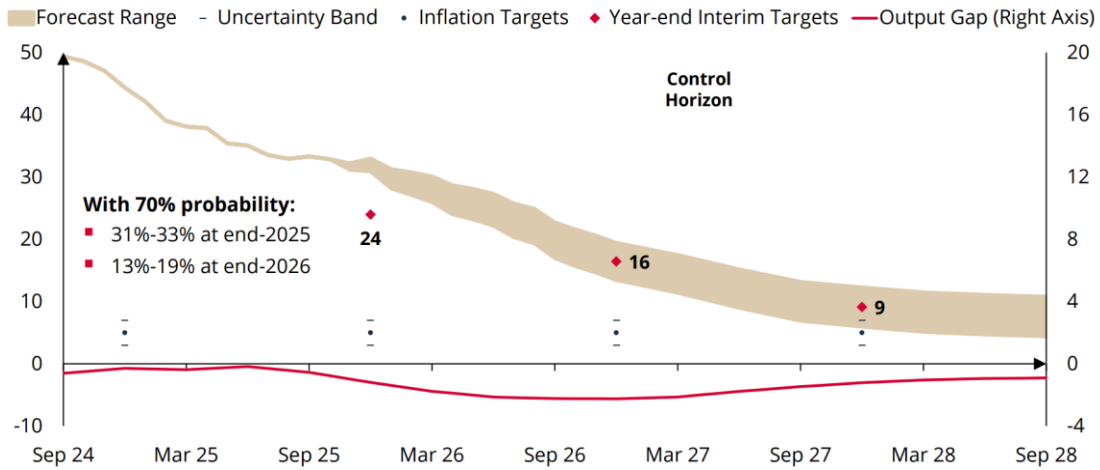


Macro: Ambitious targets, hawkish communication, costly macro backdrop

1. Forecasts

- CBRT kept its interim targets, which it had committed to achieve by separating them from the inflation forecasts in the previous reporting period, unchanged at 16% and 9% for the end of 2026 and 2027, respectively.
- The midpoint of the year-end inflation forecast band was raised from 27% to 32% for 2025, while it was kept constant at 16% and 9% for 2026 and 2027, respectively (Chart 1).
- The uncertainty band for the 2025 year-end forecast was set at 31-33% (previously: 25-29%).

Chart 1. 2025-IV 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 increases in food prices over the last three months were a determining factor in the inflation forecast increase.

2. Assumptions

External demand: Although bilateral agreements have limited the increase in tariff rates to some extent, it was emphasized that the ongoing negotiations between the US and China and the ongoing legal processes in the US have increased the uncertainty in trade policies. Therefore, the global growth assumption calculated by taking into account Turkey's export weights for 2025 was left unchanged, while the 2026 assumption was lowered by 0.1 points to 2.2%.

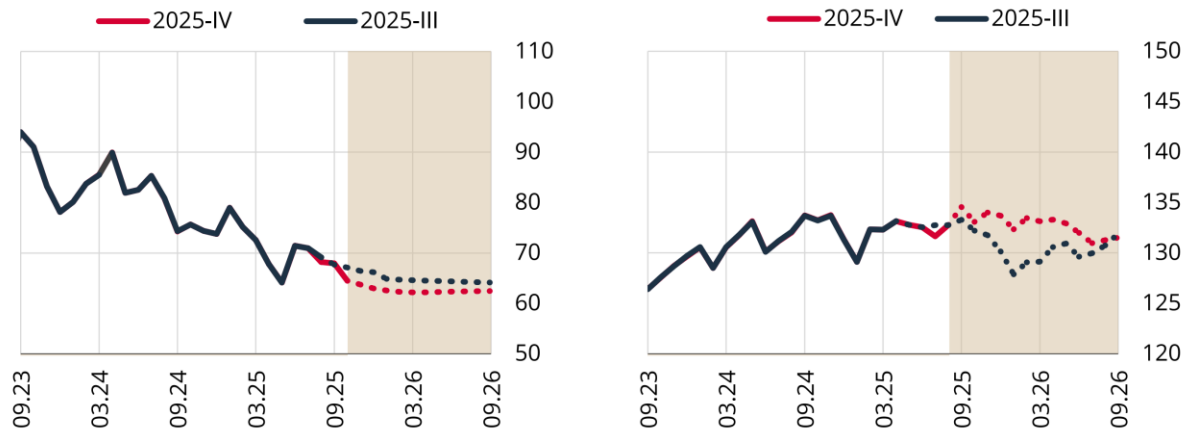
Food prices: Citing weather conditions, some agricultural purchasing prices, supply-related problems, and seasonal demand increases, the 2025 year-end food inflation assumption was raised from 26.5% to 32.3%, and the 2026 year-end assumption was raised from 17% to 18% (Table 1).

Table 1. Assumptions

		IR 2025-III	IR 2025-IV
Global Production Index* (Average Annual % Change)	2025	2.0	2.0
	2026	2.3	2.2
Oil Prices (USD, Annual Average)	2025	69.8	69.0
	2026	64.4	62.4
Import Prices (USD, Average Annual % Change)	2025	0.3	0.8
	2026	-1.3	-0.6
Food Price Inflation (Year-End % Change)	2025	26.5	32.3
	2026	17.0	18.0

Commodity prices: Oil price assumptions were lowered due to weak global demand and increasing oil supply. The 2025 average for Brent crude was revised from \$69.8 to \$69.0, and the 2026 average from \$64.4 to \$62.4. Import price assumptions were revised slightly upwards, with a 0.8% increase for 2025 and a 0.6% decrease for 2026, driven largely by increases in precious and industrial metals (Chart 2, Table 2).

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

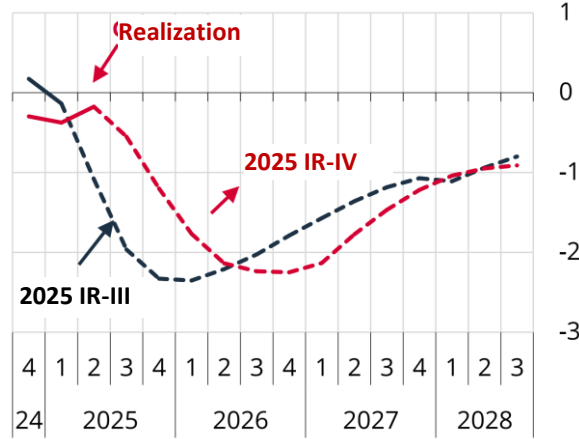


Source: Bloomberg, CBRT

* Shaded areas show the forecast horizon

Economic activity: The 2025 output gap forecasts were significantly revised upwards by 1-1.5 percentage points quarterly. Due to the slowdown in demand conditions, the period when the output gap would bottom out has been postponed by two quarters compared to the previous report. As stated at the press conference, it appears that the policy stance will be tighter than previously anticipated, given the high short-term trend in demand and inflation. A significant cooling in the economy (below potential, borderline positive growth) is projected starting in Q3 2025 and continuing until the end of 2026, with a recovery (above potential growth) expected from early 2027 (Chart 3). However, the prolonged stronger demand and growth performance than the CBRT's forecasts and the systematic upward revision of the output gap starting point raise questions about whether appropriate monetary tightening will be implemented.

Chart 3. CBRT Output Gap Forecasts



We calculate the growth in 2025, implied by the output gap path, to be between 3.5% and 3.8%, and 2026 to be between 1.7% and 3.3%. Assuming a decline in potential growth in recent years, we assess the implied growth for 2026 to be near the lower bound of this band (below 2%). Growth projections consistent with output gap projections under different quarterly potential growth assumptions are presented in Table 2:

Table 2. Growth Forecasts Implied by Output Gap Forecasts (%)

	Quarterly Potential Growth (%)		
	0.8	1.0	1.2
2025	3.5	3.6	3.8
2026	1.7	2.5	3.3
2027	3.7	4.5	5.4

3. Our Evaluations

Despite the 5 points revision in the end-2025 inflation forecast, maintaining the end-2026 forecast implies a tighter monetary stance compared to that envisaged in the previous report, as expressed in the press conference, with the internal policy response.

We believe that establishing macroeconomic conditions consistent with medium-term forecasts is not easy. Based on our inference, we can summarize the macroeconomic framework underlying the end-2026 forecast as follows:

- A prolonged recession with “disinflationary demand conditions”
 - The 2026 growth forecast is between 1.7% and 2.5%
- A flat course in the basket exchange rate throughout the year (strong real appreciation)
- An increase in labor costs of approximately 20% by the end of the year and 24% on an annual average

While each of the above projections/assumptions may change depending on the course of inflation expectations, when we take into account the current credibility gap (the difference between expectations and the target), achieving the target seems quite costly in terms of the interrelation between growth, external balance and distribution.

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