Fatih Karahan: Recent economic and financial developments in Turkey

Speech by Dr Fatih Karahan, Governor of the Central Bank of the Republic of Türkiye, at the briefing on the Inflation Report 2025-II, Istanbul, 22 May 2025.

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Distinguished Members of the Press, Esteemed Guests,

Welcome to the briefing we hold to convey the main messages from our Inflation Report.

Today also marks the Financial Literacy Day.

We are working to increase knowledge and awareness about the importance of price stability and central banking. We contribute to financial literacy through platforms such as the CBRT Blog and "Economics for All".

Dear Guests,

We continue to gradually reap the outcomes of our tight monetary policy.

Coupled with the moderation in demand, the disinflation process has continued smoothly since June 2024. Now, the underlying inflation has declined. The fall in services inflation has become more pronounced, and goods inflation remains low.

On the other hand, this process has been accompanied by intensified uncertainties in the recent period. In response to the financial market developments in March and April, the CBRT proactively took the necessary measures. Going forward, we will maintain our decisive monetary policy stance and act to ensure continuation of the disinflation process.

In the following parts of my speech, I will provide detailed evaluations of these topics.

In my presentation, I will first share our assessments of the global economy, the macroeconomic outlook, and the steps we have taken in the face of recent developments. Later on, I will present our medium-term projections. After the presentation, our Deputy Governors and I will be answering your questions.

As usual, our Inflation Report includes boxes on prominent issues on the agenda as well as our thematic analyses.

Distinguished Guests,

I would like to continue my speech with the recent key global economic developments.

As you also know, we are witnessing important changes globally. The USA announced a wide range of tariffs on April 2. These tariffs, which were expected to be sectoral or regional before the announcement, turned out to involve more than 180 countries.

On the other hand, the global trade tensions have somewhat eased following the bilateral talks and postponements of tariffs in recent weeks.

Shaded areas in the chart show the episodes in the 2017-2020 period and 2025, in which tariffs were introduced and uncertainties escalated.

Despite the recent moderation, uncertainties surrounding global trade and economic policies remain elevated.

While these uncertainties increase downside risks to global growth, potential inflationary effects vary across countries.

With tariff measures of April 2, the VIX index measuring expected volatility rose sharply.

Then, the index declined progressively on the back of the later developments, converging to its average of the first quarter of 2025.

During this period, the US Dollar Index and global stock exchanges registered sharp changes in both directions.

Likewise, we also observed fluctuations in long-term bond yields, depending on the news flow.

These fluctuations in financial asset prices increase macrofinancial risks through the balance sheets.

Affected by the protectionist measures, growth expectations for all major economies, the USA in particular, have declined.

This also affects the external demand projections for our country negatively. Changes in the euro area growth have particular significance in this respect. For instance, the 2025 growth forecast for Germany, one of the most important trade partners of Türkiye, was revised from 0.7 percent in October to 0 percent in May.

In this context, our external demand indicator points to weakening global growth in 2025.

Driven by the expected weakening in global growth, energy commodity prices – crude oil and natural gas in particular – registered marked declines at first.

Then we saw an increase again in May. However, prices still remain below the levels in the previous reporting period.

Non-energy commodity prices, on the other hand, decreased at first but then posted a rise led by gold and other precious metal prices.

Similar to financial asset prices, commodity prices may also fluctuate depending on the news flow regarding global trade policies.

The effects of recent developments on inflation expectations, on the other hand, vary across countries.

Compared to the previous reporting period, we see a moderate increase in inflation expectations in 2025, particularly for advanced economies.

Accordingly, the rise in protectionism has a potential to decelerate the fall in global inflation.

On the other hand, depending on the impact of tariffs, we think that the policy trade-off may increase in economies that face a simultaneous deterioration in the inflation and growth outlook.

As shown in the charts, global markets have been pricing more rate cuts after the tariff measures.

However, central banks continue to emphasize that they will maintain caution in rate cuts.

To sum up before moving on to domestic developments, we still navigate through high levels of global uncertainty compared to the period before April the 2nd.

Macroeconomic Outlook

Esteemed Guests,

Now, I would like to share with you our observations on domestic macroeconomic developments.

Our tight monetary policy has led to a notable balancing of demand composition in 2024. While the impact of domestic demand on growth has declined considerably, the positive impact of net exports stands out.

Meanwhile, economic activity recovered in the last quarter of the year.

In this period, household demand for goods remained robust due to the sales campaigns and the demand brought forward. Thus, private consumption increased on a quarterly basis.

Similarly, industrial production, which declined in the second and third quarters of 2024, started to increase again in the last quarter of the year.

This increase in industrial production continued in the first quarter of 2025, albeit at a slower pace.

The services production index recovered moderately in the last quarter of 2024 and then continued to increase in the first quarter of 2025.

The first-quarter increase is lower when sectors with a relatively weak relation to household demand, such as "professional, scientific, and technical activities" and "information and communication," are excluded.

Capacity utilization rates of the manufacturing industry hover below the historical average.

Business Tendency Statistics data are in line with the moderation in domestic demand as a result of the monetary tightening. In fact, registered domestic market orders from manufacturing firms hovered close to the average of the previous periods.

On the labor market front, the headline unemployment rate continues to decline, while broadly-defined indicators are still at high levels.

Data on applications per job openings also points to an increase. This outlook is similar to that of past tightening periods.

When we consider a broader set of data together with the indicators I discussed, we assess that the tightness in the labor market is less than the unemployment rate implies.

In the first quarter, domestic demand remained above projections, though it lost momentum.

In this period, the increase in the retail sales volume index decelerated slightly compared to the previous quarter. In March, the index declined on a monthly basis, for the first time since May of last year.

Excluding jewelry, which serves as a store of value rather than consumption goods, the quarterly uptrend is more muted.

The chart on the right shows retail sales volume and expenditures on goods in household final consumption, both trend-adjusted.

Following the tightening, consumption of goods has fallen below the trend. There is also a loss of momentum in retail sales. This outlook is more evident when gold is excluded.

Card spending points to a slight increase in household consumption both in the first quarter and in April.

The deviations from the trend suggest that household consumption expenditures continue to lose momentum.

When we consider the data on demand conditions as a whole, we see that the disinflationary impact of demand conditions declined in the first quarter.

The average of the indicators based on alternative methods implies a negative level in the second half of 2024 and a near-neutral level in the first quarter of this year.

On the other hand, we expect demand conditions to align more closely with the disinflationary path as of the second quarter of the year due to the tightening in financial conditions and global developments.

I would like to reiterate that we will implement the necessary measures should the demand conditions adversely affect the disinflation process.

Current account balance recorded a significant improvement in line with the moderation in domestic demand.

The ratio of the current account deficit to GDP dropped to 0.8 percent in the last quarter of 2024.

As for 2025, downside risks to the current account deficit driven by energy and commodity prices and upside risks driven by global demand stand out.

Despite the weak global demand and the recent uncertainty regarding the trade policies, exports remained strong with a mild increase.

Meanwhile, imports increased due to the demand brought forward in response to the uncertainty.

We forecast that the current account deficit-to-GDP ratio in 2025 will be slightly higher than in 2024, but will remain below long-term averages.

Distinguished Participants,

Following this brief summary of domestic economic activity, I will now share our assessment on the inflation outlook.

As I noted at the beginning of my speech, the disinflation process that started in June 2024 continues uninterruptedly.

Consumer inflation decreased to 37.9 percent in April, a significant decline from its peak in May 2024. Leading data suggest that this trend is continuing in May as well.

Since the previous reporting period, inflation has been below the midpoint of our forecast range. This was mainly driven by the lower-than-expected course of domestic energy prices and the revision to the Health Practices Communiqué.

As you may know, underlying inflation indicators provide a better picture of the inflation trajectory.

Following a rise in January, the underlying inflation slowed significantly in the February-March period. Then, we witnessed a partial increase in April due to the developments in financial markets.

Meanwhile, as can be seen in the chart, there is no significant change in the underlying inflation when analyzed using the three-month moving averages.

Here, I could add that the leading data for May point to a lower course in the underlying inflation compared to April.

Annual CPI inflation stands at 37.9 percent.

However, the average of the underlying inflation indicators and the median inflation, which has a relatively good forecasting performance, imply that the annualized underlying inflation is slightly above 30 percent. This suggests that disinflation will continue.

An analysis of consumer price developments by subgroups reveals that goods inflation remained relatively low.

Core goods inflation receded to 20 percent on an annual basis, driven by the mild course in the first quarter. Meanwhile, durable goods inflation, which is highly sensitive to financial conditions, stood at 19 percent.

We also observe a slowdown in services inflation, albeit more gradual than in goods inflation. In fact, services inflation has dropped by more than 40 points over the last year.

A closer look at services inflation reveals that items with a strong tendency to backward indexation, such as education and rent, pushed this group up.

Rent inflation displays significant inertia compared to the rest of the services group due to factors specific to the housing sector, such as earthquakes and urban renewal.

On the other hand, we observe a milder course in services subgroups, which are relatively more sensitive to demand conditions.

Another significant issue is the reflection of the recent financial market developments on prices.

On a monthly basis, core goods inflation picked up in April, while the services inflation posted a relatively limited increase.

In fact, after rising in the first quarter driven by items subject to time-dependent price-setting, services inflation resumed its downtrend.

Meanwhile, price increases gained strength in some core goods items, like durable consumption goods, which are highly sensitive to exchange rate developments. We see that automobile prices stood out in this period due in part to the developments in the euro-dollar parity.

In fact, an analysis of inflation by imported inputs intensity reveals that inflation remained on a downtrend in items with relatively low import content, while price increases grew stronger in items with high import content in line with exchange rate developments.

However, registered and leading data indicate that exchange rate pass-through has waned compared to last year, and the recent exchange rate developments have had a limited impact on inflation.

We expect that demand conditions will be milder in the remainder of the year and limit the exchange rate pass-through amid declining KKM balance, tighter financial conditions, and global developments.

In addition, we consider that, if it remains, the recent decline in commodity prices amid concerns over global trade and growth may offset some of the exchange rate-driven upward impact.

International crude oil prices, in particular, fell significantly below the path projected in the previous Inflation Report, mitigating the impact of TRY-denominated import prices on headline inflation.

However, last month's agricultural frost across the country increased the upside risks to unprocessed food prices, particularly fruit prices, for the upcoming period.

The share of the 16 most affected products in the consumer basket is around 1.5 percent.

While registered and leading data suggest that there has not yet been a negative reflection in food prices, we consider that this development may exacerbate pressures on food inflation in the upcoming period.

As we have always emphasized, inflation expectations and the course of firms' price setting behavior are also of great importance during the disinflation process.

The chart shows the 12-month-ahead inflation expectations. As you know, following the policy measures and the decline in headline inflation, inflation expectations had declined significantly, albeit varying across sectors.

Due to the recent developments in financial markets, the improvement in inflation expectations paused in April.

As for year-end expectations, we see that market participants' expectations rose to 30 percent.

Against this background, inflation expectations continue to hover above our disinflation path. This requires us to maintain our tight and decisive monetary policy stance.

Monetary Policy

Distinguished Participants,

In this part of my speech, I would like to talk about recent market developments and our monetary policy stance.

As you know, in the second half of March, we observed volatility in financial markets driven by risk aversion behavior.

Subsequently, the higher-than-expected additional customs tariffs announced on April 2 increased volatility in global markets.

From day one, we have taken steps to strengthen the tight monetary stance by assessing the likely risks to the inflation outlook posed by developments in financial markets.

We can break down these steps into three categories: those to increase the funding cost of the Turkish lira, liquidity steps and steps to limit the demand for foreign exchange.

Starting with the funding cost, we first held an Interim Meeting on March 20. At this meeting, we evaluated that the volatility might be temporary, so, we raised the Central Bank overnight lending rate from 44 percent to 46 percent. We suspended the one-week repo auctions for a period of time.

After April 2, anticipating that the heightened volatility in global financial markets might pose persistent risks to the inflation outlook, we raised the policy rate from 42.5 percent to 46 percent at our meeting on April 17.

Moreover, we raised the overnight lending rate to 49 percent and the overnight borrowing rate to 44.5 percent.

As part of the liquidity management, we extended the maturities of Turkish lira deposit auctions. We also diversified our liquidity toolset and began to issue short-term liquidity bills.

Last but not least, we took steps to limit foreign exchange demand. Accordingly, we initiated Turkish lira-settled foreign exchange forward selling transactions at the CBRT.

Additionally, in the respective period, we conducted outright government domestic debt security purchases to prevent dollarization risks and interest rate volatilities that may arise from outflows from money market funds.

The volatility in financial markets in the second half of March caused impairment in financial assets, leading to outflows from Turkish lira assets.

After the period of high volatility, investors' preference to Turkish lira deposits continued, while the outflow was driven by money market funds.

Investors' risk perception regarding the Turkish lira recovered on the back of reduced volatility in the market and the measures we took. Since April, there has been a slight increase in money market funds.

Due to the volatility experienced in March, household demand for FX deposits increased in the week of March 21.

Following the interim MPC meeting decision dated 20 March, the demand became limited, and with the MPC meeting decision dated 17 April, the decrease in FX deposits became evident again.

To sum up, we took swift action to prevent the macroeconomic outlook from deteriorating due to financial market developments.

And thanks to these measures, the volatility in markets faded away.

We will continue to use all monetary policy instruments proactively and decisively to maintain the effective functioning of markets.

At this point, I would like to share the latest developments regarding the financial conditions that are critical to the transmission of our monetary policy.

On a compounded basis, deposit and commercial loan rates are around 60 percent, while consumer loan rates are approximately 70 percent.

The rate hikes we delivered were transmitted to deposit and loan pricing as we had expected.

Thanks to our monetary policy stance and the macroprudential framework, the level of deposit rates supports the transition to Turkish lira savings.

In April, consumer loans accelerated slightly due in part to seasonal effects.

Meanwhile, data for the first half of May suggest that loan growth started to slow again on a weekly basis.

It is crucial that consumer loans follow a course that supports the rebalancing in domestic demand.

Accordingly, we will continue to use all available tools to ensure that consumer loans remain on a moderate and controlled path.

Turkish lira commercial loan growth is in line with monthly growth limits and loan demand.

Meanwhile, to strengthen the monetary transmission mechanism, we lowered the monthly growth limit for FX loans to 0.5 percent in March and narrowed the scope of exemptions.

Since this adjustment, FX loan growth has remained on a path consistent with the targets.

On the deposits side, the sum of KKM accounts exceeded 140 billion dollars in August 2023. Currently, this balance is lower at 17 billion dollars.

In February, we terminated new openings and renewals for KKM accounts for legal entities.

We ensured a decline in the KKM balance without posing a risk to financial stability and by prioritizing Turkish lira deposits.

The decline in the KKM balance increases the share of Turkish lira deposits. Thus the monetary transmission mechanism is strengthened and risks to the central bank's balance sheet are mitigated.

Although the recent volatility in financial markets led to a decrease in the share of the Turkish lira, this decline was limited thanks to the steps taken and the trend has flattened out again since mid-April.

In fact, the share of Turkish lira deposits is 58 percent, close to its historical average. This level remains about the same when mutual funds are included.

Capital inflows to Türkiye diverged positively due to the disinflation process that became more discernible as of January.

However, due to the recent developments in financial markets and lower risk appetite, capital outflows from emerging economies and Türkiye became more pronounced.

After the second half of March, outflows from Türkiye accelerated in response to the announcement of measures on tariffs.

On the other hand, it is noteworthy that in recent weeks, capital outflows from emerging economies and Türkiye have stopped and there has been a moderate capital inflow to these economies.

Gross reserves, which were 124 billion dollars in March last year, reached 171 billion dollars in mid-March this year. Meanwhile, net reserves excluding swaps rose from minus 65 billion dollars to 66 billion dollars.

Having declined to 139 billion dollars on May 2, gross reserves picked up again, reaching 146 billion dollars on May 16. In this period, net reserves excluding swaps first fell to 14 billion dollars, then rose to 21 billion dollars.

Medium-Term Projections

Distinguished Participants,

Following the economic outlook that I have summarized so far, which provides the background for our forecasts, I will share with you our medium-term projections.

As I mentioned at the beginning of my speech, the recent rise in protectionist tendencies in global trade has increased downside risks to the global growth outlook. Therefore, we have significantly revised down our assumptions for external demand, which we base our forecasts on.

In line with this outlook, we revised down our assumptions for crude oil and import prices for 2025 and 2026.

Due to unprocessed food inflation, we revised our food prices assumption for 2025 upwards.

Our medium-term forecasts are based on an outlook in which the tight monetary policy stance will be maintained until a significant and sustainable decline in inflation is achieved. We have also reflected in our forecasts that the coordination among economic policies will continue to increase.

Accordingly, same as the previous reporting period, we forecast inflation for end-2025 at 24 percent. We maintained our inflation forecast for end-2026 at 12 percent.

We target inflation to decrease to 8 percent in 2027 and stabilize at 5 percent in the medium term.

Towards the end of the year, the forecast range for 2025 would be expected to get mechanically narrower. However, due to the recent rise in uncertainties, we maintained our forecast range between 19 percent and 29 percent. The forecast range for end-2026 corresponds to 6 percent and 18 percent.

In forecast revisions for 2025, the upside and downside effects counterbalanced each other.

One of the prominent factors here was the increase in our food price assumption driven by unprocessed food. This change raised our previous forecast by 0.5 points.

Although the output gap has recently been above our forecasts, the net impact of this deviation was limited to 0.3 points thanks to the tightening we have implemented.

Despite the decrease in the assumption for oil and import prices, the revision in the assumption for Turkish lira-denominated import prices due to developments in the basket exchange rate increased the inflation forecast by 0.1 points.

Initial conditions and the underlying trend also pushed the inflation forecast up by 0.1 points.

Meanwhile, due to the reduction in health examination co-payments in February, there was a downward revision of 1.0 point stemming from administered prices.

I would like to emphasize once again that our recent policies have prevented a serious deterioration in the inflation outlook.

We will continue to monitor all developments and factors concerning the revisions. During this process, continued moderation of domestic demand on the back of our monetary policy measures is one of the most critical issues for us. Meanwhile, taking into account the high level of uncertainties compared to the previous period, we will decisively adhere to our prudent and tight monetary policy stance.

We envisage that inflation will decline steadily in the period ahead on the back of our continued cautious stance. Our decisive monetary policy stance will continue to strengthen the disinflation process through moderation in domestic demand, the real appreciation in the Turkish lira and the improvement in inflation expectations.

As expectations return to a downward trend and the fall in services inflation sustained, the decline in the underlying inflation will continue in the remainder of 2025. Increased coordination among monetary and fiscal policies will also contribute to this process.

To sum up, we will decisively maintain our tight monetary policy stance until permanent decline in inflation is sustained and price stability is achieved.

We set the policy rate in a way to ensure the tightness required by the projected disinflation path. In this process, we take into account inflation realizations, underlying inflation and inflation expectations.

We adjust the policy rate prudently on a meeting-by-meeting basis with a focus on the inflation outlook. We will be always ready to tighten our monetary policy stance in case we foresee a significant and persistent deterioration in inflation.

Distinguished Guests,

I would like to emphasize once again in this meeting that price stability is a prerequisite for sustainable growth and increased social welfare.

In the disinflation process, we will continue to do whatever it takes to bring inflation down in line with our intermediate targets.

Distinguished Participants,

As I conclude my remarks, I would like to thank all of my colleagues who have contributed to the writing of the Report, primarily the members of the Monetary Policy Committee, the Chief Advisors and the staff of the Research and Monetary Policy Department, and everyone that have contributed to the press conference.

We can now move onto the Question and Answer session. Our Deputy Governors will also be happy to answer your questions.