Macro note – 2025/I Inflation Report

In its first inflation report of the year, the CBRT raises its year-end inflation forecast for 2025 by 2.2 points to 24%. Regarding the monetary policy stance, the CBRT states that it is "not on autopilot" and that interest rate decisions will be reviewed at every meeting.

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In its first inflation report for 2025, the Central Bank shared the outlook for the local and global economies, developments in the real sector and financial markets, and medium-term forecasts. According to the November 2024 Inflation Report, the CBRT raised its 2025 inflation forecast to 24% while maintaining its 2026 year-end inflation forecast at 12%. The end-2025 inflation forecast was revised up by 0.5 points due to food prices and 1.7 points due to administered prices. Some revisions were also made to assumptions compared to the previous reporting period. In this context, the export-weighted growth index was revised down by 0.2 points to 2.2%, oil prices were revised down by USD2.3 to USD76.5, import prices were revised down by 0.2 points to 2.6% and food inflation was revised up by 2 points to 24.5%. Moreover, the revision in the consumption basket and weighting structure of CPI mechanically raised the previous end-2025 forecast by 0.8 points (21% previously and 21.8% in the new model). Thus, the end-2025 inflation forecast was revised upwards by a total of 2.2 points. This revision was driven by the mechanical effect stemming from the change in consumption patterns and the increased weight of the services group in the consumer price index led by rent and other services items. Moreover, changes in assumptions regarding unprocessed food inflation and administered prices were also influential. The inflationary impact of taxes and administered prices slowed down considerably in the last period of the year, before picking up again by early 2025. Factors such as price revisions for urban transportation items, the increase in taxes and fees by the revaluation rate, and the revision of examination co-payments in the SSI Health Implementation Communiqué (SUT) pushed consumer inflation higher. It is assessed that the primary effects of these developments will not affect inflation in the following year, while their secondary effects will be offset by maintaining the tight monetary stance. Accordingly, the end-2026 inflation forecast is maintained at 12 percent. Forecasts are based on an outlook characterized by heightened uncertainties regarding global financial markets and global economic and trade policies. Medium-term forecasts are based on an outlook in which the tight monetary policy stance will be maintained and the coordination between economic policies will be strengthened until the inflation outlook displays a permanent decline and price stability is achieved. Food and administered price revisions by the CBRT also indicate risks to the end-2025 inflation forecast. As noted in the Report, the possibility of strengthening protectionist tendencies in trade policies increases the risks to global inflation on the upside and poses downside risks to global growth.

The highlights of the general assessment of the inflation report are as follows: "Amid expectations of a slowdown in monetary easing and heightened geopolitical tension, risk sentiment towards emerging economies (EMEs) has deteriorated slightly. While financial conditions remain tight, the share of TL in deposit composition continues to increase. In the third quarter of 2024, economic activity lost momentum. Recent indicators suggest that domestic demand remains supportive of disinflation. Seasonally-adjusted employment continued to increase in the last quarter of 2024,

and the unemployment rate remained flat below historical averages. Improvement in the current account balance in the third quarter of 2024 stalled in the last quarter due to the widening foreign trade deficit despite the strong outlook in the services balance. The CBRT has reiterated that monetary policy tools will be used effectively in case of a significant and persistent deterioration in inflation, stating that its decisions would be taken with an inflation outlook-oriented, cautious and meeting-based approach. In order to strengthen the monetary transmission mechanism, the CBRT revises the RRR targets and reserve requirement ratios. "In order to ensure that credit growth and its composition remain consistent with the disinflation path, regulations on credit growth limits continue to be revised and implemented." The decline in dollarization, the significant improvement in the current account, the positive atmosphere in the labor market, and the transmission mechanism in the credit and deposit markets are likely to support disinflation through 2025. However, clarifying uncertainty regarding the rate cut, the CBRT has stated that decisions will be taken on a meeting basis and that they are not in an automatic rate cut cycle.
In the section on revisions in forecasts and their sources, the CBRT stated the following. "The year-end inflation forecast is revised upwards to 24 percent for 2025, while inflation is expected to continue its downtrend, falling to 12 percent at the end of 2026 and 8 percent at the end of 2027. With 70 percent probability, inflation is projected at between 19 percent and 29 percent with a mid-point of 24 percent at the end of 2025; between 6 percent and 18 percent with a mid-point of 12 percent at the end of 2026; and stabilizing around the medium-term inflation target of 5 percent after falling to single-digit levels and 8 percent at the end of 2027. Forecasts are based on an outlook in which the tight monetary policy stance will be maintained and the coordination between economic policies will be strengthened until a permanent fall in inflation and price stability are achieved."

In sum, in the first inflation report for 2025, the Central Bank has raised its year-end inflation forecast by 2.2 points to 24%, while maintaining its 2026-2027 forecasts at 12% and 8%, respectively. Food prices and administered prices added 0.5 and 1.7 points to the year-end 2025 forecast, respectively. In particular, revisions in service prices such as healthcare and rents have led to significant inflation inertia. It was underlined that the recent trade wars and geopolitical risks also keep upside risks to inflation alive. It was noted that the interest rate cut cycle will not include uninterrupted and automatic rate cuts of the same size, and that a data-driven monetary policy stance will be adopted. Using both the monetary transmission mechanism and macro-prudential measures effectively, the CBRT reiterated that it is determined to use all instruments to bring current inflation closer to the forecast path. We find the revisions made by the CBRT more realistic than the forecasts of the previous report period. If the global economy does not deteriorate and the CBRT maintains its decisive stance, we expect the targeted levels to be achieved in the medium term. In light of the current developments and outlook, we maintain our year-end inflation forecast at 26.4%.

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