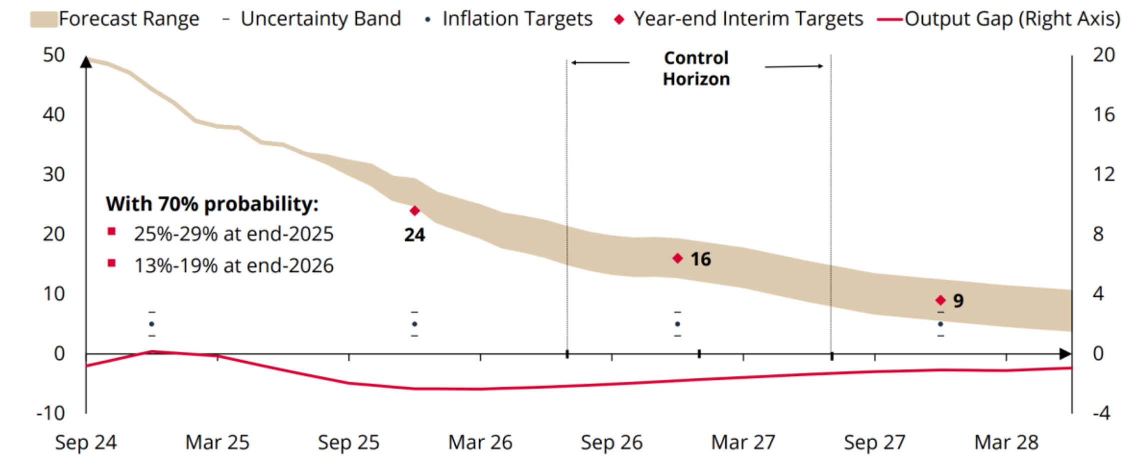
Macro: A commitment to rapid disinflation with new 'intermediate targets' in policy communication

1. Forecasts

CBRT has changed the way it communicates medium-term forecasts. Accordingly, 'interim targets', which are used as a reference in determining the monetary policy and indicate the levels to be achieved during the disinflation process, and year-end inflation forecasts are now separate. Previously, the forecasts also served as intermediate targets and could be updated frequently. Under the new framework, inflation forecasts may be revised based on data flows, while intermediate targets will not be changed unless there are extraordinary developments between reporting periods. In this regard:

- Interim targets have been set at 24%, 16% and 9% respectively for the end of 2025, 2026 and 2027.
- CBRT has updated the midpoint of its year-end inflation forecast range to 27% for 2025, 16% for 2026, and 9% for 2027 (Chart 1).
- The uncertainty bands for the year-end inflation forecasts have been narrowed. The uncertainty band for 2025 has been set at 25%–29% (previously 19%–29%). Thus, the upper band for 2025 remained unchanged.
- The uncertainty band for 2026 is 13%–19% (previously 6%–18%). Instead of the upper band that was frequently referred to in the 2025 communication and shaping of expectations, a more reasonable range has been adopted for 2026.

Chart 1. 2025-III Inflation and Output Gap Forecasts



Sources of forecast revision: No accounting was shared regarding the change in the 2025 year-end forecast band and the upward shift in its midpoint. However, statements in the report suggest that the more resistant than anticipated inertia in services, and some higher-than-expected administered price adjustments, and rising oil prices due to geopolitical developments played a role.

According to accounting for the increase in the interim target for the end of 2026 from 12% to 16%, approximately half of the 4-point update was due to the main trend and inertia of inflation being stronger than previous forecasts. Upward revisions to assumptions regarding food inflation and import prices in Turkish lira also contributed 0.9 and 1.2 percentage points, respectively, to the forecast change. The output gap was not subject to a significant revision and therefore was not included in the accounting.

Table 1. Revisions to 2026 year-end Interim Target

	2026
IR 2025-II Year-end Forecast (%)	12.0
IR 2025-III Year-end Interim Target (%)	16.0
Revision as Compared to IR 2025-II Period (% Points)	**4.0**
Sources of Revision (% Points)	
Food Prices	+0.9
Import Prices in Turkish Lira	+1.2
Underlying Inflation and Inertia	+1.9

2. Assumptions

External demand: As a result of negotiations on reciprocal tariffs, assumptions regarding external demand growth have been revised slightly upwards, reflecting lower tariff rates than initially announced in April. However, the global growth outlook for 2025 and 2026 remains more negative than in the first report of the year.

Indeed, in its July Global Economic Outlook Interim Report, the IMF stated that the slowdown in global growth caused by tariffs would be more limited than initial estimates and raised its global growth forecast from 2.8% to 3.0% for 2025 and from 3.0% to 3.1% for 2026. Prior to the tariffs, forecasts for both years were 3.3%.

Food prices: The food inflation assumption for 2025 remained unchanged at 26.5% (Table 2). The annual food inflation assumption for 2026 was raised from 13.5% to 17%, taking into account developments in agricultural purchase prices.

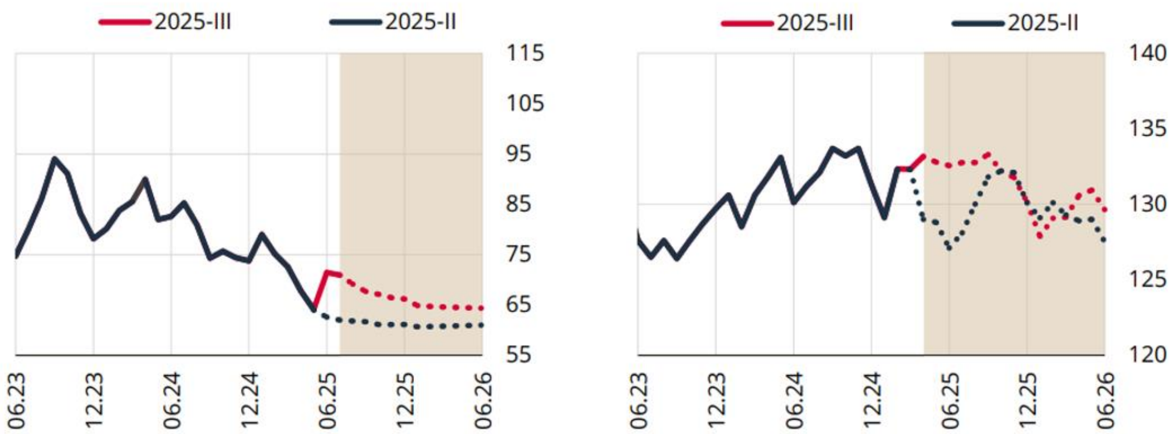
Table 2. Assumptions

		IR 2025-II	IR 2025-III
Global Production Index* (Average Annual % Change)	2025	1.9	2.0
	2026	2.1	2.3
Oil Prices (USD, Annual Average)	2025	65.8	69.8
	2026	60.6	64.4
Import Prices (USD, Average Annual % Change)	2025	-1.1	0.3
	2026	-1.3	-1.3
Food Price Inflation (Year-End % Change)	2025	26.5	26.5
	2026	13.5	17.0

* Based on the growth rates and export shares of 110 countries to which Türkiye exports.

Commodity prices: Oil prices remained significantly above the assumption in the previous reporting period due to geopolitical developments (Figure 2). As a result, the average oil price assumption for 2025 was updated from $65.8 to $69.8, and for 2026 from $60.6 to $64.4 (Chart 2, Table 2).

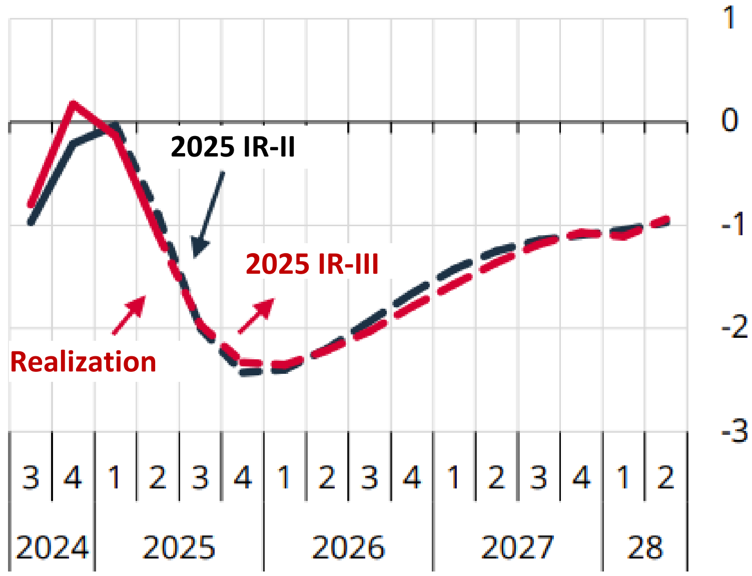
Chart 2. Oil (left panel) and Import Price (right panel) Assumptions



Source: Bloomberg, CBRT
* Shaded areas show the forecast horizon

Economic activity: No significant change was made to output gap estimates. A marked slowdown in the economy is expected from Q2 2025 until the end of the year, with recovery anticipated from early 2026 onwards (Charts 1 and 3).

Chart 3. CBRT Output Gap Forecasts



We estimate output gap-implied growth of 2.8–3.1% in 2025 and 2.6–3.4% in 2026. Growth projections consistent with output gap projections under different quarterly potential growth assumptions are presented in Table 3:

Table 3. Growth Forecasts Implied by Output Gap Forecasts (%)

	Quarterly Potential Growth (%)		
	0,8	**1,0**	**1,2**
2025	2.8	3.1	3.5
2026	2.6	3.4	4.3
2027	4.0	4.8	5.7

3. Main Messages

The key messages highlighted at the Inflation Report Press Conference can be summarized as follows:

- Tight monetary policy is leading to a more balanced demand composition.
    - The labor market outlook is more negative than the headline unemployment rate suggests. Indeed, the number of applications per job vacancy is increasing and approaching 2018 crisis levels.
    - Demand conditions are deflationary (negative output gap).
- Inflation remained within the previous forecast band, but inertia in the services sector (particularly in education and rent) continue to pose a risk.
    - The main trend in inflation is hovering around 25-27%.
    - A message of determination to maintain tight monetary policy and achieve disinflationary results was conveyed.
- Macroprudential policies are addressed under three headings: deposit preferences, credit growth and composition, and liquidity management.
    - The aim is to increase the share of TL deposits and completely eliminate FX Protected deposits (KKM). The share of TL deposits, including investment funds, is close to historical averages.
    - Controlled growth in lending will continue to be monitored. On the other hand, with the increase in credit card use instead of cash, personal loans are accelerating; it is considered important that this remains in line with moderate demand growth.
    - Deposit buying auctions will continue for effective liquidity management purposes.
- Reserve accumulation continues amid tight monetary stance; market risk and volatility indicators improving.
- If forecasts differ from interim targets, the sources of this deviation will be shared in the first report of the following year.

4. Our Evaluations

We consider the emphasis on the concept of ‘interim targets’ in communication to be the most important change. The most recent example of this change was seen in the 2021 Monetary and Exchange Rate Policy and the 2021-I Inflation Report during Naci Ağbal's tenure as Governor of CBRT.

- Interim targets that represent milestones on the path to the 5% long-term inflation target, are figures that are not easily changed and are intended to be used as a reference when determining wages, administered price/tax adjustments and contracts.
- The forecast band may differ from the interim targets in circumstances beyond the control of monetary policy. The remainder of 2025 is a good example of this. At the beginning of the year, the deviation from the previous year's intermediate target will be accounted for.
- ‘Interim targets’ shift monetary policy from a passive stance in the face of inflationary shocks to a (pro)active framework in which the monetary stance will be updated to converge towards the announced targets. This framework means that when the inflation outlook deteriorates, the CBRT will respond with the necessary policy measures rather than revising its forecast (= target) upwards.

- The relatively narrow band for 2026 [13-19%] sends a stronger message of commitment from the CBRT. The previous band [6-18%] was too wide to be used as a reference for expectations and pricing. Targeting a narrower band while having the necessary tools and time will provide a better anchor for expectations.
- The CBRT will need to/is expected to set its monetary stance at a level that will ensure the achievement of the interim target. Therefore, taking into account the persistent risk premium after March, it appears that there will be no change in the combination of high real interest rates and tight macroprudential policy in the coming year in order to achieve the interim target at the end of 2026.

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