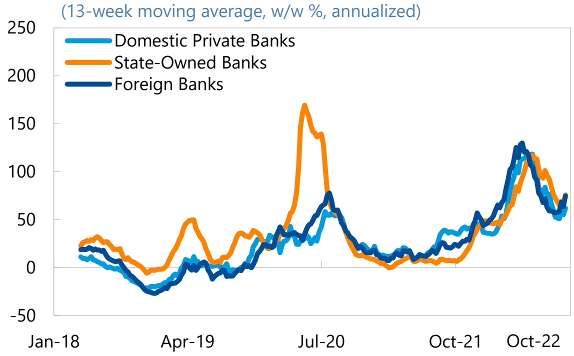


Figure 12. Türkiye: Credit Growth Developments

Lira credit growth has decelerated, until recently, across bank types.

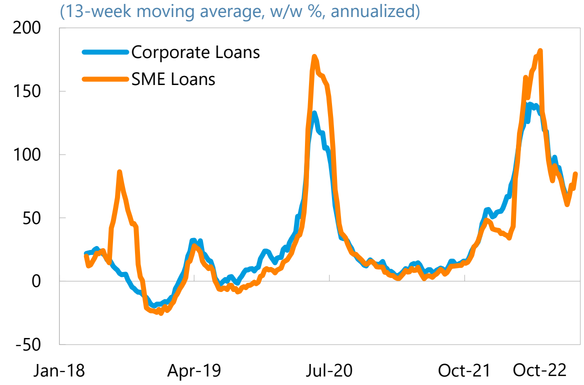
TRY Credit Growth
(13-week moving average, w/w %, annualized)



Sources: BRSA; CBRT; and IMF staff calculations.

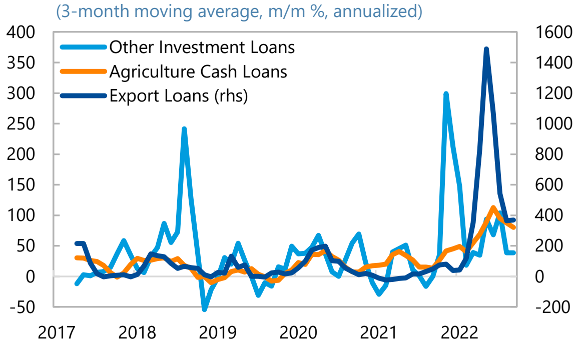
Corporate and SME credit growth have both decelerated …

TRY Credit Growth
(13-week moving average, w/w %, annualized)



… including for export loans, albeit from elevated rates.

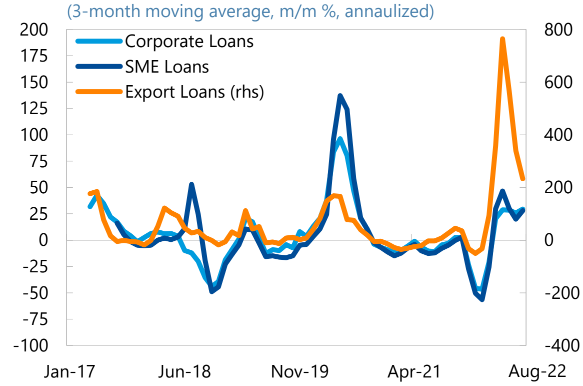
TRY Credit Growth
(3-month moving average, m/m %, annualized)



Sources: BRSA; CBRT; and IMF staff calculations.

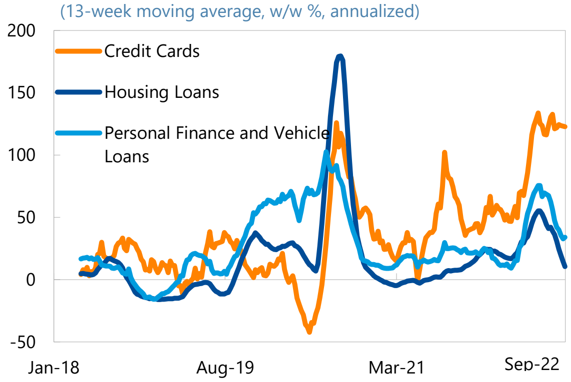
But NFC credit growth remains positive in real terms.

TRY Real Credit Growth
(3-month moving average, m/m %, annualized)



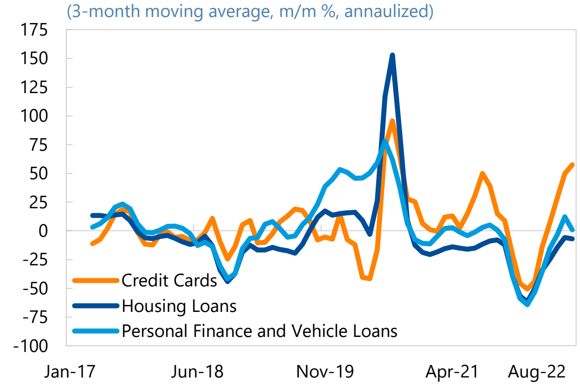
In contrast with exceptionally strong credit card lending, housing and personal loan growth slowed sharply …

TRY Consumer Credit Growth
(13-week moving average, w/w %, annualized)



… with housing loans slightly negative in real terms.

TRY Real Consumer Credit Growth
(3-month moving average, m/m %, annualized)



Sources: BRSA; CBRT; and IMF staff calculations.

Table 1. Türkiye: Selected Economic Indicators, 2018–27

Population (2021): 84.7 million
Per capita GDP (2021): US$9,654
Life expectancy (2019): 77.7 years
Gini index (2019): 41.9
Quota: SDR 4,658.6 million

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
					Est.		Proj.			
Real sector					(Percent)					
Real GDP growth rate	3.0	0.8	1.9	11.4	5.5	3.0	3.0	3.0	3.0	3.0
Final domestic demand	1.1	-2.1	4.2	11.4	10.5	4.7	3.3	3.3	3.2	3.1
Private consumption	0.6	1.5	3.3	15.3	15.3	3.4	3.4	3.5	3.5	3.2
Public consumption	6.5	3.8	2.5	2.6	2.8	13.1	3.2	2.8	3.0	3.5
Investment	-0.2	-12.5	7.4	7.4	2.8	3.9	3.0	2.9	2.5	2.5
Exports	8.8	4.2	-14.4	24.9	9.8	5.5	8.0	7.6	6.3	5.7
Imports	-6.2	-5.0	6.7	2.4	5.5	7.9	6.2	6.8	6.0	5.6
Contributions to real GDP growth 1/										
Private consumption	0.3	0.8	1.9	8.7	8.4	2.0	2.0	2.1	2.1	2.0
Public consumption	0.9	0.6	0.4	0.4	0.4	1.6	0.4	0.4	0.4	0.5
Investment (incl. inventories)	-2.4	-3.5	6.4	-4.1	-4.8	0.9	0.2	0.5	0.5	0.6
Net exports	4.1	2.9	-6.7	6.4	1.5	-1.4	0.3	0.1	-0.1	-0.1
GDP deflator growth rate	16.5	13.8	14.9	29.0	83.3	51.7	24.1	19.3	18.5	18.2
Nominal GDP growth rate	19.9	14.7	17.1	43.6	93.3	56.2	27.9	22.9	22.1	21.8
Inflation (period-average)	16.3	15.2	12.3	19.6	72.1	50.6	24.0	20.2	20.0	20.0
Inflation (end-year)	20.3	11.8	14.6	36.1	70.0	36.0	21.3	20.0	20.0	20.0
Unemployment rate	10.9	13.7	13.1	12.0	10.8	10.5	10.5	10.5	10.5	10.5
Output gap (percent of potential GDP) 1/	1.1	-2.1	-4.4	1.5	2.2	1.7	1.2	0.6	0.1	0.0
					(Percent of GDP)					
Fiscal sector										
Nonfinancial public sector										
Primary balance	-2.4	-3.0	-3.2	-2.6	-2.5	-3.2	-2.4	-2.0	-1.7	-1.6
Overall balance	-3.9	-5.0	-5.1	-4.3	-4.4	-5.3	-5.0	-4.9	-4.8	-5.0
General government gross debt (EU definition)	30.1	32.6	39.7	41.8	35.6	35.4	36.6	38.4	39.8	39.6
External sector										
Current account balance	-2.6	1.4	-4.4	-0.9	-6.0	-3.4	-2.5	-2.2	-2.2	-2.2
Gross international reserves (billions of US dollars)	93.0	105.7	93.6	111.2	125.2	102.2	94.9	93.5	91.5	89.5
Ratio to ARA Metric for emerging markets (percent)	77.3	88.7	77.6	88.0	…	…	…	…	…	…
Gross financing requirement	24.4	18.7	24.9	21.2	26.2	24.7	23.4	23.2	23.4	23.3
Gross external debt 2/	54.7	54.7	60.1	54.8	57.8	48.6	47.7	46.9	46.1	45.6
Net external debt	35.7	33.2	40.1	33.7	35.8	32.5	33.0	32.9	32.9	33.1
Net international investment position	-43.1	-40.8	-53.7	-31.3	-27.9	-26.4	-27.6	-28.3	-29.1	-29.9
Short-term external debt (by remaining maturity)	19.6	19.4	23.0	21.1	25.8	22.0	22.2	22.3	22.1	22.0
REER (CPI-based, 2003=100)	77.1	75.1	67.3	60.4	…	…	…	…	…	…
Monetary conditions					(Percent)					
Real average cost of CBRT funding to banks	1.4	5.4	-1.7	-1.9	…	…	…	…	…	…
Nominal growth of M2 broad money	18.4	27.3	33.9	53.0	…	…	…	…	…	…
Memorandum items										
GDP (billions of U.S. dollars)	780	759	720	818	850	1030	1086	1150	1210	1271
GDP (billions of Turkish lira)	3,759	4,312	5,048	7,249	14,012	21,885	27,981	34,392	41,991	51,143
Real effective exchange rate (year-on-year percent change)	-14.4	-2.7	-10.3	-10.2	…	…	…	…	…	…
GDP per capita US$	9,508	9,133	8,612	9,654	9,925	11,888	12,385	12,976	13,518	14,054
Population (million)	82.0	83.2	83.6	84.7	85.7	86.7	87.6	88.6	89.5	90.5

Sources: Turkish authorities; and IMF staff estimates and projections.

1/ Staff estimates.

2/ The external debt ratio is calculated by dividing external debt in US$ by staff-estimated GDP in US$. GDP in US$ is calculated as GDP in TL divided by the annual average exchange rate.

Table 2. Türkiye: Summary of Balance of Payments, 2018–27

(Billions of U.S. dollars, unless otherwise noted)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
					Est.			Proj.		
Current account balance	-20.1	10.8	-31.9	-7.3	-50.6	-34.8	-26.8	-25.8	-27.0	-28.6
Balance on goods and services	-9.8	21.8	-23.5	2.5	-40.8	-24.1	-15.4	-14.1	-14.8	-16.0
Goods, net	-40.7	-16.8	-37.9	-29.3	-88.5	-79.5	-62.3	-63.8	-67.6	-73.6
Exports of goods	178.9	182.2	168.4	224.7	255.4	246.0	276.2	294.8	312.7	328.9
Imports of goods	219.6	199.0	206.3	254.0	343.9	325.5	338.5	358.6	380.2	402.5
of which fuel imports	43.6	41.7	28.9	50.7	100.4	83.9	74.5	67.9	64.8	62.0
of which gold imports	11.3	11.3	25.2	5.5	14.0	8.5	8.5	8.5	8.5	8.5
Services, net	30.9	38.6	14.4	31.8	47.8	55.4	46.9	49.7	52.7	57.7
Credit	59.3	67.2	38.2	61.4	87.2	95.9	99.0	112.2	123.4	135.8
Debit	28.5	28.7	23.9	29.6	39.4	40.5	52.2	62.5	70.7	78.2
Primary income, net	-11.0	-11.8	-8.6	-10.7	-9.4	-11.5	-12.2	-12.5	-13.0	-13.5
of which interest expenditure	-7.8	-8.2	-6.1	-5.7	-5.0	-6.1	-6.4	-7.2	-7.6	-8.0
Secondary income net	0.8	0.9	0.2	0.9	-0.5	0.8	0.8	0.8	0.8	0.8
Capital account	0.1	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	21.1	-5.8	-7.6	1.4	24.9	0.0	0.0	0.0	0.0	0.0
Financial account balance	1.1	5.1	-39.5	-6.0	-25.7	-34.8	-26.8	-25.8	-27.0	-28.6
Direct investment, net	-8.9	-6.6	-4.6	-6.9	-6.1	-8.5	-8.3	-8.8	-9.1	-9.6
Portfolio investment, net	0.9	2.8	9.6	-0.8	11.5	2.9	-1.2	-2.5	-2.8	-2.9
of which government eurobonds, net	-3.9	-6.8	-4.6	-3.9	-2.9	-0.5	-0.2	1.0	-1.1	-2.1
Other investment, net	19.4	2.6	-12.6	-21.7	-50.4	-6.2	-9.8	-13.1	-13.2	-14.1
of which short-term borrowings	7.8	4.1	-3.5	2.2	1.3	1.4	1.0	0.8	0.7	0.5
Reserve assets	-10.4	6.3	-31.9	23.3	19.3	-22.9	-7.4	-1.4	-1.9	-2.0
					(Percent of GDP)					
Current account balance, *of which*	-2.6	1.4	-4.4	-0.9	-6.0	-3.4	-2.5	-2.2	-2.2	-2.2
Nonfuel current account balance	2.3	5.8	0.1	4.3	3.9	3.5	3.3	2.8	2.3	1.9
Goods and services balance	-1.3	2.9	-3.3	0.3	-4.8	-2.3	-1.4	-1.2	-1.2	-1.3
					(Percent year-on-year)					
Export value growth	6.8	4.7	-17.2	38.5	19.7	-0.2	9.7	8.5	7.1	6.6
Import value growth	-2.7	-8.2	1.1	23.2	35.2	-4.5	6.7	7.8	7.1	6.6
Oil price (US$ per barrel)	66.2	61.2	41.8	69.4	98.2	85.5	80.2	76.2	73.3	71.0
Gross international reserves (USD bn)	93.0	105.7	93.6	111.2	125.2	102.2	94.9	93.5	91.5	89.5
Ratio to ARA Metric for emerging markets (percent)	77.3	88.7	77.6	88.0	…	…	…	…	…	…
Net international reserves (USD bn)	30.2	40.6	13.5	8.1	27.4	4.5	-2.9	-4.3	-6.2	-8.2
Net international reserves (exl. govt. FX deposits) (USD bn)	27.1	35.1	1.6	-3.2	…	…	…	…	…	…
Ratio of external debt service to exports (percent)	74.6	64.5	74.4	59.9	51.7	66.0	62.1	60.9	60.4	59.3

Sources: Turkish authorities; and IMF staff estimates and projections.

Table 3. Türkiye: External Financing Requirements and Sources, 2018–27

(Billions of U.S. dollars, unless otherwise noted)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
					Est.		Proj.			
Gross external financing requirements	190.2	142.0	179.5	173.0	222.7	254.4	253.6	266.4	282.9	296.7
Current account deficit	20.1	-10.8	31.9	7.3	50.6	34.8	26.8	25.8	27.0	28.6
Government eurobonds (amortization)	3.8	4.4	4.7	6.1	8.0	7.5	10.8	12.0	9.9	8.9
Medium- and long-term debt amortization	56.3	54.9	46.3	45.7	42.5	48.4	49.4	50.5	51.9	53.6
Government 1/	2.4	2.2	1.8	1.9	1.8	1.7	1.7	1.7	1.6	1.6
Banks	36.9	30.6	26.4	25.6	22.5	28.9	28.9	28.9	29.2	29.8
Other sectors	17.0	22.0	18.2	18.2	18.2	17.9	18.9	19.9	21.0	22.2
Short-term debt amortization	110.0	93.5	96.6	114.0	121.6	163.7	166.6	178.1	194.1	205.6
Government 1/ 2/	1.8	5.9	8.5	21.3	26.1	36.0	36.0	36.0	36.0	36.0
Banks	65.1	52.4	52.4	57.2	51.4	62.8	65.1	68.5	81.0	87.5
Other sectors	43.1	35.2	35.8	35.4	44.1	64.9	65.4	73.5	77.0	82.1
Available financing	190.2	142.0	179.5	173.0	222.7	254.4	253.6	266.4	282.9	296.7
Sale of assets (net) 3/	-13.4	-15.1	-1.0	-15.7	-2.8	-4.0	-9.4	-11.4	-7.8	-8.1
Foreign direct investment (net)	8.9	6.6	4.6	6.9	6.1	8.5	8.3	8.8	9.1	9.6
Portfolio flows	3.9	8.0	-1.9	9.1	-0.7	6.7	14.3	16.8	15.2	14.4
Government eurobonds (drawings)	7.7	11.2	9.3	10.0	11.0	8.0	11.0	11.0	11.0	11.0
Domestically-issued government bonds (net)	-0.9	-3.1	-6.4	1.1	-2.3	0.0	0.0	0.0	0.0	0.0
Banks' equity and bonds (net)	-1.7	-0.1	-0.8	-3.2	-6.9	0.7	2.9	5.4	3.8	3.0
Other sectors' equity and bonds (net)	-1.1	0.1	-4.0	1.2	-2.4	-2.0	0.4	0.4	0.4	0.4
Medium and long-term debt financing	53.4	42.5	36.5	50.7	48.3	53.6	54.9	56.6	58.9	61.3
Government 1/	1.6	1.3	1.3	1.6	2.0	1.5	1.5	1.5	1.5	1.4
Banks	28.2	22.5	21.4	24.3	17.7	28.9	28.9	29.2	30.1	31.0
Other sectors	23.6	18.7	13.8	24.7	28.6	23.3	24.5	25.9	27.3	28.8
Short-term debt financing 4/	93.5	96.6	114.0	121.6	163.7	166.6	178.1	194.1	205.6	217.4
Government 1/	5.9	8.5	21.3	26.1	36.0	36.0	36.0	36.0	36.0	36.0
Banks	52.4	52.4	57.2	51.4	62.8	65.1	68.5	81.0	87.5	92.7
Other sectors	35.2	35.8	35.4	44.1	64.9	65.4	73.5	77.0	82.1	88.6
Official transfers	0.3	0.6	0.1	0.4	-0.9	0.5	0.5	0.5	0.5	0.5
Other	33.4	9.7	-4.5	23.8	27.5	0.0	0.0	0.0	0.0	0.1
GIR change (- denotes increase)	10.4	-6.3	31.9	-23.3	-19.3	22.9	7.4	1.4	1.9	2.0
Memorandum items:										
Net public sector financing (incl. IMF, excl. reserves)	7.5	9.0	17.2	8.8	12.3	0.8	0.5	-0.7	1.4	2.4
Government debt rollover rate (in percent)	192	167	214	129	137	101	100	98	102	104
Banks' loan rollover rate (in percent)	79	90	100	91	109	103	104	113	107	105
Other sectors' loan rollover rate (in percent)	98	95	91	128	150	107	116	110	112	113
Gross external financing requirements (percent of GDP)	24.4	18.7	24.9	21.2	26.2	24.7	23.4	23.2	23.4	23.3
International Investment Position (percent of GDP)	-43.1	-40.8	-53.7	-31.3	-27.9	-26.4	-27.6	-28.3	-29.1	-29.9

Sources: Turkish authorities; and IMF staff estimates and projections.

1/ Includes CBRT and the general government, excluding eurobonds issuance.

2/ The increase in government amortization in 2021 largely reflects swaps held by the CBRT, which are assumed to be rolled over.

3/ Includes sales and purchases of portfolio assets by the government, banks, and other private sectors; and sale of assets classified under Other Investments.

4/ Includes currency and deposits of non-residents.

Table 4. Türkiye: Public Sector Finances, 2018–27

(Percent of GDP)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
					Est.			Proj.		
Nonfinancial public sector primary balance	-2.4	-3.0	-3.2	-2.6	-2.5	-3.2	-2.4	-2.0	-1.7	-1.6
Central government	-1.5	-3.0	-2.6	-1.6	-1.9	-2.5	-1.7	-1.4	-1.1	-1.0
Primary revenue	18.7	17.9	18.7	18.2	18.7	17.6	18.5	19.1	19.5	19.5
Tax revenue	16.5	15.6	16.5	16.1	16.6	15.5	16.4	17.0	17.4	17.4
Personal income taxes	3.7	3.8	3.1	3.0	2.2	2.5	3.4	3.8	4.1	3.9
Corporate income taxes	2.1	1.8	2.1	2.5	3.5	3.1	3.0	3.0	3.0	3.0
VAT	4.7	4.2	4.6	5.3	5.7	4.7	4.8	5.0	5.1	5.1
Special consumption tax	3.6	3.4	4.1	2.8	3.0	3.0	3.0	3.0	3.1	3.1
Other	2.4	2.4	2.6	2.4	2.2	2.2	2.2	2.2	2.2	2.2
Nontax revenue 1/	2.2	2.2	2.2	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Primary expenditure, *of which:*	20.2	20.9	21.2	19.8	20.6	20.0	20.2	20.6	20.6	20.5
Personnel	6.3	6.8	6.7	5.6	5.6	5.6	6.2	6.3	6.3	6.3
Goods and services	1.9	2.0	1.9	1.8	1.8	1.8	1.8	1.8	1.8	1.8
Current transfers, *of which* :	8.7	9.3	9.9	8.9	8.7	8.4	8.2	8.2	8.3	8.3
Transfers to households	1.0	1.0	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Social security institutions	4.0	4.5	4.9	3.7	2.9	2.7	3.0	3.1	3.1	3.1
Agricultural subsidies	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Transfers of revenue shares	2.6	2.3	2.5	2.4	2.5	2.3	2.5	2.6	2.6	2.6
Capital transfers	0.4	0.4	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Capital expenditure	2.3	1.9	1.9	1.8	2.0	2.0	2.2	2.4	2.6	2.6
Net lending	0.6	0.6	0.6	1.4	2.1	1.8	1.5	1.4	1.3	1.2
Rest of the public sector	-0.9	0.0	-0.6	-1.0	-0.6	-0.7	-0.7	-0.6	-0.6	-0.6
Extrabudgetary funds	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Revolving funds	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social security institutions	0.0	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Unemployment insurance fund	-0.1	-0.2	-0.8	-0.6	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Local governments	-0.5	-0.4	0.2	0.0	0.1	-0.1	0.0	0.0	0.1	0.1
State -owned enterprises	-0.1	-0.2	0.0	-0.5	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4
Nonfinancial public sector overall balance 1/	-3.9	-5.0	-5.1	-4.3	-4.4	-5.3	-5.0	-4.9	-4.8	-5.0
Interest expenditure (net)	1.5	1.9	1.9	1.7	2.0	2.1	2.6	2.9	3.2	3.5
Memorandum items:										
Revenues excluded from IMF 'program definition'	1.5	2.5	1.8	1.5	1.3	0.8	0.7	0.7	0.7	0.7
Central government primary balance (headline) 2/	0.0	-0.6	-0.8	-0.2	-1.0	-1.7	-1.0	-0.7	-0.4	-0.3
Central government overall balance (headline) 2/	-1.9	-2.9	-3.5	-2.7	-3.4	-4.2	-4.1	-4.1	-4.1	-4.3
Central government cyclically-adjusted primary balance (headline) 2/ 3/	-0.3	-1.6	-0.3	-0.8	-1.5	-2.1	-1.3	-0.8	-0.4	-0.3
Central government cyclically-adjusted overall balance (headline) 2/ 3/	-2.3	-3.8	-2.9	-3.3	-4.0	-4.7	-4.4	-4.3	-4.1	-4.3
General government primary balance (headline) 2/	-0.8	-0.4	-1.5	-1.0	-1.1	-2.0	-1.3	-0.9	-0.6	-0.5
General government overall balance (headline) 2/	-3.0	-2.9	-4.3	-3.6	-3.9	-4.7	-4.5	-4.5	-4.4	-4.6
General government cyclically-adjusted primary balance (headline) 2/ 3/	-0.8	-0.9	-0.4	-1.6	-1.7	-2.5	-1.6	-1.1	-0.6	-0.5
General government cyclically-adjusted overall balance (headline) 2/ 3/	-2.9	-3.3	-3.1	-4.3	-4.6	-5.3	-4.9	-4.7	-4.4	-4.6
General government gross debt	30.1	32.6	39.7	41.8	35.6	35.4	36.6	38.4	39.8	39.6

Sources: Turkish authorities; and IMF staff estimates and projections.

1/ IMF program definition which excludes several items from non-tax revenue and the primary balance, including privatization proceeds, transfers from CBRT, dividend payments from Ziraat Bank and interest receipts.

2/ Headline or authorities' definition which includes items excluded from the IMF 'program' definition.

3/ The cyclically-adjusted balance adjusts for the economic cycle and excludes one-off CBRT revenues.

Table 5. Türkiye: Financial Soundness Indicators, 2012–21

(Percent of GDP)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022[10/]
Capital Adequacy											
CAR	18	15	16	16	16	17	17	18	19	18	19
CT1R	15	13	14	13	13	14	14	15	16	15	16
RWA / Assets	80	84	83	83	82	76	77	77	67	58	62
Asset Quality											
NPLs / Gross Loans	3	3	3	3	3	3	4	5	4	3	2
Provisions / Gross NPLs	75	76	74	75	77	79	68	65	75	80	84
Profitability											
Total Int. Income / Int. Bearing Assets (av) 1/ 2/	9	8	8	8	8	9	11	11	8	10	9
Cost / Income (Efficiency) 3/	73	71	74	76	72	73	77	78	-	-	-
ROAA 1/ 4/	2	2	1	1	2	2	1	1	1	1	3
ROAE 1/ 4/	16	14	12	11	14	16	15	11	11	15	34
Funding and Liquidity											
Loan-to-Deposit ratio	103	111	118	119	119	123	118	103	104	92	85
Loan-to-Deposit ratio (TL)	113	127	133	142	134	148	138	130	152	151	117
Loan-to-Deposit ratio (FX)	82	84	92	89	99	90	96	78	64	60	57
Non-Core / Core Liabilities 5/	44	52	55	56	56	57	57	47	51	53	42
Non-Core / Core Liabilities (TL) 5/	26	29	30	32	29	32	33	28	41	49	29
Non-Core / Core Liabilities (FX) 5/	91	103	113	101	106	101	94	71	62	57	57
Leverage Ratio 1/ 6/	5	5	6	5	5	5	5	6	5	4	5
Liquid Assets / Assets 7/	26	24	23	22	21	23	21	23	25	30	30
Assets / Liabilities (3 months, int. sensitive)	82	79	75	74	76	73	78	71	72	88	92
FX Risk											
FX Assets / FX Liabilities (on-balance sheet) 6/	94	91	91	91	94	88	91	88	86	89	91
NOP / Regulatory Capital	2	-1	-2	1	-1	1	3	0	4	6	6
NOP before hedging / Regulatory Capital	-14	-29	-28	-30	-22	-43	-34	-41	-58	-57	-40
Balance Sheet					*(Percent of GDP)*						
Total Assets	87	95	97	100	104	104	103	104	121	127	107
o/w Gross Loans	50	57	60	63	66	67	64	62	71	68	56
Liabilities	75	84	86	89	93	93	92	93	109	117	97
o/w Deposits	49	52	51	53	55	55	54	60	68	73	66
Shareholders' Equity	12	11	11	11	11	11	11	11	12	10	10
Off-Balance Sheet					*(Percent of GDP)*						
o/w Commitments	109	89	83	88	94	103	95	93	99	106	84
o/w Contingencies	15	18	19	20	21	21	21	19	20	23	19
Miscellaneous											
Deposit Interest Rate (Percent) 8/	8	8	9	11	10	13	23	10	16	20	16
Loan Interest Rate (Percent) 9/	12	13	13	16	15	18	32	15	22	26	30

Sources: BRSA data; and IMF staff calculations.
1/ Current year data are annualized using 12-month rolling sums.
2/ Net of NPL provisions.
3/ Other non-interest income added to expenses when <0.
4/ Net income as a share of average assets or equity over last 12 months.
5/ Core liabilities include deposits and shareholders' equity.
6/ Proxied by T1 Capital over last 2 months average balance sheet assets and average off-balance sheets exposures (> 3 percent).
7/ Liquid assets as reported by the BRSA in their liquidity position table.
8/ On TRY only, excluding sight and interbank.
9/ Consumer Loans (Personal+Vehicles+Housing).
10/ Data refer to 2022M09, except for deposit and loan interest rate data, which refer to 2022M10.

Annex I. External Sector Assessment

<table>
<tr><td colspan="8">Overall Assessment: On a preliminary basis, the external position in 2022 is assessed to be weaker than the level implied by medium-term fundamentals and desirable policies. While there are large uncertainties over energy prices and the drivers of large net error and omissions and their impact on Türkiye's external imbalances, the assessment is also supported by other components such as the low level of reserves, large external financing needs, and the size and composition of the NIIP, all of which contribute to external vulnerabilities. The current account deficit widened significantly in 2022, reflecting the sharp increase in imported energy prices. The degree of persistence of such price increases plays a critical role in the 2022 external assessment and adds to already large uncertainties associated with the exercise. Türkiye's negative NIIP position, while remaining large, narrowed significantly as a result of a steep decline in equity liabilities due to valuation effects. Türkiye's vulnerability to shocks remains high amid still-elevated gross external financing needs. Over the medium term, the CA deficit is projected to narrow as the REER undervaluation feeds through and as commodity price pressures ease. The final assessment for 2022 will be presented in the 2023 External Sector Report.

Potential Policy Responses: Türkiye's external position is assessed to be weaker than the level implied by medium-term fundamentals and desirable policies, and strengthening the policy framework would help underpin external sustainability going forward. Tightening of the monetary and fiscal policy stance and the rebuilding of policy credibility would help contain demand and reduce imports, thus improving the current account. It would also help support capital inflows and liraizaton, and allow for a needed buildup of reserves over time.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="7">Background. Türkiye's NIIP averaged –44 percent of GDP over 2017–21. The NIIP increased to –27.5 percent of GDP in 2022Q3, driven largely by a marked decrease in equity liabilities in dollar terms. External debt is expected to slightly increase from 55 percent of GDP in 2021 to 58 percent of GDP in 2022. Almost 53 percent of Türkiye's external debt is held by the private sector, while the public sector (General Government and Central Bank) holds the remaining 47 percent, and about a third of it is short-term (on a remaining maturity basis).

Assessment. The size and composition of gross external liabilities, coupled with low reserves, increase Türkiye's vulnerability to liquidity shocks, sudden shifts in investor sentiment, and any global upswing in interest rates. While the FX exposure of nonfinancial corporations is high, it has improved in recent years and the short-term net FX position is positive, providing some liquidity buffer. The NIIP is expected to stabilize over the medium term because of a projected improvement in the current account balance and hover around –28 percent of GDP through 2027, but unwinding of recent valuation effects could negatively affect the NIIP trajectory. External debt is sustainable over the medium term but is subject to risks, particularly from a large REER depreciation.</td></tr>
<tr><td>2022Q3(% GDP)</td><td>NIIP: –27.5</td><td>Gross Assets: 36.0</td><td>Debt Assets: 16.7</td><td>Gross Liab.: 63.5</td><td colspan="3">Debt Liab.: 48.2</td></tr>
<tr><td>Current Account</td><td colspan="7">Background. The current account deficit widened from 0.9 percent of GDP in 2021 to a projected 6 percent of GDP in 2022. Higher commodity prices resulting from the war in Ukraine have significantly weakened the energy current account balance.

Assessment. The preliminary EBA CA model norm for Türkiye is estimated at –0.5 percent of GDP, with an estimated standard error of ±0.7 percent of GDP. The CA deficit of 6 percent of GDP in 2022 narrows to a deficit of 3.4 percent of GDP after cyclical and terms of trade adjustments are made, with the resulting EBA current account gap of -2.9 percent of GDP relative to the CA norm. Adjusting for temporary pandemic-related shocks (transport:-0.5) results in an IMF staff assessed CA gap in the range of -4.1 to -2.7, with a midpoint of -3.4. The large uncertainty surrounding large net errors and omissions and energy prices, especially the extent of persistence of energy price increases, creates major uncertainties about the size of the cyclical adjustments, and makes the EBA CA assessment even more uncertain than usual.</td></tr>
<tr><td>2022 (% GDP)</td><td>CA: –6</td><td>Cycl. Adj. CA: –3.4</td><td>EBA Norm: –0.5</td><td>EBA Gap: -2.9</td><td>COVID-19 Adj.: -0.5</td><td>Other Adj.: -0.0</td><td>Staff Gap: -3.4</td></tr>
<tr><td>Real Exchange Rate</td><td colspan="7">Background. The REER depreciated by an annual average of 9.4 percent over 2017–21. The average REER depreciated by 10.2 percent in 2021, with an average nominal depreciation against the US dollar of 27 percent. As of October 2022, the REER was 8.2 percent below the 2021 average.

Assessment. Based on staff's estimates of the CA model, and taking uncertainties into consideration, staff assesses the REER gap to be overvalued with a range of 9.3, 14.1 and a midpoint of 11.7 percent (applying an estimated REER elasticity of 0.29). In contrast, as the non-energy CA continues to adjust, the EBA REER models suggest the REER is undervalued in 2022 by around 47 to 57 percent, although uncertainty is exceptionally large and the explanatory power of the models is very weak for Türkiye. Also, the gap between PPI and CPI has widened to historic highs in Türkiye, and a PPI-based measure would give a very different outcome. The REER would be broadly fairly valued if far more weight is placed on the EBA CA model, but uncertainty about such an assessment remains exceptionally high.</td></tr>
<tr><td>Capital and Financial Accounts: Flows and Policy Measures</td><td colspan="7">Background. Net capital inflows rebounded in 2022, but mainly on account of one-off flows, including large positive net errors and omissions of USD 24.9 billion. Positive net inflows were also driven by FDI, while net portfolio inflows weakened further over the year. In early 2022, among others, a new requirement for exporters to convert 25 percent of their export earnings withing 180 days was introduced, which was later increased to 40 percent.

Assessment. While net capital inflows continued to rebound in 2022, much of these were of unknown origin. With annual gross external financing needs projected at about 24 percent of GDP on average over 2022–27 (26 percent of GDP in 2022), Türkiye remains vulnerable to adverse shifts in global investor sentiment. CFMs should be phased out as conditions improve to increase market liquidity and support de-dollarization.</td></tr>
<tr><td>FX Intervention and Reserves Level</td><td colspan="7">Background. The de jure exchange rate is classified as free floating. Following the sudden depreciation of the lira in 2021Q4, gross reserves decreased sharply falling to about 100 billion US dollars in 2022Q2. Gross reserves have recovered somewhat during 2022Q3 and they were at around USD123 billion at end of November 2022. This increase is partly explained by the inflows</td></tr>
</table>

	of the Russian State Nuclear Energy Corporation, Rosatom, for the construction of a new power plant. Pressures on the lira were relieved by large foreign exchange interventions and the introduction of a scheme protecting lira term deposits against currency depreciation in December 2021. **Assessment.** Gross reserves remain at 88 percent of IMF's ARA metric as of end-November 2022, still below the floor of the recommended 100 to 150 percent range. In addition, the quality of reserves remains an issue, with non-SDR basket currencies continuing to account for a large share of the central bank's FX reserves. Once monetary policy tightening is firmly underway, significant non-borrowed accumulation of reserves is needed over time, as conditions permit. FX intervention to support the lira should also be limited to the most extreme cases of exchange rate volatility, undertaken only by the central bank itself (not state-owned banks).

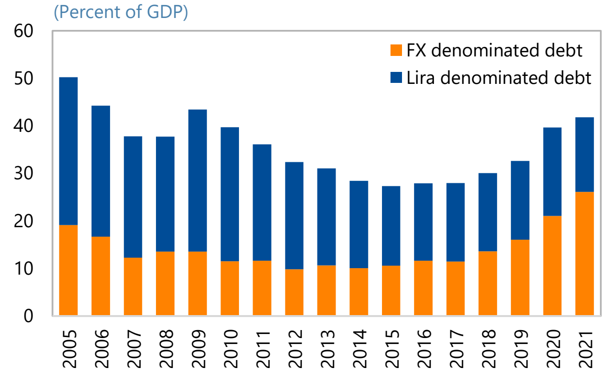
Annex II. Public Debt Sustainability

Türkiye's public debt ratio increased modestly, to around 42 percent of GDP at end-2021, from 40 percent at end-2020.[1] Public debt is projected to decline to around 36 percent of GDP in 2022, driven by higher nominal GDP growth, but is expected to increase over the medium term to nearly 40 percent of GDP, as are gross public sector financing needs. The public DSA suggests that debt vulnerabilities are rising in Türkiye, even though public debt remains below vulnerability benchmarks over the medium term under the baseline. Public debt has become more sensitive to external shocks because of contingent liabilities such as the FX-protected deposit schemes.

Baseline and Realism of Projections

1. Debt levels and composition. Türkiye's debt-to-GDP ratio stood at 42 percent of GDP at the end of 2021. Staff projects debt to decline to around 36 percent of GDP by end-2022, before rising, to nearly 40 percent of GDP by 2027. The share of FX-denominated debt has increased in recent years, reaching nearly two-thirds of total debt at end-2021. For the central government, the share of fixed-rate and floating-rate bonds for domestic debt is roughly equal, while fixed-rate debt accounts for more than 80 percent of external debt.[2]

General Government Gross Debt
(Percent of GDP)



Sources: Turkish Treasury; Haver Analytics; and IMF staff calculations.

2. Growth. A strong growth recovery following the pandemic helped boost revenues. Going forward, real GDP is expected to moderate to around 3 percent in the medium term, as growth converges to potential and the scope for further policy-based stimulus diminishes. Past forecast errors show that desks' projections have been biased to the downside (i.e., too pessimistic), particularly in years of large economic shocks.

3. Inflation and the exchange rate. Significant jumps in inflation have eroded the real value of (non-CPI linked) lira-denominated debt in recent years. High inflation is expected throughout the projection horizon, which will continue to push down debt unless bond yields are allowed to adjust.[3] On the other hand, debt has become more sensitive to real exchange rate movements through two channels. First, there is a traditional channel where real exchange rate depreciation will increase the debt burden of existing FX-denominated debt. Second, the introduction of the FX-protected deposit schemes means that a depreciation in Turkish lira will directly increase fiscal spending, and thus the

[1] Türkiye's debt figures follow EU standards (as per Maastricht criteria).

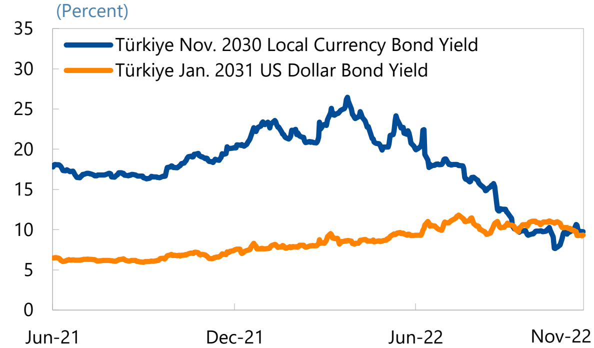
[2] Limited information on such a debt breakdown is available for general government.

[3] Bond yields have been compressed as a result of regulatory bond holding requirements introduced in 2022 under the TEM.

level of public debt, as long as these schemes remain in place. Annex V contains a more detailed discussion of external debt.

4. Sovereign yields. Türkiye's external bond yields have been steadily increasing and are over 10 percent for the benchmark Eurobond. On the other hand, local currency bond yields have fallen dramatically in recent months, as policies have curbed normal financial market adjustment. Taken together, the effective interest rate is expected to rise to 13 percent in the near term from 9.5 percent in 2021, then gradually decline to 10 percent over the medium term. Given the large share of FX debt in the total, these yield assumptions can vary significantly under alternative exchange rate scenarios.

Turkish Local Currency and US Dollar Sovereign Bond Yields
(Percent)



Source: Bloomberg Finance L.P.

5. Fiscal policy. The structural primary deficit of the general government (which adjusts for the cycle and one-off revenue items) is projected to be 3.4 percent of GDP in 2022 and is expected to stabilize at about 1.7 percent of GDP over the medium term.

6. Maturity and rollover. Maturity of domestic borrowing fluctuated in 2022. Following a sharp decline from 48 months (at end-2021) to 29 months by end 2022Q1, borrowing maturities of debt stock had lengthened to almost 62 months by August. The lengthening of borrowing maturities is related to heterodox macroprudential policy requiring banks to hold longer-term government treasuries (see Section C for detailed discussion). Domestic rollover ratios have also been volatile throughout the year and with the most recent rollover rates just short of 100 percent in August.

7. Debt profile risks. External financing requirements and the shares of FX-currency in public debt have risen compared to the last DSA assessment and now rank high relative to peers.[4] Such a shift in the debt profile highlights increased vulnerabilities of Türkiye's to external shocks such as a sharp depreciation of exchange rates. And this is compounded by the fiscal exposure to currency risk through the FX-protected deposit schemes.

Shocks and Stress Test

8. Interest rate, real exchange rate, and contingent liability shocks lead to a significant increase in public debt while the primary balance shock does not affect the debt dynamics substantially. Under a combined macro-fiscal shock, debt would reach 78 percent of GDP over the medium term. The combined macro-fiscal-contingent liability shock would increase debt to 96 percent of GDP, with a sharp increase in gross financing needs to 26 percent of GDP by 2027.

[4] The share of non-resident holdings in public debt rose in 2021, as shown in this DSA chart, but has since fallen sharply (see paragraph 12).

- **Primary balance shock.** A 1 standard deviation deterioration in the primary balance for 2 years starting in 2022 would increase public debt only moderately over the medium term. Under such a scenario, sovereign borrowing costs are also raised by 25 basis points for each 1 percentage point of GDP worsening in the primary balance. The impact on gross financing needs increases to about 10 percent of GDP over the medium-term.

- **Growth shock.** Real GDP growth rates are lowered by 1 standard deviation (5.7 percentage points) for 2 years starting in 2022. The primary balance is also assumed to deteriorate initially compared to the baseline (to 4.3 percent of GDP by 2024) as nominal revenues fall against unchanged expenditures and recover over the medium-term as shocks phase out. This also leads to higher sovereign borrowing costs. By 2027, the debt-to-GDP ratio would reach around 43 percent of GDP and gross financing needs will also rise to about 11 percent of GDP.

- **Interest rate shock.** The government's interest bill is projected to reach an implicit average interest rate of about 23 percent over the medium term under the shock scenario. By 2027, the debt-to-GDP ratio would increase gradually to reach about 41 percent while gross financing needs would climb to 11 percent of GDP from 35 percent and 7 percent in 2022, respectively.

- **Real exchange rate shock.** The real exchange rate is assumed to depreciate by 77 percent in 2023 under the shock scenario. As a result, public debt-to-GDP rises to around 48 percent of GDP, with public debt as a ratio of revenues increasing to 184 percent in 2023. Gross financing needs rise to 10 percent of GDP by 2027.

- **Contingent liability shock.** This shock could be seen as a materialization of contingent liabilities related to the financial sector (including, as a result of the sharp increase in state-owned banks' lending), PPPs, and non-financial SOEs. This shock is assumed to increase non-interest expenditures by 10 percentage points of GDP in 2022. This is combined with a real GDP growth shock (1 standard deviation for 2 years). Sovereign borrowing costs are pushed up (25 basis points for each 1 percent of GDP worsening in the primary balance) while inflation declines (0.25 percentage points per 1 percentage points decrease in GDP growth). The debt-to-GDP ratio would rise to about 49 percent of GDP under this scenario, with gross financing needs increasing to 11 percent of GDP by 2027. Since the scenario does not include contingent liabilities from FX-protected schemes, these estimates are a lower bound. Any unexpected lira weakness would increase the fiscal costs of those schemes, adding to public debt and gross financing needs.

- **Combined macro-fiscal shock.** A combined macro-fiscal shock incorporates the largest effect of the individual macro-fiscal shocks on all relevant variables. Under this scenario, public debt would rise to around 78 percent of GDP over the medium term. Gross financing needs would also rise sharply to about 19 percent of GDP over the medium term.

- **Combined macro-fiscal-contingent liability shock.** Under this extreme shock scenario incorporating the largest effect of the above shocks, public debt would breach 79 percent of GDP in 2023, reaching above 95 percent of GDP by 2027. Gross financing needs would also increase to above 25 percent of GDP over the medium term.

Figure 1. Türkiye: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

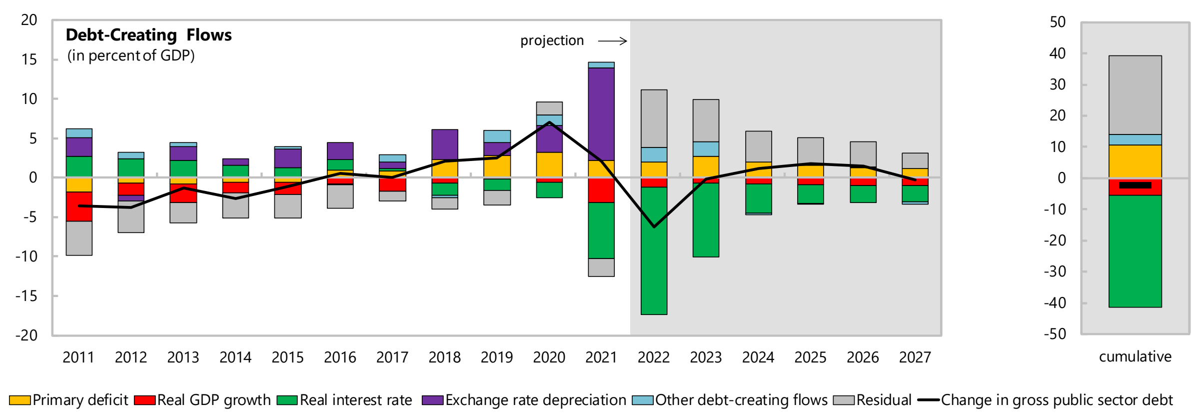
(In percent of GDP, unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of November 9, 2022		
	2011-2019 [2/]	2020	2021	2022	2023	2024	2025	2026	2027	Sovereign Spreads		
Nominal gross public debt	30.4	39.7	41.8	35.6	35.4	36.6	38.4	39.8	39.6	EMBIG (bp) 3/		490
Public gross financing needs	6.9	10.3	9.1	7.2	5.9	7.1	8.0	9.0	9.5	5Y CDS (bp)		621
Real GDP growth (in percent)	5.6	1.9	11.4	5.5	3.0	3.0	3.0	3.0	3.0	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	9.6	14.9	29.0	83.3	51.7	24.1	19.3	18.5	18.2	Moody's	B3	B3
Nominal GDP growth (in percent)	15.7	17.1	43.6	93.3	56.2	27.9	22.9	22.1	21.8	S&Ps	B	B
Effective interest rate (in percent) [4/]	9.2	10.1	9.5	12.8	12.1	11.8	12.0	12.1	12.5	Fitch	B-	B-

Contribution to Changes in Public Debt

	Actual			Projections							
	2011-2019	2020	2021	2022	2023	2024	2025	2026	2027	cumulative	debt-stabilizing
Change in gross public sector debt	-0.8	7.0	2.2	-6.3	-0.1	1.2	1.8	1.4	-0.2	-2.2	primary
Identified debt-creating flows	1.9	5.4	4.4	-13.6	-5.4	-2.8	-1.8	-1.7	-2.2	-27.4	balance [9/]
Primary deficit	0.3	3.2	2.2	2.0	2.8	2.0	1.6	1.3	1.2	10.7	-3.3
Primary (noninterest) revenue and grants	31.2	28.0	26.4	27.3	26.3	27.8	28.6	28.8	28.8	167.6	
Primary (noninterest) expenditure	31.5	31.2	28.6	29.3	29.1	29.8	30.1	30.1	30.0	178.3	
Automatic debt dynamics [5/]	1.1	0.8	1.5	-17.4	-10.0	-4.4	-3.3	-3.1	-3.0	-41.3	
Interest rate/growth differential [6/]	-0.6	-2.6	-10.2	-17.4	-10.0	-4.4	-3.3	-3.1	-3.0	-41.3	
Of which: real interest rate	1.0	-2.0	-7.1	-16.2	-9.4	-3.6	-2.3	-2.2	-2.0	-35.8	
Of which: real GDP growth	-1.6	-0.5	-3.1	-1.2	-0.7	-0.8	-0.9	-0.9	-1.0	-5.5	
Exchange rate depreciation [7/]	1.7	3.4	11.7	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.5	1.4	0.7	1.8	1.8	-0.3	-0.1	0.2	-0.3	3.2	
General Government: Net Privatization Proceeds (negative)	-0.4	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
General Government: Financing: Net Acquisition of Financial Assets	0.9	1.5	0.8	1.9	1.9	-0.2	0.0	0.2	-0.2	3.7	
Residual, including asset changes [8/]	-2.7	1.6	-2.3	7.3	5.3	4.0	3.5	3.2	1.9	25.2	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

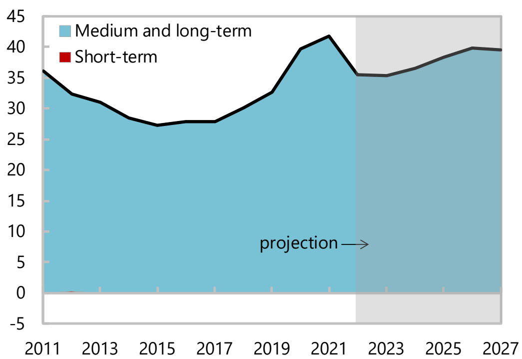
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

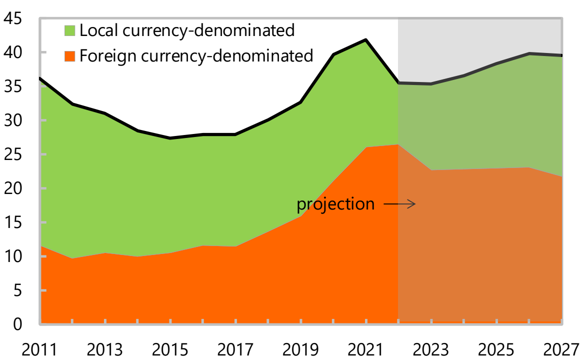
Figure 2. Türkiye: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



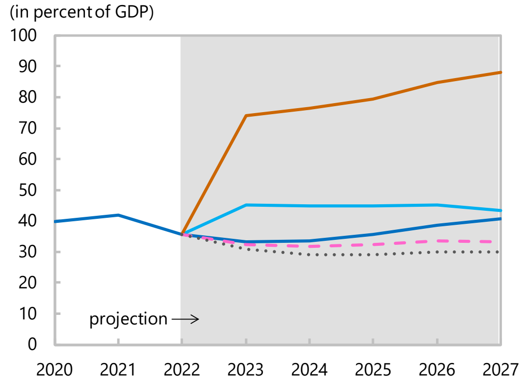
By Currency
(in percent of GDP)



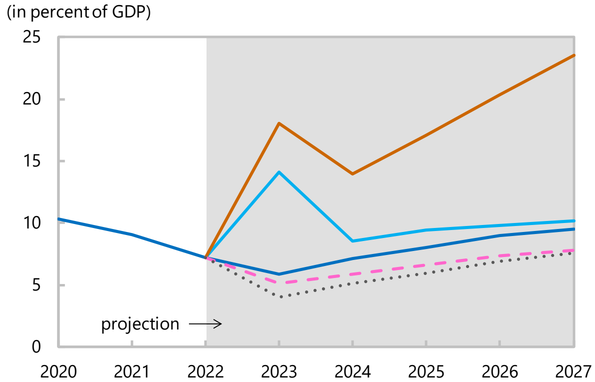
Alternative Scenarios

Baseline
Contingent Liability Shock
Historical
Constant Primary Balance
CL and combined macro-fiscal shocks

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



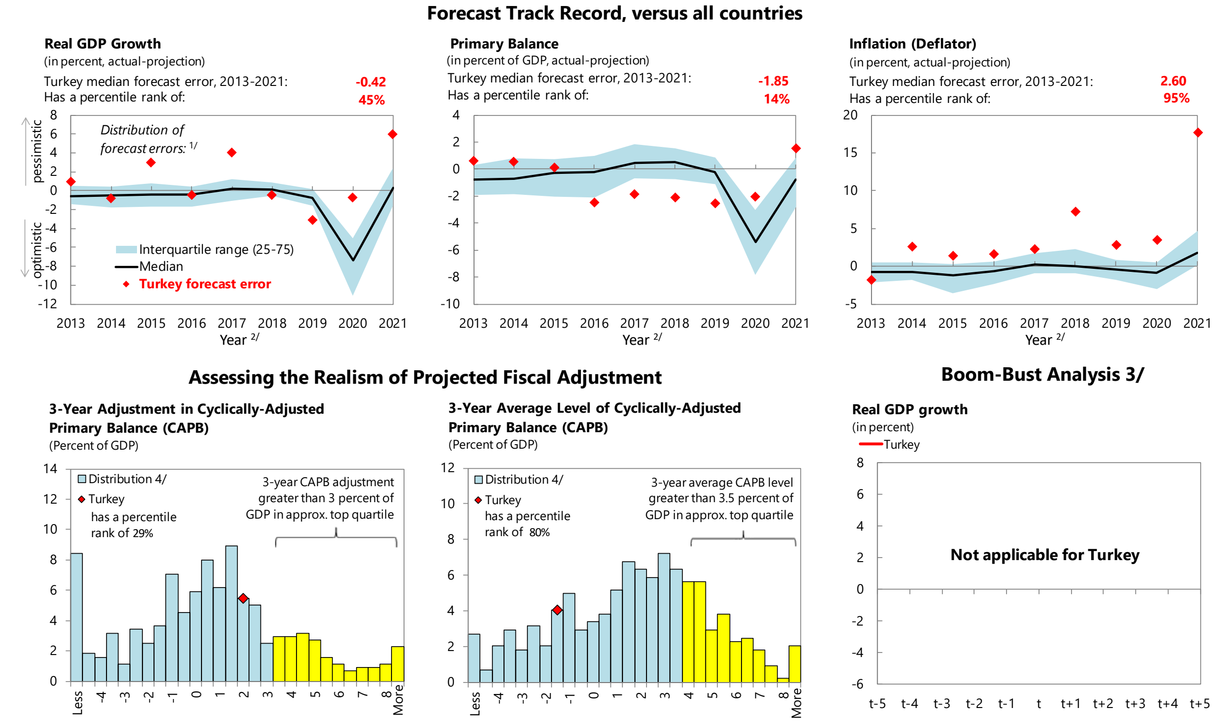
Underlying Assumptions
(in percent)

Baseline Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	5.5	3.0	3.0	3.0	3.0	3.0
Inflation	83.3	51.7	24.1	19.3	18.5	18.2
Primary Balance	-2.0	-2.8	-2.0	-1.6	-1.3	-1.2
Effective interest rate	12.8	12.1	11.8	12.0	12.1	12.5
Constant Primary Balance Scenario						
Real GDP growth	5.5	3.0	3.0	3.0	3.0	3.0
Inflation	83.3	51.7	24.1	19.3	18.5	18.2
Primary Balance	-2.0	-2.8	-2.8	-2.8	-2.8	-2.8
Effective interest rate	12.8	9.2	8.9	9.5	10.4	11.0

Historical Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	5.5	5.2	5.2	5.2	5.2	5.2
Inflation	83.3	51.7	24.1	19.3	18.5	18.2
Primary Balance	-2.0	-1.0	-1.0	-1.0	-1.0	-1.0
Effective interest rate	12.8	9.2	11.2	13.3	15.8	17.7

Source: IMF staff.

Figure 3. Türkiye: Public DSA- Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

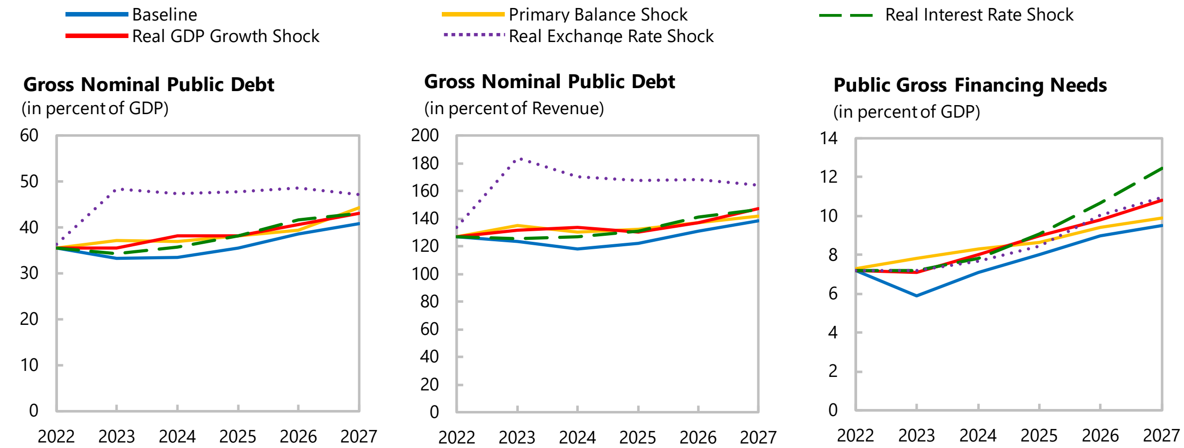
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Turkey, as it meets neither the positive output gap criterion nor the private credit growth criterion.

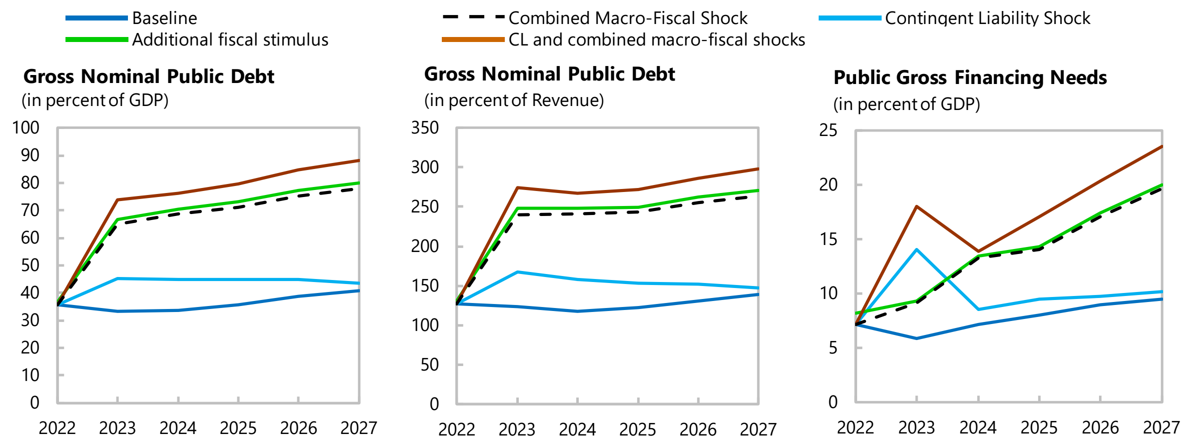
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 4. Türkiye: Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2022	2023	2024	2025	2026	2027
Real GDP growth	5.5	3.0	3.0	3.0	3.0	3.0
Inflation	83.3	51.7	24.1	19.3	18.5	18.2
Primary balance	-2.0	-3.6	-2.7	-1.6	-1.3	-1.2
Effective interest rate	12.8	9.2	9.1	9.8	10.6	11.0
Real Interest Rate Shock						
Real GDP growth	5.5	3.0	3.0	3.0	3.0	3.0
Inflation	83.3	51.7	24.1	19.3	18.5	18.2
Primary balance	-2.0	-2.8	-2.0	-1.6	-1.3	-1.2
Effective interest rate	12.8	9.2	14.1	16.9	19.9	22.1
Combined Shock						
Real GDP growth	5.5	-0.2	-0.2	3.0	3.0	3.0
Inflation	83.3	50.9	23.3	19.3	18.5	18.2
Primary balance	-2.0	-3.9	-4.3	-1.6	-1.3	-1.2
Effective interest rate	12.8	13.7	10.5	13.9	17.0	19.4

Real GDP Growth Shock	2022	2023	2024	2025	2026	2027
Real GDP growth	5.5	-0.2	-0.2	3.0	3.0	3.0
Inflation	83.3	50.9	23.3	19.3	18.5	18.2
Primary balance	-2.0	-3.9	-4.3	-1.6	-1.3	-1.2
Effective interest rate	12.8	9.2	9.2	10.0	10.7	10.5
Real Exchange Rate Shock						
Real GDP growth	5.5	3.0	3.0	3.0	3.0	3.0
Inflation	83.3	102.9	24.1	19.3	18.5	18.2
Primary balance	-2.0	-2.8	-2.0	-1.6	-1.3	-1.2
Effective interest rate	12.8	14.3	7.4	8.0	9.0	9.4

Source: IMF staff.

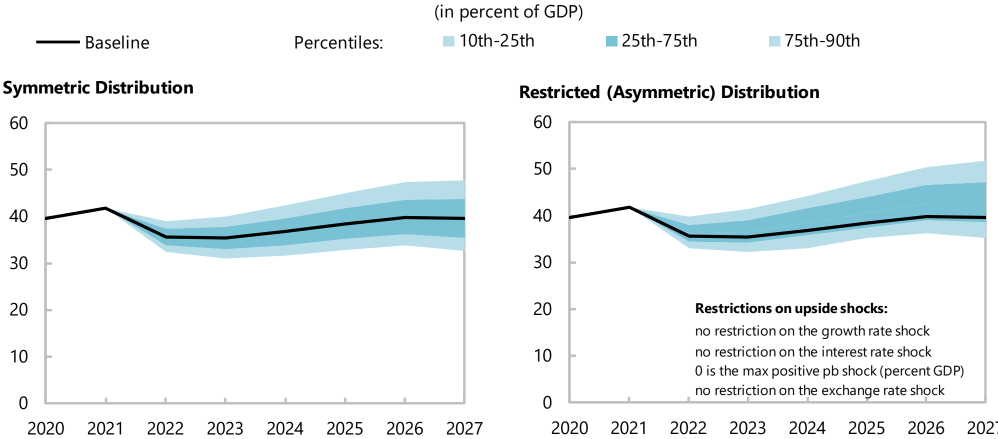
Figure 5. Türkiye: Public DSA Risk – Assessment

Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

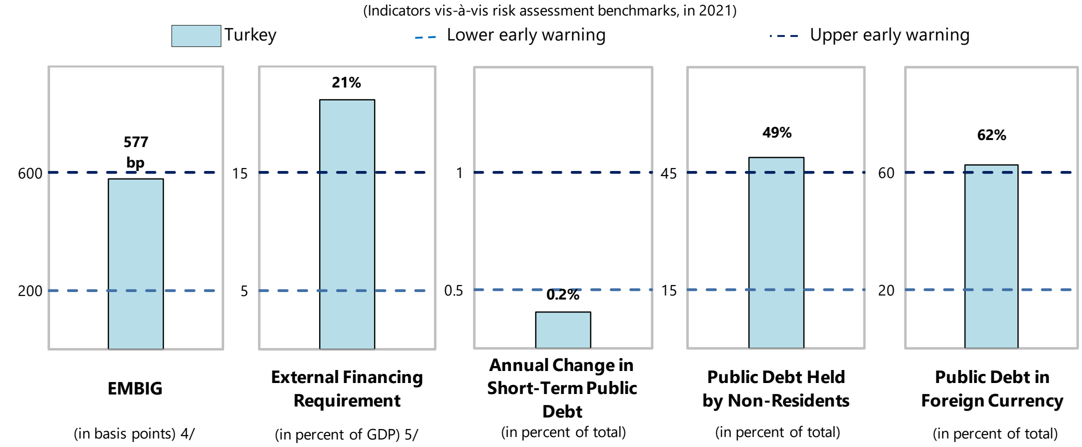
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2021)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 11-Aug-22 through 09-Nov-22.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Annex III. The Health of Non-Financial Corporations

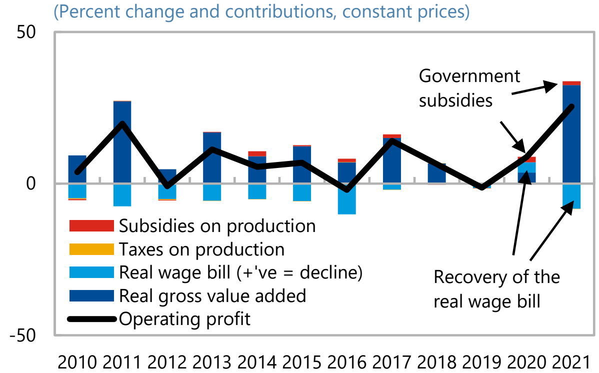
Non-financial corporate (NFC) balance sheets proved resilient during the most intense period of the pandemic. A strong rebound in economy activity, a stable real wage bill, and government support all boosted profitability. However, pockets of vulnerability remain acute in some industries, including in accommodation and food, transportation, and real estate/construction.[1] *And the significant negative net FX position, while declining in recent years, remains a major vulnerability to NFC balance sheets.*

Income Flows[2]

1. **NFC operating profits reached a record high in 2021.** In 2020, despite the pandemic, real revenue growth remained positive. A decline in the real wage bill (through layoffs and high inflation) and an increase in government subsidies pushed the growth of real operating profits to above the pre-pandemic average. This trend continued in 2021: consistent with strong GDP growth, NFC real gross value added was exceptional, increasing by 21 percent, yoy. Despite a recovery in the real wage bill, mainly driven by stronger employment, real operating profits increased by a record amount. This is consistent with the large increase (decrease) in the capital (labor) share of GDP witnessed in recent quarters.

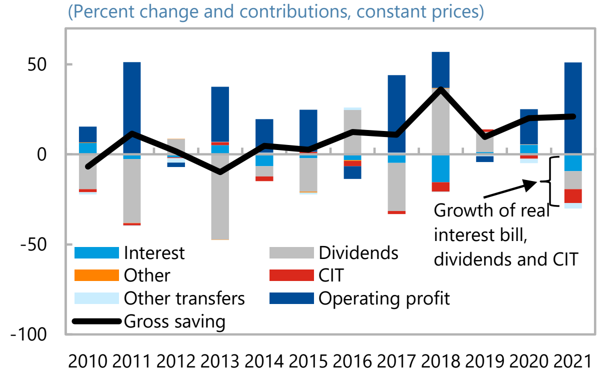
2. **These profit developments supported gross saving, despite financial and tax outflows.** In 2020, despite the strong increase in real operating profits, real dividend payments remained unchanged, as firms sought to enhance buffers. Real interest payments also declined, likely associated with lower policy rates, high inflation, and financial sector policy support measures. These factors reversed in 2021, with the real interest bill, dividend payments and higher corporate income tax (CIT) payments all increasing. Nevertheless, these factors were more than offset by the high operating profits, supporting a further increase in real gross saving.

Production Account
(Percent change and contributions, constant prices)



Sources: Turkstat and IMF staff calculations.

Gross Saving After Financial and Tax Flows
(Percent change and contributions, constant prices)



Sources: Turkstat and IMF staff calculations.

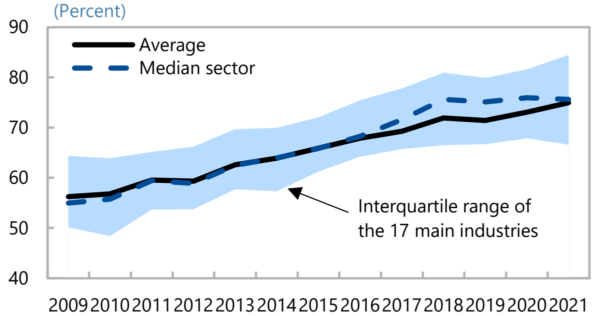
[1] This annex focuses on the evolution of corporate balance sheets in 2020 and 2021. For a longer perspective, see Box 4 of the 2021 Article IV Consultation for Türkiye.

[2] Institutional sector accunts give a helpful way to link NFC real and financial flows with different sectors of the economy. It tracks 'value-added' growth through to financial balance sheets.

Balance Sheets

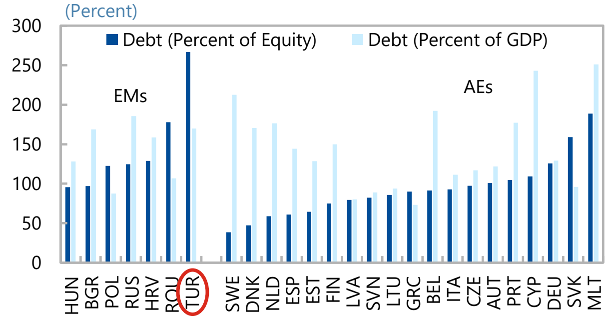
3. Leverage has been broadly stable in recent years but remains high relative to peers. Despite high real gross saving in 2020-21, NFCs also increased real investment and built inventories, resulting in higher net borrowing. As such, leverage increased only moderately, leaving an average equity buffer of around 25 percent of total assets in 2021.[3] Nevertheless, NFC leverage in Türkiye is high relative to OECD peers, leaving the sector vulnerable to shocks to profitability and interest rates, as well as valuation effects, in particular from the exchange rate.

Leverage
(Percent)



Sources: CBRT; and IMF staff calculations.
Note: Leverage = non-equity liabilities/total assets using the CBRT company accounts database.

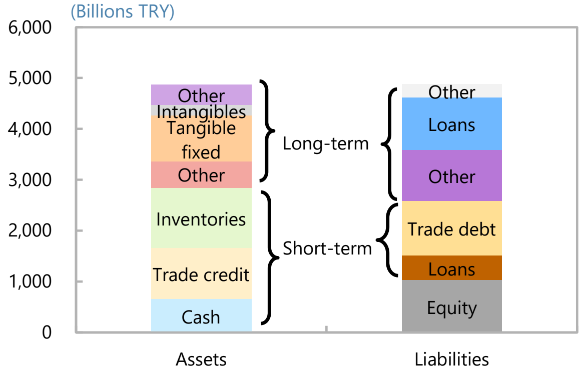
NFC Debt, 2021
(Percent)



Sources: Haver Analytics and IMF staff calculations.
Note: Uses unconsoldiated financial accounts data, which involves different acounting principles to the CBRT's "Company Accounts "database

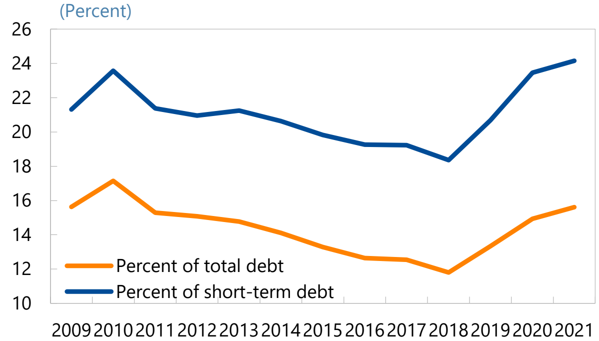
4. Much of the recent NFC borrowing was used to build assets, especially cash holdings. After stagnating in 2018 and 2019, real lending to NFCs increased significantly in 2020 and 2021, consistent with economy-wide monetary and credit trends. But much of the borrowing was used to build assets, rather than to cover pandemic-related losses. In particular, FX cash holdings and inventories increased significantly, improving NFC liquidity indicators, providing an inflation hedge and building an important buffer against temporary cash flow and exchange rate shocks.

Change in Balance Sheet, 2019-21
(Billions TRY)



Source: CBRT Company Accounts Database.

Liquid Assets 1/
(Percent)



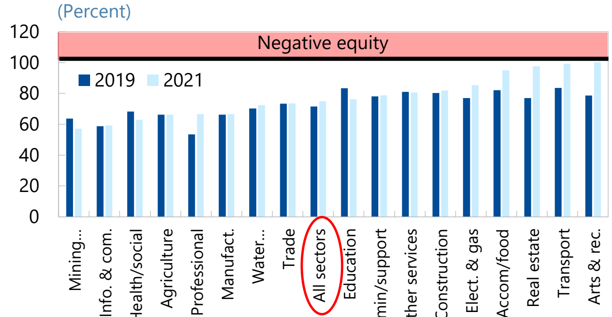
Sources: CBRT and IMF staff calculations.
1/ Cash, deposits, checks received etc.

[3] Based on the CBRT Company Accounts database, which covers more than 930,000 firms, across 17 sectors, over 2009-21. The sample of firms appears broadly representative of all NFCs in Türkiye, although a comparison with OECD data suggests that micro firms may be somewhat underrepresented.

Vulnerabilities

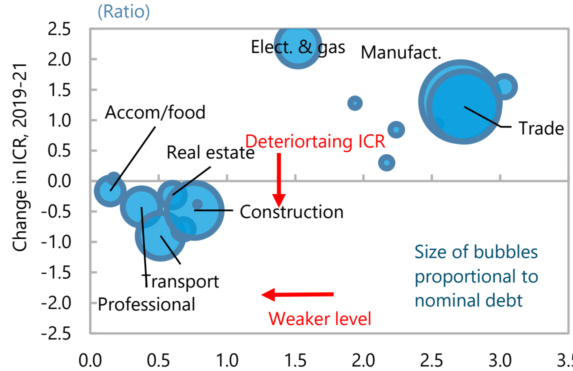
5. The NFC sector has shown signs of resilience, but some industries remain vulnerable. In the transportation, real estate and accommodation and food sectors, leverage jumped significantly, with average equity buffers near zero as of end-2021. And the interest coverage ratio (ICR)—a measure of debt service risk—remains problematically low for these sectors. A strong tourism season and modest recovery in real estate output have likely reduced vulnerabilities somewhat in these industries in 2022. However, given the high nominal debt stock of some of these industries, widescale corporate distress could quickly lead to financial stability problems.

Leverage by Industry
(Percent)



Sources: CBRT and IMF staff calculations.
Note: Leverage = non-equity liabilities/total assets using the CBRT company accounts database.

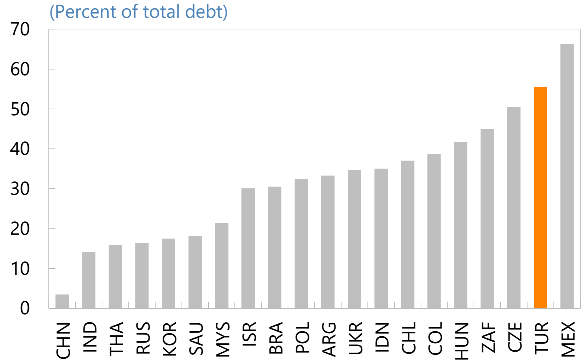
Interest Coverage
(Ratio)



Sources: CBRT and IMF staff calculations.

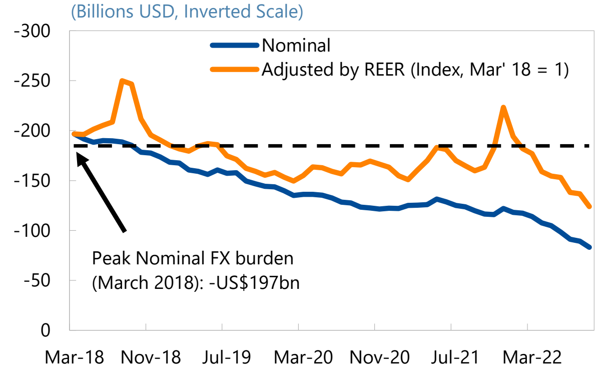
6. Foreign currency denominated debt, whilst declining, remains a significant risk. As of 2022Q2, half of NFC debt (loans and bonds) was FX-denominated, higher than in most emerging market peers. And FX-liabilities (including imports payable) represents around one-quarter of total liabilities. Over the last 4 years, the NFC sector has undergone significant nominal FX deleveraging, cutting the net FX position by around one-half. But the recent REER depreciation has undone much of the progress of recent years, implying a continuing real FX burden on NFCs. Sector-wide liquidity risk is mitigated by a positive short-term net FX position, which has increased by 40 percent since the beginning of 2020.

Foreign Currency Denominated Debt, 2022Q2
(Percent of total debt)



Sources: Haver and IMF staff calculations.

Net Foreign Exchange Position
(Billions USD, Inverted Scale)



Sources: Haver Analytics and IMF staff calculations.

Annex IV. Risk Assessment Matrix (November 1, 2022)[1]

Risks	Likelihood	Economic Impact	Policy Response
Global Conjunctural Risks			
Intensifying spillovers from Russia's war in Ukraine. Further sanctions resulting from the war and related uncertainties exacerbate trade and financial disruptions and commodity price volatility.	High	**High.** Export growth is likely to remain limited as the economies of major trading partners could face a recession due to energy trade disruptions with Russia.	• Additional targeted fiscal support to vulnerable households and viable firms. • Allow automatic fiscal stabilizers to operate fully and provide further targeted, temporary support as needed. • Use exchange rate as a shock absorber, strictly limiting FXI given limited reserves.
Commodity price shocks. A combination of continuing supply disruptions (e.g., due to conflicts and export restrictions) and negative demand shocks causes recurrent commodity price volatility and social and economic instability.	High	**High.** Further pressure on CPI inflation may risk destabilizing inflation expectations, generate social unrest, and require a stronger policy response.	• Tighter fiscal and monetary policies to anchor inflation expectations and limit second-round effects of commodity price shocks. • Increase transfers to vulnerable households as needed to alleviate the impact of higher inflation. • Use exchange rate as a shock absorber, strictly limiting FXI given limited reserves.
De-anchoring of inflation expectations and stagflation. Supply shocks to food and energy prices sharply increase headline inflation and pass-through to core inflation, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets. Central banks tighten monetary policy more than envisaged leading to weaker global demand, currency	High	**High.** Türkiye could face further currency depreciation and be exposed to a higher risk of debt distress.	• Tighter fiscal and monetary policies to anchor inflation expectations and prevent second-round effects of commodity price shocks. • Increase transfers to vulnerable households as needed to alleviate the impact of higher inflation.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenario highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon. The RAM differs slightly from the FSSA RAM due to a more updated starting point for the analysis.

depreciations in EMDEs, and sovereign defaults. Together, this could lead to the onset of stagflation.			
Abrupt global slowdown or recession. Global and idiosyncratic risk factors combine to cause a synchronized sharp growth slowdown, with outright recessions in some countries, spillovers through trade and financial channels, and downward pressures on some commodity prices.	Medium	Medium. Lower trading partner growth and sharp tightening of global financial conditions could curb Türkiye's growth and widen its external imbalances and risk premia.	• Use the exchange rate as a shock absorber, strictly limiting FXI given limited reserves. • Additional targeted fiscal support to vulnerable households.
Global Structural Risks			
Deepening geo-economic fragmentation and geopolitical tensions. Broadening of conflicts and reduced international cooperation accelerate deglobalization, resulting in a reconfiguration of trade, supply disruptions, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial system, and lower potential growth.	High	High. Türkiye's market access could be adversely affected, worsening balance of payments pressures.	• Use the exchange rate as a shock absorber, strictly limiting FXI given limited reserves. • Tighter monetary policy. • Accelerate reforms to improve export competitiveness, diversify markets, and support multilateral rules-based trade system.
Natural disasters related to climate change. More frequent natural disasters deal severe damage to infrastructure (especially in smaller vulnerable economies) and amplify supply chain disruptions and inflationary pressures, causing water and food shortages and reducing medium-term growth.	Medium	Medium. Droughts could pose challenges for the country's water supply and directly affect the agricultural sector.	• Provide targeted assistance to affected groups and sectors. • Prioritize public investment in disaster-resistant infrastructure.
Domestic Risks			
Disorderly macrofinancial cycle of deleveraging and income compression. Possible triggers include	High	High. Continued erosion of policy buffers and monetary policy credibility, leading to erosion in confidence, capital outflows,	• Tighter monetary and fiscal policy. • Use the exchange rate as a shock absorber.

domestic policy mistakes (including an inadequate policy response to reemerging market pressures), domestic political and social tensions, and/or external financing pressures giving rise to rapid exchange rate depreciation, which weakens corporate balance sheets and worsens bank asset quality, triggering sharp deleveraging and slowdown of economic activity.		accelerated dollarization, reserve depletion, and pressure on currency. NFCs lose access to external finance.	• Allow automatic fiscal stabilizers to operate fully and provide targeted, temporary support. • Fast track third-party asset quality review, followed by rigorous stress tests and follow-up measures as needed. • Promote out-of-court debt workouts. • Adopt a medium-term fiscal plan that creates additional fiscal space to help with the fallout from the private sector.

Annex V. External Debt Sustainability[1]

External debt under the baseline is assessed to be sustainable over the medium term but it is high and sensitive to shocks. External debt is expected to decline from about 55 percent of GDP at end-2021 to 46 percent of GDP by 2027, as the real exchange rate appreciates, but the external debt path remains sensitive to lira depreciation. Large external financing needs of around 24 percent of GDP each year expose the economy to liquidity risks, especially given low international reserves.

Background

1. External debt has increased in recent years. External debt has slightly increased from about 53 percent of GDP in 2017 to 55 percent in 2021, and it is expected to reach about 58 percent of GDP by the end of 2022. The private sector owes about half of it.

2. The share of short-term debt is set to increase, driven by the private sector, where capital flows have shown a trend towards shorter maturities. Short-term debt is expected to grow from 27 percent of total external debt at the end of 2021 to about 37 percent of total external debt by 2027. Longer-term non-debt creating inflows, mostly FDI, have slowed and are expected to remain below the long-term average of 1½ percent of GDP.

Assessment

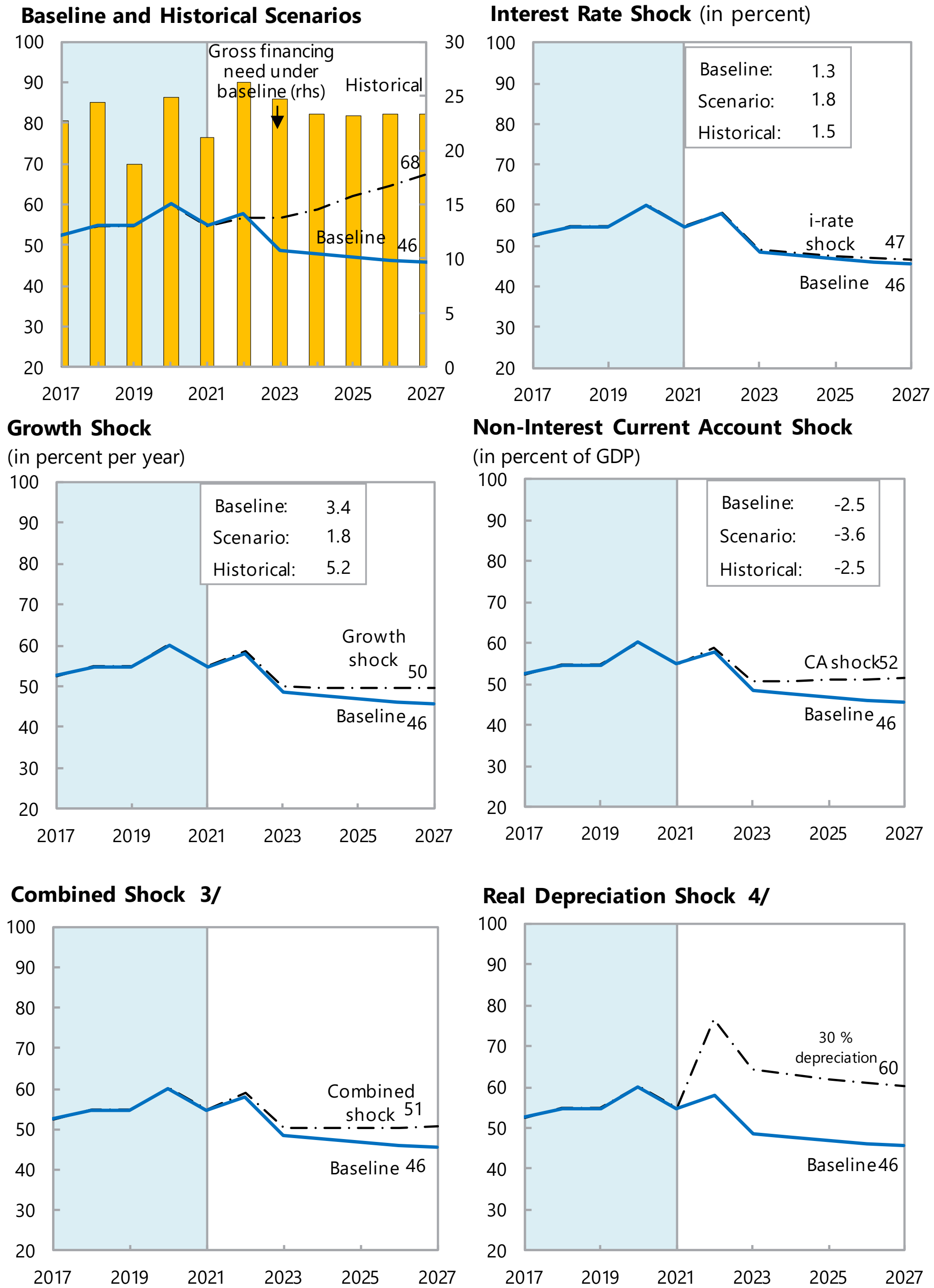
3. Türkiye's external debt is sustainable under the baseline but it is vulnerable to lira depreciation. After narrowing in 2021, Türkiye's current account deficit is projected to significantly worsen in 2022, mainly reflecting higher energy import prices. Türkiye's external debt trajectory improves under the baseline, as the current account deficit narrows and as the real exchange rate appreciates. Standard stress tests suggest that the debt level could increase substantially under a real depreciation shock given that most external debt is foreign-currency denominated. A permanent lira depreciation of 30 percent over the baseline would push the external debt stock temporarily to around 76 percent of GDP by end-2022, before subsequently falling to 60 percent of GDP by the end of the projection period.

4. Türkiye's external debt sustainability remains susceptible to liquidity risks. Around one third of Türkiye's private external debt is short term, although most comprises of large bank deposits by non-residents and trade credit, which have historically been stable over time. Türkiye's gross external financing needs of about USD179 billion (22 percent of GDP) in 2021 will remain elevated, with GEFNs averaging 24 percent of GDP over the projection period, creating both funding and rollover risks because of the rising share of the short-term debt component.

[1] This external debt sustainability analysis is based on the definition of external debt used by the authorities, covering liabilities arising from loans obtained from nonresidents and liabilities related to bonds issued in international capital markets. Government securities issued in Turkish lira are excluded, while Eurobonds held by domestic banks are included in this presentation of external debt.

Figure 1. Türkiye: External Debt Sustainability: bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: IMF staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. The shocks to interets rate was increased to 2 standard deviation. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2022.

Table 1. Türkiye: External Debt Sustainability Framework: 2017–27

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2017	2018	2019	2020	2021			2022	2023	2024	2025	2026	2027	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	52.5	54.7	54.7	60.1	54.8			**57.8**	**48.6**	**47.7**	**46.9**	**46.1**	**45.6**	**-2.9**
Change in external debt	5.8	2.2	0.0	5.4	-5.3			3.0	-9.3	-0.9	-0.8	-0.7	-0.5	
Identified external debt-creating flows (4+8+9)	3.3	5.9	-1.5	6.6	-7.7			2.7	1.3	0.3	0.1	0.1	0.2	
Current account deficit, excluding interest payments	3.9	1.6	-2.5	3.6	0.2			5.4	2.8	1.9	1.6	1.6	1.6	
Deficit in balance of goods and services	3.7	1.3	-2.9	3.3	-0.3			4.8	2.3	1.4	1.2	1.2	1.3	
Exports	26.0	30.6	32.8	28.7	35.0			40.3	33.2	34.6	35.4	36.0	36.6	
Imports	29.7	31.8	30.0	32.0	34.7			45.1	35.5	36.0	36.6	37.3	37.8	
Net non-debt creating capital inflows (negative)	-1.3	-1.0	-0.9	0.0	-0.7			-0.3	-0.6	-0.8	-0.8	-0.8	-0.8	
Automatic debt dynamics 1/	0.7	5.3	1.9	3.1	-7.3			-2.3	-0.8	-0.8	-0.7	-0.7	-0.7	
Denominator: 1+g+r+gr	1.0	0.9	1.0	0.9	1.1			1.0	1.2	1.1	1.1	1.1	1.1	
Contribution from nominal interest rate	0.7	1.0	1.1	0.8	0.7			0.6	0.6	0.6	0.6	0.6	0.6	
Contribution from real GDP growth	-3.5	-1.7	-0.4	-1.1	-6.0			-2.9	-1.4	-1.4	-1.4	-1.3	-1.3	
Contribution from price and exchange rate changes 2/	3.5	6.1	1.3	3.3	-1.9			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	2.5	-3.7	1.5	-1.2	2.4			0.3	-10.6	-1.2	-0.9	-0.9	-0.7	
External debt-to-exports ratio (in percent)	202.0	179.1	166.7	209.5	156.6			143.6	146.4	138.0	132.4	128.1	124.9	
Gross external financing need (in billions of US dollars) 4/	194.6	190.2	142.0	179.5	173.0			222.7	254.4	253.6	266.4	282.9	297.1	
in percent of GDP	22.7	24.4	18.7	24.9	21.2			26.2	24.7	23.4	23.2	23.4	23.4	
Scenario with key variables at their historical averages 5/						10-Year Historical Average	10-Year Standard Deviation	**56.6**	**56.6**	**58.9**	**61.9**	**64.7**	**67.5**	**-0.8** For debt stabilization
Key Macroeconomic Assumptions Underlying Baseline														
Nominal GDP (US dollars)	858.9	779.7	759.5	720.1	817.5			850	1030	1086	1150	1210	1271	
Real GDP growth (in percent)	7.5	3.0	0.8	1.9	11.4	5.2	3.2	5.5	3.0	3.0	3.0	3.0	3.0	
Exchange rate appreciation (US dollar value of local currency, percent change)	-17.2	-24.3	-15.1	-19.0	-20.9	-15.1	6.2	-46.2	-22.4	-17.6	-13.8	-13.8	-13.8	
GDP deflator (change in domestic currency)	11.0	16.5	13.8	14.9	29.0	12.2	6.9	83.3	51.7	24.1	19.3	18.5	18.2	
GDP deflator in US dollars (change in percent)	-8.1	-11.9	-3.4	-7.0	2.0	-5.0	5.2	-1.4	17.7	2.3	2.8	2.2	2.0	
Nominal external interest rate (in percent)	1.6	1.7	1.9	1.5	1.3	1.5	0.2	1.1	1.2	1.3	1.4	1.4	1.4	
Growth of exports (US dollar terms, in percent)	12.0	6.8	4.7	-17.2	38.5	5.5	15.3	19.7	-0.2	9.7	8.5	7.1	6.6	
Growth of imports (US dollar terms, in percent)	16.7	-2.7	-8.2	1.1	23.2	1.8	11.6	35.2	-4.5	6.7	7.8	7.1	6.6	
Current account balance, excluding interest payments	-3.9	-1.6	2.5	-3.6	-0.2	-2.5	2.3	-5.4	-2.8	-1.9	-1.6	-1.6	-1.6	
Net non-debt creating capital inflows	1.3	1.0	0.9	0.0	0.7	1.1	0.5	0.3	0.6	0.8	0.8	0.8	0.8	

Source: IMF staff calculations.

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP

3/ For projections, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Annex VI. Implementation of Past Fund Advice

1. **Recent Fund advice focused on risks associated with externally-funded credit and demand stimulus.** The 2021 Article IV staff report recognized that Türkiye had experienced a remarkable recovery from the pandemic, buoyed by large interest rate cuts, rapid credit provision by state-owned banks, and extensive liquidity support. But those same policies had also exacerbated pre-existing vulnerabilities and reduced buffers. Therefore, staff underscored the importance of strongly committing to, and delivering, a firm monetary policy stance to bring inflation towards target as well as strengthening central bank independence. However, current policies—centered around low policy rates despite inflation well above target and a positive output gap—have further departed from Fund advice.

2. **Progress relative to the 2016 FSAP has been mixed.** Partial progress has been made on financial sector oversight, regulation, and macroprudential policy, while policies around systemic liquidity risk management and crisis management and resolution remain insufficient. In particular, the methodology for conducting risk assessments and inspections of the banking sector has been broadened and corporate governance rules and enforcement of regulations have also improved. Macroprudential policies to lower economy-wide FX risks have also been implemented. However, systemic liquidity risk management remains a key deficiency, with little improvement in the emergency liquidity capacity of the CBRT and with reserves still below the Fund's Assessment of Reserves Adequacy metric. On crisis management and resolution, no action has been taken on coordinating arrangements in the event of a cross-border bank failure. For further details on progress related to the implementation of outstanding 2016 FSAP recommendations see 2022 FSAP Appendix II.

INTERNATIONAL MONETARY FUND

REPUBLIC OF TÜRKİYE

December 21, 2022

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By European Department

CONTENTS

FUND RELATIONS

(Data as of October 31, 2022)

There is no outstanding Fund credit.

Membership Status: Türkiye became a member of the Fund on March 11, 1947.

General Resources Account

	SDR Million	Percent Quota
Quota	4,658.60	100.00
Fund holdings of currency	4,545.83	97.58
Reserve position in Fund	112.78	2.42

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	5,536.39	100.00
Holdings	5,508.24	99.49

Outstanding Purchases and Loans: None.

Latest Financial Arrangements

	Approval Date	Expiration Date	Amount Approved	Amount Drawn
			In millions of SDRs	
Stand-By	05/11/05	05/10/08	6,662.04	6,662.04
Stand-By	02/04/02	02/03/05	12,821.20	11,914.00
Stand-By	12/22/99	02/04/02	15,038.40	11,738.96
Of Which: SRF	12/21/00	12/20/01	5,784.00	5,784.00

Projected Payments to the Fund[1]

(In millions of SDRs; based on existing use of resources and present holdings of SDRs).

	Forthcoming				
	2022	2023	2024	2025	2026
Principal	--	--	--	--	--
Charges/Interest	0.13	0.77	0.77	0.77	0.77
Total	0.13	0.77	0.77	0.77	0.77

Safeguard Assessments: An assessment of the central bank's safeguards framework was conducted under the last SBA and completed on June 29, 2005. While it uncovered no material weaknesses in the central bank's safeguard framework, a few recommendations were made to address some

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

remaining vulnerabilities in the areas of internal audit and controls. Those recommendations have been implemented.

Exchange Rate Arrangement: The currency of Türkiye is the Turkish lira, which replaced the new Turkish lira on January 1, 2009. The *de jure* exchange rate arrangement is free floating; the *de facto* exchange rate arrangement is floating. Türkiye accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement as of March 22, 1990 and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions except for those maintained solely for the preservation of national or international security and which have been notified to the Fund pursuant to Executive Board Decision No. 144–(52/51).

Article IV Consultations: Board discussion of the last Article IV staff report took place on May 27, 2021. The Article IV staff report (IMF Country Report No. 21/110) was published on June 11, 2021.

FSAP: Financial stability assessments under the Financial Sector Assessment Program (FSAP), every five years, are a mandatory part of Article IV surveillance. Three FSAP missions to Türkiye took place in 2022, and the Aide Memoire was presented to the authorities. The FSAP findings are summarized in the accompanying Financial System Stability Assessment (FSSA), which will be discussed at the Board together with the 2022 Article IV staff report.

Resident Representative:

The IMF currently has a resident representative office in Ankara. Mr. Azim Sadikov has been the senior resident representative December 2021.

ROSCs

Standard or Code Assessed	**Date of Issuance**	**Document Number**
Fiscal Transparency	June 27, 2000	N/A
Corporate Governance	December 11, 2000	Prepared by the World Bank
Data ROSC [1/]	March 14, 2002	Country Report No. 02/55
Fiscal ROSC	November 25, 2003	Country Report No. 03/363
Fiscal ROSC	March 24, 2006	Country Report No. 06/126
FSSA and related ROSC	November 9, 2007	Country Report No. 07/361
Data ROSC	September 3, 2009	Country Report No. 09/286
FSSA and related ROSC	September 7, 2012	Country Report No. 12/261
BCP [2/]	March 7, 2014	N/A
IAIS [3/]	March 7, 2014	N/A
FSSA and related ROSC	February 3, 2017	Country Report No. 17/35
BCP	February 8, 2017	Country Report No. 17/46
CPMI IOSCO	February 8, 2017	Country Report No. 17/45
IAIS	February 8, 2017	Country Report No. 17/47

[1/] Report on Observance of Standards and Codes (ROSC).
[2/] Basel Core Principles for Effective Banking Supervision (BCP).
[3/] International Association of Insurance Supervisors (IAIS).

Recent Technical Assistance

Dept.	Timing	Purpose
MCM	February 2012	Stress testing framework for the financial sector supervisor
FAD	September 2012	G–20 budget institutions
MCM	October 2012	Early warning system and stress testing
FAD	November 2012	Measurement of structural fiscal balances
STA	January 2013	National account statistics
MCM	December 2013	Stress testing
STA	December 2013	Monetary and financial statistics
STA	March 2014	Government finance statistics
STA	March 2014	National accounts statistics
FAD	April 2014	Performance-based budgeting
FAD	May 2014	Tax revenue modeling
STA	May 2014	Financial sector accounts
STA	July 2014	Government finance statistics—public sector debt statistics
STA	April 2015	National accounts statistics
FAD	June 2015	Fiscal transparency evaluation
STA	January 2016	Compilation system for independent annual estimates of GDP
STA	April 2016	Government finance statistics—GFSM2014 and ESA10
FAD	December 2017	Public-Private Partnerships (PPP)
FAD	January 2018	VAT Policy Issues
MCM	September 2018	Stress testing (follow up)
STA	November 2019	Commercial Property Price Index
STA	November 2019	Consumer Price Index

RELATIONS WITH THE WORLD BANK GROUP

A. International Bank for Reconstruction and Development (IBRD)

1. **The partnership between Türkiye and the World Bank Group (WBG) is outlined in the Country Partnership Framework (CPF).** The CPF was initially designed to cover the FY18–21 period but was updated and extended to include FY22–23 through the Performance and Learning Review (PLR) in 2020. The PLR confirmed that CPF objectives remain valid and ensured continued alignment with the Government strategies including the 11th Development Plan (DP, 2019–2023) and the New Economic Program (launched in 2021). The WBG program continues to maintain a long-term focus that maximizes opportunities to support Türkiye's progression to high-income status.

2. **There are 24 active IBRD operations for US$8.5 billion, placing Türkiye in the top five IBRD countries by portfolio size.** The portfolio also includes one Global Environment Facility (GEF)-financed project and six trust-funded projects, including almost $600 million in European Union trust funds through the Facility for Refugees in Türkiye. Portfolio indicators are strong with a low-level of risk, high nominal disbursements, satisfactory closing of operations, no effectiveness lag, and no disconnect with Independent Evaluation Group (IEG) reviews. The CPF proposed IBRD financing for the FY17–23 period at US$7-10.5 billion and, to date, almost US$8.5 billion of this envelope has been delivered.

3. **The WBG Program for FY23 supports the Government's goals on mobilizing climate financing.** The climate response related lending pipeline in FY23 is rich and is focused on climate change adaptation or mitigation projects that are directly linked to the implementation of Türkiye's Nationally Determined Contribution (NDCs). As part of the recently-completed CCDR (which was the first CCDR delivered), discussions are underway to step up the ambition under a revised NDC. The Bank is providing assistance to this.

4. **The WBG Program has supported the Government's strategy to boost human capital, expand opportunities for vulnerable youth and women, and prepare and respond to pandemics.** The WBG portfolio has expanded support to firm-led job creation in vulnerable regions impacted by a high influx of refugees; mitigating learning loss through hybrid and online education to address COVID and future shocks; and boosting the Government's health system response to COVID. The Bank is in discussions with authorities regarding boosting investments in green human capital, skills and jobs, particularly for vulnerable youth and women.

5. **As part of the EU's response to the Syrian refugee crisis, the WBG was entrusted with managing a total of US$650 million of the EU-funded Facility for Refugees in Türkiye (FRiT).** In the first tranche agreed in 2016, three projects for a combined total of US$205 million were targeted towards education, employment and entrepreneurship. The second tranche (US$395 million) of the FRiT supported socio-economic and municipal services projects. In addition, the Trust Fund portfolio

has increased with projects funded by Clean Technology Fund (CTF), EU Instrument for Pre-Accession Assistance (IPA) funds, and GEF funds.

6. The ASA portfolio is strategically consolidated around core and extended core ASAs. These include: Programmatic Public Finance Review, Pandemic Preparedness and Response and Country Green Growth. Also, a new Systematic Country Diagnostic (SCD) is under preparation and expected to be delivered in March 2023.

B. International Finance Corporation

7. **IFC portfolio implementation continued to perform satisfactorily.** IFC's own-account investment program reached US$3,813 million between FY17 and FY22 since the beginning of the CPF which is in line with expected CPF deliverables. In addition, IFC mobilized a cumulative US$2,000 million during the same period, bringing IFC's long term finance commitments to $5,811 between FY17 and FY22 (total Long Term Finance (LTF) commitments, FY17: US$1,348m, FY18: US$1,127m, FY19: US$222m, FY20: US$973m, FY21: US$1,062, FY22: US$1,079). IFC also committed a cumulative US$4.2 billion (FY17-FY22) to Turkish banks under its Global Trade Finance Program (GTFP), broadening access to finance for companies. IFC continues to maintain a high level of exposure to Türkiye at around US$4 billion at end FY22, representing its 3rd largest country exposure globally.

C. Multilateral Investment Guarantee Agency

8. **Türkiye continued to be Multilateral Investment Guarantee Agency's (MIGA) largest country by gross exposure, representing about 9 percent of MIGA's gross portfolio.** As of end-FY22, MIGA's gross exposure in Türkiye totaled about US$2.235 billion across 16 projects (six in the infrastructure sector, four in the financial sector, and six in the services sector). About two-thirds of the portfolio stems from MIGA non-honoring guarantees to state-owned enterprises and sub-sovereigns, with the remainder being political risk insurance guarantees, in support of PPPs in the healthcare sector and electricity distribution.

STATISTICAL ISSUES

(As of October 31, 2022)

I. Assessment of Data Adequacy for Surveillance
General: Data provision to the Fund is broadly adequate for surveillance purposes, despite some shortcomings especially in national accounts and government finance statistics.
National Accounts: Published data for 1998 onwards adheres to the standards of the *System of National Accounts 2008 (2008 SNA)/ European System of Accounts 2010 (ESA 2010).* The Turkish Statistical Institute (TURKSTAT) compiles and disseminates a comprehensive set of national accounts series, including quarterly Gross Domestic Product (GDP) at current prices and in chain-linked volume terms (production approach and expenditure approach); quarterly and annual GDP at current prices (income approach); financial and non-financial sectoral accounts; government accounts; regional accounts; and supply and use tables. In December 2016, TURKSTAT published a new series of national accounts, with reference year 2009 and benchmark year 2012. Quarterly national accounts are published within 2 months after the reference period. Since the end-2016 revision, annual GDP is estimated independently from the quarterly estimates and is published within 9 months after the reference period. The end-2016 dissemination of rebased national accounts led to a significant upward revision of GDP, with many changes introduced, including improvements in methodology, the adoption of the *2008 SNA/ESA 2010*, and the use of new data sources.
Price Statistics: The consumer price index (CPI) and the producer price index (PPI) generally conform to international standards. The CPI has 2003 as base year and the weights are based in the Household Budget Survey conducted yearly by TURKSTAT. The PPI is compiled for mining, manufacturing, and utilities. A separate PPI is disseminated for agriculture.
Government Finance Statistics: Coverage of the budget is largely complete. Data for some fiscal operations conducted through extra budgetary funds are available only with some lags. Fiscal analysis is further complicated by some quasi-fiscal operations carried out by state banks, state economic enterprises (SEEs), and other public entities; and technical problems associated with consolidating the cash-based accounts of governmental entities with the accrual-based accounting of SEEs. It is difficult to reconcile fiscal data with monetary and BOP data, especially in the accounting of external debt flows and central government deposits. Data available for publication in the *Government Finance Statistics Yearbook* cover the general government sector and its subsectors with coverage of both stocks and flows, including a full general government balance sheet. Quarterly general government data on an accrual basis, including revenue, expenditure, financing, and balance sheet data, are reported for publication in *International Financial Statistics (IFS)*.

Monetary and Financial Statistics: The Central Bank of Türkiye (CBRT) reports monetary statistics for the central bank, other depository corporations, and other financial corporations, using the standardized report forms (SRFs), which accord with the concepts and definitions set out in the IMF's *Monetary and Financial Statistics Manual*. The CBRT reports data on some key series and indicators of the Financial Access Survey (FAS), including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).	
Financial Sector Surveillance: The Banking Regulatory and Supervision Agency (BRSA) reports all 12 core FSIs and nearly all the encouraged FSIs on a quarterly basis.	
External Sector Statistics: The CBRT compiles and disseminates balance of payments and international investment positions (IIP) statistics on monthly basis in broad conformity with the conceptual framework of the sixth edition of the *Balance of Payments and International Investment Position Manual* (*BPM6)*. The CBRT participates in the IMF coordinated surveys on direct and portfolio investments, and reports data template on international reserves and foreign currency liquidity and the currency composition of the IIP (beginning with 2016 data) regularly.	
II. Data Standards and Quality	
Türkiye has subscribed to the Special Data Dissemination Standard (SDDS) since 1996.	The latest Data ROSC was published in September 2009.

Türkiye: Table of Common Indicators Required for Surveillance
(As of October 31, 2022)

	Date of latest observation	Date received	Frequency of data[7/]	Frequency of reporting[7/]	Frequency of publication[7/]	Memo Items:	
						Data Quality – Methodological soundness[8/]	Data Quality Accuracy and reliability[9/]
Exchange Rates	Oct 2022	10/31/2022	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1/]	Sep 2022	10/20/2022	W	W	W		
Reserve/Base Money (narrow definition)	Sep 2022	10/31/2022	W/M	W/M	W/M	O, O, LO, O	O, O, O, O, O
Reserve/Base Money (broad definition)	Sep 2022	10/31/2022	W/M	W/M	W/M		
Broad Money	Sep 2022	10/31/2022	W/M	W/M	W/M		
Central Bank Balance Sheet	Sep 2022	10/31/2022	W/M	W/M	W/M		
Consolidated Balance Sheet of the Banking System	Sep 2022	10/31/2022	W/M	W/M	W/M		
Interest Rates[2/]	Oct 2022	10/20/2022	D/W/M	D/W/M	D/W/M		
Consumer Price Index	Sep 2022	10/03/2022	M	M	M	O, LO, O, LO	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3/] – General Government[4/]	Sep 2022	9/30/2022	Q	Q	Q	O, LO, O, O	O, O, LO, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3/] Central Government	Sep 2022	10/17/2022	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5/]	Sep 2022	10/20/2022	M	M	M		
External Current Account Balance	Aug 2022	10/11/2022	M	M	M	O, O, O, LO	O, O, O, O, O
Exports and Imports of Goods and Services	Aug 2022	10/27/2022	M	M	M		
GDP/GNP	2022Q2	8/31/2022	Q	Q	Q	O, LO, O, O	LO, O, LO, O, LO
Gross External Debt	2022Q2	9/30/2022	Q	Q	Q		
International Investment Position[6/]	Aug 2022	10/18/2022	M	M	M		

1/ Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
2/ Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
3/ Foreign, domestic bank, and domestic nonbank financing.
4/ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
5/ Including currency and maturity composition.
6/ Includes external gross financial asset and liability positions vis-à-vis nonresidents.
7/ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).
8/ These columns should only be included for countries for which Data ROSC (or a Substantive Update) has been published.
9/ This reflects the assessment provided in the data ROSC or the Substantive Update (published on September 3, 2009 and based on the findings of the mission that took place during October 2016) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).