Macro note – 2025/II Inflation Report

In the second inflation report of the year, CBRT keeps its year-end inflation forecasts for 2025-2026 unchanged at 24% and 12%. The message is given that a possible interest rate cut is very unlikely before the downward effects of the decisions taken on the inflation trend are seen...

Abdulkadir DOGAN
Chief Economist
adogan@sekeryatirim.com.tr
(+90) 212 334 33 33/313

In the second 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 February 2025 Inflation Report, CBRT maintained its 2025 inflation forecast at 24% and its end-2026 inflation forecast at 12%. The year-end 2025 inflation forecast received a contribution of +0.5 points from food prices, +0.3 points from the output gap, +0.1 points from TL-denominated import prices and +0.1 points from the underlying trend of inflation. The total +1 point upside effect was offset by the -1 point revision from administered prices, leaving the year-end inflation forecast unchanged. Compared to the previous reporting period, some revisions were also made to assumptions. Accordingly, the export-weighted global growth index was revised down by 0.3 points to 1.9%, oil prices were revised down by 10.7 USD to 65.8 USD, import prices were revised down by 3.7 points to -1.1% and food inflation was revised up by 2 points to 26.5%. Forecasts are based on the assumption that uncertainties regarding tariff policies pose risks to inflation in both directions. The strong tendency to index pricing behavior to past inflation slows down the disinflation process. Moreover, it is crucial to strengthen the coordination between monetary and fiscal policies in the disinflation process. The disinflation process is expected to be strengthened by rebalancing domestic demand, real appreciation of the Turkish lira and improvement in inflation expectations.

The highlights of the overall assessment of the inflation report are as follows: "*The ongoing uncertainties regarding global trade policies have increased following the recent protectionist steps, and risks to the global economy and financial markets have become more pronounced. In a conjuncture where the global risk appetite remained weak amid rising tariff uncertainties and deteriorating global economic outlook, risk sentiment towards TL-denominated assets deteriorated as of mid-March due to domestic developments. Financial conditions tightened amid the policy rate hike and measures to support the tight monetary stance. Leading indicators suggest that domestic demand lost momentum in the first quarter, yet remained above projections, and its disinflationary effect waned. Employment declined in the first quarter, while the unemployment rate continued to fall. The seasonally and calendar-adjusted current account deficit narrowed in the first quarter. Annual consumer inflation fell to 37.86 percent in April, below the midpoint of the forecast range presented in the previous Report. The disinflation process continues*".

In the section on revisions in forecasts and their sources, the following explanations are given "The year-end inflation forecasts for 2025 and 2026 are maintained at 24% and 12%, respectively. With 70% probability, inflation is projected to be between 19% and 29% with a mid-point of 24% at the end of 2025; between 6% and 18% with a mid-point of 12% at the end of 2026; and stabilize around the medium-term inflation target of 5% after falling to single-digit levels at the end of 2027 and falling to 8%. Due to the recent increase in uncertainties, the forecast ranges are kept the same as in the previous Report. 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 is achieved".

In sum, in the second inflation report for 2025, the Central Bank maintained its year-end inflation forecasts for the 2025-2026-2027 periods at 24%, 12% and 8%, respectively. Upward pressures from food, output gap, inflation trend and imported prices were offset by the decline in administered prices and forecasts remained unchanged. It was underlined that the recent trade wars and geopolitical risks also keep upside risks to inflation alive. The Committee reemphasized the tight monetary stance and underlined those decisions regarding interest rate cuts would depend on the inflation outlook. Using both the monetary transmission mechanism and macroprudential measures effectively, the CBRT reiterated that it is determined to use all instruments to bring inflation closer to the forecast path. With the current outlook, we believe that the CBRT remains optimistic in its inflation forecasts. If the global economy does not deteriorate and the CBRT maintains its resolute stance, we estimate that the end-2025 forecast level can be reached with a one-quarter lag. In light of the current developments and outlook, we maintain our year-end inflation forecast at 30.3%.

ŞEKER INVEST RESEARCH

Şeker Yatırım Menkul Değerler A.Ş.
Buyukdere Cad. No: 171 Metrocity
A Blok Kat 4-5 34330 SİSLİ /IST
TURKEY

TEL: +90 (212) 334 33 33
Fax: +90 (212) 334 33 34
E-mail: research@sekeryatirim.com
Web: http://www.sekeryatirim.com/english/index.aspx

For additional information, please contact:

Research

Kadir Tezeller	**Head**	**+90 (212) 334 33 81**	ktezeller@sekeryatirim.com
Burak Demirbilek	**Utilities, Defense Industry**	**+90 (212) 334 33 33-128**	bdemirbilek@sekeryatirim.com
Engin Değirmenci	**Cement**	**+90 (212) 334 33 33-201**	edegirmenci@sekeryatirim.com
A. Can Tuğlu	**Food & Bev., Retail, Auto, Aviation, Oil&Gas**	**+90 (212) 334 33 33-334**	atuglu@sekeryatirim.com
Esra Uzun Özbaskın	**Telcos, Iron & Steel, Cons. Dur.**	**+90 (212) 334 33 33-245**	euzun@sekeryatirim.com
Başak Kamber	**Glass**	**+90 (212) 334 33 33-251**	bkamber@sekeryatirim.com

Economy & Politics

Abdulkadir Doğan	**Chief Economist**	**+90 (212) 334 91 04**	adogan@sekeryatirim.com

Institutional Sales

Batuhan Alpman	**Head**	**+90 (212) 334 91 01**	balpman@sekeryatirim.com
Deniz Keskin	**Trader**	**+90 (212) 334 33 36**	dkeskin@sekeryatirim.com
Soner Bayram	**Trader**	**+90 (212) 334 33 38**	sbayram@sekeryatirim.com

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