Macro note – 2025/III Inflation Report

The Central Bank of the Republic of Türkiye (TCMB) revised its forecast range and interim target in its third inflation report of the year. In this context, the interim target was kept steady at 24% for the end of 2025, while the forecast range was updated to 25-29%...

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

In its third inflation report for 2025, the Central Bank shared its outlook on the local and global economies, developments in the real sector and financial markets, and its medium-term forecasts. The Central Bank of the Republic of Turkey (CBRT) has revised its communication and forecasts, setting an inflation forecast band and intermediate targets. Within this framework, intermediate targets focused on the end of the year have been set, which the central bank has committed to and which economic units can use as a reference in the disinflation process aimed at reaching 5% in the medium term. In the new approach, the interim targets set for the forecast horizon (the next three years) serve as commitments and anchors. Interim targets can be defined as headline inflation levels that are committed to be achieved in the shorter term through the internal monetary policy path while reaching the medium-term inflation target of 5%. Intermediate targets will be maintained unchanged between Inflation Report periods unless there are extraordinary (extreme) updates to the set of assumptions. In this way, intermediate targets will be used as a reference in adjusting the current and near-term monetary policy tightness level. In the event of a deviation from the intermediate target in the year-end inflation realization, in line with the principles of transparency and accountability, the accounting of the deviation will be shared with the public in the first Inflation Report of the following year. If developments that could prevent the achievement of intermediate targets and are within the scope of monetary policy are anticipated, monetary policy tightness will be adjusted accordingly.

Following this revision, according to the May 2025 Inflation Report, the CBRT maintained its 2025 inflation interim target at 24% while updating the forecast range to 25-29%. The significantly updated 2026 year-end forecast (12%) was revised to an interim target of 16% with this change. The 2026 year-end inflation intermediate target faced upward pressure totaling +4 points, consisting of +0.9 points from food prices, +1.2 points from TL-denominated import prices, and +1.9 points from the main inflation trend. Some updates have also been made to the assumptions compared to the previous reporting period. In this context, the export-weighted global growth index for 2025 has increased by 0.1 points to 2%, oil prices have increased by USD 4 to USD 69.8, import prices have increased by 1.4 points to 0.3%, and food inflation has been kept steady at 26.5%. The forecasts were prepared based on the assumption that macroeconomic policies would be determined in a coordinated manner with a medium-term perspective focused on reducing inflation. In this context, it was assumed that fiscal policy coordination would contribute significantly to the disinflation process and that public-controlled administered-guided prices, borrowing, tax, and revenue policies would be determined in a manner that would support the decline in inflation when forming medium-term forecasts.

The main points highlighted in the overall assessment of the inflation report are as follows: "Although the recent uncertainty in global trade policies has decreased somewhat with bilateral agreements, it remains at a high level. In addition, geopolitical risks continue to affect the global economic outlook. The negative effects of this uncertainty and these risks on expectations for global economic activity are still being felt. Energy commodity prices increased slightly compared to the previous reporting period due to geopolitical developments. Weak demand conditions and production increases were the factors limiting the upward movement during this period. Domestically, as a targeted result of our tight monetary policy, the balanced trend in demand composition continues. Private consumption growth slowed in the first quarter of 2025. Compared to the period before tightening, the contribution of private consumption to growth has declined significantly. Similarly, the annual contribution of net exports now presents a more balanced picture. The normalization of demand composition is also clearly visible when growth data is examined on a quarterly basis. While private consumption declined in the first quarter, net exports made a positive contribution to growth as a result of increased exports and decreased imports. In this context, domestic demand weakened in the first quarter of the year due to continued tight financial conditions, while the external balance improved. Looking at the data for the second quarter, we see that the increase in the industrial production index has slowed. When sectors exhibiting typical volatility are excluded, industrial production declined slightly on a quarterly basis. There is also a negative output gap in the second quarter of the year. Therefore, with the continuation of tight financial conditions, we see that demand conditions are moving more in line with the disinflationary path during this period. We expect this outlook to continue for the remainder of the year. The current account deficit increased slightly in the second quarter but remained moderate in line with the domestic demand outlook. When compared to the first two Inflation Report periods of the year, we observe that inflation expectations have declined across all sectors. However, even though expectations have improved, they are still above our inflation forecasts. In this regard, expectations continue to pose a risk to the disinflation process. This outlook necessitates maintaining our tight and determined stance in monetary policy.

The section containing the updated forecasts and their sources includes the following explanations: "Inflation is expected to be between 25% and 29% at the end of 2025 with a 70% probability, and between 13% and 19% at the end of 2026. It is anticipated that inflation will decline to single digits by the end of 2027 and stabilize at the medium-term inflation target of 5 percent. The forecast range has been narrowed compared to the previous Report period, reflecting the reduction in global uncertainties and the decline in inflation to lower levels. Furthermore, as explained in Focus 3.1, the CBRT has made changes to its medium-term forecast communication framework, defining an intermediate target for each year in addition to the forecast path. The intermediate targets for 2025, 2026, and 2027 have been set at 24%, 16%, and 9%, respectively. The CBRT may update its forecasts during the Inflation Report periods, taking into account changes in actual outcomes and assumptions. However, the intermediate targets, which serve as commitments and anchors, will not be changed unless there is an extraordinary update to the assumption set and will be used as a reference in the internal determination of the policy rate path.

In summary, the Central Bank has updated its year-end inflation forecasts and intermediate targets in its third inflation report for 2025. The intermediate targets will serve as a reference for the communication channel and monetary policy stance. It has been emphasized that recent trade wars and geopolitical risks continue to pose upside risks to inflation. Statements regarding the tight monetary stance were reiterated, and it was emphasized that decisions on interest rate cuts are dependent on the inflation outlook. The CBRT, which effectively uses both the monetary transmission mechanism and macroprudential measures, has once again stated that it is determined to use all tools at its disposal to bring current inflation closer to the forecast path. Given the current outlook, we believe that the CBRT remains optimistic in its inflation forecasts. If there is no deterioration in the global economy and the CBRT maintains its determined stance, we estimate that the year-end forecast level for 2025 could be reached with a quarter-long delay. In light of current developments and the outlook, we are maintaining 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
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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