

INFLATION REPORT

2026-III

August 13, 2026



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1. Overview

Uncertainties regarding the global economic outlook persist, while the news flow concerning the US-Israel war on Iran is constantly evolving. Following the agreement on a ceasefire in June, vessel traffic through the Strait of Hormuz picked up, and crude oil prices retreated to pre-war levels. However, as tensions in the region escalated again in July, prices climbed back, and shipping activity declined. Currently, energy prices stand markedly above pre-war levels. While input costs declined slightly in June, disruptions in supply chains improved only to a limited extent. In July, this picture appears to have reversed. Therefore, when compared to the pre-war period, supply-side constraints are still present. Accordingly, the global growth outlook remains weak and fragile. The continued rise in realized and expected inflation in many countries has also heightened expectations of tighter monetary policy globally. Should the period of uncertainty be prolonged and the increase in energy prices become more persistent, further monetary tightening on a global scale might be necessary to anchor expectations and contain secondary effects.

The ceasefire talks between the US-Israel war on Iran led to reduced volatility in financial markets, yet geopolitical uncertainties remain. Compared to the previous reporting period, Türkiye's CDS premium receded broadly in line with emerging market risk premiums and stood at 225 basis points as of August 10. The implied volatility of the Turkish lira declined during the current reporting period. The CBRT gross international reserves fell by USD 1.0 billion to USD 164.5 billion, also driven by the decline in gold prices. Following a decrease at the start of the current reporting period amid reduced geopolitical risks, yields on government domestic debt securities (GDDS) increased across all maturities due to the recent rise in war-related uncertainties and potential risks to inflation.

During the current reporting period, financial conditions remained tight in line with the CBRT's decisions to support tight monetary policy in response to geopolitical developments. Following the decision on March 1 to suspend one-week repo auctions for a period in light of the developments in financial markets, overnight interest rates continue to hover very close to the upper bound of the CBRT's interest rate corridor. The CBRT made changes in the reserve requirement practice based on loan growth to support the tight monetary policy stance and strengthen macro-financial stability. Tight financial conditions are reflected in deposit and loan rates. Deposit and loan rates are broadly close to those recorded at the end of the previous reporting period. During the current reporting period, the share of Turkish lira deposits reached 62%, even amid geopolitical uncertainties, also due to the tight monetary policy stance. Meanwhile, the annualized 13-week growth of FX-adjusted total loans edged down.

In the first quarter of 2026, annual and quarterly growth rates continued to decline, with economic activity growing below its potential. In the first quarter, GDP increased by 2.5% year-on-year and by 0.1% quarter-on-quarter. The positive contribution of private consumption and total investments to annual growth decreased slightly. On a quarterly basis, private consumption posted a limited rise, while total investments declined. In that period, there was also a decline in both imports and exports of goods and services. Accordingly, net exports kept making a negative contribution to quarterly growth, albeit to a lesser extent. Against this backdrop, economic activity continued to lose pace in the first quarter, registering growth below its potential.

Indicators for the second quarter of 2026 suggest a moderate course of economic activity and stronger support from domestic demand conditions for the disinflation process. In that period, growth in retail sales excluding gold slowed compared with the previous quarter, and sales remained below their long-term trend. White goods sales went up in the second quarter but still failed to offset the first quarter's decline. The drop in automobile sales in the first quarter continued in the second quarter and into July. Card spending declined in the second quarter. Data for July indicate a continued weak course of card spending. Findings from interviews with firms regarding consumption expenditures also suggest that domestic sales remained weak in July. On the production side, industrial production went up in the second quarter. Excluding typically volatile sectors, industrial production still increased, albeit falling slightly behind the rise in the headline index. Survey-based indicators such as the Business Tendency Survey (BTS) and the PMI pointed to an increase in July. As of May, the services production index remained nearly flat in the second quarter of the year. The quarterly and annual growth rates of the construction production index were negative during the same period.

The labor market is less tight than implied by the headline unemployment rate. Based on the quarterly averages of seasonally adjusted monthly data, employment increased by 155 thousand people in the second quarter of the year, standing at 32.5 million people. During this period, the seasonally adjusted unemployment rate dropped by 0.3 percentage points on a quarterly basis to 7.9%, and the labor force participation rate remained nearly flat. Although it remained high, the labor underutilization rate declined by 0.2 percentage points compared to the first quarter. In the first quarter of 2026, as a result of the rise in real per capita wages outpacing the increase in labor productivity, non-farm real unit wages went up.

The seasonally and calendar-adjusted current account deficit decreased in the second quarter of 2026. As of May, the current account deficit narrowed in the second quarter due to the decline in the foreign trade deficit as defined by the balance of payments. The services balance surplus and the improvement in the income balance also contributed positively to the current account balance during this period. In the second quarter of the year, external demand was stronger compared to the previous quarter despite the adverse effects of the war, and export prices continued to rise. According to the foreign trade statistics published by TURKSTAT, seasonally and calendar-adjusted exports increased in the second quarter compared to the previous quarter. The increase in exports is assessed to be due to a shift in some demand toward Türkiye, driven by geopolitical developments and higher logistics costs. Meanwhile, imports increased due to rising energy imports, fueled by the sharp rise in energy prices triggered by the war. The slowdown in gold imports amid falling gold prices in the second quarter and the flat trend in imports excluding gold and energy limited the increase in total imports. As for goods groups, imports of investment and consumption goods declined in the second quarter compared to the previous quarter, while those of intermediate goods increased. Provisional foreign trade statistics pointed to a decline in both exports and imports in July, with the decrease being more pronounced in imports. Accordingly, the foreign trade deficit in July remained below the second-quarter average. The main factor that will keep upward risks to the current account deficit alive in the coming period is assessed to be a potential increase in net energy imports due to high and volatile energy prices, although these prices declined somewhat compared to the previous reporting period. On the financing side, capital inflows were recorded in the second quarter, as of May. A significant portion of these inflows were through the other investments item. Data for July point to continued portfolio inflows, particularly into GDDS, despite recent geopolitical developments.

Consumer inflation stood at 31.75% in July, above the forecast presented in the previous Report.

Developments across subitems over the last three months indicate that the energy and alcohol-tobacco-gold groups made a downward contribution to annual consumer inflation while the other subcategories made an upward contribution. During the current reporting period, supply-side pressures weakened somewhat compared to the previous period but slowed the disinflation process. Despite declining in June, led by energy prices, international commodity prices rebounded in July as geopolitical uncertainties escalated. Meanwhile, agricultural commodity prices fluctuated due to supply concerns, geopolitical developments, and unfavorable weather conditions, and rose compared to the previous reporting period. While the fact that the lump-sum tax adjustment implied by the six-month D-PPI increase in fuel prices was not implemented in July limited price increases, crude oil prices, which resumed an upward trend, and the effects of the gradual phase-out strategy from the sliding scale system created pressure on inflation. In the current reporting period, geopolitical developments as well as administered prices and tax adjustments had a prominent impact on headline inflation. On the administered prices front, the revision in medical examination copayments under the Communiqué on Healthcare Implementation added 0.22 points to monthly consumer inflation in July. As of that month, the annual rate of inflation in the F index, calculated excluding administered prices, remained lower than headline inflation, at 30.37%. As for tax adjustments, prices of alcoholic beverages posted an increase in July due in part to the lump-sum tax revision. The lump-sum tax on tobacco products was raised while the ad valorem SCT was reduced, the upward effect of which is being observed on inflation in August. The Global Supply Chain Pressure Index remained above its historical average despite falling over the past two months, while the delivery times displayed a normalization tendency starting from May. The stable course of the Turkish lira throughout the reporting period alleviated cost pressures. Accordingly, increases in producer prices lost momentum over the last two months, and annual producer inflation declined to 27.83%. Second-quarter data suggest that demand conditions remain supportive of disinflation. Inflation expectations, however, continue to hover above the inflation forecast and the interim target. The effects of geopolitical developments on the inflation outlook through the cost channel, economic activity, and the expectation channel continue to be closely monitored.

The interim inflation targets have been maintained at 24%, 15%, and 9% for 2026, 2027, and 2028, respectively. The CBRT will ensure the tightness required by the projected disinflation path in line with the interim targets, by taking into account realized and expected inflation and its underlying trend.

Inflation is forecast to be 28% at end-2026 and 15% at end-2027. Inflation is projected to decline to 9% at end-2028 and then stabilize around the medium-term inflation target of 5%. The upward revision of the year-end inflation forecast for 2026 was driven by the increase in the assumption for TRY-denominated import prices in view of the developments in prices of diesel oil, natural gas, and some other commodities. The impact of the regulations relating to the sliding-scale system was also factored into the forecasts. Besides, the upward revision in the food inflation assumption based on actual data, as well as regulations regarding administered prices also pushed the inflation forecast up. The path for the output gap for 2026 was revised slightly upward compared to the previous reporting period. Despite this revision, the gap remains at a level that maintains disinflation. Domestic demand is expected to stay weak in the coming period as the tight financial conditions will be maintained.

Medium-term forecasts are based on a framework in which the tight monetary policy stance will be maintained decisively until price stability is achieved, and the coordination among economic policies will be sustained. In order to contain the risks to the inflation outlook posed by geopolitical developments, the weighted average funding cost was kept at 40%, and monetary tightness was supported by macroprudential policies. The forecasts are based on a framework where monetary policy is determined prudently with a focus on the inflation outlook, considering interim targets. The underlying rate of inflation has declined recently after rising due to supply shocks, and this decline is expected to continue in the period ahead as the tight monetary stance will underpin the improvement in expectations and pricing behavior. Moreover, the fall in services inflation is projected to become more evident once the inertia weakens in services items that display a strong backward-indexation tendency, such as rent and education in particular. However, energy prices remain a significant factor of uncertainty in terms of the inflation outlook. The high volatility in energy prices caused by geopolitical developments and the course of the sliding-scale system will be significant in determining the extent to which international oil price changes pass through to inflation.

1.1 Monetary Policy Decisions

The CBRT kept the policy rate constant at 37% in June and July. At the June meeting, the CBRT reported that the underlying trend of inflation decreased slightly in May following its rise in the first months of the year. The CBRT stated that the first-quarter data pointed to slowdown in economic activity whereas the leading indicators suggested ongoing weakening in domestic demand. Nevertheless, it was also highlighted that energy prices continued to remain volatile and elevated due to the uncertainties resulting from geopolitical developments. At the July meeting, the CBRT stated that the weak course in domestic demand became more pronounced. The CBRT also emphasized that as a result of the growing uncertainty amid geopolitical developments, energy prices started trending up again. Underlining that the impact of geopolitical developments on the inflation outlook through the cost channel and economic activity were closely monitored, the CBRT kept the policy rate at 37 percent both in June and July.

The CBRT introduced changes to loan growth-based reserve requirement regulations to strengthen macro-financial stability. With the amendment dated May 23, 2026, loan growth limits were tightened to be effective as of July 17, 2026. Accordingly, the monthly growth limits were reduced from 4% to 3% for vehicle and general-purpose loans, from 2% to 1% for overdraft account limits, from 5% to 4.5% for Turkish lira loans extended to SMEs, and from 3% to 2% for Turkish lira loans extended to large firms. Moreover, restructured loans and reimbursed non-cash loans were included in the loan growth calculation. Also, the reserve requirement reduction amount for banks with total assets above TRY 2 trillion was raised from TRY 500 million to TRY 2 billion.

The CBRT took simplification steps regarding foreign currency reserve requirements to strengthen macro-financial stability and support the monetary transmission mechanism. The additional Turkish lira reserve requirement ratio for FX deposits/participation funds, which was introduced in 2023 and applied at 2.5%, was terminated. In addition, foreign currency deposits/participation funds' reserve requirement ratios applied to demand deposits and deposits with maturities up to 1 month and with longer maturities at different levels were increased by 2 percentage points to 32 percent and 28 percent, respectively.

During the current reporting period, market liquidity fluctuated, and a temporary liquidity shortage emerged in the system for a while. Market liquidity fluctuated mainly due to the CBRT's foreign exchange operations, the course of the Ministry of Treasury and Finance's TRY account balance, and TRY required reserve management of banks. In the May 7-May 22 period, a temporary liquidity shortage in the system reemerged on the back of banks' raised required reserve balances and the CBRT's foreign exchange operations. In June, owing to the CBRT's foreign exchange purchases, the system's funding need declined, and as of June 17, the system had excess liquidity again. In the subsequent period, the remuneration of TRY required reserves and the CBRT's foreign exchange operations brought about a higher excess liquidity in the market (Chart 1.1.1). In the current reporting period, the amount of Turkish lira funding provided via the swap channel reached the highest level of USD 3.7 billion on May 26, before decreasing in line with the funding need and hitting zero on August 5.

Throughout the current reporting period, the funding need of the system and sterilization operations were provided at the CBRT's overnight lending rate. The CBRT has not held one-week repo auctions since March 2, and the weighted average funding rate has materialized at the CBRT's overnight lending rate. In the current reporting period, as funding and sterilization operations were carried out at the overnight lending rate rather than the CBRT's policy rate, the overnight interest rates in the market hovered close to the upper bound of the CBRT's interest rate corridor (Chart 1.1.2). Excess liquidity is mostly sterilized via overnight Turkish lira deposit buying auctions. In this period, one-week reverse swap auctions against gold continued to be held for sterilization purposes. The amount of sterilization through deposit buying auctions with one-week maturity has also been on the increase since mid-June.

Chart 1.1.1: CBRT OMO and Swap Transactions
(One-Week Moving Average, TRY Billion)

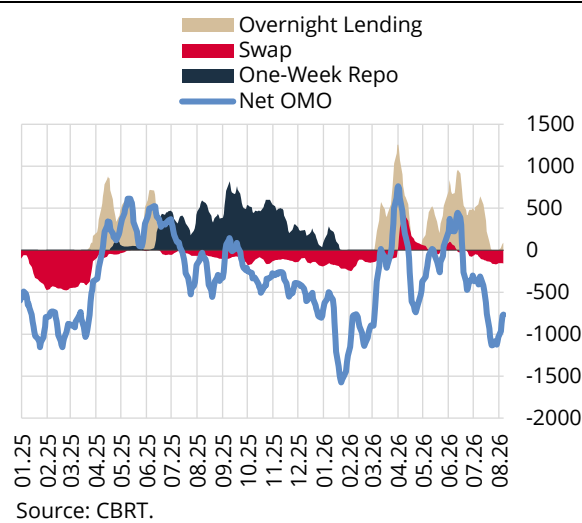
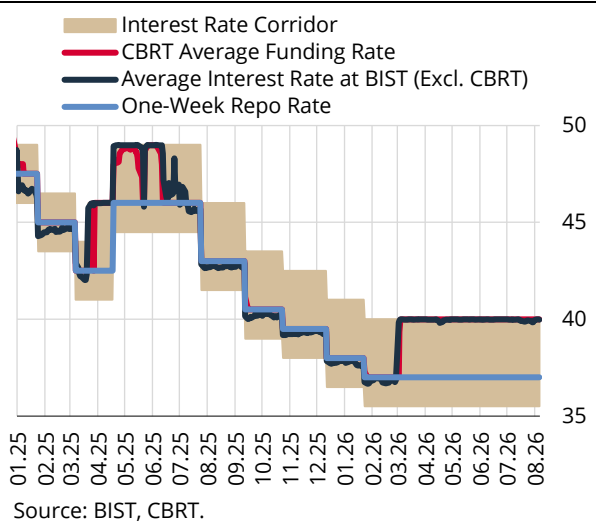


Chart 1.1.2: CBRT Interest Rates and Short-Term Interest Rates (%)

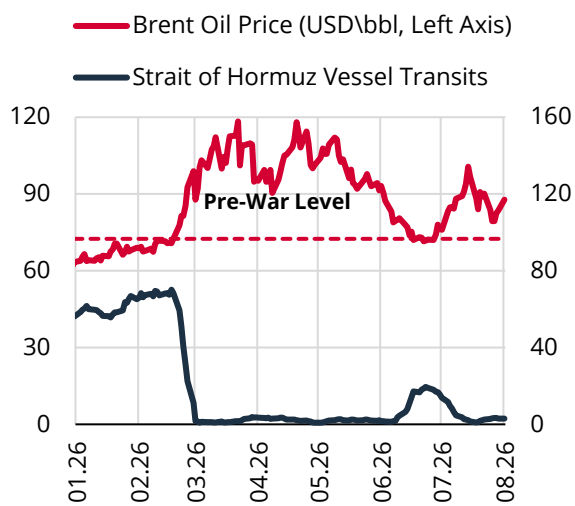


Economic Outlook

2.1 Global Economy

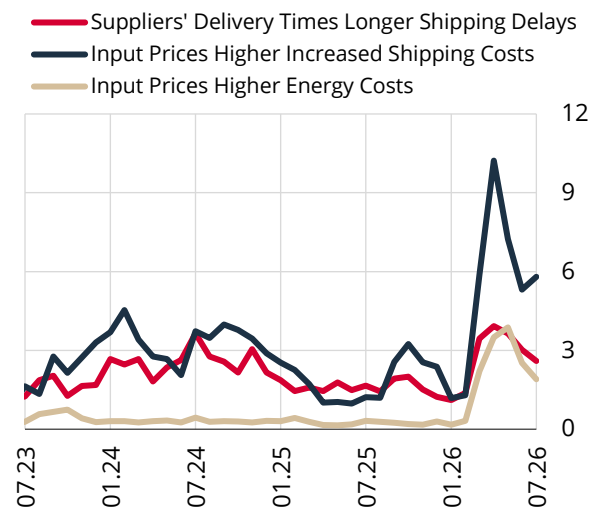
Uncertainties regarding the global economic outlook persist, while the news flow concerning the US-Israel war on Iran is constantly evolving. Following the agreement on a ceasefire in June, vessel traffic through the Strait of Hormuz picked up, and crude oil prices retreated to pre-war levels. However, as tensions in the region escalated again in July, prices climbed back, and shipping activity declined (Chart 2.1.1). The effects of the war can best be observed through shipping times and costs, as well as increases in input prices driven by energy prices. While survey indicators regarding freight-related supply constraints and input prices showed a limited improvement in June, the negative trend persists compared to the pre-war period (Chart 2.1.2). The recent resurgence of tensions in the Red Sea also poses a risk of further increasing costs and supply constraints.

Chart 2.1.1: Oil Prices and Vessel Traffic Through the Strait of Hormuz*



Source: Bloomberg.
* As of July 31, 2026.

Chart 2.1.2: PMI Comment Trackers*



Source: S&P Global.
* As of July 2026. The indices are compiled by monitoring the comments made in the PMI surveys and are normalized by equalizing the long-term average to one.

Volatility and high levels in energy prices persist due to the uncertainty caused by the war. The price of Brent oil per barrel decreased by 16.1% compared to the publication date of the previous Report but increased by nearly 30% in annual terms compared to the average of the publication month of the Report. After falling below USD 70 at the beginning of July, prices went up again due to the collapse of the ceasefire, and upside risks have intensified. Moreover, the rise in diesel refinery margins driven by geopolitical developments has negatively impacted import prices. TTF (Title Transfer Facility) natural gas prices, which are indicative for Europe, also showed a very strong upward trend. The course of the war, current and future damage to the energy infrastructure, and the extent and duration of the disruptions in energy transportation will continue to influence prices. As for non-energy commodity prices, prices have declined across the board, except for agricultural commodities. Compared to the publication date of the previous Report, precious metal prices fell by 8.5% and industrial metal prices by 3.3%, while agricultural commodity prices rose by 2.1% (Table 2.1.1).

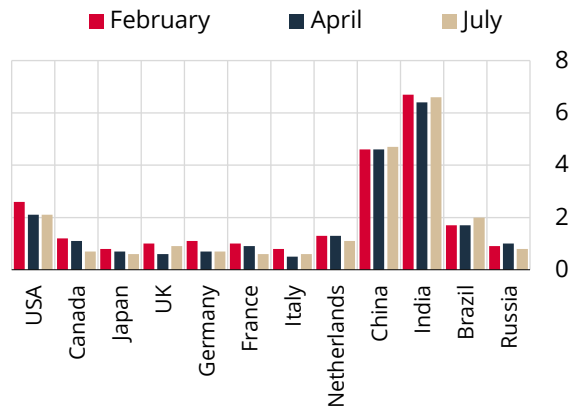
Table 2.1.1: Commodity Prices (%)

	May 2026	June 2026	July 2026	August 2026	Annual	Over the Previous Reporting Period*
Headline	1.2	-10.5	0.1	0.6	23.2	-7.4
Energy	1.2	-15.2	0.9	-0.1	31.0	-9.9
Agriculture	3.2	-6.4	8.1	0.6	10.2	2.1
Industrial Metal	3.5	-2.2	-3.4	3.4	32.7	-3.3
Precious Metal	-2.0	-8.6	-4.2	4.0	28.0	-8.5
Non-Energy	1.1	-4.6	-0.8	1.3	15.5	-4.4
Brent Oil	-11.7	-20.9	-2.3	6.2	29.9	-16.1
Natural Gas (USA)	9.3	9.1	-7.8	-8.2	-6.3	-3.5
Natural Gas (Europe)	4.4	-4.8	20.0	4.4	72.6	27.6
Coal	-1.8	9.2	-10.2	-0.1	15.4	-1.1
Aluminum	1.8	-5.9	-8.2	3.2	25.3	-11.4
Copper	6.3	1.1	-1.0	5.8	49.0	0.7
Iron	2.8	-7.8	-2.8	-4.1	-7.2	-14.8
Wheat	5.7	-7.1	9.3	-0.7	25.9	-1.0
Soy	2.3	-5.7	6.0	-3.0	15.1	-1.4
Rice	13.0	0.9	8.7	4.0	14.9	13.0
Corn	2.0	-9.4	6.1	-0.6	14.9	-2.9
Cotton	8.5	-8.9	5.0	5.6	24.7	-1.5
Sugar	4.8	-5.8	6.5	5.5	-4.7	9.9

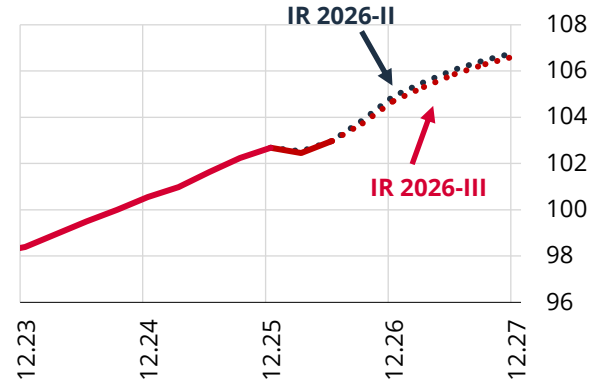
Source: Bloomberg.

* Percentage change in prices between May 14, 2026 and August 10, 2026. Red and green colors indicate increases and decreases in prices, respectively. Figures in the table are calculated using the averages of daily closing prices for the relevant period.

The global growth outlook remained weak and fragile. Growth projections for 2026, which were revised downwards after the onset of the war, have remained at low levels in many countries. However, the magnitude and nature of the impacts on growth projections may vary across countries (Chart 2.1.3). The global supply shock caused by energy prices and supply constraints has continued to affect the growth outlook negatively. While the likelihood of the war and the war-related uncertainties to extend over a longer time has grown stronger in the recent period, risks to global economic activity tend to be on the downside. On the other hand, investments in artificial intelligence and technology are contributing positively to global growth and are mitigating the negative effects of geopolitical developments to some extent. However, these investments could affect the future global growth outlook either way, i.e. while they could lead to productivity gains beyond expectations, excessive pricing in financial markets seems possible as well (Zoom-In 2.1). Against this backdrop, the change in Türkiye's external demand outlook was limited compared to the previous reporting period. The Export-Weighted Global Growth (EWGG) Index is estimated to grow by 1.6% in 2026, down by 0.1 points compared to the previous reporting period. The index is expected to recover somewhat in 2027, due in part to the base effects, and increase by 2.5% (Chart 2.1.4).

Chart 2.1.3: 2026 Growth Forecasts (%)

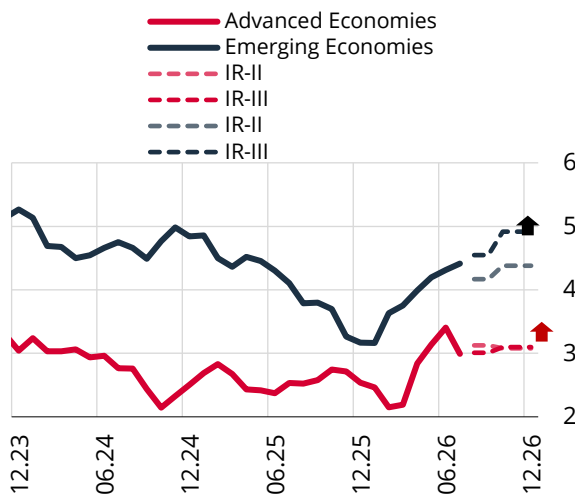
Source: CBRT, Consensus Economics, S&P Global.

Chart 2.1.4: EWGG Index*
(September 2024=100)

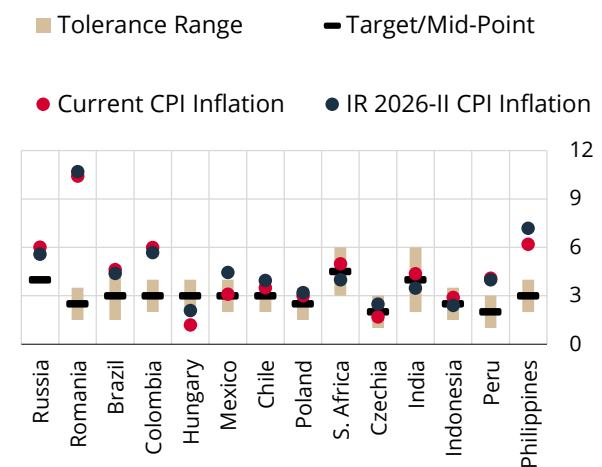
Source: CBRT, Consensus Economics, S&P Global.

* The EWGG Index is calculated by weighting the growth rates and forecasts of Türkiye's trading partners by their respective shares in exports.

Both realized and expected inflation rates continued to rise on a global scale. Energy prices, which fluctuated throughout the reporting period, remain influential on global inflation and inflation expectations. Declining energy prices in June have led to a drop in inflation rates in advanced economies. As of June, headline inflation declined to 3.5% in the US and 2.8% in the euro area. As for emerging economies, divergences across countries continue. During this period, inflation forecasts were revised upward in both country groups, albeit to a more limited extent in advanced economies (Chart 2.1.5). That said, headline inflation increased in many countries compared to the previous reporting period, and in some countries, it remained above the target and outside the tolerance range (Chart 2.1.6). The deterioration in the global inflation outlook may continue due to the ongoing strains in oil and gas supply driven by the war as well as due to the indirect effects on food prices and output costs. This may also lead to a rise in the current relatively moderate rates of core inflation through the second-round effects.

Chart 2.1.5: Global Inflation and Forecasts for 2026 (GDP-Weighted, Annual, %)

Source: Bloomberg.

Chart 2.1.6: Consumer Inflation in Emerging Economies (%)

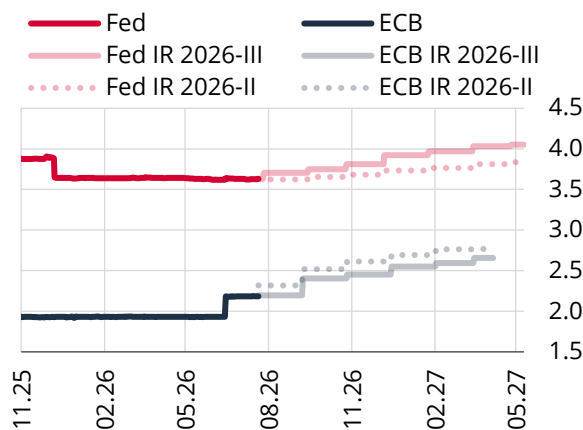
Source: Bloomberg.

As inflationary risks persist, expectations for tighter monetary policy on a global scale have strengthened.

While the Fed kept the policy rate unchanged in June and July, markets have been pricing a stronger probability of rate hikes by Fed in 2026. The market-implied policy rate path has shifted significantly upward. On the other hand, for the ECB, which raised its policy rate in June, the change in market-implied policy rate path remained limited (Chart 2.1.7). In addition, the Fed's decision to abandon its forward guidance strategy has increased monetary policy uncertainty in the US. As for central banks from other advanced economies,

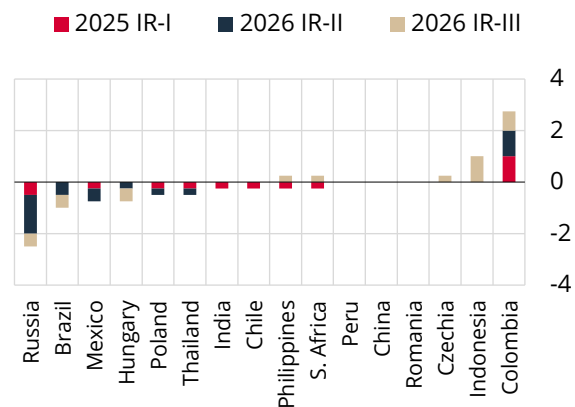
during the reporting period, Bank of Israel cut its policy rate by 50 basis points, while Bank of Japan, the Reserve Bank of New Zealand, Bank of Korea, and Danmarks Nationalbank each raised their policy rates by 25 basis points with emphasis on inflationary pressures. During this period, divergences across countries persisted in emerging market economies, yet the number of central banks raising rates increased (Chart 2.1.8). Magyar Nemzeti Bank, Banco Central do Brasil and the Bank of Russia each cut the policy rate by 50 basis points, whereas Bank Indonesia raised the policy rate by 100 basis points, the Central Bank of Colombia by 75 basis points, and Czech National Bank, South African Reserve Bank, and the Bangko Sentral ng Pilipinas by 25 basis points each. Meanwhile, People's Bank of China continued to take monetary easing steps to support growth, accompanied by its communication for a milder path of monetary policy. Central banks of emerging economies also continued to emphasize the war-related risks in their communication. While some central banks that already completed their rate-cut cycles remain on hold, rate-cutting central banks state that they will proceed with caution and monitor the developments. Compared to the period before the war, expectations for weaker growth and higher inflation on a global scale stand out (Zoom-In 2.2). However, if the period of uncertainty extends and changes in energy prices become more lasting, further monetary tightening may be necessary to anchor inflation expectations and keep second-round effects under control.

Chart 2.1.7: Policy Rates and Market-Implied Policy Paths (Effective, %)



Source: Bloomberg.

Chart 2.1.8: Policy Rate Changes in Emerging Economies (% Points)

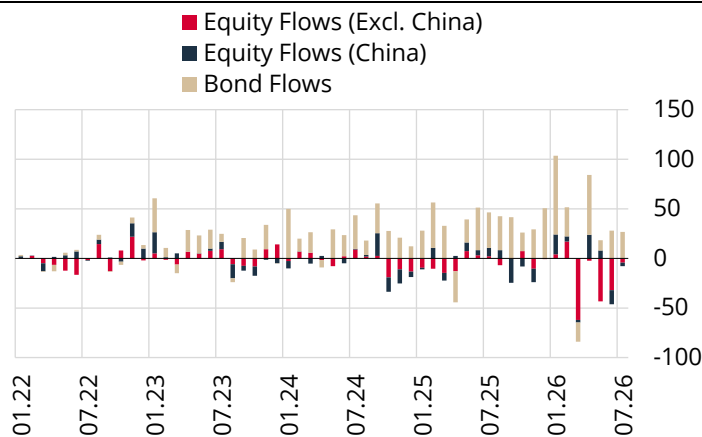


Source: Bloomberg.

Portfolio outflows from emerging economies were observed as global uncertainty remained elevated.

Across the reporting period, equity markets mostly saw portfolio outflows, whereas bond markets mostly recorded portfolio inflows (Chart 2.1.9). These outflows appear to be concentrated in South Korea and Taiwan, where strong profit-taking sales were recorded in the artificial intelligence and chip sectors. Monetary policies of advanced economies in the coming period may be influential on portfolio movements. Possible tightening steps have the potential to affect the global risk appetite.

Chart 2.1.9: Portfolio Flows to Emerging Economies (Monthly, USD Billion)



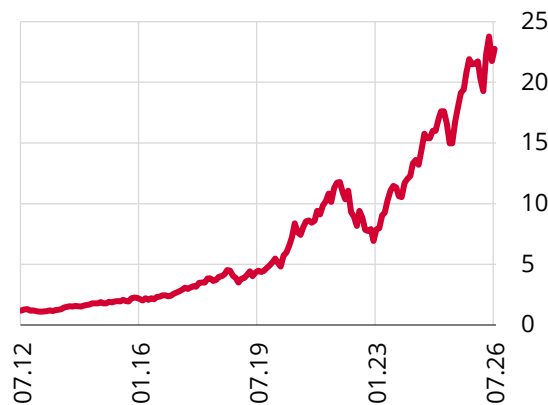
Source: IIF.

Zoom-In 2.1

The Impact of Artificial Intelligence Companies on the Market

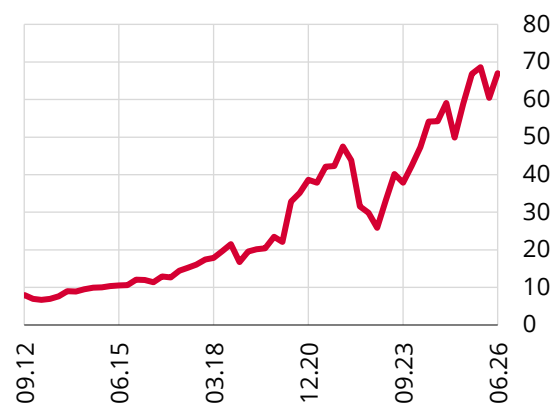
The recent AI-driven rise in equity valuations has placed major technology companies, which are few in number, in a position of systemic importance in global markets. The combined market capitalization of the seven major technology companies, which stood at nearly USD 1.2 trillion in 2012, reached approximately USD 23 trillion as of 2026. The acceleration in this growth, particularly after 2022, highlights the determining influence of the artificial intelligence theme in company valuations (Chart 1). The increase in valuations means that these companies have reached a significant scale not only in stock markets but also relative to the size of the US economy. Indeed, the ratio of the total market value of these companies to US national income climbed from 7% to over 65% during the same period (Chart 2).

Chart 1: Total Market Value of the Seven Major Technology Companies (USD Trillion)



Source: Bloomberg.

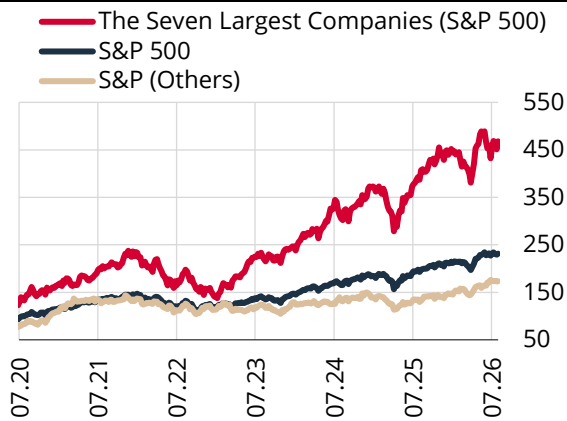
Chart 2: Ratio of the Total Market Value of the Seven Major Technology Companies to US GDP (%)



Source: Bloomberg.

The rise in US stock markets has been concentrated in technology companies, and a similar trend is observed in other countries as well. Since 2020, the return on the seven major companies has been more than five times that of the rest of the companies in the index (Chart 3). Moreover, the share of these companies in the index has risen from around 20% to 35% during the same period. Notably, the recent AI-driven increase in stock markets has not been confined to the US, with similar increases also observed in other countries that are leading players in chip and semiconductor production and electronics supply chains (Chart 4). On the other hand, the sharp rise in capital expenditures by technology companies and their rapid gains in value have also prompted the view that the very strong growth in revenues and profitability expected in the future may already be priced in. Against this backdrop, while the current outlook points to a structural transformation supported by actual investments, it should also be emphasized that, if the expected revenue and productivity gains from artificial intelligence investments are delayed, the high valuations and increasing index concentration could become a significant source of vulnerability for global equity markets.

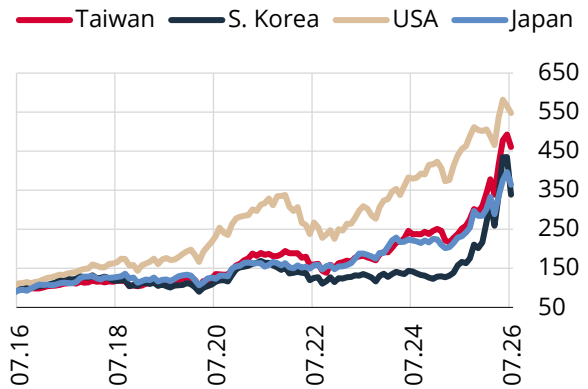
Chart 3: S&P Index*



Source: Bloomberg.

* January 2020=100.

Chart 4: Selected Countries' Stock Indices*



Source: Bloomberg.

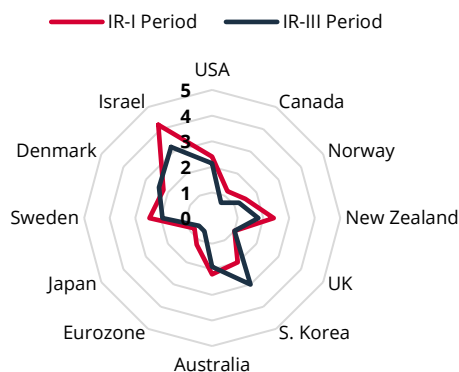
* January 2015=100.

Zoom-In 2.2

Impact of the War on Global Growth and Inflation Expectations

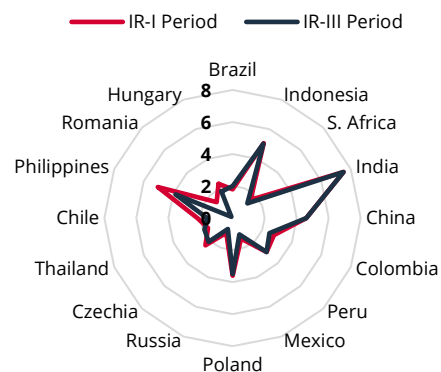
The US-Israel war on Iran is affecting global growth and inflation expectations. Compared to the pre-war period, growth expectations for 2026 have been mostly revised slightly downward across emerging economies, while expectations in advanced economies have also likewise weakened moderately. Among emerging economies, downward revisions are more significant particularly in the Philippines, Romania and Hungary, whereas expectations are largely maintained in India and China, and have improved moderately in Brazil and Thailand. Among advanced economies, growth expectations have been revised downward in the US, Canada, the euro area and New Zealand, while slight upward revisions have taken place in South Korea and Denmark. The overall picture suggests that the war-driven uncertainties and the weakening global demand have adversely affected growth expectations (Charts 1 and 2).

Chart 1: Growth Expectations of Advanced Economies for 2026 (%)



Source: Bloomberg.

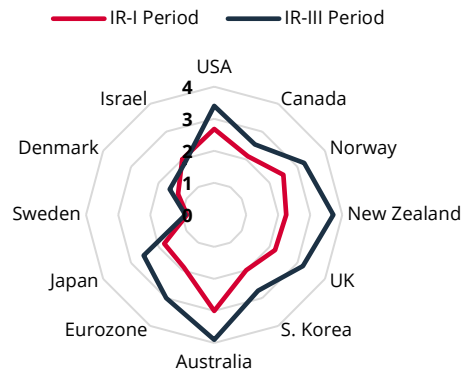
Chart 2: Growth Expectations of Emerging Economies for 2026 (%)



Source: Bloomberg.

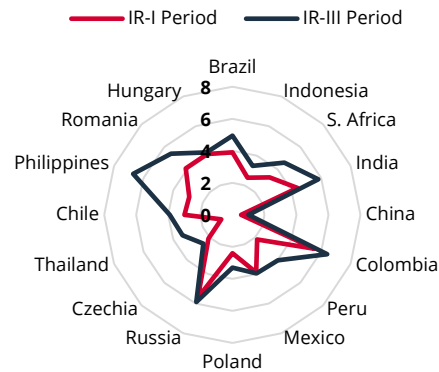
Inflation expectations have generally been revised upward both in advanced and emerging economies compared to the pre-war period. While expectations have increased to a more limited extent in advanced economies, energy costs and inertia in services inflation have unfavorably affected the inflation outlook. In emerging economies, increases in expectations have been more evident, with the rise in commodity prices, the exchange rate volatility, and supply-side cost pressures further strengthening their impact on expectations. On a country basis, expectations have increased at relatively high rates in the Philippines, Thailand, and Peru, whereas the change has remained limited in Russia and Hungary. The overall picture indicates that the war has had an upward effect on global inflation expectations, which is felt more strongly in emerging economies (Charts 3 and 4).

Chart 3: Inflation Expectations of Advanced Economies for 2026Q4 (%)



Source: Bloomberg.

Chart 4: Inflation Expectations of Emerging Economies for 2026Q4 (%)

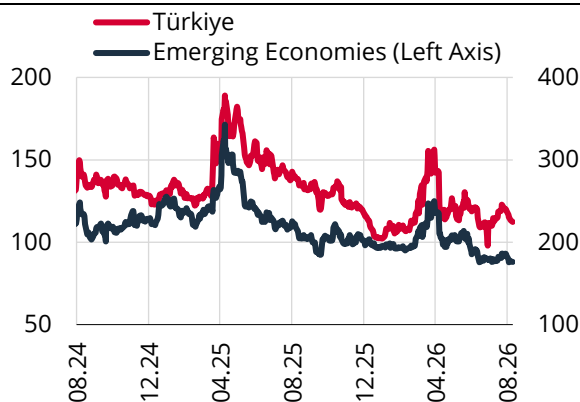


Source: Bloomberg.

2.2 Financial Conditions

Although volatility in financial markets has eased amid ceasefire talks between the US-Israel war on Iran, geopolitical uncertainties persist. This has an impact on the pricing of financial assets and the course of portfolio flows. Compared to the previous reporting period, Türkiye's CDS premium declined in line with emerging market risk premiums, reaching 225 basis points as of August 10 (Chart 2.2.1). During the current reporting period, portfolio outflows from emerging markets continued, whereas Türkiye recorded portfolio inflows. Accordingly, there was an inflow of USD 3.6 billion into the GDDS market and an outflow of USD 0.8 billion from the equity market, resulting in a net portfolio inflow of USD 2.8 billion (Chart 2.2.2).

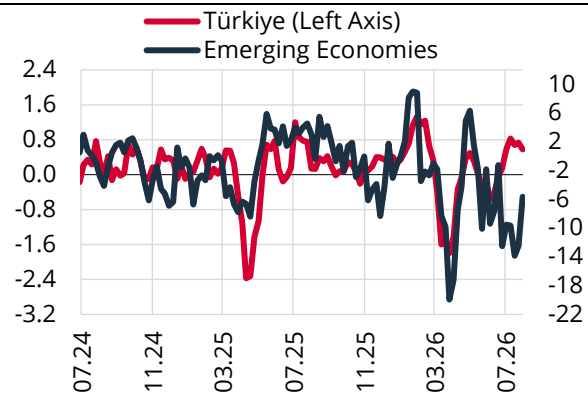
Chart 2.2.1: CDS Premium in Türkiye and Emerging Economies* (Five-Year, Basis Points)



Source: Bloomberg.

* Emerging economies include Brazil, Chile, Colombia, Indonesia, Malaysia, Mexico, South Africa, and the Philippines.

Chart 2.2.2: Portfolio Flows to Türkiye and Emerging Economies* (Four-Week Average, USD Billion)

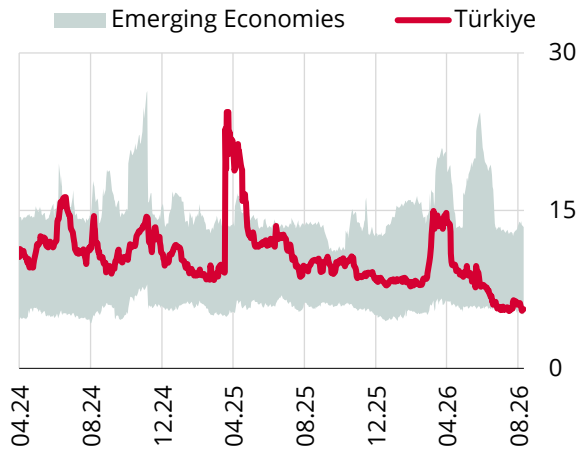


Source: CBRT, IIF.

* Data for Türkiye covers portfolio flows to equity and GDDS markets. Repo is excluded from the GDDS data.

The implied volatility of the Turkish lira declined. In the current reporting period, short-term exchange rate volatility declined relative to other emerging markets, while long-term exchange rate volatility remained elevated. The implied volatility of the Turkish lira stands at 5.6% for the one-month maturity and 18.6% for the 12-month maturity (Charts 2.2.3 and 2.2.4).

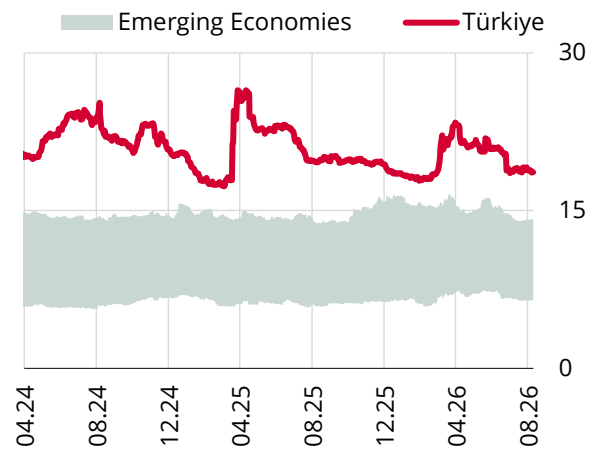
Chart 2.2.3: Implied Volatility of FX Options*
(Against USD, One-Month Maturity, %)



Source: Bloomberg.

* Emerging economies include Brazil, Chile, Colombia, Hungary, Indonesia, Malaysia, Mexico, Poland, Romania, South Africa, and the Philippines.

Chart 2.2.4: Implied Volatility of FX Options*
(Against USD, 12-Month Maturity, %)

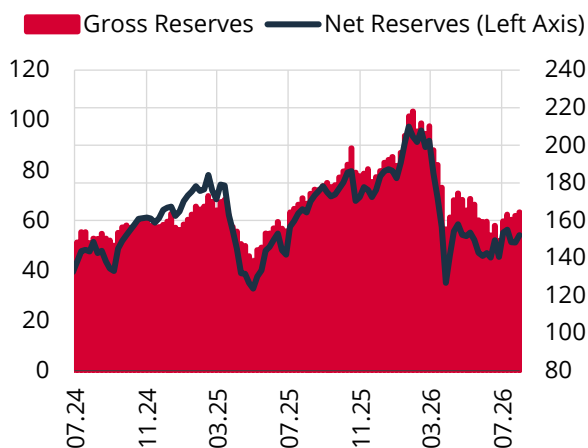


Source: Bloomberg.

* Emerging economies include Brazil, Chile, Colombia, Hungary, Indonesia, Malaysia, Mexico, Poland, Romania, South Africa, and the Philippines.

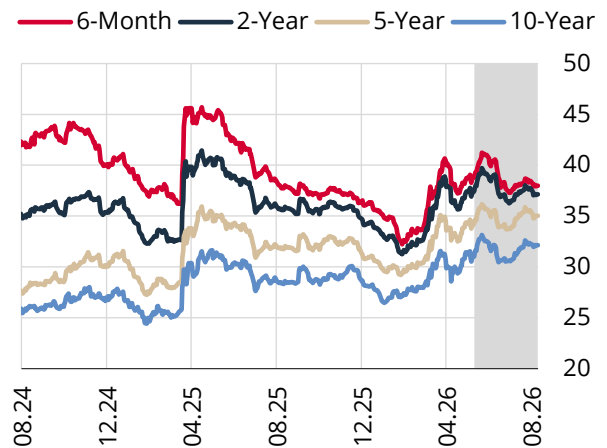
CBRT gross reserves declined compared to the previous reporting period. During the reporting period, the CBRT's gross international reserves decreased by USD 1 billion to USD 164.5 billion, driven in part by the decline in gold prices (Chart 2.2.5). While geopolitical developments, global risk appetite, and volatility in financial markets may lead to fluctuations in reserves, CBRT reserves have recently exhibited an upward trend.

Chart 2.2.5: CBRT's Gross International Reserves (Weekly, USD Billion)



Source: CBRT.

Chart 2.2.6: GDDS Yields (%)

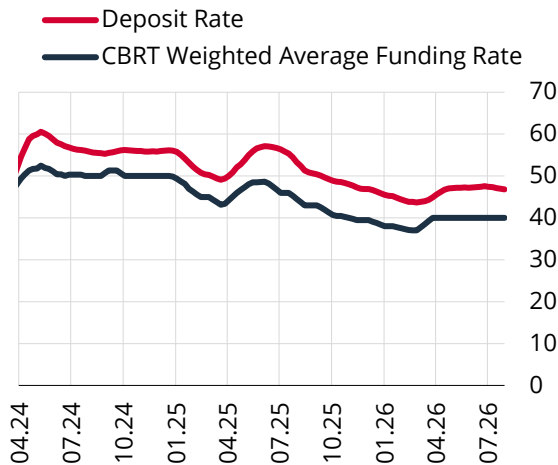


Source: Bloomberg.

GDDS yields remained broadly unchanged during the current reporting period. Following a decrease at the start of the current reporting period amid reduced geopolitical risks, GDDS yields increased across all maturities due to the recent rise in war-related uncertainties and potential risks to inflation (Chart 2.2.6). Should risk perceptions related to geopolitical developments improve and global risk appetite strengthen, GDDS yields are expected to evolve in a manner more consistent with the inflation and monetary policy outlook.

During the current reporting period, financial conditions remained tight, due to the CBRT'S decisions to support the monetary transmission mechanism in the face of geopolitical developments. Following the decision on March 1 to suspend one-week repo auctions in light of the developments in financial markets, overnight interest rates continue to hover very close to the upper bound of the CBRT's interest rate corridor. Tight financial conditions are also reflected in deposit and loan rates. Compared to the previous reporting period, as of July 31, deposit rates and TRY commercial loan rates declined slightly to 46.7% and 48.5%, respectively. Meanwhile, personal, housing and vehicle loan rates were 64.9%, 41.8%, and 45.9%, respectively (Charts 2.2.7 and 2.2.8).

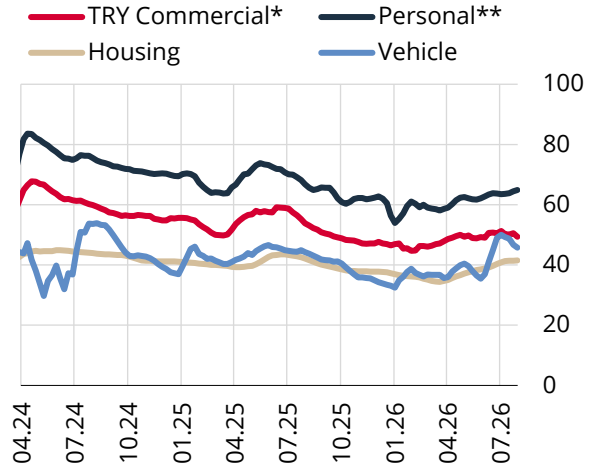
Chart 2.2.7: Turkish Lira Funding Rates* (Four-Week Moving Average, %)



Source: CBRT.

* Deposit rate is compound interest rate, while the CBRT average funding rate is simple interest rate.

Chart 2.2.8: Loan Rates*** (Flow, Four-Week Moving Average, %)



Source: CBRT.

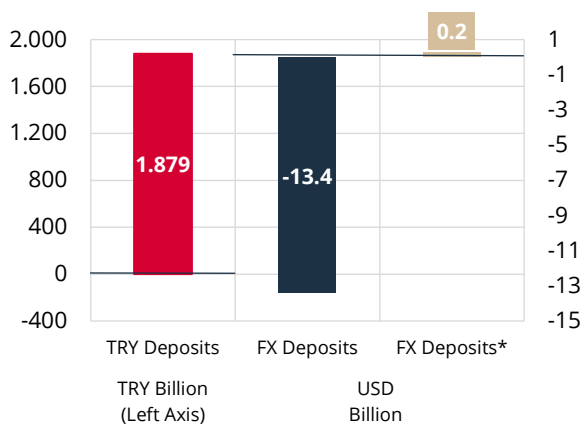
* Excluding overdraft accounts and credit cards.

** Excluding overdraft accounts.

*** Loan rates are compound interest rates.

The TRY share in banks' deposit composition continues to hover close to its historical average. In the current reporting period, owing also to the tight monetary policy stance, the preference for Turkish lira continued and TRY deposits increased by TRY 1.879 trillion. Meanwhile, the FX deposit balance decreased by USD 13.4 billion. However, adjusted for parity and price effects, this balance increased by USD 0.2 billion (Chart 2.2.9). Despite geopolitical uncertainties, the share of TRY deposits reached 62% in the current reporting period, due also the tight monetary policy stance (Chart 2.2.10).

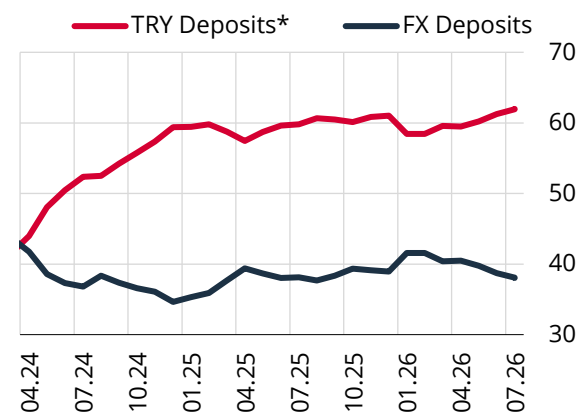
Chart 2.2.9: Change in Deposits
(July 17, 2026-April 24, 2026)



Source: CBRT.

* Shows parity- and price-adjusted change. TRY deposits exclude KKM and FX-protected deposit accounts converted from FX. The change in FX deposits is the change in residents' deposits in domestic branches.

Chart 2.2.10: Deposit Composition
(% Share)



Source: CBRT.

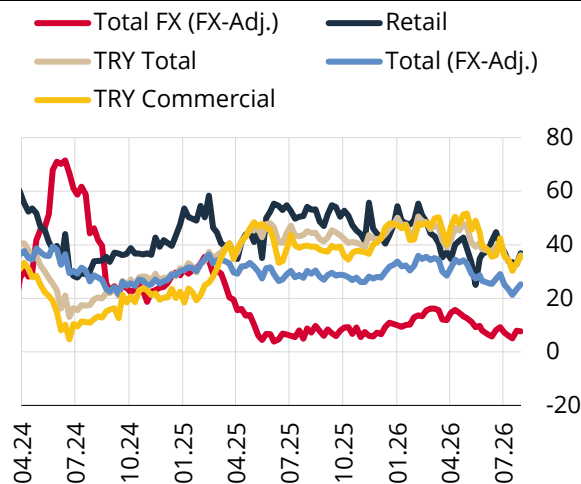
* TRY deposits exclude KKM and FX-protected deposit accounts converted from FX.

Commercial loan growth decelerated compared to the previous reporting period. As of July 31, the 13-week annualized growth rate of FX commercial loans, adjusted for exchange rates, stood at 7.7%, while that of TRY commercial loans was 35.7%. The FX-adjusted 13-week annualized growth rate of total loans also decreased somewhat during the reporting period, reaching 25.2% as of the same week (Chart 2.2.11).

Retail loan growth declined due to the slowdown in its subitems, particularly housing loans. The 13-week annualized growth rate of retail loans stood at 36.8% as of July 31. The growth rate of housing loans declined markedly in the current reporting period, reaching 27.8%, while the growth rate of personal loans decreased to 30.2%. Growth in personal credit card balances also decelerated modestly to 45.6%, while the growth rate of vehicle loans remained in negative territory despite a limited increase (Chart 2.2.12).

Chart 2.2.11: Loan Growth

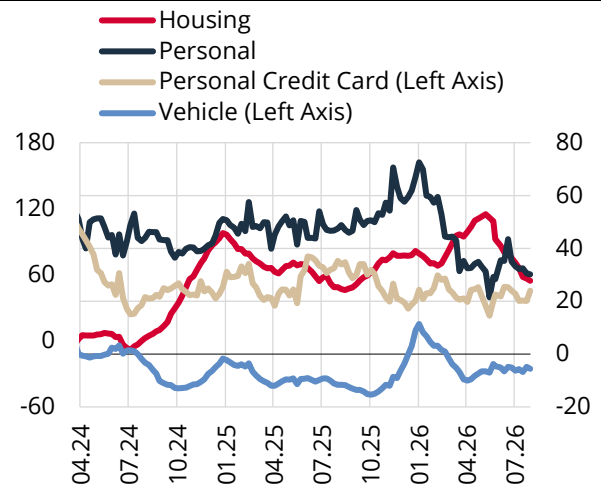
(13-Week Annualized, %)



Source: CBRT.

Chart 2.2.12: Retail Loan Growth

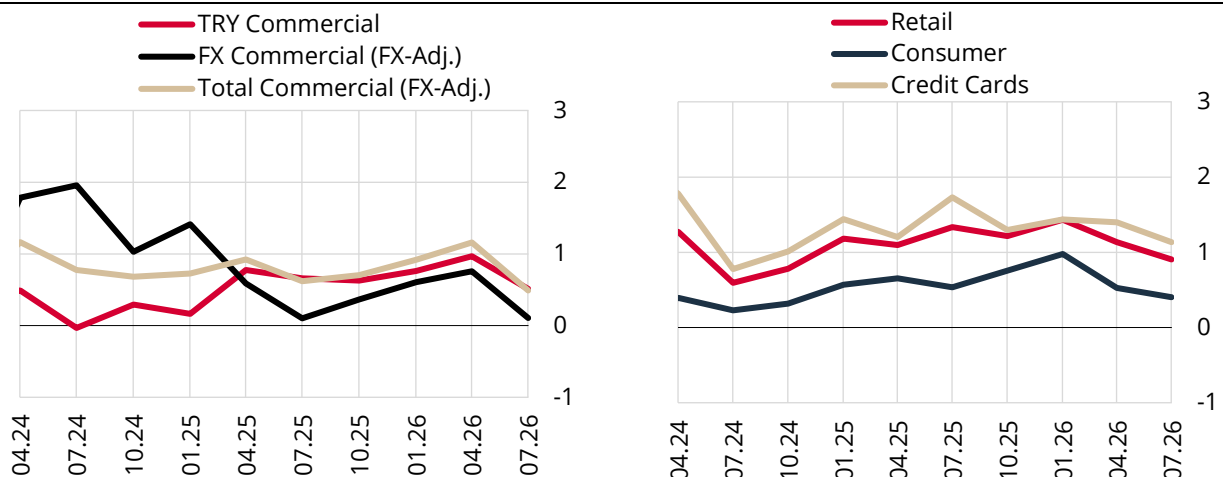
(13-Week Annualized, %)



Source: CBRT.

Real utilization of commercial loans lost some momentum during the current reporting period but remained above its long-term average. The FX-adjusted and deflated standardized change in total commercial loans declined somewhat in the current reporting period, driven by both TRY and FX loans, but remained above its long-term average. While standardized changes in retail loans also declined in the current reporting period, they remained above their long-term averages (Chart 2.2.13).

Chart 2.2.13: Changes in Loans* (13-Week Average, Real, Standardized)



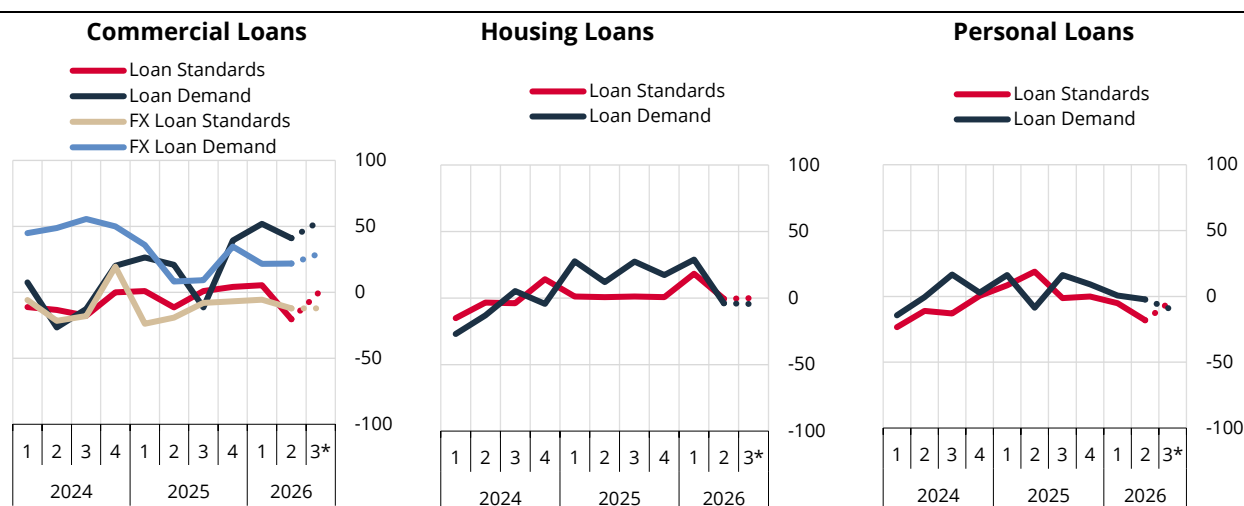
Source: CBRT.

* Series are deflated by the CPI. The mean and standard deviations of the series are calculated based on the 2006–2019 period. The 13-week average is taken after weekly real changes in loan stock balances are standardized. Consumer loans are composed of housing, vehicle, and personal loans, while retail loans are the sum of consumer loans and personal credit cards

According to the Bank Loans Tendency Survey (BLTS), banks expect commercial loan demand to increase in the third quarter of 2026. Banks expect commercial loan standards to ease somewhat, while standards for FX commercial loans are expected to remain tight. In the second quarter of the year, loan demand declined, while demand for FX commercial loans remained broadly unchanged. Lending standards, on the other hand, remained tight (Chart 2.2.14).

In the second quarter of the year, housing loan demand declined, while standards remained tight. Banks expect housing loan demand to remain flat in the third quarter, with standards remaining unchanged. As for personal loans, although demand declined modestly in the second quarter, lending standards eased compared to the first quarter but remained below the threshold value, indicating that they continued to stay tight. For the third quarter, banks expect personal loan demand to decrease but lending standards to remain tight (Chart 2.2.14).

Chart 2.2.14: Loan Standards and Loan Demand



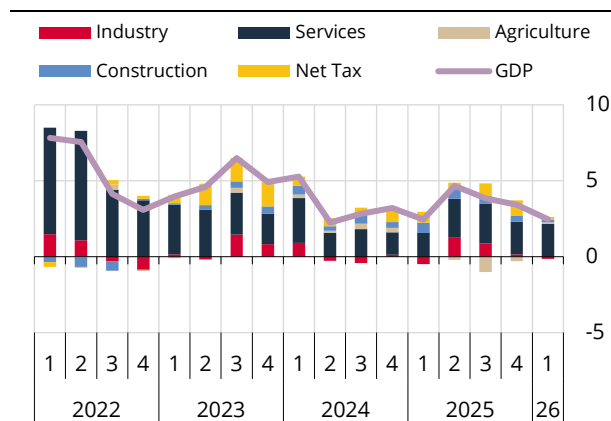
Source: BLTS, CBRT.

*Denotes banks' expectations. Loan Standards and Loan Demand indices are calculated as follows: Banks are asked how their loan standards (loan demand) have changed in the past three months. Net trends, which are calculated using the percentages of responses, show the direction of change in loan standards (loan demand). An index value above zero indicates easing in loan standards (increase in loan demand).

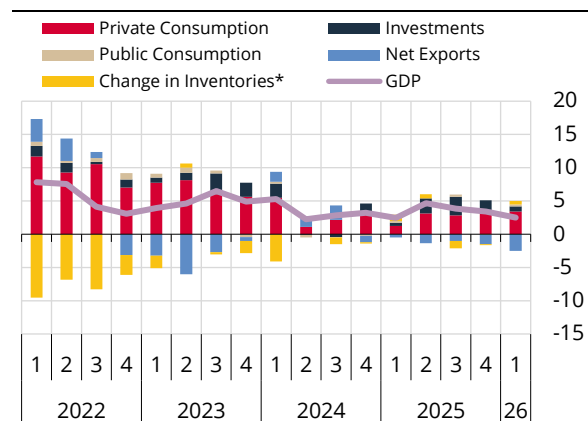
2.3 Economic Activity

Supply and Demand Developments

In the first quarter of 2026, GDP increased by 2.5% year-on-year and 0.1% quarter-on-quarter. On the production side, the services sector was the main driver of annual growth in the first quarter. Agricultural value added, which had declined in 2025 due to a fall in crop production caused by frost and drought, increased by 4.6% year-on-year in the first quarter of 2026, contributing positively to annual growth. The positive contributions of construction sector value added and the net tax item to growth continued, albeit at a declining pace. Meanwhile, industrial value added went down on an annual basis (Chart 2.3.1). On the expenditures side, the contributions of private consumption and total investments to annual growth moderated somewhat compared to the previous quarter (Chart 2.3.2). On a quarterly basis, private consumption made only a limited contribution to growth, while total investments contributed negatively. During this period, both imports and exports of goods and services fell quarter-on-quarter, with exports recording a sharper decline. Accordingly, the negative contribution of net exports to quarterly growth continued, albeit with a smaller impact. Overall, domestic demand remained subdued in the first quarter, partly reflecting the continued tightness in financial conditions, while economic activity kept slowing.

Chart 2.3.1: Annual GDP Growth and Contributions from Production Side (% Points)

Source: CBRT, TURKSTAT.

Chart 2.3.2: Annual GDP Growth and Contributions from Expenditures Side (% Points)

Source: CBRT, TURKSTAT.

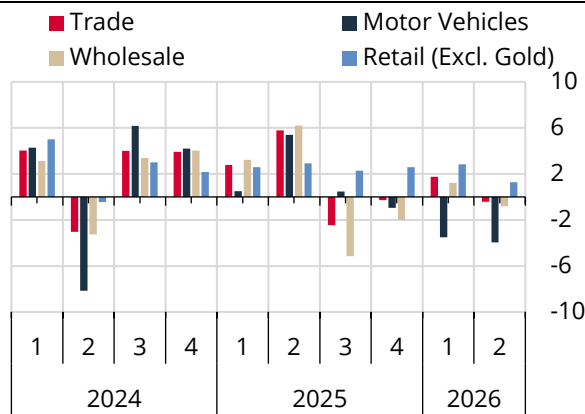
* Includes changes in inventories and statistical discrepancy due to chain-linking.

Leading indicators for the second quarter of 2026 imply that economic activity remained moderate, and domestic demand conditions provided stronger support to the disinflation process. The quarterly growth in the retail sales volume index slowed from 4.9% in the first quarter to 1.7% in the second quarter (Chart 2.3.3). Similarly, the quarterly growth in retail sales excluding gold declined (Chart 2.3.4). Over the same period, the trade sales volume index decreased by 0.4% quarter-on-quarter, driven by wholesale and vehicle trade. White goods sales increased on a quarterly basis but still failed to offset the first quarter's decline (Chart 2.3.5). Automobile sales, which had fallen in the first quarter, continued this trend in the second quarter and in July. Survey data from manufacturing firms pointed to a moderate outlook for registered domestic market orders in the second quarter. PMI data likewise implied a decline in domestic market orders during the quarter. Card spending decreased in the second quarter compared to the first quarter (Chart 2.3.6 and Box 2.1). The heat map of consumption-related indicators, including production, sales, imports, loans, card spending, and payment data, also suggests a slowdown in domestic demand in the second quarter (Table 2.3.1). Data for July indicate that card spending remained weak. During the same period, BTS data implied a decline in manufacturing firms' assessments of registered domestic market orders, as well as in their expectations for future domestic orders. PMI data indicated that the weakness in total orders persisted in July. Findings obtained from firm interviews on consumption expenditures also showed that domestic sales continued to slow in July (Box 2.2). Overall, recent data suggest a more pronounced slowdown in domestic demand.

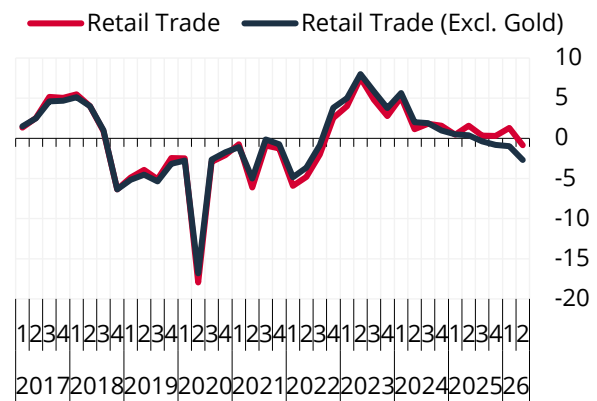
Table 2.3.1. Consumption Expenditure Indicators Heat Map* (Annual Change)

	24-Q1	24-Q2	24-Q3	24-Q4	25-Q1	25-Q2	25-Q3	25-Q4	26-Q1	26-Q2
Card Spending (Total)	Green	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow
Spending with International Cards	Yellow	Yellow	Yellow	Yellow	Green	Yellow	Yellow	Yellow	Yellow	Yellow
Spending with Domestic Cards	Green	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow
Cash Withdrawal Amount (Domestic Cards)	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow
Cash Withdrawal Amount (International Cards)	Yellow	Green	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow
Retail Payment System Transactions (Real)	Green	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow
Change in Consumer Loans and Card Spending	Green	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow
Services Turnover Index (Real)	Green	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow
Domestic White Goods Sales	Green	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow
Total Vehicle Sales	Green	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow
Automobile Sales	Green	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow
Housing Sales	Green	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow
Retail Sales Volume Index	Green	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow
Consumption Goods Production Index	Green	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow
Consumption Goods Imports	Green	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow
Services Production Index	Green	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow

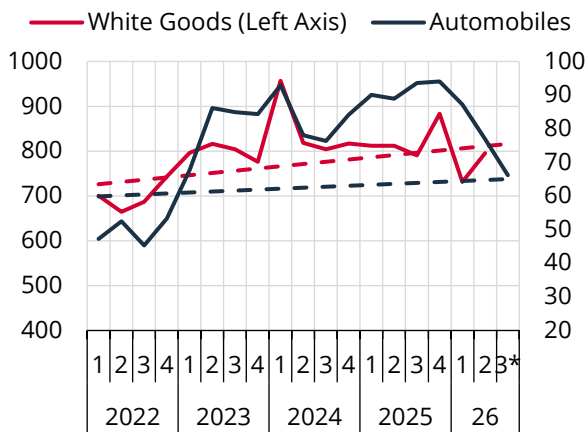
* The color coding is based on the average values over the 2024Q1–2026Q2 period. The smallest and largest values of each indicator are colored red and green, while the median values are yellow. The color transitions between the smallest and largest values occur linearly.

Chart 2.3.3: Sales Volume Indices (Seasonally and Calendar-Adjusted, Quarterly % Change)

Source: TURKSTAT.

Chart 2.3.4: Retail Sales Volume Index (Deviation from HP Trend, %)

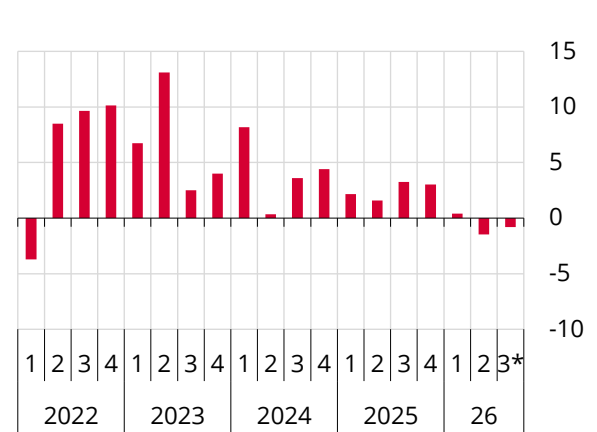
Source: CBRT, TURKSTAT.

Chart 2.3.5: Sales of White Goods and Automobiles** (Thousand, Seasonally and Calendar-Adjusted)

Source: CBRT, ODMD, TURKBESD.

* As of July for automobile sales.

** Dashed lines show the trend for the 2010-2018 period.

Chart 2.3.6: Card Spending (Real, %)

Source: CBRT.

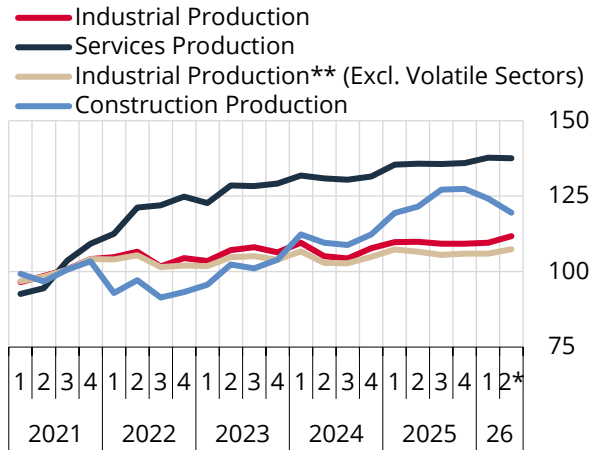
* Deflated by CPI. Excluding public and individual pension payments. As of July for the third quarter.

In the second quarter of the year, the industrial production index increased relative to the first quarter, while the services production index remained broadly flat, and the construction production index declined.

During this period, the annual growth rate of monthly industrial production exhibited significant volatility due to bridge days associated with religious and public holidays. Accordingly, industrial production increased year-on-year in April, declined in May, and rebounded in June. Adjusted for seasonal and calendar effects, industrial production, which had remained nearly flat in the previous quarter, posted a quarterly increase of 2.0% in the second quarter (Chart 2.3.7). Excluding typically volatile sectors such as other transport and related sectors to better capture the underlying trend, the quarterly increase was somewhat lower than that of the headline index. Nevertheless, the underlying trend in industrial production improved. The services production index declined on a monthly basis in April and May while remaining broadly flat on a quarterly basis. As for the subitems, production in the transport and information-communication sectors decreased, while that in other sectors grew. During the April-May period, the construction production index fell by 3.8% on a quarterly basis, continuing the declining trend in the first quarter. This picture is largely driven by the normalization of construction production in the first half of this year, following the strong performance particularly in the second half of last year in line with the goal of delivering housing units in the earthquake-affected region by 2025. The BTS data for July indicated an increase in production expectations. Although the PMI production index rose both month-on-month and quarter-on-quarter in July, it remained below the threshold value of 50 (Chart 2.3.8). The capacity utilization rate (excluding the manufacture of coke and refined petroleum products) showed a limited increase in the second quarter but fell in July. Overall, production indicators for the second

quarter point to a rise in industrial production, a decline in construction production, and a near-flat trend in services production. Meanwhile, survey-based indicators suggest a weak trend in industrial production in the third quarter of the year as of July.

Chart 2.3.7: Industrial, Services and Construction Production Indices
(Seasonally and Calendar-Adjusted, 2021=100)



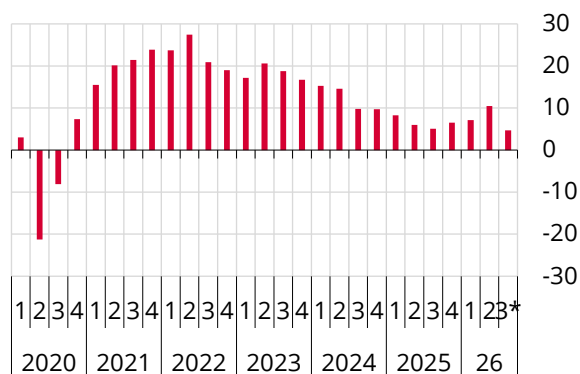
Source: CBRT, TURKSTAT.

* As of May for services and construction production indices.

** Industrial production excluding recorded media, computer-optical instruments, basic pharmacy, and other transport sectors that are typically volatile.

Investment expectations of manufacturing firms picked up in the second quarter but declined in July. Firms' tendency to invest showed an upward trend from the fourth quarter of 2025 onward, followed by a notable decline in the third quarter of 2026 as of July (Chart 2.3.9). In the second quarter of the year, production of capital goods excluding vehicles increased quarter-on-quarter. On the other hand, there was a decline in the production of capital goods excluding vehicles and other transport, as well as imports of capital goods excluding transport vehicles (Chart 2.3.10).

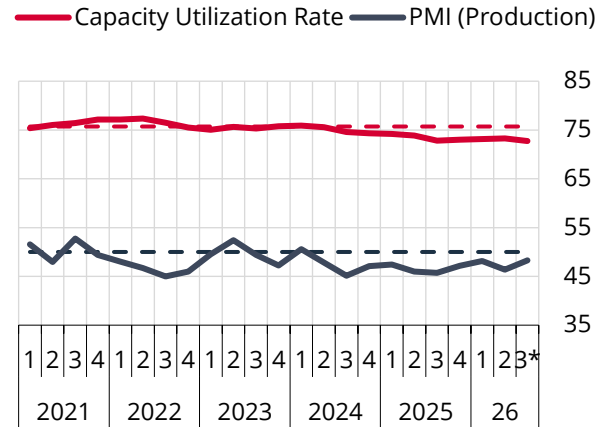
Chart 2.3.9: BTS Expectations for Fixed Capital Investment Spending (Up-Down, Seasonally Adjusted, %)



Source: CBRT.

* As of July.

Chart 2.3.8: Capacity Utilization Rate and PMI** (Seasonally Adjusted, %)

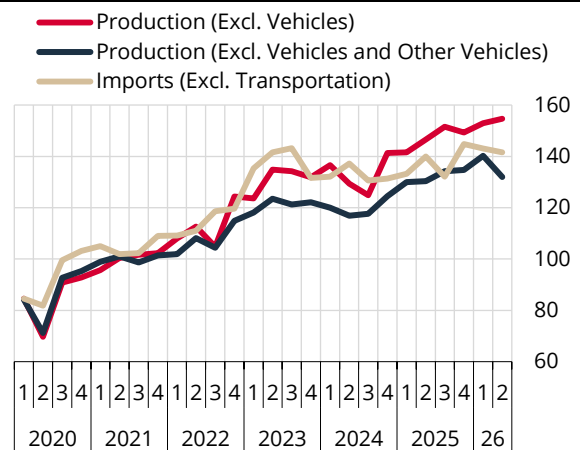


Source: CBRT, S&P, TURKSTAT.

* As of July.

** Excluding manufacture of coke and refined petroleum products. Dashed lines represent the 2007–2024 average for capacity utilization rate and the threshold value of 50 for PMI.

Chart 2.3.10: Production and Import Quantity Indices of Capital Goods Excluding Vehicles (Seasonally Adjusted, 2021=100)

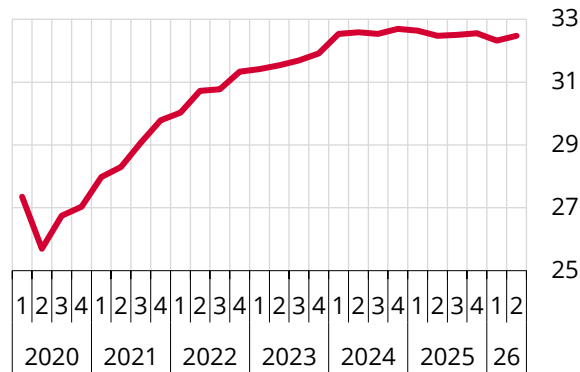


Source: CBRT, TURKSTAT.

Labor Market Developments

Employment edged up in the second quarter of the year. According to the quarterly averages of seasonally adjusted monthly data, employment stood at 32.5 million people in the second quarter of the year (Chart 2.3.11). During this period, the seasonally adjusted unemployment rate fell by 0.3 percentage points on a quarterly basis to 7.9%, while the labor force participation rate remained largely flat (Chart 2.3.12). Population growth had an upward effect of 0.25 percentage points, while employment growth and the very slight decline in the labor force participation rate had downward effects of 0.44 percentage points and 0.07 percentage points, respectively (Chart 2.3.13).

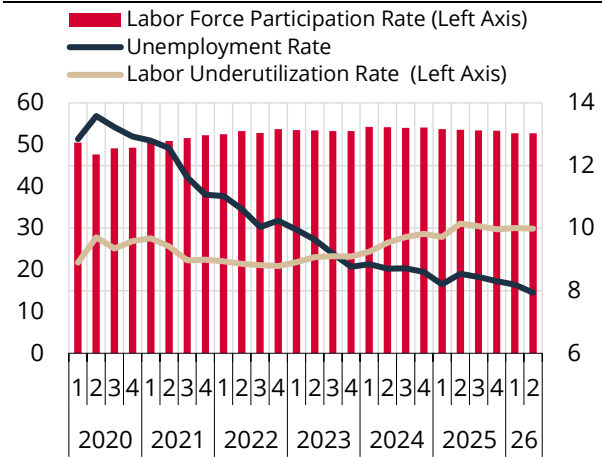
Chart 2.3.11: Total Employment* (Seasonally Adjusted, Million People)



Source: TURKSTAT.

* The last quarter is the average of monthly data.

Chart 2.3.12: Total Unemployment Rate and Labor Force Participation Rate* (Seasonally Adjusted, %)

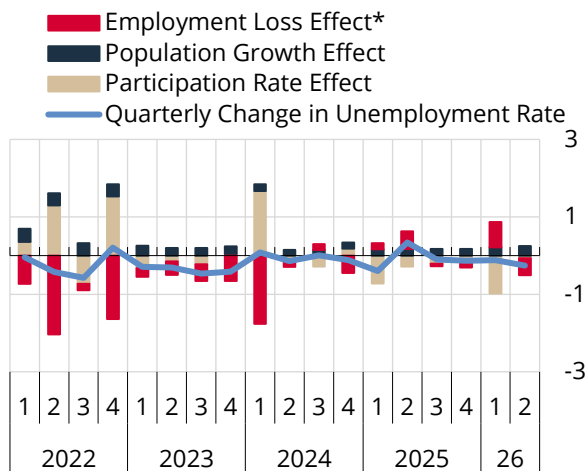


Source: TURKSTAT.

* The last quarter is the average of monthly data.

The labor market is less tight than implied by the headline unemployment rate. In the second quarter, the labor underutilization rate, one of the complementary indicators of the labor market, declined by 0.2 percentage points to 29.9%. The Composite Labor Market Conditions Index went up during the second quarter, reaching almost zero (Chart 2.3.14). The total number of applications per job listing on Kariyer.net edged down but was still high (Chart 2.3.15). In light of these data, the labor market is assessed to be less tight than implied by the headline unemployment rate.

Chart 2.3.13: Contributions to Change in Total Unemployment Rate** (Seasonally Adjusted, % Points)

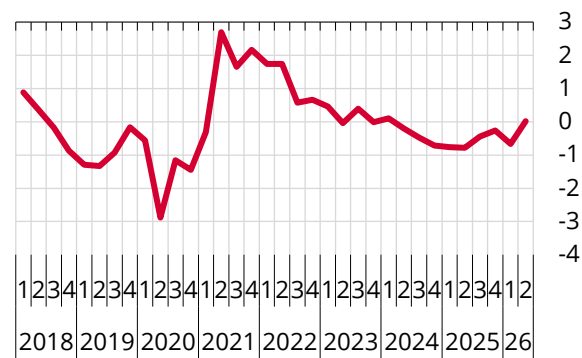


Source: CBRT, TURKSTAT.

* A negative value for the employment loss effect indicates an increase in employment.

** The last quarter is the average of monthly data.

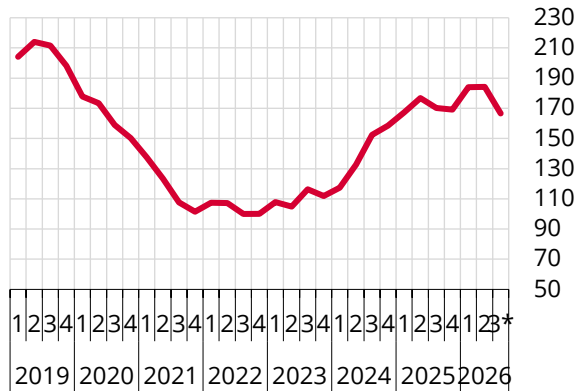
Chart 2.3.14: Composite Labor Market Conditions Index (Standardized Values)



Source: CBRT.

Survey indicators show that manufacturing firms' employment expectations for the future still hover below the historical average. Survey data from manufacturing firms indicate that, in the second quarter, firms' employment expectations remained below their historical firms average (Chart 2.3.16). While BTS data pointed to a monthly increase in employment expectations in July, the PMI employment index declined slightly over the same period, staying below the threshold level.

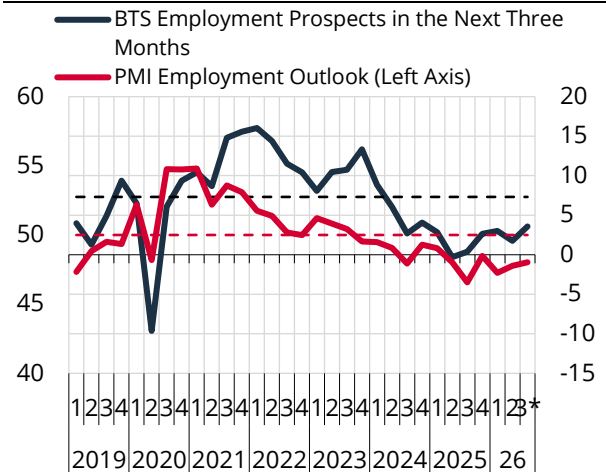
Chart 2.3.15: Total Applications per Job Listing on Kariyer.net
(Seasonally Adjusted, Number of Applications)



Source: CBRT, Kariyer.net.

* As of July.

Chart 2.3.16: Employment Outlook and Expectation in the Industrial Sector**
(Seasonally Adjusted, Up-Down)



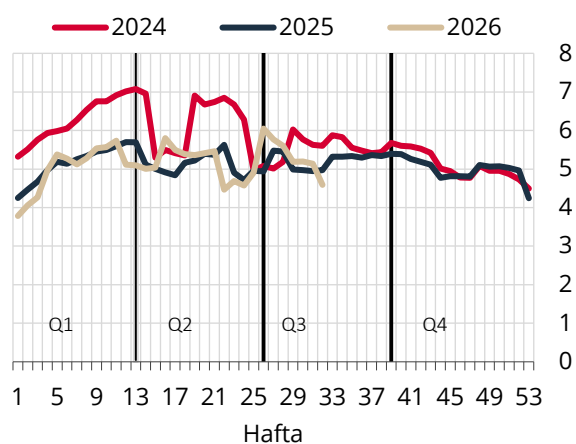
Source: CBRT, S&P Global.

* As of July.

** Dashed lines show the 2007-2025 average for BTS and the threshold value of 50 for PMI.

High-frequency data suggest that both labor demand and labor supply remained close to the previous year's levels. According to data from Kariyer.net, the number of new job postings and total job applications in the second quarter remained close to their levels in the previous year. In July, however, both new job postings and total job applications were lower than their levels in the same period of the previous year (Charts 2.3.17 and 2.3.18).

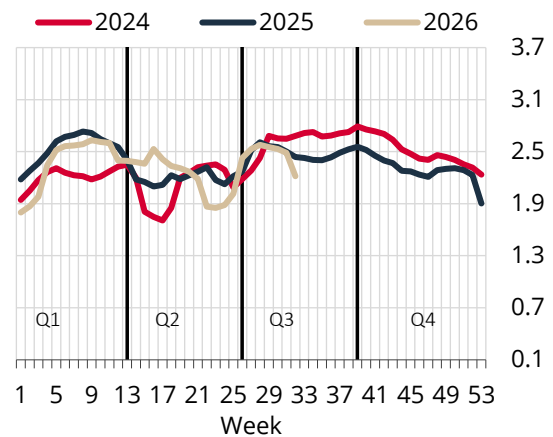
Chart 2.3.17: New Job Postings* (Four-Week Average, Thousand)



Source: Kariyer.net.

* As of July 31. Vertical lines show the beginning of quarters.

Chart 2.3.18: Total Job Applications* (Four-Week Average, Million)

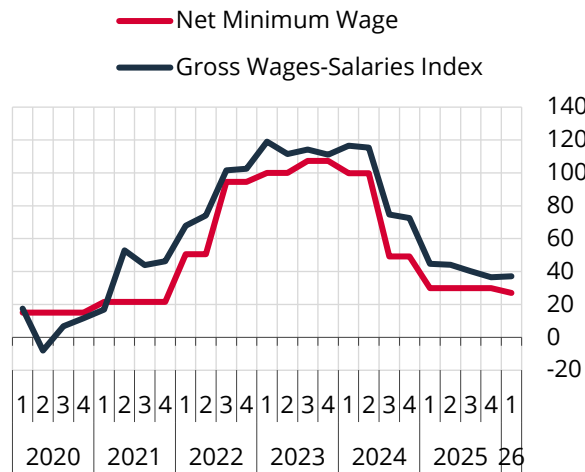


Source: Kariyer.net.

* As of July 31. Vertical lines show the beginning of quarters.

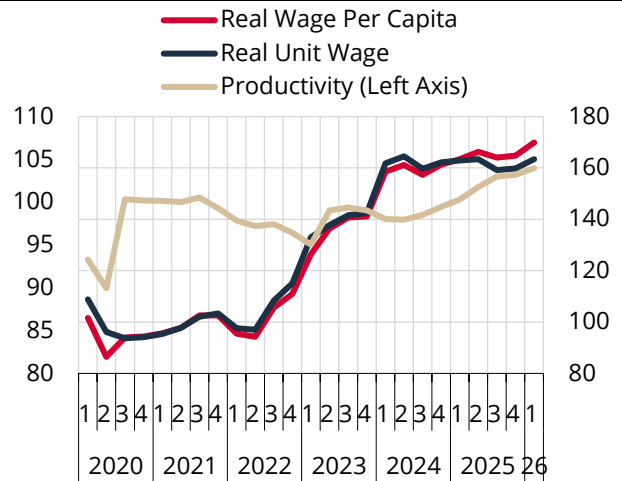
The annual rate of increase in non-farm nominal wages was 37.0% in the first quarter of 2026 (Chart 2.3.19). In the first quarter, partial labor productivity in the non-farm sector (non-farm value added/non-farm employment) improved. As real wages per capita grew faster than productivity, real unit wages in the non-farm sector (real wage per capita/productivity) increased in the first quarter (Chart 2.3.20).

Chart 2.3.19: Net Minimum Wage and Non-Farm Wage Index (Nominal, Annual % Change)



Source: CBRT, Ministry of Labor and Social Security, TURKSTAT.

Chart 2.3.20: Non-Farm Partial Labor Productivity*, Real Wage Per Capita, and Real Unit Wage (Seasonally Adjusted, 2021=100)**



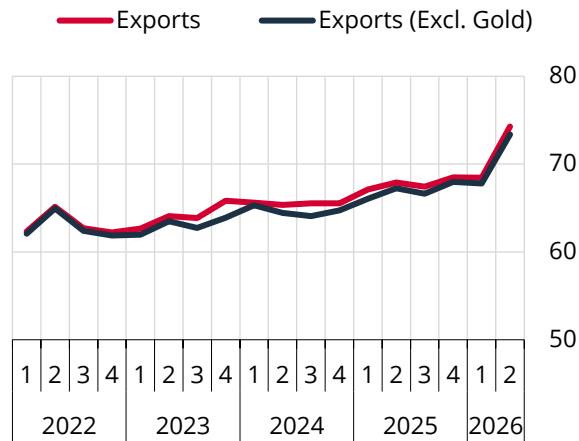
Source: CBRT, TURKSTAT.

* Non-farm value added/non-farm employment.

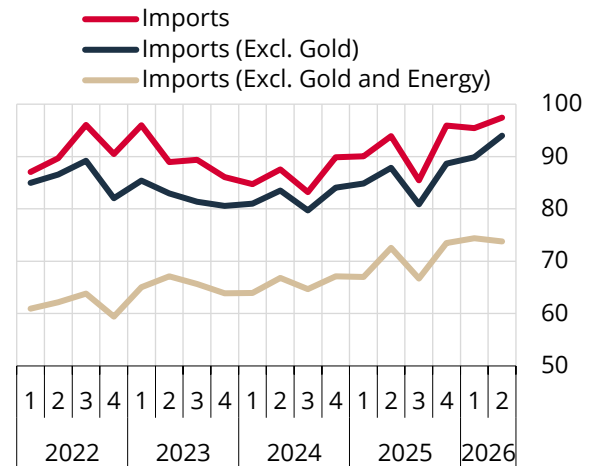
** Real wage per capita/productivity. Deflated by CPI.

Foreign Trade and Balance of Payments Developments

The seasonally and calendar-adjusted foreign trade deficit narrowed in the second quarter of 2026. In the second quarter, external demand remained stronger than in the previous quarter despite the adverse effects of the war, and the upward trend in export prices continued. Over the same period, seasonally and calendar-adjusted exports rose markedly on a quarterly basis (Chart 2.3.21). The rise in exports was supported by a partial shift in demand toward Türkiye amid geopolitical developments and higher logistics costs. Base metals, other transport vehicles, petroleum products, chemicals, motor vehicles, food products, electrical equipment, machinery and equipment, other manufacturing, wearing apparel, and rubber and plastic products stood out among the groups that made notable positive contributions to quarterly export growth. Most of the remaining product groups also contributed positively to export growth. Meanwhile, seasonally and calendar-adjusted imports rose in the second quarter, driven by an increase in energy imports (Chart 2.3.22). During this period, elevated global energy prices driven by geopolitical developments continued to affect imports, with seasonally adjusted energy imports recording a marked quarterly increase. On the other hand, gold imports declined by approximately USD 2.2 billion quarter-on-quarter in the second quarter, reflecting the fall in global gold prices. By goods group, imports of investment and consumption goods decreased compared to the previous quarter, while intermediate goods imports increased. Energy imports contributed positively to intermediate goods imports, whereas gold imports had a negative contribution. Intermediate goods imports excluding gold and energy remained broadly flat. Against this backdrop, both the seasonally and calendar-adjusted foreign trade deficit and the foreign trade deficit excluding gold and energy narrowed. Meanwhile, provisional foreign trade data for July point to declines in both exports and imports in seasonally and calendar-adjusted terms. As the decline in imports was more pronounced, the foreign trade deficit was below the second-quarter average. Although lower energy prices in June and July relative to the second-quarter average suggest a more favorable trajectory for the foreign trade deficit, volatility in energy prices continues to pose upside risks.

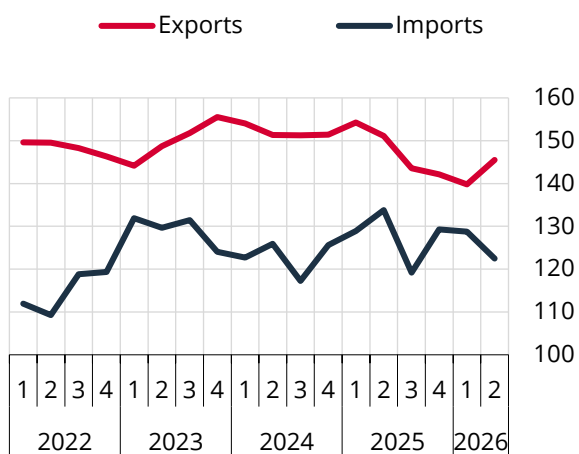
Chart 2.3.21: Exports (Seasonally and Calendar-Adjusted, USD Billion)

Source: CBRT, TURKSTAT.

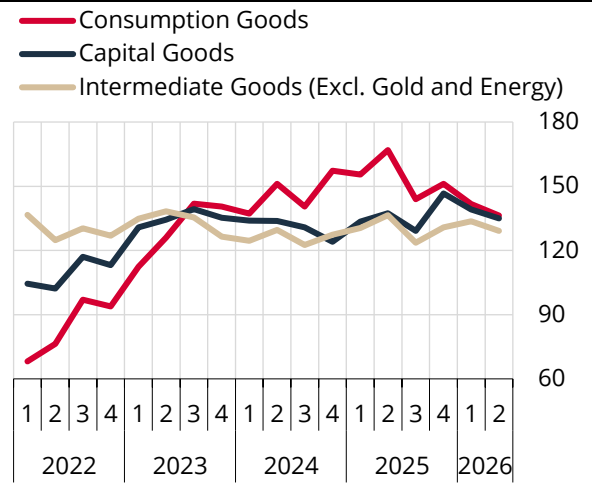
Chart 2.3.22: Imports (Seasonally and Calendar-Adjusted, USD Billion)

Source: CBRT, TURKSTAT.

In the second quarter, the export quantity index rose, while the import quantity index fell, and the terms of trade recorded a slight decline. Seasonally and calendar-adjusted foreign trade quantity indices pointed to an increase in exports and a decline in imports in the second quarter (Chart 2.3.23). An analysis of changes in export volumes by sector reveals that computer-electronics and furniture made negative contributions, while all other sectors contributed positively. There was a decline in import volumes across all three goods groups—consumption goods, investment goods, and intermediate goods. Import volumes of intermediate goods excluding gold and energy also fell (Chart 2.3.24). Meanwhile, export and import prices both rose in the second quarter compared to the previous quarter, but the larger increase in import prices led to a deterioration in the terms of trade (Chart 2.3.25). Accordingly, developments in foreign trade unit value indices in favor of import prices had a negative effect on the foreign trade balance during the reporting period.

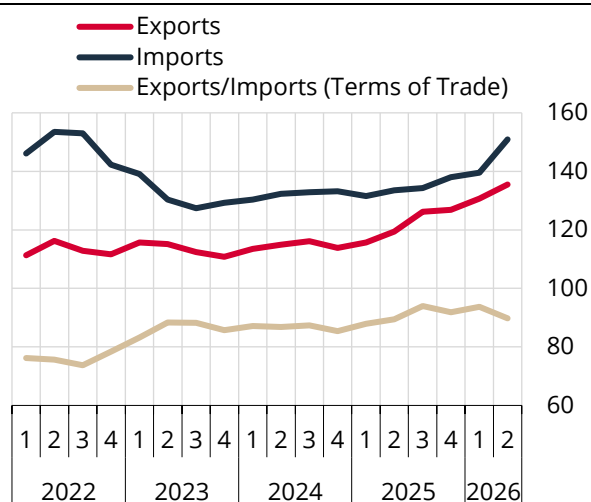
Chart 2.3.23: Foreign Trade Quantity Indices (Seasonally Adjusted, 2015=100)

Source: TURKSTAT.

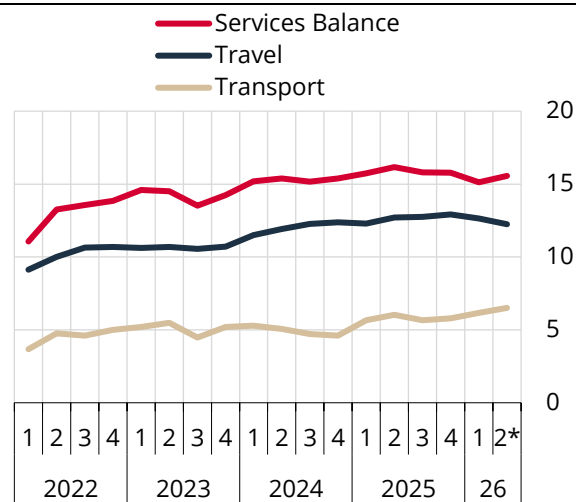
Chart 2.3.24: Import Quantity Indices by Goods Groups (Seasonally Adjusted, 2015=100)

Source: CBRT, TURKSTAT.

The services balance surplus increased in the second quarter. Among the main drivers of the services balance, net transport revenues went up in seasonally adjusted terms in the second quarter, while travel revenues declined (Chart 2.3.26). Meanwhile, net revenues from services sectors other than transport and travel recorded a modest increase during the period. In the second quarter, the total number of visitors edged down due to war-related effects, resulting in a slight decrease in net travel revenues. Meanwhile, preliminary data for July imply that the number of overnight stays by foreign visitors is higher than that in the same period of the previous year, pointing to a more favorable outlook compared to the second quarter (Zoom-In 2.3).

Chart 2.3.25: Foreign Trade Unit Value Indices
(2015=100)

Source: CBRT, TURKSTAT.

Chart 2.3.26: Services Balance (Seasonally and Calendar-Adjusted, USD Billion)

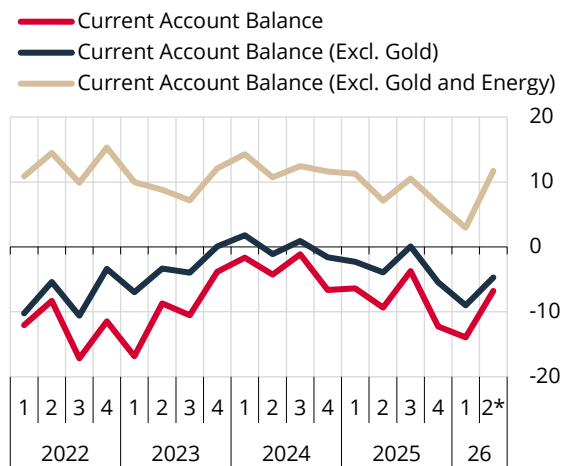
Source: CBRT.

* As of May.

The seasonally and calendar-adjusted current account deficit decreased in the second quarter

(Chart 2.3.27). As a result of the decline in the foreign trade deficit in the second quarter of the year, the balance of payments-defined foreign trade deficit narrowed and affected the current account balance positively. In this period, the current account deficit also narrowed due to an improvement in the services balance. While the transportation balance increased, the travel balance declined, and the primary income balance rose due to the increase in net investment income. The main factor driving upward risks to the current account deficit in the coming period is a potential increase in net energy imports due to high and volatile energy prices, although these prices declined somewhat compared to the previous reporting period. Risks posed by tariffs and protectionist measures implemented under global trade policies are coupled with risks stemming from the secondary effects of geopolitical developments that constrain economic activity. In addition, developments in global trade policies are aggravating competitive pressure in our export markets. Given the recent decline in gold prices and the resulting drop in gold imports, the positive contribution to the current account balance through this channel may continue. While the ongoing tightness in financial conditions further limits domestic demand-driven pressures on imports, the real appreciation of the Turkish lira maintains its supportive role for import demand. In this context, upside risks to the current account deficit have decreased somewhat compared to the previous reporting period. Nevertheless, the current account deficit to GDP is expected to remain below its long-term average in 2026.

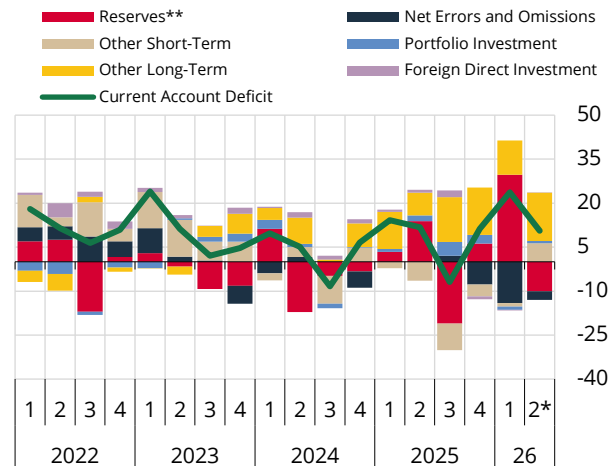
Chart 2.3.27: Current Account Balance
(Seasonally and Calendar-Adjusted, USD Billion)



Source: CBRT.

* Average values for April and May were used for June.

Chart 2.3.28: Financing of the Current Account Deficit (USD Billion)



Source: CBRT.

* Average values for April and May were used for June.

** Denotes the CBRT reserves plus cash and deposits at banks abroad. A negative value indicates an increase in reserves.

The need for external financing decreased and capital inflows increased in the second quarter. Amid the fall in the current account deficit, the need for external financing dropped in the second quarter (Chart 2.3.28). Following the capital outflows in March amid geopolitical developments, there was a net capital inflow in the second quarter, and these inflows mainly occurred through the other investments item. Against this backdrop, the negative balance of the net errors and omissions item declined significantly in the second quarter compared to the first quarter, and official reserves increased. Data for July point to continued portfolio inflows, particularly into GDDS, despite recent geopolitical developments.

Public Finance Developments

In the first half of 2026, the central government budget ran a deficit of TRY 942.8 billion and a primary surplus of TRY 521.4 billion. In this period, the Ministry of Treasury and Finance was a net borrower in both domestic and external markets to meet its funding need. In June 2026, the central government debt stock-to-GDP ratio is estimated to be 20.8%, while the ratios of domestic and external debt stocks to GDP are estimated to be 12.5% and 8.3%, respectively.

In the January-June period of 2026, revenues increased by 39.1% and expenditures by 32.7% compared to the same period of the previous year. In the first six months of the year, the coverage ratio of tax revenues to non-interest expenditures was 91.1%. Current transfers and personnel expenses, which account for a significant share of non-interest expenditures, saw annual growth rates of 24.0% and 42.7%, respectively, during this period. Under the category of assignment expenses, TRY 94.5 billion was transferred to Electricity Generation Inc. and TRY 83.0 billion to BOTAŞ, while under the lending category, TRY 50.2 billion was transferred to the Turkish Railways and TRY 26.3 billion to Türkiye Şeker Fabrikaları A.Ş. These amounts stand out among the transfers made to public enterprises in the first half of 2026. Income tax, which has contributed the most to the increase in tax revenues in recent months, recorded a year-over-year increase of 54.6% during the January-June period. The growth rates for VAT collected on domestic sales and VAT collected on imports, both of which are consumption-sensitive items, were 38.4% and 32.7%, respectively, compared to the first half of 2025. On the other hand, due to the impact of the sliding scale system currently in effect, collections from petroleum and natural gas products fell by 34.1% compared to the same period of the last year, and the annual increase in excise tax was limited to 8.5%.

As of June 2026, the budget deficit-to-GDP ratio is estimated to be 2.5%. The end-2026 target announced in the Medium-Term Program is 3.5%. The ratios of 12-month cumulative budget revenues, primary expenditures and interest to GDP are estimated to be 20.8%, 19.9%, and 3.3%, respectively.

In July 2026, the Treasury cash balance posted a deficit of TRY 395.7 billion. Thus, in the first seven months of the year, the Treasury cash balance posted a deficit of TRY 1,435.9 billion. The 12-month cumulative cash deficit-to-GDP ratio is estimated to be 3.0% as of July.

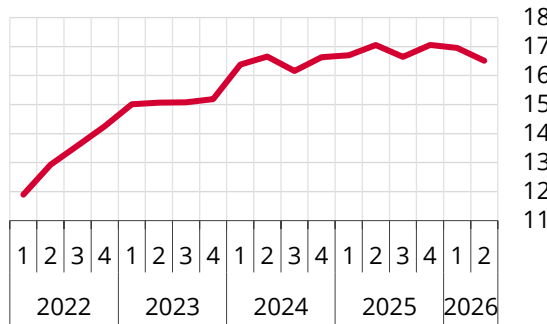
Zoom-In 2.3

Recent Developments in Tourism

The impact of the US-Israel war with Iran on travel revenues in the second quarter remained limited, despite a decline in the number of foreign visitors. In the first quarter of 2026, the seasonally adjusted total number of visitors edged down on a quarterly basis (Chart 1). Following the geopolitical developments that began in late February, the decline in the number of visitors to Türkiye from the Middle East and North Africa (MENA) region—which includes Iran—contributed to the fall in the first quarter. The European region, on the other hand, helped mitigate the decline (Chart 2).

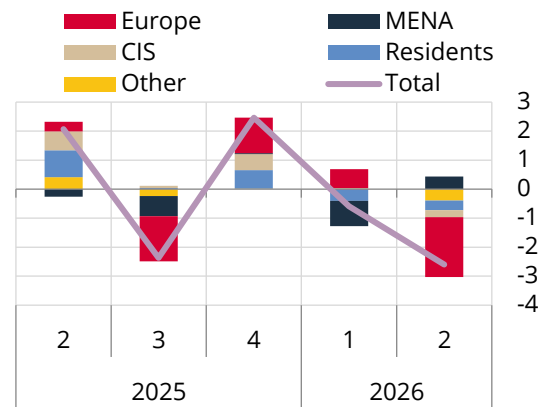
In the second quarter of the year, partly due to concerns stemming from geopolitical developments, the number of visitors from Europe, with the UK and Germany in the lead, declined compared to the previous quarter. On the other hand, the MENA region made a positive contribution in the second quarter, partly due to the recovery in the number of visitors from Iran following the temporary ceasefire.

Chart 1: Number of Visitors
(Seasonally Adjusted, Million People)



Source: CBRT, TURKSTAT.

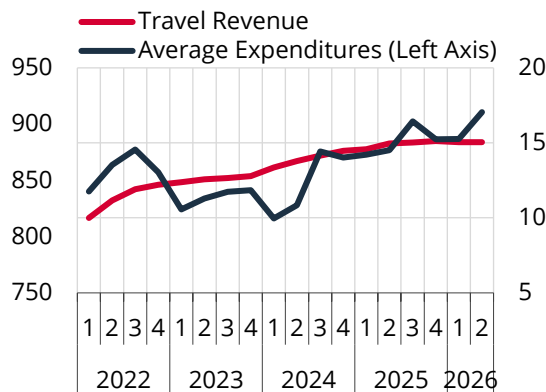
Chart 2: Quarterly Contributions to the Change in the Number of Visitors
(Seasonally Adjusted, % Points)



Source: CBRT, TURKSTAT.

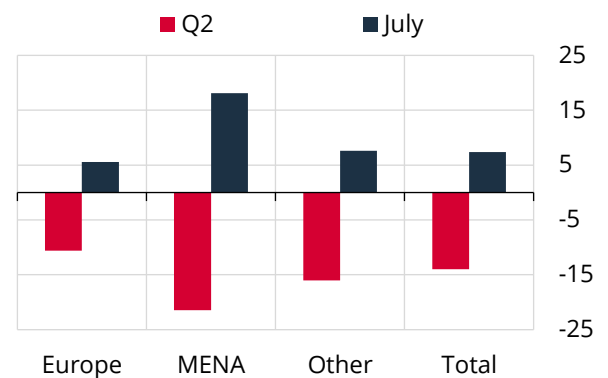
Despite the decline in total number of visitors, increases in average spending, mostly in the second quarter of the year, allowed travel revenue to remain flat and limited the negative impact of geopolitical developments on revenues (Chart 3). Meanwhile, leading data for July implied that the number of overnights of foreign visitors was above that of the last year, pointing to a more favorable outlook compared to the second quarter (Chart 4).

Chart 3: Travel Revenue and Average Expenditures
(USD Billion)



Source: CBRT, TURKSTAT.

Chart 4: The Number of Overnights of Foreign Visitors
(Annual % Change)

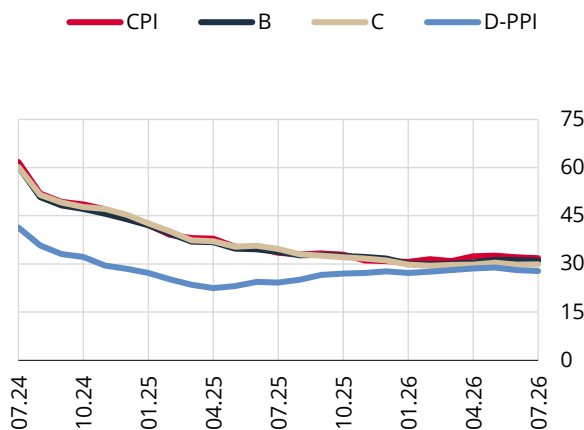


Source: General Directorate of Security.

2.4 Inflation

Consumer inflation stood at 31.75% in July, above the forecast presented in the previous Report. Despite weakening somewhat compared to the previous period, supply-side pressures slowed the disinflation process. International commodity prices posted a decline led by the energy group but assumed an upward trend again due to heightened geopolitical uncertainties in July. Meanwhile, agricultural commodity prices followed a volatile course and increased over the previous reporting period due to supply concerns, geopolitical developments, and adverse weather conditions. Geopolitical developments and the regulation on the phase-out strategy from the sliding-scale system aggravated the upward pressures on inflation. The Global Supply Chain Pressure Index remained above its historical average despite falling over the past two months. While container and dry cargo indices remained elevated, delivery times began to normalize starting from May. The stable course of the Turkish lira throughout the reporting period stood as a factor containing cost pressures. Second-quarter data suggest that demand conditions remain supportive of disinflation. Producer price increases showed a slowdown tendency over the last two months, and annual D-PPI inflation reached 27.83% (Chart 2.4.1). In the scope of administered prices, the revision in medical examination copayments under the SSI's Communiqué on Healthcare Implementation added approximately 0.22 points to monthly consumer inflation in July, while the increases in the Turkish Medical Association's maximum price tariffs were monitored for their impact on healthcare services prices. An evaluation of developments in consumer prices by subcategories over the past three months reveals that energy and alcohol-tobacco-gold groups had a downward effect on annual consumer inflation, while other subgroups had an upward effect (Chart 2.4.2).

Chart 2.4.1: CPI, D-PPI, B Index, and C Index*
(Annual % Change)

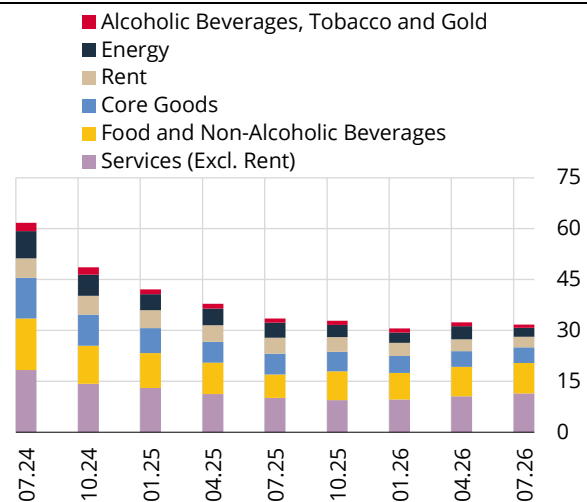


Source: TURKSTAT.

* B index: CPI excluding unprocessed food, energy, alcoholic beverages, tobacco, and gold.

C index: CPI excluding food and non-alcoholic beverages, energy, alcohol-tobacco, and gold.

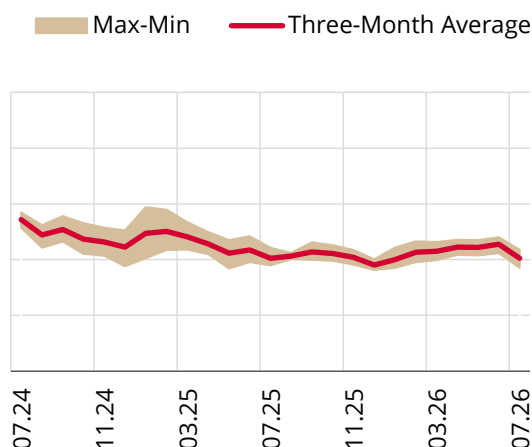
Chart 2.4.2: Contributions to Annual CPI
(% Points)



Source: CBRT, TURKSTAT.

The underlying trend of inflation decreased in July. The quarterly average of the indicators monitored for the underlying inflation increased from 2.2% in April to 2.3% in the second quarter, before falling to 2.0% as of July (Chart 2.4.3). The trend inflation indicator, which focuses on longer-term movements and excludes one-off effects by design, remained flat during the reporting period (Chart 2.4.4). The underlying trend indicators pointed to some deceleration in the disinflation process in the second quarter due to geopolitical developments.

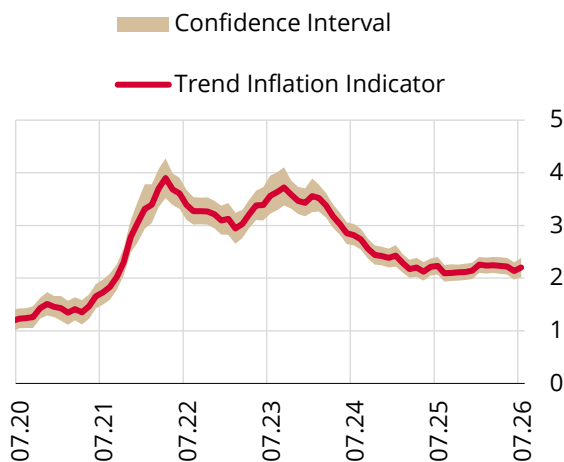
Chart 2.4.3: Indicators of Underlying Inflation* (Seasonally Adjusted, Monthly % Change, Three-Month Average)



Source: CBRT, TURKSTAT.

* Quarterly average of seasonally adjusted B and C indices, SATRIM, Median, excluding volatile items (VOLX) and dynamic factor model (DFM) indicators. The shaded area represents the range between the maximum and minimum values.

Chart 2.4.4: Multivariate Trend Inflation Indicator* (Monthly, %)



Source: CBRT, TURKSTAT.

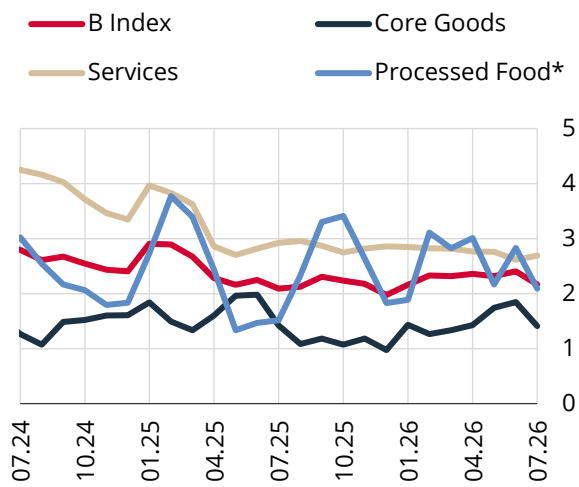
* Obtained by applying the Stock and Watson (2016) MUCSVO model to monthly price changes of processed food and seasonally adjusted core goods and services.

Among the components of the B index, price increases decelerated in the processed food group and remained relatively flat in the services and core goods groups during the current reporting period

(Chart 2.4.5). Although price increases lost pace in the reporting period, prices of milk and dairy products as well as non-alcoholic beverages, tea in particular, had a discernible impact on the processed food group. Annual core goods inflation at 16.82% remained significantly below headline inflation as of July (Chart 2.4.6). The three-month inflation in durable consumption goods rose somewhat over the previous reporting period. While quarterly inflation slowed slightly in furniture, the acceleration in white goods prices was driven by the cost hikes stemming from raw materials, energy and freight. On the other hand, the rise in automobile prices remained relatively moderate due to weak demand, intense competition and SCT brackets. In the other core goods group, price increases became pronounced in personal care and household cleaning products that are strongly linked to petrochemical products. In the current reporting period, price increases in the services group remained relatively high (Chart 2.4.5). Transport services continued to stand out among subcategories. Displaying volatility amid geopolitical developments, fuel prices continued to affect passenger transport services negatively. During this period, bus fares were affected not only by fuel costs but also by demand related to the religious holiday. Domestic passenger transport by air was another subcategory notable for price hikes in the reporting period. Despite losing pace, price increases in communication services remained elevated due to mobile phone call and internet charges. In services, the transport and communication groups slowed the disinflation process in the first seven months of the year, while cumulative price increases in rent, demand-sensitive restaurants-hotels, and education services affected by the regulatory change decelerated compared to the same period last year. In healthcare services, the medical examination copayment regulation under the SSI's Communiqué on Healthcare Implementation made in July and the increases in the Turkish Medical Association's tariffs were influential in prices.

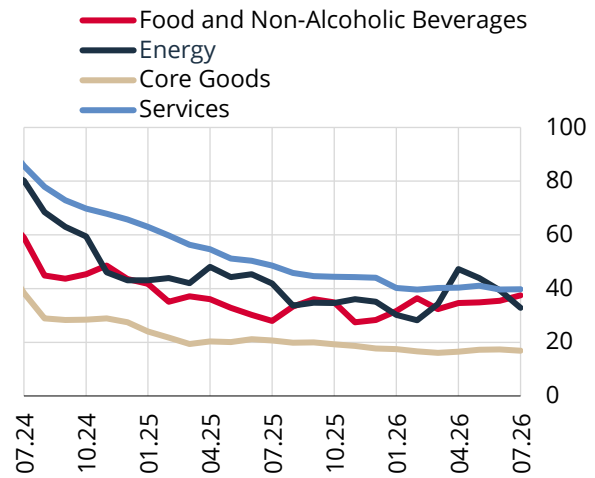
Chart 2.4.5: B Index and Subgroups

(Seasonally Adjusted, Monthly % Change, Three-Month Average)



Source: CBRT, TURKSTAT.

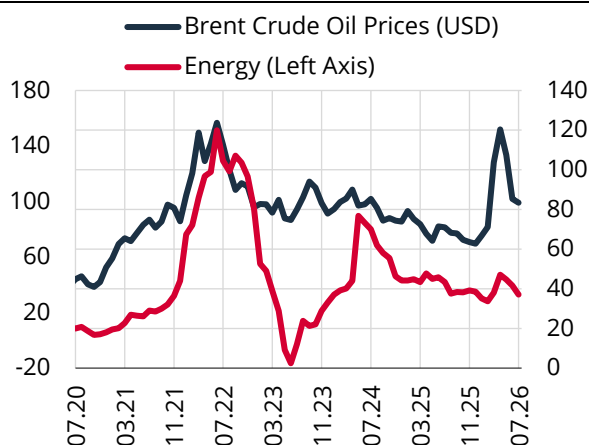
* Processed food is not adjusted for seasonality due to the absence of statistically significant seasonal effects.

Chart 2.4.6: CPI and Main Expenditure Groups (Annual % Change)

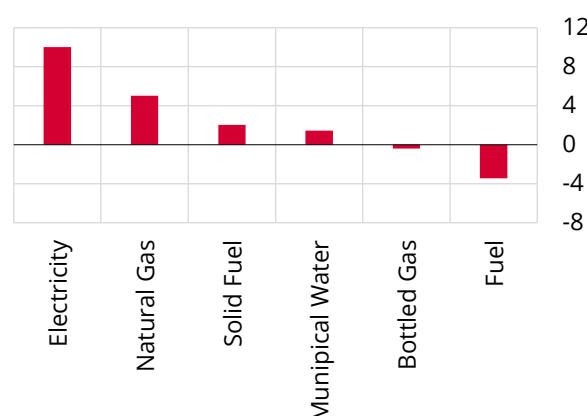
Source: CBRT, TURKSTAT.

Energy prices declined in May and June on the back of the fall in international oil prices, but rose again in July amid geopolitical developments. Nevertheless, annual energy inflation receded to 32.86% in July due to the base effect (Chart 2.4.6). Movements in global energy prices triggered by geopolitical developments are reflected on inflation through fuel, electricity and natural gas (Zoom-In 2.4). Having declined in May and June, the Brent crude oil price increased in July as the ceasefire between the US and Iran was broken (Chart 2.4.7), while a similar picture was seen also in TTF natural gas prices. Domestic energy prices, which fell in May -June, picked up again in July. The rise in crude oil prices and the gradual phase-out strategy from the sliding-scale system pushed fuel prices up in July. While electricity prices rose in July driven by the Last Resort Supply Tariff (SKTT) as a result of Market Clearing Price (MCP) and Renewable Energy Support Mechanism (YEKDEM) developments, the rise in natural gas prices became pronounced in May due to the tiered tariff system (Chart 2.4.8). The mild course of the currency basket continued to limit cost pressures.

In the current reporting period, while quarterly inflation decelerated in the food and non-alcoholic beverages group, annual inflation was above headline inflation at 37.5% (Chart 2.4.6). Food price increases, which accelerated at the beginning of the year, followed a mild course in May and June but strengthened again in July. While the normalization in vegetable prices in May and June played a determining role in this development, vegetable prices increased again in July due to losses of crop yield in some products and problems related to the transition from greenhouse to open-field cultivation. The import tax rate was reduced for onions, the supply of which was scarce, and potato prices rose at a higher rate than the historical average due to the fall in their crop yield. The rise in potato prices is expected to lose pace in the coming months as new crops reach the market. Prices of coffee-tea, milk and dairy products, and meat products increased above their historical averages in the reporting period, whereas meat prices dropped due in part to weakening demand after the Eid-al-Adha. Despite the expected improvement in agricultural production in 2026, food inflation has trended upward since March (Box 2.4).

Chart 2.4.7: Energy Prices (Annual % Change)

Source: Bloomberg, CBRT, TURKSTAT.

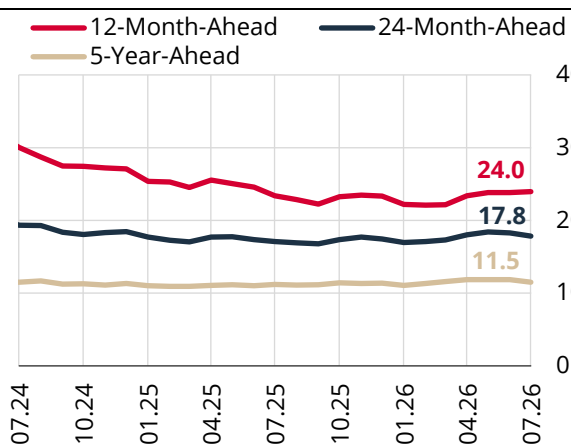
Chart 2.4.8: Prices of Energy Subitems
(% Change in the Last Three Months)

Source: CBRT, TURKSTAT.

Over the reporting period, the alcoholic beverages, tobacco, and gold products group continued to make a downward contribution to consumer inflation. Having remained almost flat in May, prices in this group went up in June. This was driven by the rise in prices of tobacco products stemming from price adjustments by producer firms, while prices of alcoholic beverages also posted a slight increase. The effects of the lump-sum tax increase were seen on alcohol products in July. The lump-sum tax on tobacco products was raised while the ad valorem SCT was reduced, the upward effect of which was observed on inflation in August. During the reporting period, the group's annual inflation declined by 3.2 points over the previous period to 28.9% in July amid the fall in gold prices.

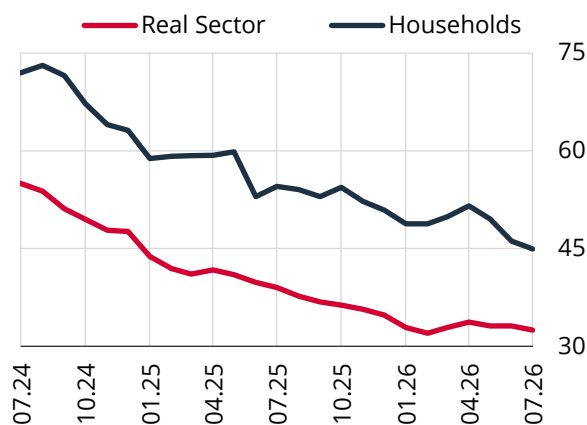
Drivers of Inflation

Inflation expectations continue to hover above the inflation forecast and the interim target. The results of the July Survey of Market Participants show a 0.6-point increase in the 12-month-ahead inflation expectations compared to the previous Inflation Report, while the 24-month-ahead and five-year ahead inflation expectations decreased by 0.2 and 0.4 points, respectively (Chart 2.4.9). Inflation expectations for end-2026 and end-2027 remained above the forecasts and interim targets, standing at 29.2% and 21.5%, respectively. In the current reporting period, while a modest decline was observed in the real sector's 12-month-ahead inflation expectations, the decline in households' expectations was more pronounced (Chart 2.4.10).

Chart 2.4.9: Consumer Inflation Expectations from the CBRT Survey of Market Participants* (Annual, %)

Source: CBRT.

* Results of the CBRT Survey of Market Participants that polls real and financial sector professionals.

Chart 2.4.10: Consumer Inflation Expectations of the Real Sector and Households* (12-Month-Ahead, Annual, %)

Source: CBRT, TURKSTAT.

* Inflation expectations of the real sector and households are obtained from sectoral inflation expectations.

There was a partial improvement in pricing behavior in July. An analysis of seasonally adjusted data using three-month moving averages reveals that the diffusion index for the goods sector fell somewhat despite displaying volatility due to geopolitical developments, while the diffusion index for the services sector remained elevated (Chart 2.4.11). Distributions of monthly price changes for items at the five-digit level suggest that the distribution for July 2026 recorded some extreme values due in part to time-dependent price-setting behavior, but the consensus nevertheless strengthened further around median inflation (Chart 2.4.12).

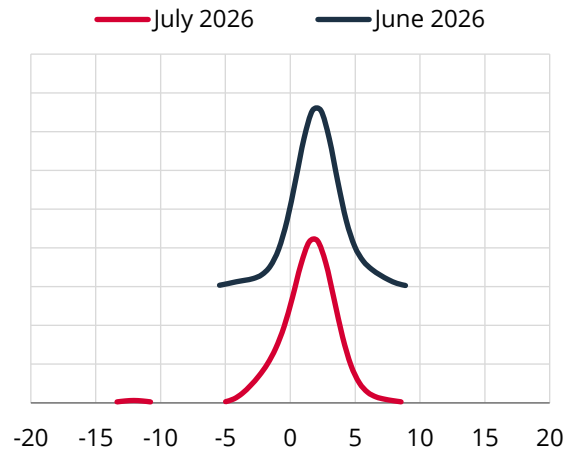
Chart 2.4.11: Diffusion Indices* (Seasonally Adjusted, Three-Month Moving Average)



Source: CBRT, TURKSTAT.

* Calculated as the ratio of the difference between the number of items with price increases and the number of items with price decreases to the total number of items.

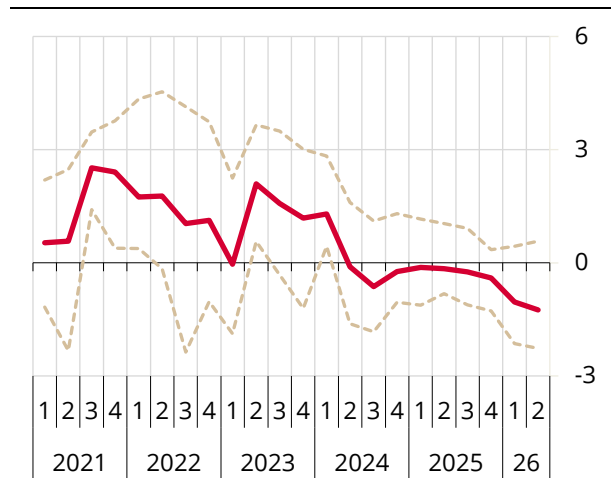
Chart 2.4.12: Distribution of Monthly CPI Inflation* (Seasonally Adjusted, Five-Digit)



Source: CBRT, TURKSTAT.

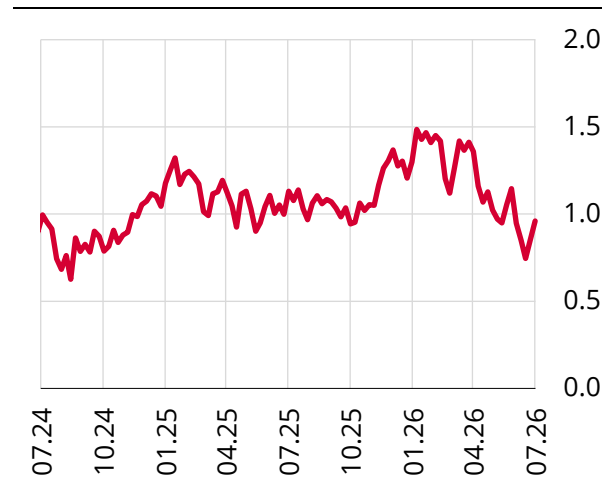
* CPI excluding fresh fruits and vegetables, energy, alcoholic beverages, and tobacco.

In the second quarter of the year, economic activity is estimated to stay below its potential, and the output gap is estimated to be in the disinflationary range (Chart 2.4.13). In this period, industrial production increased on a quarterly basis, whereas services production decreased slightly (Chart 2.3.7), and the capacity utilization rate remained flat (Chart 2.3.8). Meanwhile, demand indicators also remained weak, and the retail sales volume index excluding gold remained below its trend (Chart 2.3.4), while card spending declined (Chart 2.3.6). During the current reporting period, real credit use (adjusted for the exchange rate) followed a volatile course (Chart 2.4.14). Against this background, demand conditions are assessed to have further underpinned the disinflation process.

Chart 2.4.13: Output Gap* (%)

Source: CBRT.

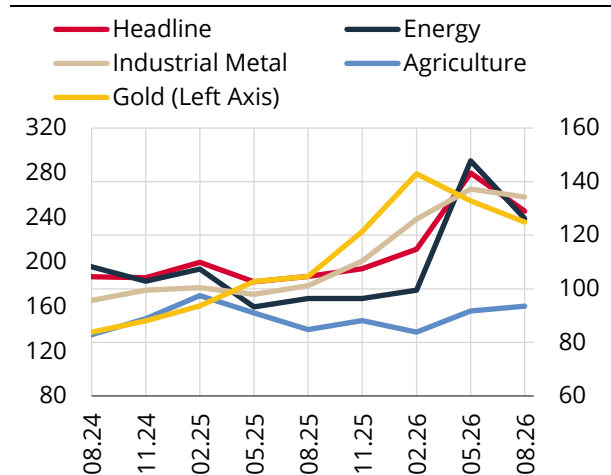
* The average of output gap indicators, calculated by using different methods, is displayed with minimum and maximum values.

Chart 2.4.14: Total Credit Change*
(13-Week Average, FX-Adjusted, Real, Standardized Value)

Source: CBRT.

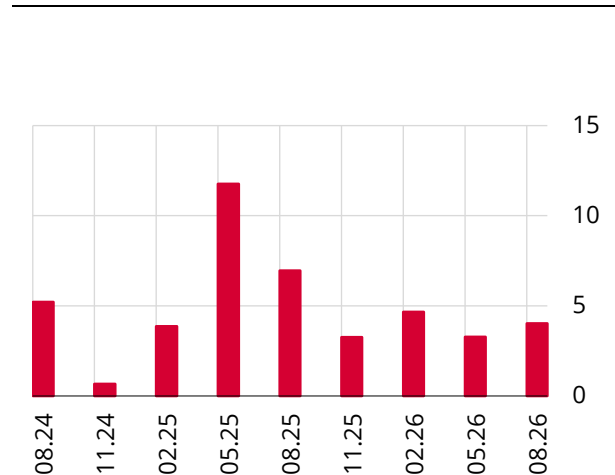
* FX-adjusted weekly credit changes are deflated by the CPI. The 13-week average is taken after weekly real changes are standardized. The mean and standard deviations of the series are calculated based on the 2006–2019 period.

While commodity prices dropped with energy and gold in the lead during the current reporting period, agricultural commodity prices edged up. Energy prices, which rose significantly in the previous reporting period due to geopolitical developments, decreased somewhat during the current reporting period. Meanwhile, gold and industrial metal prices also declined (Chart 2.4.15). Having receded in June, commodity prices picked up again in the last two months due to escalating geopolitical tensions. The depreciation in the Turkish lira has been moderate over the past three months (Chart 2.4.16).

Chart 2.4.15: Commodity Price Indices*
(2021=100)

Source: Goldman Sachs.

* As of August 11.

Chart 2.4.16: Currency Basket*
(Three-Month % Change)

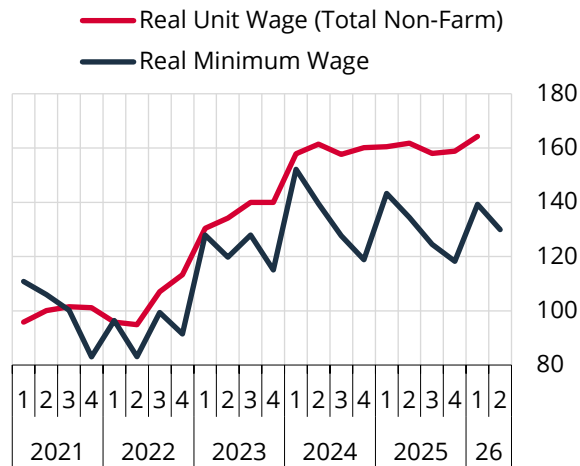
Source: CBRT.

* As of August 11. The US dollar and euro have equal weights. Percentage changes were calculated based on the average values for the respective months.

The underlying producer inflation fell somewhat compared to the previous reporting period. Real unit wages, which rose in the first quarter of 2026, are projected to decline in the second quarter as nominal wage increases lose pace (Chart 2.4.17). Regarding transportation costs, container rates continued to go up, while dry cargo transport costs maintained their elevated course though they posted some decline. During this period, the Global Supply Chain Pressure Index remained above its historical average despite falling over the past two months. Commodity prices went down compared to the previous reporting period, predominantly

driven by the decrease in energy commodity and gold prices. The stable course of exchange rates was a factor curbing cost pressures. Manufacturing PMI data pointed to a partial improvement in delivery times. Against this background, the producer inflation and underlying manufacturing inflation weakened in this period (Chart 2.4.18).

Chart 2.4.17: Real Unit Wage per Hour Worked* (Value Added, 2021=100, Seasonally Adjusted) **and Real Minimum Wage**** (2021=100)

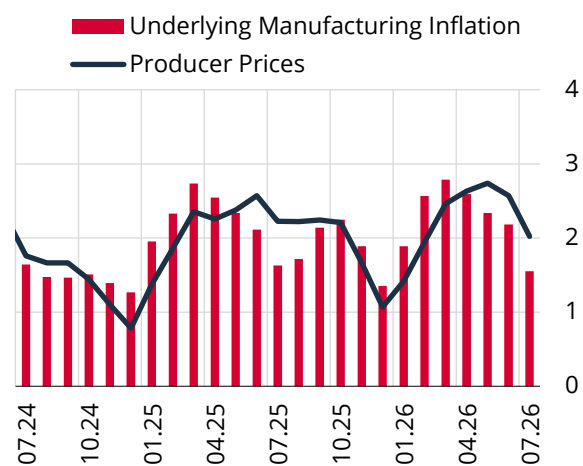


Source: CBRT, TURKSTAT.

* Deflated by seasonally adjusted CPI. Real wage per hour worked/productivity.

** Net minimum wage is deflated by seasonally adjusted CPI.

Chart 2.4.18: Underlying Manufacturing Inflation* and Headline Producer Prices (Monthly % Change, Three-Month Moving Average)



Source: CBRT, TURKSTAT.

* Manufacturing industry producer prices excluding base metals and petroleum.

In the current reporting period, geopolitical developments as well as administered prices and tax adjustments had a prominent impact on headline inflation (Zoom-In 2.5). In July, the medical examination copayment regulation under the SSI's Communiqué on Healthcare Implementation and the increases in the Turkish Medical Association's tariffs had their impact on healthcare services prices. During this period, electricity prices rose due to the SKTT as a result of market swap rate and YEKDEM developments. While price increases in fuel were contained as the lump-sum tax revision implied by the six-month rise in D-PPI was not implemented in July, this effect was partly offset by the re-increasing crude oil prices and the phasing out of the sliding scale system. Prices of alcoholic beverages were up in July due in part to the lump-sum tax revision. On the other hand, the lump-sum tax on tobacco products was raised while the ad valorem SCT was reduced, the upward effect of which was observed on inflation in August. The recently announced additional customs duties are expected to have a very limited impact on consumer inflation due to the small share of included goods in total imports and consumption.

Zoom-In 2.4

Recent Developments and Outlook in Energy Prices

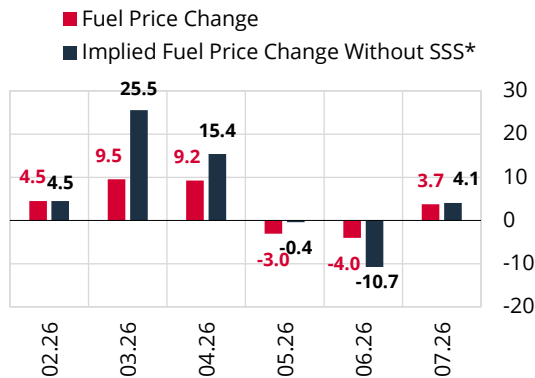
Energy prices have recently exhibited high volatility due to geopolitical developments as well as changes in domestic pricing mechanisms. Regulations regarding the sliding scale tariff for fuel prices, developments in the MCP and the YEKDEM in the electricity sector, and the tiered pricing system for natural gas have been the primary factors shaping the recent trend in energy prices. This zoom-in analysis evaluates the effects of these mechanisms on the inflation outlook in general terms and, specifically, on energy inflation.

The Sliding Scale System

To limit the pass-through from fuel price hikes amid geopolitical tensions to consumer inflation, the sliding scale tariff was put into effect in March 2026.¹ This mechanism limits the rise in fuel prices by offsetting a certain portion of increases in international oil prices through a flat-rate SCT. Counterfactual scenario analyses indicate that the measure considerably limited the cumulative increase in fuel prices during the February–July 2026 period. In fact, fuel prices rose by 15.5%, but if the sliding scale tariff had not been in effect in this period, the rise would have reached 34% (Charts 1 and 2). This picture reveals that this mechanism significantly curbs the direct pass-through from energy price shocks to consumer inflation.

Chart 1: Fuel Prices*

(Monthly % Change)

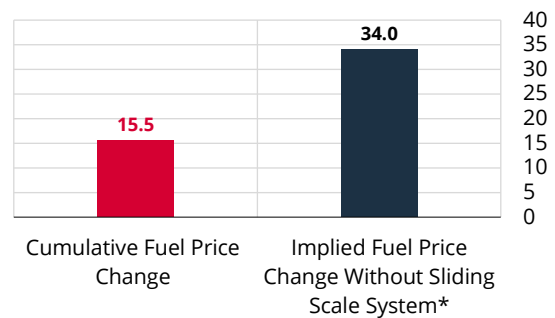


Source: CBRT, EMRA, TURKSTAT.

* The implied fuel price scenario was calculated based on EMRA product prices (listed under the “CIF MED” heading in Platts European Market Scan).

Chart 2: Cumulative Price Changes in Fuel*

(February–July 2026, %)



Source: CBRT, EMRA, TURKSTAT.

* The implied fuel price scenario was calculated based on EMRA product prices (listed under the “CIF MED” heading in Platts European Market Scan).

Amendments have been introduced to the sliding scale system. With the change introduced on 3 July, the SCT coverage rate of the increase in refinery prices was reduced from 75% at the start of the system to 50% in July and to 25% for the August–September period; it was also announced that the system would be abolished with effect from October 1, 2026. It was also stated that, in the event of a reduction in refinery prices, the SCT would increase by an amount equal to the full extent of the reduction. Subsequently, a second amendment was introduced to revise the specific duties on diesel.

¹ Gökcü, M. & Sezer, E. (2026). The Sliding Scale System for Fuel Prices and Its Potential Impact on Inflation. CBRT Blog.

The impact of fuel prices on inflation is not limited to the energy sector. Developments in fuel prices, which are passed on to prices via the cost channel in many sectors (transport, logistics and food in particular) can also shape expectations and pricing behavior.

Recent geopolitical developments indicate that risks stemming from energy prices persist. In this context, the latest regulation on diesel has managed to limit the upside pressure on inflation to some extent. It is important for the course of disinflation that fuel prices follow a moderate trend in the coming period.

Effects of the Tiered Price Scheme on Electricity and Natural Gas

The recent volatility in electricity and natural gas tariffs has been driven not only by international energy prices but also by the transition to tiered pricing schemes. On the electricity front, bills covered by the SKTT based on consumption, and on the natural gas front, prices set according to tiers that vary depending on seasonal and regional consumption patterns, are shaping energy inflation.

Under the SKTT for residential electricity tariffs, prices are set based on the costs of the MCP and YEKDEM.² The course of the MCP is shaped by the composition of electricity generation: it falls during periods of heavy rainfall as hydroelectric generation increases, while it rises again during the summer months. YEKDEM, on the other hand, is the unit cost arising from incentives paid to power stations generating electricity from renewable energy sources and is included in the calculation based on the estimated cost projected by EMRA for the relevant month. In this context, while the increase resulting from the national tariff change in April had a more limited impact on the relevant period due to the fall in the MCP, in July, the rise in the MCP caused electricity prices to rise by 5.8%. The increase in the YEKDEM cost, as updated by EMRA, also contributed to this rise in July (Table 1).

Table 1: Monthly Changes in Electricity Prices (%)

	April 2026	May 2026	June 2026	July 2026
Driven by Raised National Tariff	21.0	2.3	-	-
Realization	16.9	1.3	2.7	5.8

Source: CBRT, TURKSTAT.

With the introduction of a tiered pricing system for natural gas tariffs, as is the case with electricity, monthly prices may be affected not only by changes in tariffs but also by tier weights that vary according to seasonal and regional consumption patterns. Consequently, even if tariff prices remain fixed, the average natural gas price may increase or decrease on a monthly basis. Indeed, in July, the natural gas price fell by 1.6% due to a reduction in the weighting of the second tier. However, the impact of these fluctuations on annual inflation is expected to remain relatively limited.

Increases in global energy prices amid the geopolitical turmoil have spillovers into inflation through fuel, electricity, and natural gas channels. In the electricity sector, the MCP and YEKDEM mechanisms, and in the natural gas sector, tiered weightings linked to seasonal and regional consumption variations, can cause volatility in monthly prices. In the fuel sector, the sliding scale mechanism has significantly limited the pass-through of energy price shocks to consumer inflation. The future course of this mechanism is of critical importance in terms of spillovers of international oil prices into inflation.

² CBRT (2025). Last Resort Supply Tariff and Its Implications for Residential Electricity Prices. Inflation Report 2025-II, Box 2.3.

Zoom-In 2.5

The Role of Administered Prices on Inflation

Administered prices are prices for goods and services that are set directly by the public sector or public-sector affiliated institutions (municipalities, public enterprises, etc.) and/or are subject to public approval. These prices are mostly determined in accordance with the pricing policies of the relevant bodies, rather than by the balance of supply and demand in the market.

Public pricing behavior plays a significant role in Türkiye's inflation dynamics. TURKSTAT publishes the F-index (CPI excluding administered prices) in accordance with the Eurostat definition, excluding items covered by the AP; and the weight of these items in the CPI basket is 15% as of 2026 (Table 1). On the other hand, there are also items not included in the Eurostat definition that nevertheless have their prices set or administered by public authorities or councils and committees in which the public sector has a considerable role. For example, raw milk prices are set by the National Dairy Council, in which the Ministry of Agriculture and Forestry plays an active role, while publicly announced agricultural purchase prices can also influence the prices of many food items in the CPI. Indeed, when these items are also taken into account, the weight of products whose prices are directly or indirectly set by the government in the CPI basket reaches 25%.³ This share, corresponding to approximately one-fourth of the consumer basket, indicates that government pricing plays a significant role in shaping inflation in Türkiye.

Table 1: Products under the Administered Price Category of TURKSTAT

Item	Weight in CPI (%)	July 2026 Inflation (Annual % Change)
Food (Weight: 1.06%)		37.52
Tea and Other Plant Products for Infusion	0.71	47.0
Sugar	0.35	14.1
Energy (Weight: 3.01%)		32.86
Natural Gas and Related Subscription Fees	1.08	59.8
Water (Tap Water)	0.66	24.2
Electricity	1.27	26.4
Health (Weight: 1.81%)		49.24
Outpatient and Rehabilitative Services	0.40	114.4
Medicines, Vaccines and Other Pharmaceutical Preparations	0.69	40.2
Inpatient Curative and Rehabilitative Services	0.72	35.9
Transport Services (Weight: 5.49%)		50.09
Passenger Transport by Sea and Inland Waterway	0.05	31.3
Passenger Transport by Taxi and Hired Car with Driver	0.66	52.8
Passenger Transport by Subway and Tram	0.02	44.9
Passenger Transport by Bus and Coach	3.65	46.2
School Buses	0.79	40.2
Tolls	0.03	29.1
Driving Courses, Roadworthiness Tests, Emissions Control Tests etc.	0.19	24.5
Passenger Transport by Railway	0.10	19.2
Education (Weight: 0.11%)		44.18
Accommodation Services of Boarding Schools, Universities and Other Educational Establishments	0.11	41.8
Other (Weight: 3.73%)		
Cigarettes	2.16	29.6
Religious Services (Hajj)	0.40	32.7
Compulsory Earthquake Insurance (DASK)	0.05	32.3
Other Unclassified Services (Notary etc.)	0.77	20.5
Private Transport Insurance (Traffic Insurance)	0.35	15.3
Total Weight (%)	15.2	

Source: TURKSTAT.

³ Other sectors include bread and cereals, red meat products, coal, air travel, mobile and internet communications, and education (higher education, pre-school, primary, and secondary education). When processed food products indirectly affected by raw milk and red meat are also included, the scope of sectors that administered prices can influence expands even further.

The public sector's impact on inflation is not limited to the administered prices but can also be visible through tax adjustments. The lump-sum SCT amounts for items such as alcoholic beverages, tobacco products, bottled gas, and fuel are revised every six months based on the D-PPI. However, these revisions may be limited or additional tax increases may be imposed by presidential decrees. Furthermore, while the prices of various public services, such as notary fees and fixed-rate fees, are revised annually based on the revaluation rate, occasional adjustments to SCT tranches and rates for automobiles can lead to significant fluctuations in the prices of the relevant items. Thus, when assessing the government's impact on inflation, it is important to consider not only administered prices but also items subject to frequent tax adjustments. A comparison of annual inflation in the CPI and F indices reveals that the F index, which stood at 30.37%, remained below the headline inflation (31.75%) in July.

Why are Administered Price Adjustments Important?

The direct effect of administered prices on consumer inflation can be apparent during certain periods. For example, subsequent to geopolitical developments, residential natural gas tariffs shifted to a tiered pricing system—similar to the one applied to electricity—where households with higher consumption pay more. As a result of this measure, residential natural gas prices rose by 45.10% in April, adding 0.5 percentage points to consumer inflation. Furthermore, adjustments to administered prices carry significance beyond their direct effects due to their high visibility. Public pricing behavior serves as a signal of the support provided by public authorities to the disinflation process.

In addition to direct effects, administered prices has indirect effects on inflation through three main channels. The first such channel is production costs. Since energy products such as fuel, electricity, and natural gas serve as inputs for many sectors of the economy, changes in prices or taxes on these items are reflected in the production costs of other goods and services across the index. For example, the effect of a rise in the SCT on fuel on inflation will not be limited to the equal of the multiplication of the price change and the index weight. It will also indirectly raise consumer inflation passing on to the costs of numerous goods and services, with transportation in the lead.

The second channel of indirect effects is through expectations. A decline in the predictability of monetary policy adjustments and an increase in their volatility can weigh on inflation uncertainty, thereby adversely affecting pricing behavior and making it more difficult to manage expectations.

Thirdly, administered prices can reinforce inflation inertia through indexation on past inflation. For example, public sector price hikes or lump-sum tax raises based on the revaluation rate – calculated according to past increases in the D-PPI – as well as the strong indexation practices in private education services, can amplify the spread of inflation shocks, resulting in a weakening of the monetary policy transmission mechanism.

In sum, the course of administered prices is significant in terms of disinflation dynamics, given its impact across a broad range of the consumer basket. In this context, the impact of public sector pricing behavior on inflation can be classified into three main categories: (i) the course of administered prices increases relative to headline consumer inflation, (ii) the predictability and volatility of price adjustments, and (iii) indexation behavior (e.g. indexation to past inflation). Improvements in these areas will support the disinflation process, contributing to price stability and the effectiveness of macroeconomic policies in turn.

Box 2.1

The Effect of Monetary Policy on Card Spending

Card spending is among the key indicators that make it possible to monitor the current course of domestic demand, thanks to its high-frequency nature and broad coverage. However, since total card spending combines different types of consumption, it does not directly reveal the consumption components through which monetary tightness affects aggregate consumption. Drawing on the approach of Grigoli and Sandri (2022), which is based on heterogeneity across spending groups, this box classifies the 887 MCC (Merchant Category Code) sub-activity codes for card spending into discretionary and non-discretionary consumption, taking into account the ways spending can be postponed or not as consumers balance financial conditions with basic needs. Subsequently, the effects of an unanticipated monetary policy shock on these two spending groups are examined using the local projections (LP) method.

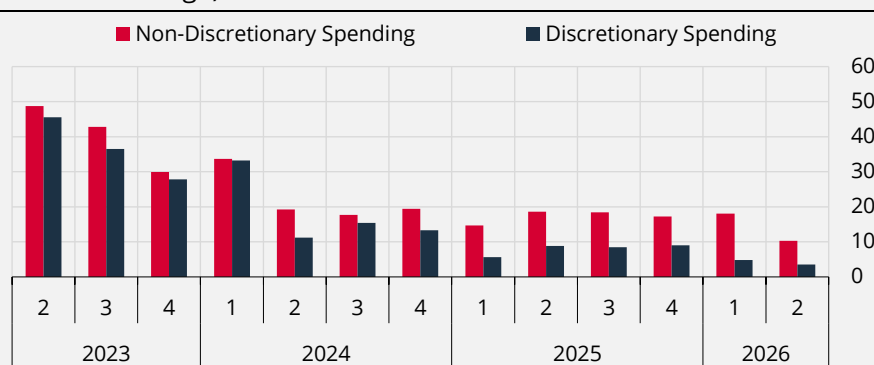
Classification of Spending

First, the 887 MCC sub-activity codes for domestic card spending are classified as discretionary and non-discretionary in line with judgmental assessments that take into account the basic-necessity character and the ability to postpone spending. Within this scope, 788 sub-codes are assigned to the discretionary group and 99 sub-codes to the non-discretionary group. Since the classification is applied at the level of detailed sub-activity codes rather than at the level of main spending items, a single main item may contain both discretionary and non-discretionary spending. Although discretionary spending covers a larger number of sub-items under this classification, the shares of the two groups in total card spending across the entire sample are close to each other.

Accommodation, airlines, travel, car rental, furniture and miscellaneous services are predominantly included in discretionary spending, whereas health, fuel, grocery, education and public payments are major non-discretionary expenditures. Main items such as clothing, electronics, telecommunications and services, on the other hand, may be represented in both groups depending on the nature of the underlying sub-activities.

Each sub-item is adjusted for price effects by the deflator of the main group to which it belongs. The sub-groups thus expressed in real terms are then aggregated into non-discretionary and discretionary spending groups. The growth rates of discretionary and non-discretionary card spending have declined gradually over the course of monetary tightening. The divergence between these growth rates has become particularly pronounced in the recent period (Chart 1). Since 2005, growth in spending on discretionary goods and services has been increasingly slower than that of non-discretionary spending, while in the second quarter of 2026 the annual increase in discretionary spending fell slightly. Non-discretionary spending, by contrast, displayed a more moderate slowdown and remained relatively resilient. This picture is consistent with households reducing discretionary consumption first as financing costs rise and credit conditions tighten. Accordingly, the marked loss of momentum observed in discretionary spending in the recent period points to a strengthening of the effect of tight monetary policy on private consumption demand and to the rebalancing in domestic demand taking place increasingly through discretionary consumption components.

Chart 1: Non-Discretionary and Discretionary Spending (Real, Annual % Change)



Source: CBRT, ICC.

Methodology and Dataset

The more pronounced slowdown observed in discretionary spending in Chart 1 suggests that monetary tightening operates primarily through discretionary consumption items. Nevertheless, the descriptive picture is not sufficient to disentangle the effect of monetary policy on card spending from the effects of other macroeconomic developments. To this end, the local projections model is used, which allows the dynamic effects of monetary policy shocks on spending to be traced directly at different horizons. Monetary policy shocks in the tightening direction are derived from the difference between the policy rate decision and the policy rate expectation reported in the Bloomberg survey. This makes it possible to test whether an unanticipated monetary tightening generates the contractionary effect predicted for discretionary spending, and how this effect evolves over time.

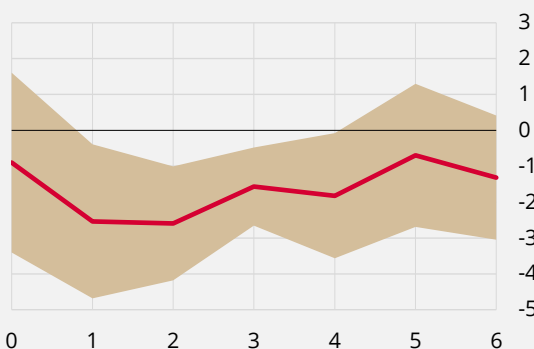
$$y_{t+h} = \alpha_h + \beta_h MP_t + \sum_{p=1}^6 \rho_{h,p} y_{t-p} + \sum_{p=1}^6 \gamma_{h,p} MP_{t-p} + \sum_k \sum_{p=1}^6 \delta_{h,k,p} X_{k,t-p} + \varepsilon_{t+h}$$

In the model, y_{t+h} denotes the change in real card spending h months after period t for each of the two spending groups, while MP_t denotes the unanticipated monetary policy shock. Two separate models are estimated, with the dependent variable being discretionary and non-discretionary spending, respectively. In these models, six lags of the monetary policy shock and of the control variables are used. The control variables include the industrial production index, total consumer loans, the real effective exchange rate and the CDS indicator. The estimation horizon extends from the month in which the shock occurs up to six months. The coefficient β_h shows the response generated in the relevant spending group h months later by a one-unit increase in the monetary policy shock, that is, by an unanticipated monetary policy tightening of 100 basis points. The confidence intervals of the coefficient estimates are computed using Newey-West standard errors that are robust to heteroskedasticity and autocorrelation. This estimation framework makes it possible to measure the dynamic effect of monetary tightening particularly on discretionary spending and to compare this response with that of non-discretionary spending.

Findings

The impulse-response functions show that an unanticipated monetary tightening of 100 basis points generates a rapid and pronounced contractionary effect on discretionary spending (Chart 2). The response of discretionary spending reaches approximately -2.5% in the first month following the shock, peaks at around -2.6% in the second month, and remains negative and statistically significant in the third and fourth months as well. From the fifth month onwards, the point estimates remain negative, but the confidence intervals include zero and statistical significance is lost. In non-discretionary spending, by contrast, the responses display a more limited and irregular pattern (Chart 3). Taken together, the findings indicate that the contractionary effect of monetary policy on consumption becomes evident particularly in discretionary spending that can be postponed. This result supports the divergence observed in the recent period in the chart in the previous section and shows that monetary tightness affects private consumption demand particularly through discretionary spending items.

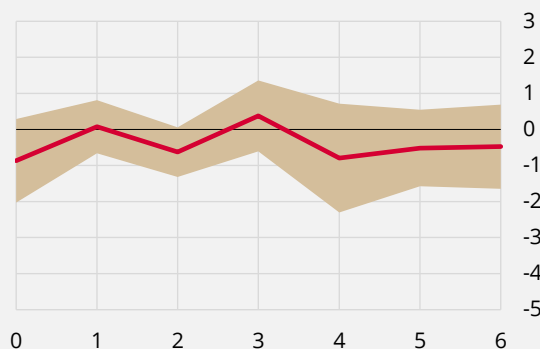
Chart 2: Effect of the Monetary Policy Shock on Discretionary Spending*
(Impulse Response Function, %)



Source: Authors' calculations.

* Shaded areas denote the 95% confidence interval.

Chart 3: Effect of the Monetary Policy Shock on Non-Discretionary Spending*
(Impulse Response Function, %)



Source: Authors' calculations.

* Shaded areas denote the 95% confidence interval.

Taken together, the findings suggest that the short-term effect of an unanticipated monetary tightening on card spending differs across spending groups, and that in the first months this effect is concentrated in discretionary spending, where the postponable character is more dominant. Non-discretionary spending, owing to its basic-necessity character, provides a comparison group that can be adjusted only to a more limited extent in the short term.

Conclusion

Classifying card spending into discretionary and non-discretionary makes it possible to monitor the effect of monetary policy on aggregate consumption from the perspective of the composition of consumption. Descriptive indicators show that real growth in discretionary spending has weakened markedly in the recent period, while the model findings show that an unanticipated monetary tightening reduces discretionary spending significantly and that this effect is larger than that on non-discretionary spending. In this framework, the results point to monetary policy transmission in private consumption operating primarily through discretionary items. The fact that the effect of monetary tightness on discretionary demand has become more pronounced is assessed as an important indicator in terms of limiting demand-driven price pressures and supporting the disinflation process.

References

Grigoli, F., & Sandri, D. (2022). Monetary Policy and Credit Card Spending. IMF Working Paper No. 22/255.

Box 2.2

Findings from Interviews with Firms

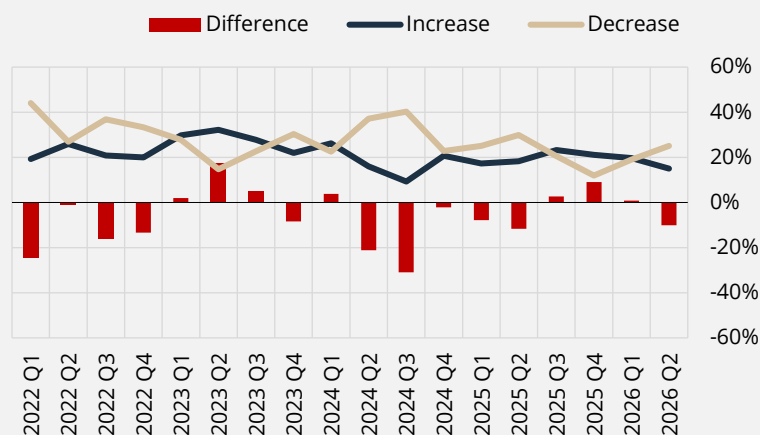
The CBRT holds face-to-face meetings with firms as part of the “**Economic Lens to the Real Sector (RESİM)**” study.¹ This box summarizes the findings from the interviews conducted in the April-June 2026 period and firm assessments regarding the impact of geopolitical developments on global supply chains.

In the second quarter of the year, the decrease in domestic sales balanced with a moderate increase in exports and economic activity remained flat.

Domestic sales weakened in the second quarter compared to the previous quarter.

Domestic sales recovered partially in May with the support of special days and the religious holiday following the weakening in April. However, June meetings indicated that this recovery was not permanent (Chart 1).

Chart 1: Demand Perception of Firms* (Compared to the Previous Quarter)



Source: CBRT RESİM.

* Demand perception shows the evaluation made in view of the current sales, orders and expectations of the firms. The difference series shows the difference between firms with a positive perception of demand and those with a negative perception of demand compared to the previous quarter and provides information on the prevalence of the change in demand perception, not the size of the change.

Tightening credit conditions, rising costs and increased uncertainty driven by geopolitical developments negatively affected domestic sales.

On the consumer side, while purchases are mainly driven by necessity, a tendency to wait for the right time to buy became prominent. In line with this, consumers favored model/product-based campaigns. As for firms, profitability pressure and imports tendency continue to negatively affect inter-firm trade.

¹ The main purpose of this study is to obtain information on periodic production, domestic and international sales, investments, employment, credit conditions, cost and price developments in a timely manner, to closely monitor economic activity and to improve the communication between the CBRT and real sector representatives through meetings with firms in different sectors. The findings obtained from the semi-structured interviews constitute a high quality and timely source of information for monetary policy decisions. Interviews are held with firms in the manufacturing industry and trade and services sectors within the framework of the sample created by considering their weight in the total economic activity at sectoral, regional and scale levels. The charts are produced by scoring the anecdotal information obtained from the firm interviews. This study includes evaluations and inferences based on interviews with firms and does not reflect the views of the CBRT. The information and findings obtained may differ from the official statistics, information and findings that will be published later.

Firms expect a gradual recovery in economic activity during the second half of the year if geopolitical risks do not escalate. While meetings held in July indicated domestic sales remain weak in the third quarter, firms expect sales might recover starting from the second half of August driven by the return to work and school.

Exports increased moderately compared to first quarter with support from geopolitical developments.

Longer delivery times from the Far East due to the closure of the Strait of Hormuz, rising costs and security concerns caused a shift in demand from European countries to Türkiye. Precautionary purchases and front-loaded demand for chemical products and base metals sectors, as well as supplier diversification in the apparel and textile sectors supported this demand. In addition to that, firms emphasized pressure of competitive pricing difficulties on exports and they saw the demand shift from the Far East as temporary. On the other hand, geopolitical developments boosted defense industry exports and defense-related foreign sales.

Demand recovered gradually in the second quarter as the impact of the war on tourism faded. However, persistent—albeit weakening—security concerns, a decline in flight numbers, and rising package tour prices caused business volumes of the sector to remain below seasonal levels. Representatives of the sector expect that demand might reach last year's level in the next quarter, due to the decrease in security concerns and price cuts.

Production increased slightly in the second quarter.

While activities of exporting firms backed production, activities of firms primarily operating in the domestic market slowed down due to demand conditions. Tight financial conditions, cash flow problems, competitive pressures, and the rising import tendency continued to be factors limiting production. Although geopolitical developments led to supply delays and additional freight costs, they supported production in some sectors.

The weakness in investment stance became more apparent in the second quarter of the year.

The prolongation of the US-Israel war on Iran increased uncertainties regarding domestic and foreign demand. High financing costs, rising production costs and excess capacity in some sectors were additional factors limiting investment.

The prioritization of managing working capital and cash flow continued to repress the appetite for fixed capital investments intended to create additional capacity. However, a limited number of firms with strong equity structure that manufacture value-added products maintained capacity expanding investments. Machinery and energy investments aimed at increasing efficiency and reducing costs came to the fore in current investment plans.

Growing uncertainty and weakening investment stance negatively affected employment plans.

While a significant share of firms anticipates to maintain their current employment level for the next six months, the number of firms planning to reduce employment increased slightly. Decreasing business volume and profit margins, high labor costs along with automation investments continue to depress employment. On the other hand, the fact that firms were already operating with a minimum workforce, and difficulties they faced in finding qualified employees limited employment losses.

The emphasis on the need for additional financing driven by working capital requirements continued to rise in the second quarter.

Cost developments played a prominent role in the increased focus on working capital. Driven by the war in the Middle East, cost increases related to energy and inputs persisted during the first two months of the quarter. However, regarding the potential end of the war in June, positive developments were observed to alleviate cost pressures.

In addition to cost developments, extended collection periods weakened firms' cash flows, thereby increasing the need for additional working capital. Tight credit conditions persisted throughout the quarter, with difficulties in accessing finance being more widely cited.

Terms of inter-firm trade tightened significantly compared to the first quarter, with increased emphasis on problems related to payment terms and cash flow. While the share of firms reporting difficulties in receivables' collection rose slightly on a quarterly basis, a cautious stance remained prevalent in commercial relationships.

Costs remained high due to the conflict in the Middle East. However, demand and competitive conditions, alongside the expectation of intensified negotiations by the end of the quarter, limited the upward trend in prices.

Firms continued to face cost pressures stemming from inputs, transportation, energy, and financing. Conversely, the increased likelihood of negotiations in June led to declines in the prices of oil, petrochemical products, commodities, positively influencing cost expectations for the coming period.

Rising costs led to more pronounced price increases in inter-firm trade during the second quarter. However, a moderation in expectations regarding future cost increases, combined with demand and competitive conditions, limited the upward trend in prices. The lagged effects of cost increases that have not been fully reflected in prices are expected to persist, becoming relatively more pronounced in the retail channel in the upcoming period.

RESİM Focus: Firm assessments regarding the impact of geopolitical developments on supply chains.

Prominent global supply risks are being examined by taking into account the geographical distribution of countries' production networks and their dependencies on inputs. In this context, the risks faced by countries are analyzed based on the potential for vulnerabilities in supply processes to lead to disruptions, delays, or cost increases in manufacturing flows.

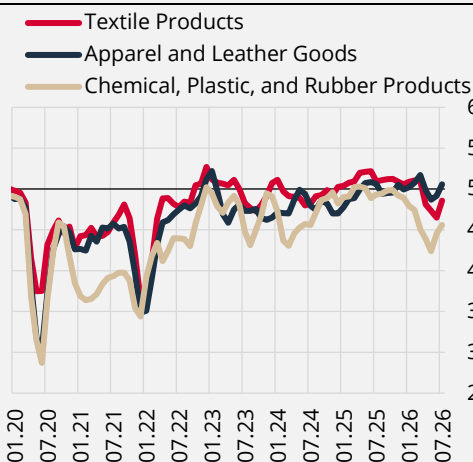
Prior to the pandemic, global supply risks were primarily addressed in terms of efficiency and cost optimization. Following the pandemic, however, these risks have taken on a more complex and multidimensional nature, driven by factors such as geopolitical tensions, strategic dependencies, energy security, and critical raw materials. As a recent example of geopolitical tensions, the US-Israel war on Iran has resulted in the following:

- Transits through the Strait of Hormuz were halted,
- Some transport and loading operations in the Gulf region were suspended,
- Passage through the Suez Canal and the Bab-el-Mandeb Strait was reduced, with traffic rerouted around the southern side of Africa (Cape of Good Hope),
- Insurance and other costs rose,

and these developments caused disruptions in supply processes for countries heavily dependent on input imports from the region.

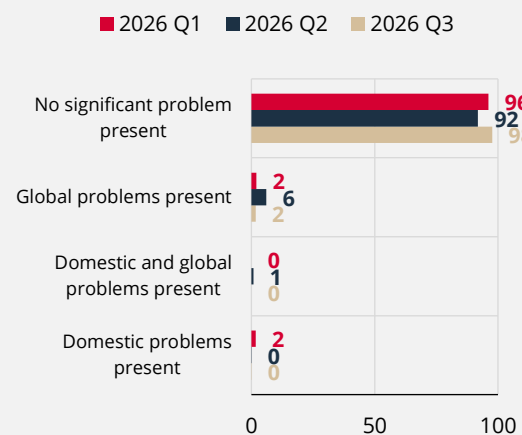
From the perspective of the Turkish economy, the repercussions of rising global supply risks can be observed through PMI data of the Istanbul Chamber of Industry and findings from the RESİM study. PMI data indicate that suppliers in some sectors experienced longer delivery times during the second quarter. This outlook is evident in textile products, apparel and leather goods, and the chemical, plastic and rubber products sectors (Chart 2).

Chart 2: Supplier Delivery Times (Three-Month Moving Average)



Source: Istanbul Chamber of Industry.

Chart 3: Firm Assessments Regarding Supply Processes (% Share)



Source: TCMB RESİM.

While the RESiM study yielded findings regarding war-related difficulties in certain sectors, no significant supply issues were observed across the majority of the manufacturing industry (Chart 3). According to the limited number of firms reporting problems in the second quarter, the impact originated primarily from logistical challenges and regional manufacturing disruptions, leading mainly to cost increases. An analysis of key sectoral developments reveals that while cost increases were more pronounced in chemicals and petrochemical-related sectors, difficulties in supplying imported inputs for the textile industry were largely mitigated by a shift toward the domestic market and the maintenance of adequate inventory levels by firms. Supply constraints eased in the third quarter.

In conclusion, global geopolitical developments led to cost increases and albeit to a limited extent prolonged supply processes in some sectors. However, RESiM findings indicate that these developments did not disrupt production within the manufacturing sector. The ability to utilize alternative supply channels and effective inventory management played a significant role in this outcome.

Box 2.3

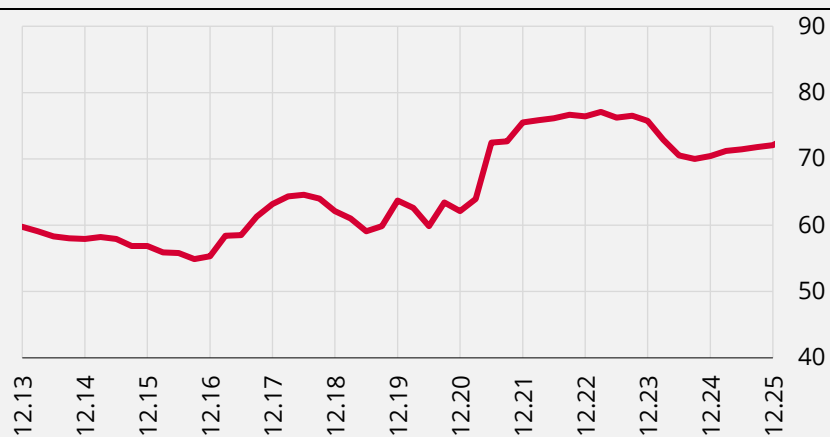
The Effect of Economic Activity on Firm Entry: Quantity or Quality?

Cyclical developments in economic activity affect firm dynamics through production, demand and employment channels, thereby influencing new firm entry. During periods of strong economic activity, favorable financial conditions also support a higher frequency of new investment and firm entry. When demand weakens and financial conditions tighten, however, firms may postpone the start of operations and creation of new employment. In addition to financing costs and demand conditions, firms' expectations regarding future demand and revenues also influence these decisions. On the other hand, firms that decide to enter under more challenging conditions may have higher initial productivity, operate with larger employment or have stronger equity positions. Therefore, assessing firm entry requires considering compositional characteristics alongside quantitative indicators. This box examines the characteristics of firms entering under different economic activity conditions and their employment and productivity in subsequent years. The findings are relevant for assessing the real-economy implications of the rebalancing in domestic demand observed alongside the monetary policy implemented during the disinflation process.

Firm Entry, Selection, and Persistence

The literature on firm entry suggests that entry is procyclical. Lee and Mukoyama (2015) show that more production plants enter during expansions and that the size and productivity distribution of entrants varies over the business cycle. Sedláček and Sterk (2017) and Moreira (2017) emphasize that macroeconomic conditions at entry may be associated with the subsequent employment and growth performance of firm cohorts. These studies suggest that entry conditions may affect not only the number of firms entering in a given year but also subsequent firm dynamics. Another strand of the literature argues that tighter financing conditions and higher entry thresholds under adverse conditions may lead to stronger selection. Ates and Saffie (2021) show that fewer firms enter following sudden stops, while financial selection may increase the average productivity of entrants. This mechanism requires tracking whether initial differences associated with entry conditions persist as firms age.

Chart 1: Number of Entering Firms (Four-Quarter Moving Average, Thousand)



Source: Authors' calculations, SSI.

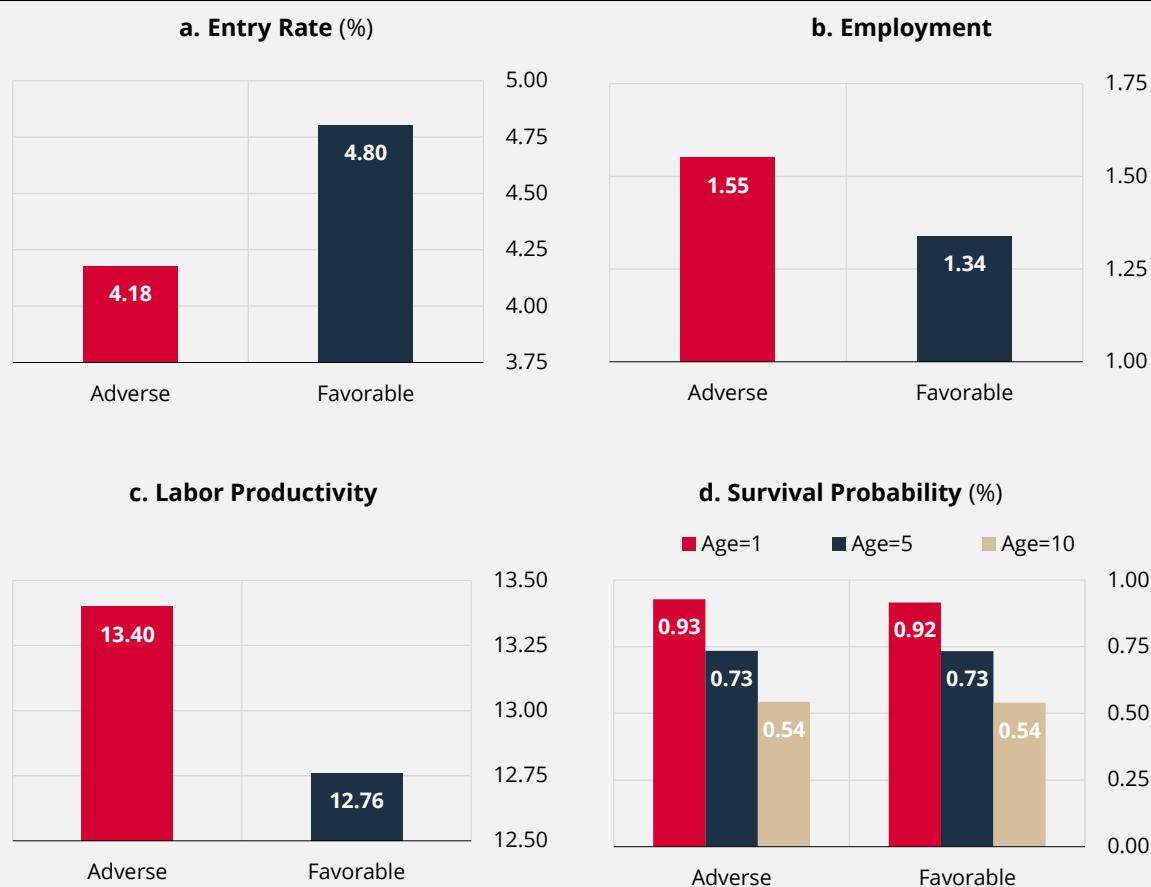
Data, Descriptive Findings, and Methodology

The analysis combines firm-level employment records with firms' annual balance-sheet data for the 2010-2024 period. In this study, firm entry is defined not as legal incorporation or the establishment of a legal identity, but as becoming economically active. Accordingly, the first period in which a firm employs a worker is used as the most directly measurable indicator of firm entry (Chart 1). The main

outcome variables are employment and labor productivity, measured as turnover per employee. Economic activity conditions are captured by a cyclical indicator defined as the deviation of real GDP from its HP-filtered trend.

Chart 2 provides an initial comparison of the characteristics at the entry of firms under different economic activity conditions. The firm entry rate is around 4.8% during periods of stronger economic activity and 4.18% during periods of weaker economic activity. By contrast, firms entering during weaker periods have higher average employment and productivity. These statistics are calculated for firms that remain active and continue to be observed in the dataset. If firms entering in different periods exhibit different survival patterns, the fact that their characteristics are no longer observed after exit may affect the observed outcomes. Survival probabilities, defined as the share of firms that remain observed after a given period relative to the total number of firms at entry, are estimated to be very similar across periods. Accordingly, the results on firm characteristics are not expected to be materially affected by differential survival. Overall, the evidence points to a quantity-quality distinction: more firms enter when economic activity is stronger, while the characteristics of entrants may differ across periods.

Chart 2: Firm Comparisons by Economic Activity Conditions*



Source: Authors' calculations.

* Employment is expressed as number of employees, while labor productivity is expressed in natural logarithms. For panels (a)-(c), the null hypothesis that the means for the two periods are equal is tested using a t-test. The p-values are 0.0001 for panel (a), 0.0014 for panel (b) and 0.0115 for panel (c). Survival probabilities are estimated using the Kaplan-Meier method.

The averages also reflect differences in firm age, time and firm characteristics across periods. Therefore, the relationship between economic conditions at entry and firm characteristics in subsequent periods is examined using an econometric model that controls for these differences.

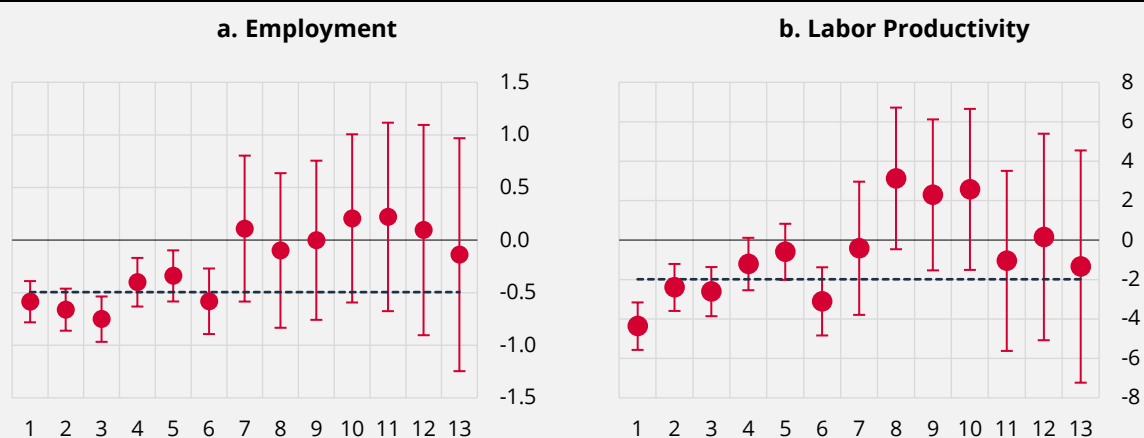
$$y_{i,a} = \alpha + \sum_{k=1}^{13} \beta_k [1 \{Firm\ Age = k\} \times Economic\ Activity_{Entry}] + \delta_a + \tau_t + \lambda_{s(i)} + \vartheta_{l(i)} + \varepsilon_{i,a} \quad (1)$$

In Equation (1), $y_{i,a}$ denotes the natural logarithm of observed employment or labor productivity of firm i at age a after entry. $Economic\ Activity_{Entry}$ is the real GDP gap at the time of firm entry. β_k coefficients capture the relationship between economic activity at entry and employment or labor productivity at firm age k . A positive coefficient indicates a positive association between entry conditions and firm characteristics, whereas a negative coefficient indicates an inverse relationship. Therefore, a positive β_k implies that firms entering under weaker economic activity conditions, i.e. when the real GDP gap is negative, have lower employment and productivity, while a negative coefficient implies higher employment and productivity. Firm-age fixed effects (δ_a) control for age-related changes after entry, while time fixed effects (τ_t) control for common time-varying shocks affecting all firms, such as demand and inflation. Sector fixed effects ($\lambda_{s(i)}$) and firm legal-status fixed effects ($\vartheta_{l(i)}$) control for NACE-4 sectoral differences and differences across firm legal forms, respectively. Thus, β_k coefficients estimate age-specific differences in firm characteristics across entrants facing different conditions, conditional on age, period, sector and legal status.

Results

The estimates of β_k in Equation (1), which capture age-specific differences, are presented in Chart 3. The negative coefficients estimated for employment indicate that firms entering when economic activity is weaker, i.e. when the real GDP gap is negative, have higher employment and that this size difference persists for the first six years after entry. The coefficients lose statistical significance from the seventh year onward, suggesting that entry conditions and early employment differences do not persist throughout firms' life cycles. Labor productivity estimates display a similar pattern during the early years of firms. The negative coefficients in the first three years indicate higher productivity among firms entering under weaker conditions. The differences weaken from the fourth year onward and are no longer statistically significant after the seventh year. Thus, the productivity advantage observed at early ages, similar to employment, persists over the medium term but does not translate into a permanent long-term advantage. It should be noted that estimates at older ages are conditional on firms that entered in earlier periods remaining active; differences in survival probabilities and exit rates across firm ages should therefore be considered when interpreting these results.

Chart 3: Estimated Coefficients by Firm Age and Entry Conditions*



Source: Authors' calculations.

* The chart presents the age-specific coefficients estimated from Equation (1). Dots show point estimates of β and vertical lines show 95% confidence intervals for each estimated β . The dashed horizontal line shows the coefficient on entry conditions when Equation (1) is estimated without age-specific interaction terms. The number of observations is 4,063,069. Negative coefficients indicate that firms entering when GDP is below its trend have higher employment and productivity at the respective age.

Conclusion

The data for firm entry show that fewer firms enter when economic activity is below trend and that the characteristics of entering firms may differ across periods. The findings support this observation, indicating that firms entering under weaker economic conditions have higher employment and productivity at entry. Firm-level differences across periods also persist in subsequent years, but gradually decline as firms age and do not become permanent. The results point to a selection channel in firm entry: alongside a lower number of entrants in the short term, firms that do enter may have stronger structural characteristics. Therefore, when assessing the real effects of the disinflation process, it is important to consider not only factors measurable along the quantity dimension, but also compositional characteristics related to quality.

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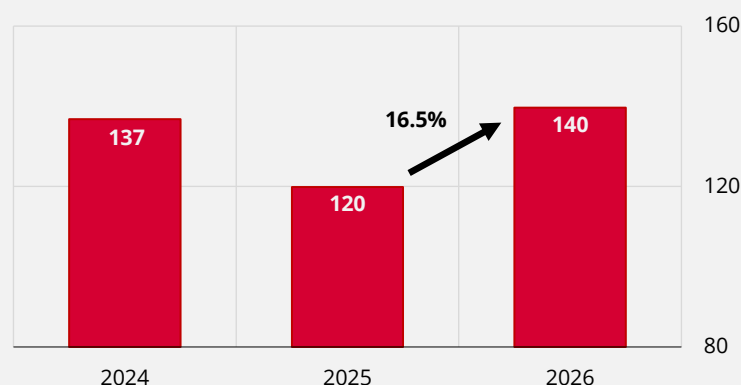
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Box 2.4

Supply and Cost Dynamics in Food Inflation

The first crop production estimates for 2026 indicate that production, which weakened last year due to drought and frost, is expected to recover this year (Chart 1). According to the initial estimates, cereal and fruit production—particularly wheat—is projected to increase markedly compared with the previous year, while output in some product groups is expected to exceed its 2024 levels. This outlook is expected to support domestic supply and alleviate price pressures in the relevant product groups.

Chart 1: Total Crop Production* (Million Tonnes)

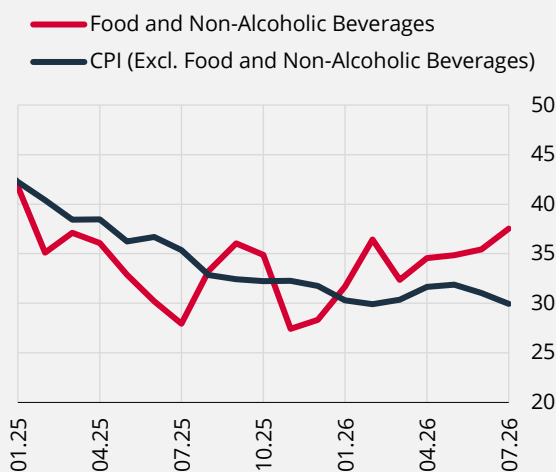


Source: Ministry of Agriculture and Forestry.

* First yield estimates for crop production in 2026.

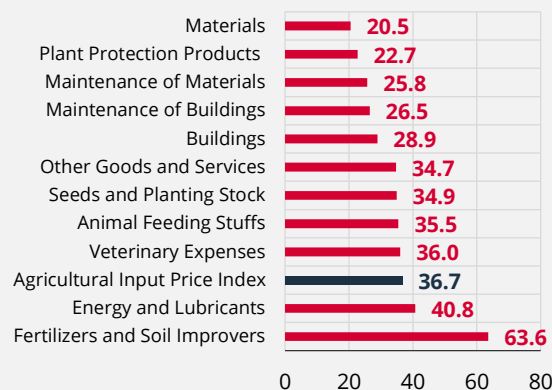
Despite the favorable supply-side outlook provided by this improvement in production, food inflation has been on an upward trend since March (Chart 2). Over the same period, developments in international commodity markets following geopolitical tensions exerted upward pressure on agricultural production costs. As of May, the annual rate of change in the agricultural input price index reached 36.7%, with cost increases particularly pronounced in subcomponents closely linked to the war, such as fertilizers, energy and animal feed (Chart 3). The volatile course of geopolitical developments has also caused agricultural input costs to be volatile.

Chart 2: Food and Non-Food Consumer Inflation (Annual % Change)



Source: CBRT, TURKSTAT.

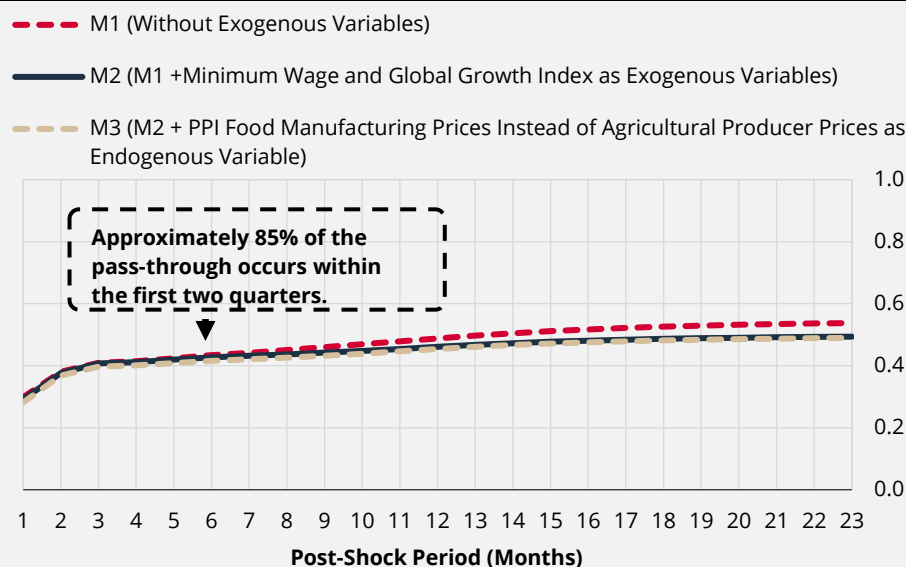
Chart 3: Agricultural Input Price Index by Subcategory (May 2026, Annual % Change)



Source: TURKSTAT.

To assess the impact of agricultural input costs on consumer food prices, a set of Bayesian Vector Autoregression (BVAR) models covering the period from January 2018 to May 2026 is estimated¹ (Chart 4). The findings indicate that the pass-through from agricultural input costs to consumer food prices is both sizeable and relatively rapid. A 10% shock to the agricultural input price index is estimated to increase consumer food inflation by around 5 percentage points in the long run. Given that the agricultural input price index measures changes in the average prices of goods and services purchased by farmers for agricultural production and therefore does not incorporate the effects of support schemes and subsidies, the estimated pass-through effect should be interpreted as an upper bound.

Chart 4: Median Cumulative Pass-Through from Agricultural Input Prices to CPI Food Prices* (%)



Source: Authors' calculations, CBRT.

* The results show the cumulative median impulse response functions obtained from BVAR models estimated over the January 2018–May 2026 period. Reflecting Türkiye's small open economy structure, a block exogeneity restriction is imposed such that international agricultural commodity prices are assumed not to be simultaneously affected by domestic variables. The models employ a Normal-Wishart prior distribution, while structural shocks are identified using a Cholesky decomposition. All variables other than the output gap are specified in log differences. Seasonally adjusted data are used for the agricultural input price index, agricultural products producer prices, and CPI food and non-alcoholic beverages prices.

M1 (Endogenous variables): FAO food prices (USD), exchange rate basket, agricultural input price index, output gap, agricultural products producer prices, and CPI food and non-alcoholic beverages prices. Exogenous variable: Constant.

M2 (Baseline model): In addition to M1, the minimum wage and export-weighted global growth are included as exogenous variables.

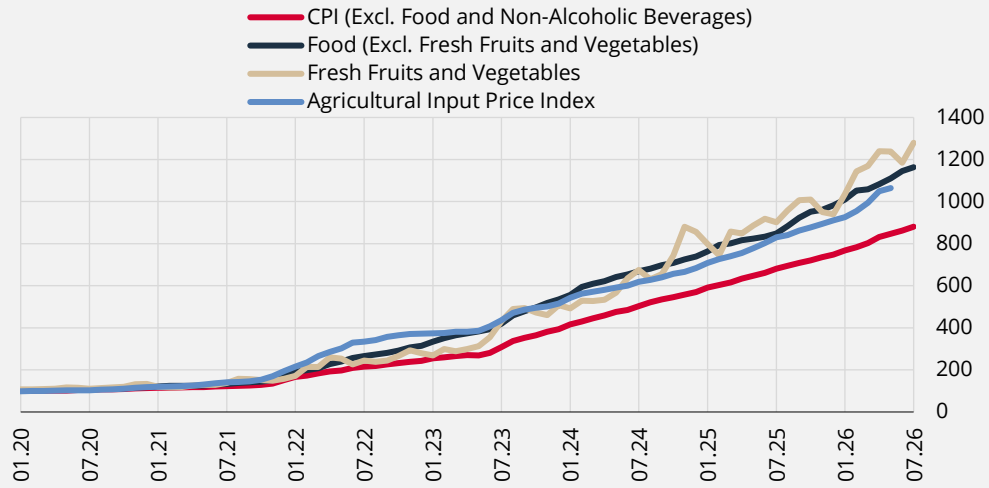
M3: Agricultural products producer prices in M2 are replaced by domestic producer prices in the food manufacturing industry.

Model findings indicate that agricultural input costs are an important determinant of food price dynamics, but are not sufficient on their own to explain the recent rise in food inflation. This assessment is also corroborated by historical decomposition analyses. As shown in Chart 5, from a longer-term perspective, increases in food prices tend to exceed increases in agricultural input prices.

¹ The model incorporates a range of variables, including the FAO food prices, the exchange rate basket, agricultural products producer prices, and domestic producer prices in the food manufacturing industry, and examines the dynamic effects of changes in agricultural input prices on consumer food prices through impulse response functions.

This points to the importance of other factors beyond the cost channel, including the timing of supply across products and regions, price formation along the producer-to-consumer chain, storage and distribution conditions, the degree of competition in the market, and pricing behavior.

Chart 5: Food Price Subcategories, CPI Excluding Food, and Agricultural Input Price Index (Seasonally Adjusted, Level, December 2019=100)



Source: CBRT, TURKSTAT.

From a longer-term perspective, food prices are observed to diverge from non-food prices, while fresh fruit and vegetable prices exhibit particularly high volatility (Chart 5). This suggests that structural factors other than agricultural input prices also play a role in food price dynamics and that addressing these factors is critical for the disinflation process. High and volatile food inflation poses challenges to the disinflation process through several channels. Firstly, given the weight of fresh fruit and vegetables in the consumer basket and the magnitude of their price movements, even short-lived shocks can generate pronounced fluctuations in both headline and food inflation. Secondly, frequent and sizeable price changes make it more difficult to extract signals regarding the underlying trend of inflation and increase the uncertainty surrounding the persistence of the decline in food inflation. More importantly, sharp price increases in staple food products, which households observe at a high frequency, can have a substantial impact on inflation perceptions and expectations. This may reinforce the sensitivity of pricing behavior to past inflation and encourage precautionary price adjustments, thereby limiting the extent to which the disinflation process can be reinforced through the expectations channel. Accordingly, it is of critical importance to address potential structural issues that may help explain this divergence in food prices and the volatility² in unprocessed food prices, such as productivity, market competition, deficiencies in information infrastructure, the efficiency of supply and logistics chains, and market structure. Establishing a more predictable price formation process that is more closely aligned with underlying supply fundamentals appears to be key not only for containing food inflation, but also for supporting the continuity and credibility of the disinflation process.

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² See Orman et al. (2010).

3. Medium-Term Projections

3.1 Current State, Short-Term Outlook and Assumptions

Changes in Key Forecast Variables

In the first quarter of 2026, demand conditions continued to contribute to the disinflation process, in line with the forecasts in the previous reporting period. According to the GDP data for the first quarter, while the contribution of private consumption and total investments to annual growth declined slightly compared to the previous quarter, domestic demand remained weak. Indicators for the second quarter of 2026 point to a continued moderate trend in economic activity and a more pronounced weakening in domestic demand. In line with the monetary policy stance, financial conditions remained tight, while the slowdown in credit growth strengthened the support provided by domestic demand conditions to the disinflation process. Complementary indicators suggest that the labor market is less tight than implied by the headline unemployment rate. Despite the weak global demand outlook, external demand has been stronger than anticipated as geopolitical developments and rising logistics costs redirected demand partly towards Türkiye. In this context, the output gap projection for the second quarter of 2026 has been revised slightly upwards compared to the previous reporting period (Table 3.1.1).

In May and June, consumer inflation remained broadly consistent with the path projected in the previous Inflation Report, while annual inflation in July exceeded the forecast at 31.8%. Although the demand outlook and financial conditions continued to support disinflation, the deviation from the forecast was mainly driven by geopolitical developments and supply-side effects. Over the past three months, the energy and alcohol-tobacco-gold groups made a downward contribution to the change in annual consumer inflation, while other sub-groups made an upward contribution. Food inflation remained moderate in May and June but rose in July due to developments in unprocessed food, particularly in vegetable prices. The price increases in the energy group in July were affected by the rise in international oil prices as well as the regulation regarding the gradual phase-out of the sliding scale system and also developments related to electricity and natural gas. While demand conditions and the moderate trend in exchange rates continue to support the disinflation process in line with forecasts, supply-side developments have caused a slight loss of momentum in disinflation. In this context, the secondary effects that geopolitical developments may have on expectations and pricing behavior through energy costs are being closely monitored.

The underlying trend decreased in July. Indicators monitored for the underlying trend pointed to a slight loss of momentum in the disinflation process during the second quarter, partly due to geopolitical developments. Underlying trend indicators, however, declined in July. This outlook was driven by price developments that proved to be more positive than expected in the broad-based core goods and processed food groups, classifications that have a large number of subcategories. Meanwhile, the trend inflation indicator, which is a longer-term measure by design and excludes one-off effects, remained flat. While services inflation remained elevated, the easing rigidity in subcategories with high inertia—particularly rent and education—has been supporting the disinflation process in the services group.

Table 3.1.1: Changes in Key Forecast Variables*

	2026-I	2026-II
Output Gap	-1.0	-1.3
(%)	(-1.1)	(-1.4)
Consumer Inflation**	32.4	31.8
(Annual % Change)	(32.4)	(30.7)
B Index Inflation**	30.5	31.0
(Annual % Change)	(30.5)	(30.7)

* Figures in parentheses denote values presented in the previous Inflation Report.

** 2016-I denotes inflation for April 2026 and 2026-II for July 2026.

Assumptions for Exogenous Variables

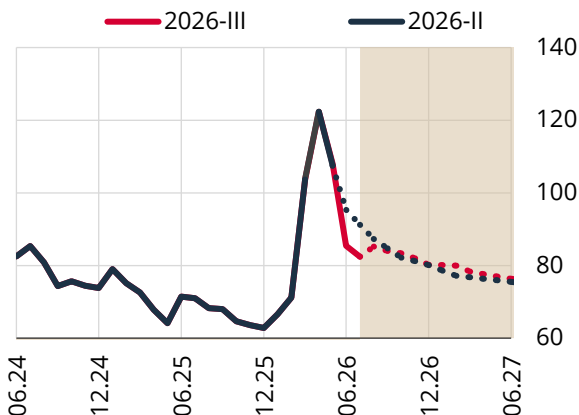
As uncertainties surrounding the US-Israel war on Iran persist, global growth has remained weak and fragile.

Supply-side pressures stemming from high and volatile energy prices, transportation costs that remain elevated compared to pre-war levels, and prolonged lead times continue to weigh on global growth. As the likelihood of a prolonged war has increased due to the breakdown of the ceasefire, downside risks to economic activity have increased. Against this backdrop, growth forecasts for 2026—which were significantly revised downward following the war—remain at low levels in many countries. On the other hand, the positive contribution from investments in artificial intelligence and technology to global growth is somewhat mitigating the negative effects of geopolitical developments. In this context, the assumed annual growth rate of the global growth index—calculated based on Türkiye's export weights with its trading partners—has been revised to 1.6% and 2.5% for 2026 and 2027, respectively (Table 3.1.2). Meanwhile, the demand directed towards Türkiye due to rising international logistics costs is supporting Türkiye's export performance despite the weak growth outlook of its trading partners.

Geopolitical developments have continued to have a tightening effect on global financial conditions. High volatility in energy prices has been pushing both actual and expected inflation higher. Moreover, risks related to oil and natural gas supply, along with their potential secondary effects on food prices and production costs, suggest that the rise in global inflation may be more persistent. In this context, while central banks of advanced economies, led by the Fed, have adopted a cautious stance in their communications, the market implied policy rate path for 2026 has shifted significantly upward. Rising global uncertainty and tightening financial conditions have led to portfolio outflows from emerging markets. Accordingly, inflation forecasts have been formulated based on a framework of tight global financial conditions.

Energy prices, which had risen with the outbreak of the war, declined during the ceasefire but rose again when the ceasefire broke down; these developments have also led to a marked increase in the volatility in energy prices. International oil prices fell in May and June following the ceasefire but started to rise in July as the ceasefire broke down and geopolitical tensions flared up again. Meanwhile, TTF natural gas prices showed a sharper increase. Uncertainty regarding the course of events in the Middle East, damage to the energy infrastructure, and the extent and duration of disruptions in energy transportation are causing energy prices to remain high and volatile. As for non-energy commodities, agricultural commodity prices rose slightly compared to the previous reporting period, while precious metal prices declined. Against this backdrop, crude oil prices have been assumed to average USD 87.8 per barrel in 2026 and USD 76.4 per barrel in 2027 taking into account the course of the war (Chart 3.1.1). Despite the more moderate outlook for oil prices compared to the previous reporting period, the annual average rate of increase in the import unit value index has been revised upward for 2026 taking into account actual developments, the increase in diesel oil refining margins, and the trend in natural gas prices, and downward for 2027 due to the base effect (Chart 3.1.2 and Table 3.1.2).

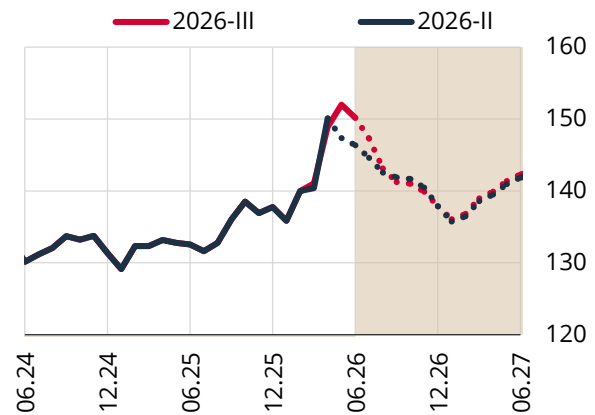
Chart 3.1.1: Revisions in Oil Price Assumptions* (USD/bbl)



Source: Bloomberg, CBRT.

* Shaded area denotes the forecast period.

Chart 3.1.2: Revisions in Import Price Assumptions* (Index, 2015=100)



Source: CBRT, TURKSTAT.

* Shaded area denotes the forecast period.

The assumption for food prices for 2026 has been revised upward. Food price increases, which remained moderate in May and June, accelerated in July due to production losses and supply issues in certain products in the vegetables category. Meanwhile, price increases in products with administered prices—such as milk and dairy products, as well as bread and grains—have remained above the historical average. In the upcoming period, although rising agricultural production is expected to support supply conditions, it is assessed that high agricultural input costs stemming from geopolitical risks are likely to put upward pressure on food prices. Taking these developments into account, the food inflation assumption for the end of 2026 has been revised upward from 26.3% to 28.5%, while the assumption for 2027 remained at 19.0% (Table 3.1.2).

Table 3.1.2: Revisions in Assumptions*

	2026	2027
Export-Weighted Global Growth Index (Annual Average % Change)	1.6 (1.7)	2.5 (2.5)
Oil Prices (Average, USD)	87.8 (89.4)	76.4 (75.4)
Import Prices (USD, Annual Average % Change)	6.9 (6.3)	-0.4 (-0.2)
Food Price Inflation (Year-End % Change)	28.5 (26.3)	19.0 (19.0)

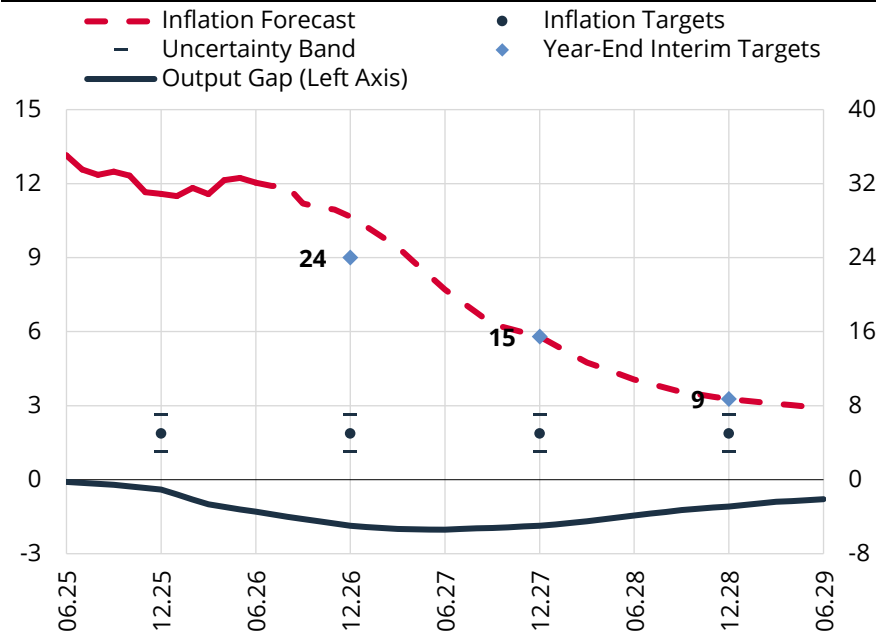
* Figures in parentheses denote values presented in the previous Inflation Report.

The forecasts are based on an outlook in which macroeconomic policies are determined in a coordinated manner focused on disinflation by adopting a medium-term perspective. In the current reporting period, geopolitical developments as well as the impact of administered prices and tax adjustments affected headline inflation. In this period, price increases were observed in healthcare services and electricity prices resulting from administrative arrangements, while the decision not to implement the revised one-off tax adjustment on fuel prices limited price increases. However, rising crude oil prices and the gradual phasing out from the sliding scale system partially offset this effect. The forecasts have been produced taking into account the regulations regarding the sliding scale system. While tax adjustments on alcoholic beverages and tobacco products have had an upward effect on inflation, the impact of the recently announced additional customs duties on consumer inflation is expected to remain limited. While formulating the medium-term projections, it was assumed that the fiscal policy will contribute to the disinflation process, and the government policies regarding administered prices as well as borrowing, tax, and incomes policies will be set in line with the interim targets.

3.2 Medium-Term Projections

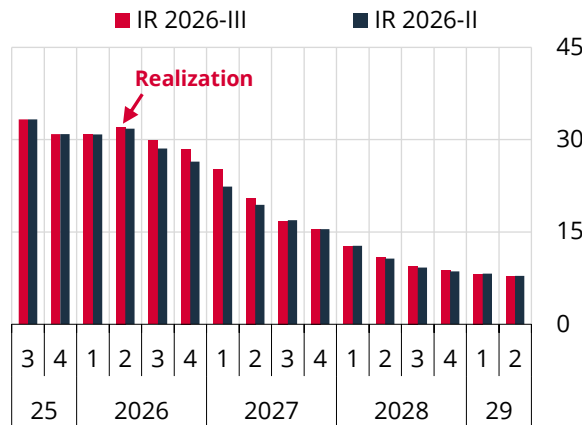
Inflation is projected to be 28% at the end of 2026 and 15% at the end of 2027. Inflation is projected to decline to 9% at end-2028 and then stabilize around the medium-term inflation target of 5% (Chart 3.2.1). The interim targets have been kept unchanged at 24%, 15%, and 9% for 2026, 2027, and 2028, respectively. The CBRT will ensure the necessary monetary tightness required by the projected disinflation path taking into account realized and expected inflation and its underlying trend.

Driven by geopolitical developments, the high volatility observed particularly in commodity prices is significantly increasing uncertainty. Changes in the frequency and nature of shocks are limiting the capability of the traditional forecast range approach to reflect the current uncertainty level. Against this backdrop, the CBRT, in common with some central banks, suspended the publication of forecast ranges in the previous reporting period, and adopted a framework incorporating narratives on the main risk factors as identified by the Committee (ER 2026-II, Zoom-In 3.1). This practice has continued in the current reporting period.

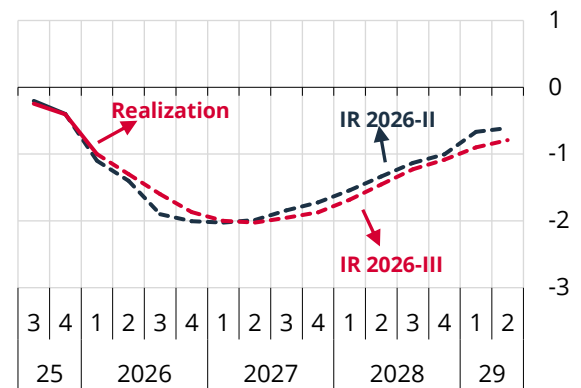
Chart 3.2.1: Inflation Forecasts (%)

Source: CBRT, TURKSTAT.

The inflation forecast for the end of 2026 has been revised up from 26% to 28% (Chart 3.2.2). This revision was based on the rise in the assumption for TRY-denominated import prices, taking into account the outlook for diesel oil, natural gas, and other commodity prices. The impact of regulations regarding the sliding scale system has also been reflected in the forecasts. Moreover, an upward revision to the food inflation assumption, driven by actual data, has pushed up the inflation forecast. In this period, regulatory measures taken with regard to administered prices also played a role in the upward revision of the forecast. Although the output gap path for 2026 has been revised slightly upwards compared to the previous reporting period, it remains at a level supportive of disinflation (Chart 3.2.3). As tight financial conditions will be maintained, domestic demand is expected to remain weak in the coming period. It is assessed that the improvement in inflation expectations and the weakening in the backward-indexation behavior—supported by the tight monetary policy stance—will support the disinflation process. Under this outlook, the recent decline in the underlying inflation trend is projected to continue.

Chart 3.2.2: Inflation Forecast
(Quarter-End, Annual % Change)

Source: CBRT, TURKSTAT.

Chart 3.2.3: Output Gap Forecast (%)

Source: CBRT.

Forecasts are based on an outlook in which global growth remains weak, and there is no deterioration in the sovereign risk premium. The rise in geopolitical risks again is causing global uncertainty to remain high. In parallel with these developments, the tightening trend in global financial conditions continues. The tight monetary policy stance and the current state of the CBRT's international reserves will continue to limit the potential negative effects of volatility in global financial markets on Türkiye's risk premium.

Medium-term forecasts are based on a framework in which the tight monetary policy stance will be maintained decisively until price stability is achieved, and the coordination among policy components will be sustained. The convergence of inflation expectations to interim targets in the short term and to the target of 5% in the medium term is critical to achieving lasting low inflation. During the current reporting period, to contain the risks that geopolitical developments may pose, the weighted average funding cost was kept at 40%, and the monetary tightness was supported by macroprudential policies. The forecasts are based on a framework in which monetary policy is determined prudently with a focus on the inflation outlook, taking into account interim targets. Accordingly, forecasts are based on an outlook in which the tight monetary policy stance is maintained. Moreover, in the forecast period, a framework was drawn based on the assumption that other economic policies will be conducted in coordination with the monetary policy and in compliance with interim targets.

The tight monetary policy stance will continue to support the disinflation process through the demand, exchange rate, and expectations channels. It is assessed that the output gap will remain at disinflationary levels throughout the forecast period as the effects of tight financial conditions on domestic demand will continue (Chart 3.2.3). While weak demand conditions are limiting the pass-through from cost increases to prices and expectations (Box 3.1), the moderate trend in the Turkish lira is supporting the disinflation process by easing import cost pressures. The underlying trend of inflation, which had risen due to supply shocks, has recently moderated, and this moderation is expected to continue in the upcoming period as the tight monetary stance supports improvements in expectations and the pricing behavior. Furthermore, it is projected that the decline in services inflation will become more apparent once the inertia weakens in services categories—particularly rent and education—in which backward-indexation tendency is strong. Nevertheless, energy and commodity prices continue to be an important factor of uncertainty with respect to the inflation outlook. In addition to the high volatility in energy prices caused by geopolitical developments, the future trend of the sliding scale system will be important regarding the effects of international oil prices on inflation.

3.3. Key Risks to Inflation Forecasts and their Impact Channels

The outlook underlying the medium-term forecasts presented in the previous section is shaped by the Committee's assessments and key assumptions regarding the forecast period. However, the inflation outlook and the monetary policy stance may change in the case domestic and global developments diverge from these assumptions. Key risks that may affect the inflation outlook and the potential impacts of these risks are summarized in Table 3.3.1.

Table 3.3.1: Key Risks to Inflation Forecasts and Possible Impact Channels*

Risk	Evaluation of Risks Compared to the Baseline Scenario and Possible Effects on Inflation (↑ ↔ ↓)	Indicators Monitored
Global Uncertainties, and the Course and Volatility of Commodity Prices	<ul style="list-style-type: none"> Geopolitical developments stemming from the U.S./Israel-Iran conflict are keeping upward risks to energy and commodity prices alive through risks related to energy supply and the global supply chain. ↑ Persisting uncertainties regarding the ceasefire process may fuel volatility in energy prices, and thus increase upward risks. ↑ Conversely, easing of conflicts, normalization of energy flows, and an increase in oil supply may pose a downward risk to crude oil prices. ↓ 	<ul style="list-style-type: none"> Global inflation and growth indicators and forecasts Global economy and trade policies Global trade uncertainty index Global risk appetite indicator EWGG Index Crude oil prices and supply-demand balance OPEC+ decisions Indicators for domestic energy market Sliding scale system and lump-sum SCT taxes Course of refining margins on diesel oil Import unit value index Oil and LNG tanker transits
Changes in the Nature, Frequency, and Magnitude of Economic Shocks	<ul style="list-style-type: none"> The nature of both global and domestic shocks has changed, greatly increasing the frequency and magnitude of supply and uncertainty shocks. ↑ More frequent and larger-scale supply shocks may slow the disinflation process by increasing inflation inertia. ↑ The secondary effects of shocks on expectations and pricing behavior pose a significant upside risk to the inflation outlook. ↑ 	<ul style="list-style-type: none"> Understanding the nature of economic shocks Analysis of the nature and magnitude of potential future shocks Global commodity prices Import unit value index Inflation inertia
Inflation Expectations	<ul style="list-style-type: none"> The asymmetric response of inflation expectations to data surprises and expectations remaining above interim targets keep upside risks alive. ↑ The effects of geopolitical developments, supply shocks and elevated volatility in commodity prices on the disinflation process through inflation expectations and the pricing behavior are closely monitored. ↑ 	<ul style="list-style-type: none"> Sectoral inflation expectations Distribution of Inflation expectations Inflation uncertainty indicators Alignment of inflation expectations with Inflation Report forecasts Survey- and market pricing-based inflation and exchange rate expectations News feed related to geopolitical developments

Food Prices	<ul style="list-style-type: none"> While strong crop yield forecasts act as a downward pressure on food inflation, uncertainties regarding weather conditions and supply developments could pose risks to food prices in either direction. The potential of geopolitical developments to increase agricultural input costs by pushing up agricultural commodity and energy prices continues to keep upside risks alive. 	↑	<ul style="list-style-type: none"> Prices of fresh fruits and vegetables, and processed food, particularly bread and cereals International agricultural commodity prices Meteorological and climate statistics such as temperature and precipitation Agricultural commodity prices
Risks to the Effectiveness of the Coordination Between Monetary and Fiscal Policies	<ul style="list-style-type: none"> Any weakening in the coordination between monetary and fiscal policies may pose risks to inflation and the rebalancing of domestic demand. A decrease in subsidies implemented in electricity and natural gas prices may slow the disinflation process. 	↑ ↑	<ul style="list-style-type: none"> Adjustments in administered prices and taxes Developments in tax revenues and public expenditures Energy subsidies and sliding scale system Medium-Term Program and fiscal policy measures Budget and public debt stock indicators Structural budget balance forecasts Share of direct taxes in total taxes Minimum wage and public wage increases

* Each risk row in the table indicates the possible channel and the direction for the change in inflation forecasts in case the particular risk materializes. The signs ↑, ↓ indicate that the risk to the inflation forecast is upside and downside, respectively. The ↔ sign is used when the net impact on the inflation forecast is not completely clear. The indicators through which the risk is monitored are also listed in the right column.

Waning predictability regarding global developments, coupled with high volatility in financial markets as well as in commodity prices, is significantly exacerbating uncertainty. In fact, rapid and two-way movements in oil and natural gas prices on the back of news on geopolitical developments over the last three months suggest that the direction, magnitude and timing of risks can vary substantially in a very short period of time. This increases the likelihood of various shocks appearing simultaneously and feeding into one another, while also broadening the range of possible outcomes around the baseline scenario. Therefore, it becomes more challenging to cover all risk combinations under a single scenario. As in the previous Inflation Report, the risks surrounding the baseline scenario were assessed qualitatively, and the risk factors highlighted by the Committee are presented in Table 3.3.2.

Table 3.3.2: Key Risks to the Inflation Outlook

Risk	Nature of the Risk	References*
Energy Prices	<ul style="list-style-type: none"> Upside: Depending on the course of the war, oil prices may remain higher for longer than envisaged in the main assumptions. Geopolitical risks concerning the energy infrastructure and the rise in LNG demand from Europe may keep natural gas prices under upward pressure. Changes in electricity production costs and industrial input costs may spill over into consumer inflation through the cost channel. In addition, increases in diesel prices driven by higher refinery margins may also pose an upside risk. Downside: Depending on the course of the war, oil prices may remain lower than stated in main assumptions. However, past experiences indicate that the pass-through of the decline in energy prices to consumer prices may remain more limited than that of increases. 	<ul style="list-style-type: none"> CBRT (2026). The impact of geopolitical developments on inflation: The commodity channel. Inflation Report 2026-II, Box 2.4. Gökcü, M., & Sezer, E. (2026). The Sliding Scale System for Fuel Prices and Its Potential Impact on Inflation. CBRT Blog. Ertuğ, D. & Özmen, M.U. (2020). Indirect effects of electricity and natural gas price increases on consumer prices. <i>CBRT Blog</i>.
Food Prices	<ul style="list-style-type: none"> Upside (War-driven increase in global food prices): As the war adversely impacts the supply of agricultural commodities, logistics networks, and fertilizer markets, global food prices may rise even further than projected in the baseline scenario. This may push up domestic inflation through higher costs of imported inputs and, chiefly, processed food prices. Upside (Negative supply shock in milk and meat): Feed costs, a decline in livestock numbers, import restrictions, or rising production costs may put upward pressure on milk and meat prices. Downside and Upside (Two-sided supply shocks affecting fruits and vegetables prices): Developments in the supply of fruits and vegetables in either direction due to factors such as weather conditions may lead to volatility in unprocessed food inflation. 	<ul style="list-style-type: none"> CBRT (2026). The impact of geopolitical developments on inflation: The commodity channel. Inflation Report 2026-II, Box 2.4. Can, U., Çepni, O., Kazdal, A., & Yılmaz, M. H. (2024). Climate Anomalies and Inflationary Pressures: Evidence from Türkiye. <i>CBRT Working Paper No. 24/12</i>. CBRT (2026). Supply and Cost Dynamics in Food Inflation. Inflation Report 2026-III, Box 2.4.
Frequency of Supply Shocks and Inflation Inertia	<ul style="list-style-type: none"> Upside: The fact that supply-side shocks—such as those affecting energy, food, petrochemicals, and packaging products—recently have occurred more frequently and successively than anticipated may disrupt pricing behavior and slow the pace of inflation's decline. Firms' tendency to set prices based on past inflation may exacerbate inflation inertia. 	<ul style="list-style-type: none"> CBRT (2026). The Impact of Geopolitical Developments on Inflation: The Commodity Channel. Inflation Report 2026-II, Box 2.4.

* The studies cited here contain quantitative findings regarding the potential economic impacts of the relevant risks. However, when evaluating these findings, it should be noted that the reported impact/response coefficients, elasticities, and similar measures are subject to specific model assumptions, the sampling period, and statistical uncertainty. Macroeconomic variables are affected by multiple shocks, and the relationships between variables are, in most cases, dynamic, simultaneous, and endogenous. Therefore, directly comparing coefficients related to different risks, using them mechanically, or calculating total/net effects through simple arithmetic operations may not yield accurate results. Furthermore, these estimates are typically derived from linear statistical or econometric models and are more applicable to the average shock magnitudes and historical relationship patterns seen in the past. The validity of these coefficients may be limited in the case of shocks that trigger larger, persistent, or nonlinear transmission channels. In some cases, since the measured effects reflect the combined outcome of multiple shocks, decomposition and counterfactual impact analysis require more complex dynamic modeling. Given that policy responses may also vary in the face of large-scale shocks, the quantitative findings in the reference studies should be interpreted not as definitive values but as context-sensitive approximate magnitudes.

Box 3.1

Transmission of Upward Cost Surprises to Firms' Expectations: Demand Conditions and the Disinflation Period

Firms' inflation expectations are shaped not only by macroeconomic developments but also by changes in their own cost conditions. Coibion et al. (2018) show that firms have limited and heterogeneous information about inflation, while Andrade et al. (2022) find that firms may generalize sector- and firm-level conditions and incorporate them into their inflation expectations. A firm's costs may increase because of factors specific to its supply chain or production structure, or because of developments affecting the economy as a whole. How firms distinguish between these two cases determines the extent to which cost developments affect their inflation expectations. In this respect, the transmission of firm-level developments to inflation expectations is important for the anchoring of expectations and the course of the disinflation process. This box uses BTS micro data to examine how firms update their own sales price expectations and inflation expectations when they face an unexpected cost increase, and how this relationship varies across periods and firm-specific demand conditions.

The analysis uses monthly firm-level microdata from the BTS. The survey asks firms about both their cost expectations for the next three months and the change in their costs over the past three months, using a three-category scale (increase/increased, remain unchanged/remained unchanged, and decrease/decreased). Matching the responses to these two questions across periods makes it possible to determine whether a firm has faced an unexpected cost development. An upward cost surprise is defined as a case in which a firm expected its costs to remain unchanged over the next three months at $t-3$ but reported at t that its costs had increased over the past three months. The control group consists of firms that expected their costs to remain unchanged at $t-3$ and reported at t that their costs had remained unchanged, in line with this expectation. Thus, the effect of unexpected cost increases on firms' expectations is estimated by comparing firms with the same initial expectation but different subsequent cost realizations. First, as shown in Equation (1), the firm's response to the question on whether it expects its sales price to increase over the next three months is used to analyze the effect of the cost surprise variable on its expectation of an increase in its own sales price.

$$E_{i,t}[\text{PriceInc}] = \beta \cdot \text{Surprise}_{i,t} + \alpha_i + \gamma_{s,t} \quad (1)$$

Next, as shown in Equations (2) and (3), the effect of the same cost surprise variable on the revision in the firm's 12-month-ahead PPI and CPI inflation expectations is examined.

$$\Delta E_{i,t}[\pi^{\text{PPI}}] = \beta \cdot \text{Surprise}_{i,t} + \alpha_i + \gamma_{s,t} \quad (2)$$

$$\Delta E_{i,t}[\pi^{\text{CPI}}] = \beta \cdot \text{Surprise}_{i,t} + \alpha_i + \gamma_{s,t} \quad (3)$$

In the equations above, $\text{Surprise}_{i,t}$, is a dummy variable equal to 1 for firms exposed to an unexpected upward cost surprise between $t-3$ and t , and 0 for firms experiencing no cost surprise. In Equation (1), $E_{i,t}[\text{PriceInc}]$ is a dummy variable equal to 1 if firm i reports at time t that it expects to increase its own sales price over the next three months, and 0 otherwise. The equation is estimated as a linear probability model, and the corresponding coefficient captures the change in the probability of expecting a price increase. In Equations (2) and (3), $\Delta E_{i,t}[\pi]$ denotes the revision in firm i 's inflation expectation at t relative to $t-3$. α_i and $\gamma_{s,t}$ denote firm fixed effects and sector-time fixed effects, respectively. Sector-time fixed effects allow each firm to be compared with other firms in the same sector and period. Thus, common cost and demand shocks at the sector-time level are absorbed, enabling the effect of unexpected firm-level cost surprises to be estimated.

The analysis is conducted separately for 2007-2017, when inflation was relatively low and stable, 2018-2023, when inflation was relatively high and volatile, and 2024 onwards, corresponding to the disinflation period. The findings show that unexpected cost increases raise the probability that firms expect a price increase and that this relationship remains statistically significant in all subsamples. On average, firms exposed to an upward cost surprise are 19.2 percentage points more likely to expect a price increase than firms in the control group. When the analysis is repeated using revisions in firms' inflation expectations as the dependent variable, the effects of unexpected cost increases on PPI and CPI expectations are positive and statistically significant in the first two periods, but statistically insignificant in the latest period (Table 1).

Table 1: Effect of an Upward Cost Surprise

	(1) 2007-2017	(2) 2018-2023	(3) 2024 Onwards	(4) Full Sample
(1) Dependent Variable: Expectation of a Sales Price Increase over the Next Three Months				
Surprise	0.154*** (0.005)	0.243*** (0.007)	0.198*** (0.013)	0.192*** (0.004)
Observations	108,336	43,611	16,072	168,406
R-Squared	0.27	0.41	0.46	0.28
(2) Dependent Variable: Change in 12-Month-Ahead PPI Inflation Expectations from Three Months Earlier				
Surprise	0.135*** (0.020)	1.043*** (0.218)	-0.444 (0.347)	0.317*** (0.059)
Observations	93,828	38,004	14,145	146,326
R-Squared	0.17	0.29	0.19	0.25
(3) Dependent Variable: Change in 12-Month-Ahead CPI Inflation Expectations from Three Months Earlier				
Surprise	0.101*** (0.018)	0.616*** (0.178)	-0.076 (0.337)	0.253*** (0.056)
Observations	76,353	37,311	13,978	128,004
R-Squared	0.13	0.28	0.19	0.24

Standard errors in parentheses are clustered at the firm level.

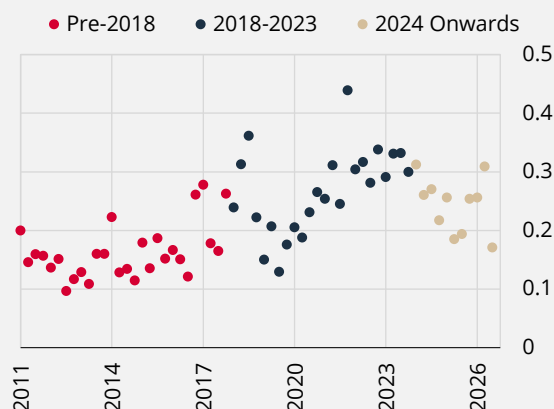
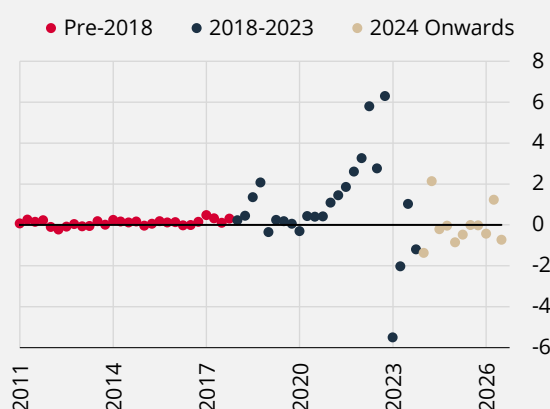
*, ** and *** denote statistical significance at the 10%, 5% and 1% levels, respectively.

In addition, to trace the transmission of cost shocks to expectations over time, the following equations allow a separate coefficient to be estimated for each year-quarter.

$$E_{i,t}[\text{PriceInc}] = \sum_{\tau} \beta_{\tau} \cdot (\text{Surprise}_{i,t} \times \mathbb{1}[q = \tau]) + \alpha_i + \gamma_{s,t} \quad (4)$$

$$\Delta E_{i,t}[\pi] = \sum_{\tau} \beta_{\tau} \cdot (\text{Surprise}_{i,t} \times \mathbb{1}[q = \tau]) + \alpha_i + \gamma_{s,t} \quad (5)$$

Under this specification, the coefficient β_{τ} is estimated using only observations from quarter τ and measures the transmission of an unexpected cost increase to expectations in that quarter. Charts 1 and 2 present the evolution of these coefficients over time for expectations of a sales price increase and PPI inflation expectations, respectively. The coefficients for sales price expectations in Chart 1 remain positive throughout the sample and continue to be statistically significant in the latest period. The coefficients for PPI expectations in Chart 2 are statistically significant before 2018, but remain relatively small, also reflecting the limited size of cost surprises. They rise markedly in 2018-2023. From 2024 onwards, the coefficients decline rapidly, fluctuate around zero, and lose statistical significance.

Chart 1: Effect on Expectations of a Sales Price Increase over the Following Three Months (Coefficient of the Interaction Term)**Chart 2: Effect on 12-Month-Ahead PPI Inflation Expectations* (Coefficient of the Interaction Term)**

* Similar results are obtained when the estimation is conducted for 12-month-ahead CPI inflation expectations.

The two charts show that firms continue to reflect cost surprises in their own pricing decisions. At the same time, in the latest period they appear to distinguish more clearly between firm-specific and economy-wide developments. This indicates that the effect of firm-specific developments on inflation expectations has weakened markedly in the recent period. The strong response of sales price expectations in the latest period makes it difficult to explain the weaker response of inflation expectations solely by smaller cost surprises or their reduced economic importance. This divergence is consistent with two developments: the re-anchoring of expectations amid tight monetary policy and disinflation communication, and weaker transmission of firm-level cost developments to aggregate inflation expectations.

Firms' responses to the BTS question on current domestic order books are used to examine whether demand conditions affect the transmission of cost surprises to expectations. Accordingly, a firm is classified as facing weak demand conditions at the firm level if, at $t-3$, it reported that its current domestic order books were below normal. In Equations (6), (7), and (8), $WeakD_{i,t-3}$ is a dummy variable equal to 1 for firms facing weak demand conditions at $t-3$, and 0 otherwise.

$$E_{i,t}[\text{PriceInc}] = \beta_1 \cdot \text{Surprise}_{i,t} + \beta_2 \cdot (\text{Surprise}_{i,t} \times \text{WeakD}_{i,t-3}) + \beta_3 \cdot \text{WeakD}_{i,t-3} + \alpha_i + \gamma_{s,t} \quad (6)$$

$$\Delta E_{i,t}[\pi^{\text{PPI}}] = \beta_1 \cdot \text{Surprise}_{i,t} + \beta_2 \cdot (\text{Surprise}_{i,t} \times \text{WeakD}_{i,t-3}) + \beta_3 \cdot \text{WeakD}_{i,t-3} + \alpha_i + \gamma_{s,t} \quad (7)$$

$$\Delta E_{i,t}[\pi^{\text{CPI}}] = \beta_1 \cdot \text{Surprise}_{i,t} + \beta_2 \cdot (\text{Surprise}_{i,t} \times \text{WeakD}_{i,t-3}) + \beta_3 \cdot \text{WeakD}_{i,t-3} + \alpha_i + \gamma_{s,t} \quad (8)$$

In this framework, the coefficient β_1 in the equations above captures the effect of an upward cost surprise for firms not facing weak demand conditions, while β_2 shows the extent to which this effect differs for firms facing weak demand conditions. For the full sample, the findings indicate that β_2 is negative and statistically significant for all three dependent variables (Table 2). In other words, weak demand conditions at the firm level significantly limit the transmission of cost surprises both to the probability that a firm expects to increase its own sales price and to its inflation expectations. This finding indicates that the transmission of firm-specific cost developments from the firm level to economy-wide expectations is closely related to demand conditions.

Table 2: Effects of an Upward Cost Surprise and Demand Conditions

	(1) 2007-2017	(2) 2018-2023	(3) 2024 Onwards	(4) Full Sample
(6) Dependent Variable: Expectation of a Sales Price Increase over the Next Three Months				
Surprise	0.162*** (0.005)	0.251*** (0.008)	0.216*** (0.014)	0.201*** (0.005)
Surprise x Weak Demand	-0.037*** (0.007)	-0.038*** (0.013)	-0.085*** (0.025)	-0.046*** (0.007)
Observations	108,336	43,611	16,072	168,406
R-Squared	0.27	0.41	0.46	0.28
(7) Dependent Variable: Change in 12-Month-Ahead PPI Inflation Expectations from Three Months Earlier				
Surprise	0.140*** (0.021)	1.340*** (0.248)	-0.416 (0.405)	0.408*** (0.068)
Surprise x Weak Demand	-0.017 (0.043)	-1.388*** (0.392)	-0.152 (0.656)	-0.386*** (0.108)
Observations	93,828	38,004	14,145	146,326
R-Squared	0.17	0.29	0.19	0.25
(8) Dependent Variable: Change in 12-Month-Ahead CPI Inflation Expectations from Three Months Earlier				
Surprise	0.095*** (0.020)	0.748*** (0.200)	-0.111 (0.377)	0.298*** (0.062)
Surprise x Weak Demand	0.035 (0.040)	-0.597** (0.303)	0.140 (0.696)	-0.197* (0.109)
Observations	76,353	37,311	13,978	128,004
R-Squared	0.13	0.28	0.19	0.24

Standard errors in parentheses are clustered at the firm level.

*, ** and *** denote statistical significance at the 10%, 5% and 1% levels, respectively.

Overall, the findings indicate that the effect of firm-specific cost surprises on inflation expectations is not constant, but is state-dependent and varies with macroeconomic conditions and the demand outlook. The effects of these surprises on revisions in PPI and CPI inflation expectations are positive and statistically significant before 2018 and during 2018-2023, but statistically insignificant from 2024 onwards. By contrast, firms' own sales price expectations respond positively and statistically significantly to upward cost surprises in all subperiods. Moreover, the transmission of cost surprises to both sales price and inflation expectations is markedly more limited among firms facing weak demand conditions.

This divergence does not suggest that firms have become generally less sensitive to cost developments. Instead, it indicates that firm-level cost shocks are being reflected less in inflation expectations. This picture indicates that the tight monetary policy stance and the disinflation process have contributed to the re-anchoring of expectations. Weak demand conditions also limit the transmission of cost increases to expectations, indicating an additional channel through which demand rebalancing supports the disinflation process.

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