

# Türkiye | How far can the policy mix go for targeted disinflation?

Adem Ileri / Seda Guler Mert

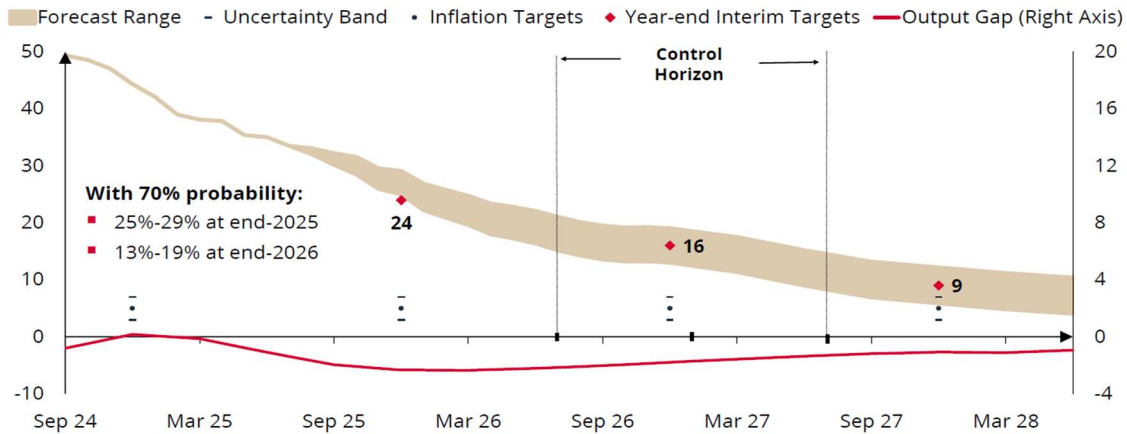
- The Central Bank of the Republic of Türkiye (CBRT) has revised its framework for medium-term forecast communication, introducing interim targets for year-end: 24%, 16%, and 9%, for 2025, 2026, and 2027, respectively, to be kept unless there are exceptional circumstances.
- The interim targets will serve as a reference for determining the endogenous monetary policy path, given the control horizon defined as the period between 12 and 24 months from now.
- Under the new framework, the CBRT will be able to review its inflation forecasts more frequently, even outside the regular inflation report schedule. Any deviations from the interim targets will be explained transparently in the first inflation report of the following year.
- With 70% probability, the CBRT forecasts 2025 year-end inflation in the range of 25-29% and 2026 year-end inflation of 13-19%. Since the CBRT has already started easing as of July with a bolder than expected rate cut, maintaining this year's 24% target even out of the forecast band raises question marks about the capacity to achieve next years' more aggressive targets. In contrast, the CBRT tries to be perceived with a stronger commitment on the back of a narrower forecast range for next year, instead of the previous range of 6-18%.
- The effort to highlight a simple reference point for both economic agents and administered prices sounds positive to reduce the impact from backward indexation. Not changing the targets by means of frequent revisions in the forecasts will also help credibility. In this respect, actions will be essential to see how accountable and proactive the CBRT could be if inflation projections and readings remain far from the targeted levels.
- The current gap between inflation forecasts and interim targets suggest that the CBRT could act more aggressively, yet, with inconsistencies on growth forecasts of around 3% in 2025 and 4% in 2026, that we calculate via their output gap projections. Sacrifice ratio still appears to be low.
- On the fiscal stance, after realizing a limited expansion in 1Q25, primary deficit shrank by 1.2pp to 1.1% of GDP between March and July, showing efforts to decelerate non-interest spending. Nevertheless, given the increasing challenges to reduce spending beyond earthquake areas to reach the MTP primary balance target of 0% for 2025 and the latest attempts on additional quasi-fiscal policies, we suspect that the fiscal policy might still remain supportive but to a lower extent.
- Overall, we maintain our view that the sensitivity on growth and employment might continue to shape the policy mix with a trade-off of a slower disinflation path. Prolonged process of disinflation with a stronger reliance on macro-prudential measures -if needed- going forward might distort inflation expectations and weaken the monetary transmission mechanism. We will closely watch the Medium Term Program (MTP), to be revised in early September, to have more color on the political preferences on the near term growth outlook.

## Positive efforts as a reference point for inflation, yet credibility matters

In the new framework, year-end interim inflation targets will serve as explicit policy commitments and anchors of the CBRT for the control horizon defined as 12 and 24 months from now. In this respect, the CBRT maintained 2025 year-end inflation target of 24% with a revised forecast band of 25-29%. The previous 12% year-end forecast of 2026 has been updated to an interim target of 16%. The details of the revision can be seen in Figure 2.

The CBRT acknowledges the challenges from higher inertia than their expectations, which is also underlined as the main reason behind the next year's revision. We also see a higher nominal depreciation assumption going ahead, possibly allowing a non-significant real depreciation or a slower real appreciation, as an exit strategy from the most recent strong real appreciation period. Additionally, they stress the uncertainties about food inflation due to extreme weather conditions.

**Figure 1. CBRT Inflation Projections (YoY)**



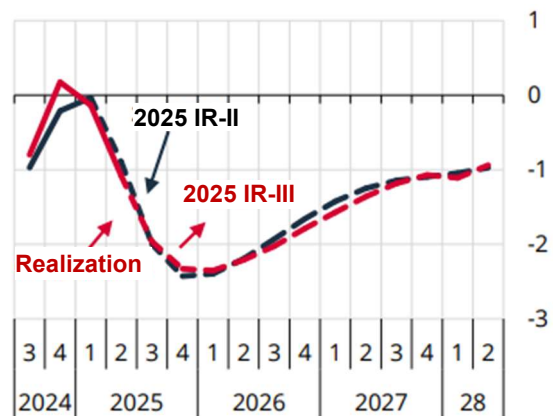
Source: CBRT

**Figure 2. CBRT Revision for 2026 year-end Annual CPI**

	2026
IR 2025-II Year-end Forecast (%)	12
IR 2025-III Year-end Interim Target (%)	16
Revision Compared to IR 2025-II Period (pp)	4
Sources of Revision (pp)	4
Food Prices	0.9
Import Prices in TL	1.2
Underlying Inflation and Inertia	1.9

Source: CBRT

**Figure 3. CBRT Output Gap Projections (% , deviation from the potential output)**

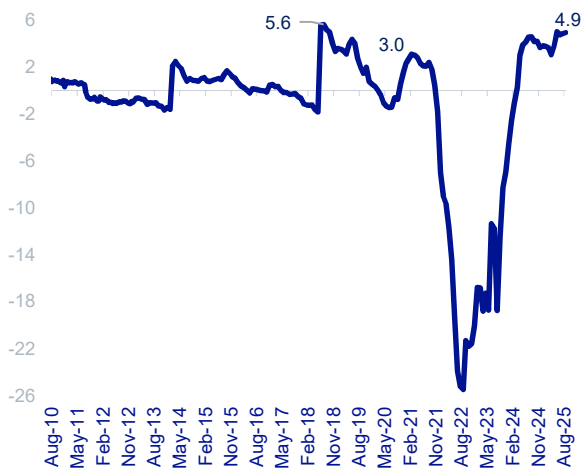


Source: CBRT

The CBRT had again an upward revision on their output projections, resulted from 1Q25 GDP realization. However, they almost did not change future projections, which we implicitly calculate nearly 3% GDP growth for 2025 and 4% for 2026, on the back of the assumption of a 1.2% q/q potential GDP growth (Figure 3). Given next years' aggressive interim targets, much higher real rates would be required compared to the markets' 12-month ahead expectation of around 5pp (Figure 4), which could translate into a stronger trade-off on growth that is not seen in the CBRT output gap forecasts. Instead, we observe a much softer impact on growth so far, compared to previous monetary tightening episodes (Figure 5).

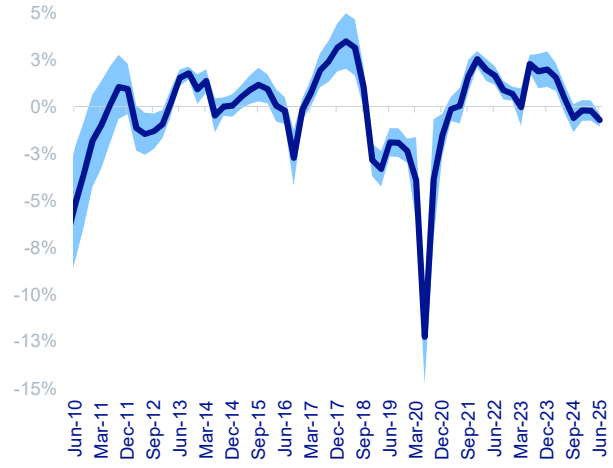
In this regard, we understand macro-prudential measures and liquidity policies will remain essential during the rate cutting cycle that is already in motion. According to our calculations, the implied policy rate that we derive from the impact of the monetary policy on financial markets and credit & deposit pricing except for the credit growth caps has again closed the gap with the official average cost of funding (Figure 6). Accordingly, year-to-date implied gap has come down to 1pp on average compared to 3pp of the same period of last year. As a result, additional tightening over credit and deposit rules can take longer, while rate cuts gradually continue. In any case, we evaluate the prolonged process of disinflation with continuing reliance on macro-prudential measures might distort inflation expectations and slow down the gains over the inflation outlook going forward. Instead, much slower than expected rate cuts could be more effective since we already started to observe a fast easing over the financial conditions, getting closer to the neutral level (Figure 7).

**Figure 4. Market Participants Survey 12-month ahead Real Rate Expectations (%)**



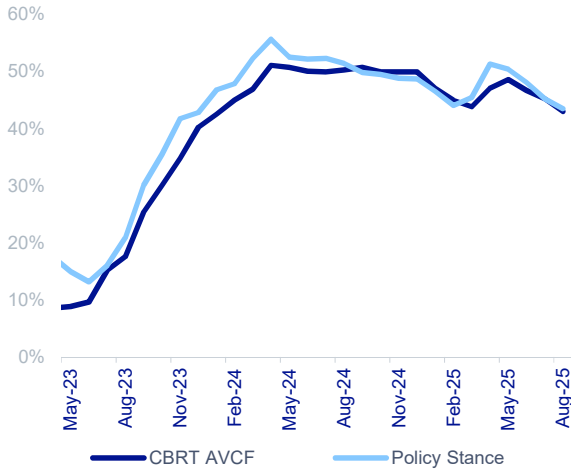
Source: Garanti BBVA Research, CBRT

**Figure 5. Garanti BBVA Output Gap Estimates (% , deviation from the potential output)**



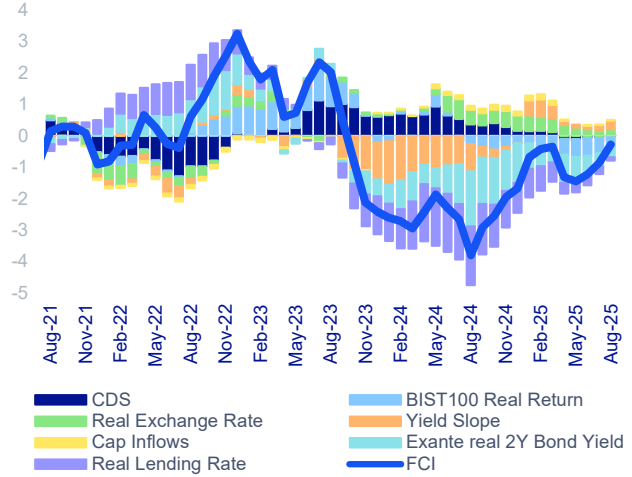
Source: Garanti BBVA Research, TURKSTAT

**Figure 6. CBRT Implied Policy Stance & CBRT Average Cost of Funding (%)**



Source: Garanti BBVA Research, CBRT, Bloomberg, TURKSTAT

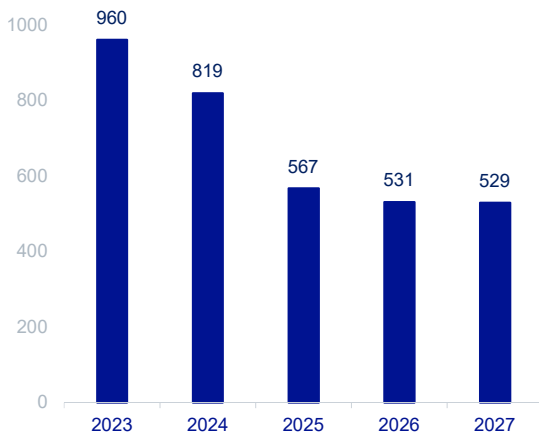
**Figure 7. Garanti BBVA Financial Conditions (FCI) Index (standardized, + easing, - tightening)**



Source: Garanti BBVA Research, CBRT, Bloomberg, TURKSTAT

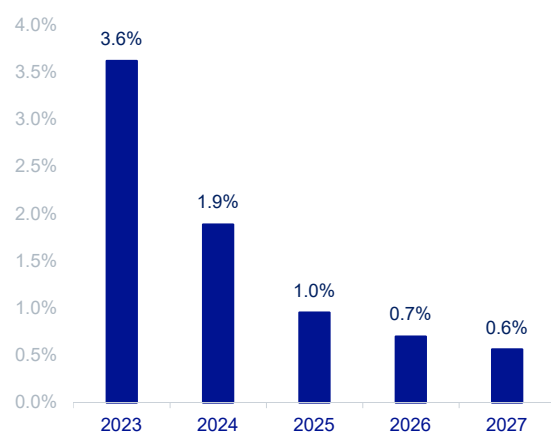
On the fiscal side, the cumulative gap between the cash and the accrual budget deficit between February 2023 and December 2024 reached nearly TL 0.8trn, signaling around 60% of the previously planned earthquake expenditures had been spent in cash in 2023 and 2024. In contrast, the cash deficit in the first seven months of 2025 occurred to be TL 358bn higher than the accrual one, implying the cumulative gap since February Kahramanmaraş earthquakes has come down to roughly TL 0.4trn, and around 50% of the planned quake spending for 2025 has been spent till August (Figures 8-9). We hope to see official figures in the revised MTP in order to much better evaluate the evolution in the Treasury cash balance.

**Figure 8. Accrued Earthquake Related Expenditures (bn TL)**



Source: Treasury and Finance Ministry

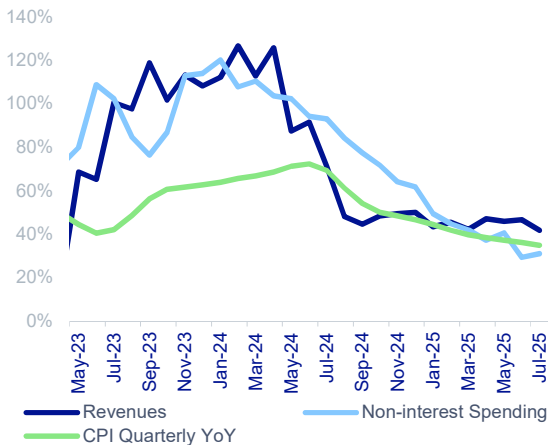
**Figure 9. Accrued Earthquake Related Expenditures (% GDP)**



Source: Treasury and Finance Ministry

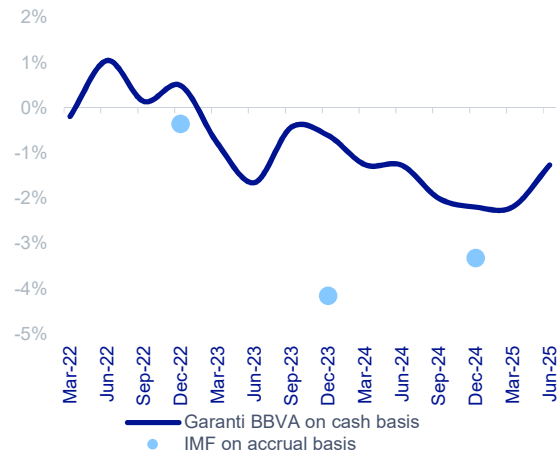
On the revenues, we observe somewhat a stabilization above the inflation trend, being supported by mainly value-added and income taxes (Figure 10). The moderation in economic activity and much weaker corporate taxes due to inflation accounting has slowed down the revenues performance, yet the year-to-date revenues still account for 55% of the budgeted figure of 2025. On the expenditures, we have started to see a clearer deceleration in non-interest spending since April, putting its quarterly growth down the inflation trend, led by spending on mainly personnel, investment and current transfers. This is also confirmed in our cyclically adjusted primary balance calculations, where we see a negative fiscal impulse on a cash basis for the first time since 2H23 (Figure 11). As a result, even though the shrinkage in the overall cash budget deficit has been modest with 4.2% of GDP in July compared to -4.8% of December 2024, primary cash deficit has come down to 1.1% of GDP in July, down from 2.1% by end 2024 (Figure 12-13).

**Figure 10. Cash Budget Revenues & Expenditures (3-month YoY)**



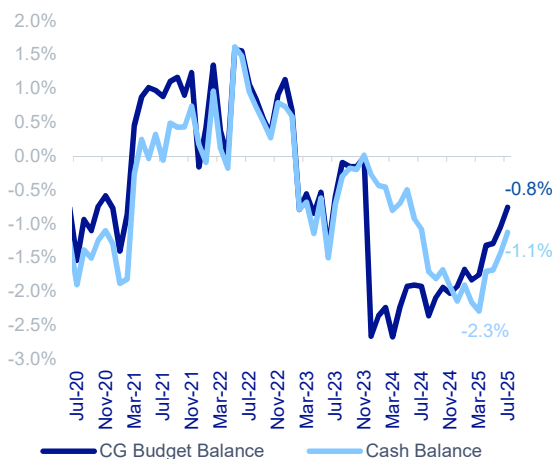
Source: Garanti BBVA Research, Treasury and Finance Ministry

**Figure 11. Cyclically Adjusted Primary Balance (annualized, % GDP)**



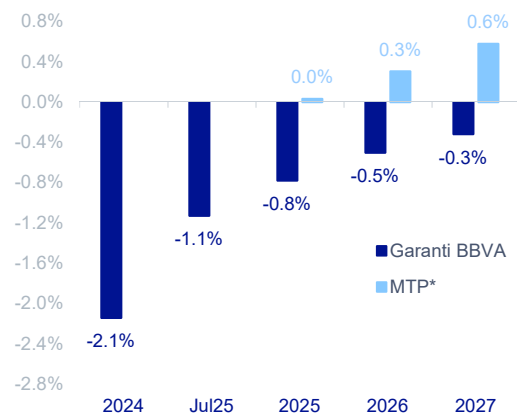
Source: Garanti BBVA Research, Treasury and Finance Ministry, IMF

**Figure 12. Accrual Budget & Cash Primary Balance (% GDP)**



Source: Garanti BBVA Research, Treasury and Finance Ministry

**Figure 13. Cash Primary Balance Forecasts (% GDP)**



Source: Garanti BBVA Research, Treasury and Finance Ministry  
 \*MTP figures refer to accrual primary balance.

All in all, we observe an increasing effort on fiscal consolidation, which we doubt about its adequacy to reach MTP targets and therefore its support on the disinflation pace. In this regard, we are closely watching the most recent quasi-fiscal policies via mainly state banks focusing on mostly SMEs, which are still limited in size but give clues about the point of view on the trade-off on economic activity. We expect the MTP, to be revised in early September, to have more color on the political preferences on near term growth outlook, which we previously had growth forecasts of 4% for 2025 and 4.5% for 2026. On the monetary stance, the revised communication and the inflation targets of the CBRT signal a tighter than expected policy mix, yet with inconsistencies on their growth projections, which lead us to think about a potentially stronger reliance going ahead on macro-prudential measures during the already started rate cuts. Therefore, we maintain our view that the sensitivity on growth and employment might continue to shape the policy mix with a trade-off of a slower disinflation path. We expect 3.5% and 4.0% GDP growth for 2025 and 2026, which can surprise the next-year's end of the year inflation consensus expectation of 20% on the upside after achieving around 30% inflation at the end of this year.

## DISCLAIMER

This document has been prepared by BBVA Research Department. It is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Any estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

With regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions on the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. Reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process is prohibited, except in cases where it is legally permitted or expressly authorised by BBVA on its website [www.bbvarresearch.com](http://www.bbvarresearch.com).