

THE ECONOMY WILL COPE WITH RENEWED HEADWINDS ONCE AGAIN

Turkish growth has slowed significantly since Q4 2025, and the oil shock since March has led to a significant erosion of foreign exchange reserves, a more pronounced depreciation in the lira than in other emerging-market currencies, and pressure on domestic bond yields. The risk of disruptions to hydrocarbon and fertilizer supplies is limited. However, the revision of official inflation forecasts, the subsequent tightening of monetary policy, and warnings of the finance minister about potential budget slippage have dampened investor sentiment, which is further unsettled by the AKP's strategy of systematically sidelining potential rivals in the presidential elections. There are often recurring financial tensions in Türkiye. However, the risk of economic destabilization is low given the government's moderate debt levels and the strength of the banking system. The slowdown is even beneficial, as it will help to limit the current account deficit and should help the central bank in curbing expectations of inflation and rebuilding its foreign exchange reserves.

ECONOMIC GROWTH: A WELCOME SLOWDOWN

The slowdown in growth is becoming increasingly evident (Chart 1). GDP decelerated sharply in Q4 2025 before virtually stagnating in Q1 2026 (+0.1% q/q), notably because consumer credit momentum has eased. The indicators available for April and May (industrial production, exports, business and consumer confidence indices) point to a slight recovery (particularly in exports), although this is yet to be confirmed.

A slowdown in domestic demand is needed because the underlying trade balance (i.e. excluding oil and net imports of gold) has returned to a deficit since the end of 2025, and inflation remains too high to be sustainable in the long term (risk of an overvalued exchange rate, increased interest burden on index-linked debt). In H2 2025, growth in domestic demand was still above potential growth and domestic credit growth remained very robust.

The presidential and general elections, due to be held by spring 2028 at the latest, are drawing nearer; fiscal policy, whilst not necessarily expansionary, will not act as a moderating factor. As a result, the burden of moderation falls on monetary policy, which has performed this role thus far (see below).

FINANCIAL TENSIONS, REFLECTING VULNERABILITY TO THE OIL SHOCK AND POLITICAL RISK

Foreign investors' jitters since March have led to a sharp decline in international reserves (forex reserves + gold holdings), from USD 218 bn in early February to USD 157 bn on June 21st. However, there is no immediate danger. They still more than cover the hot money¹. Moreover, the deterioration in the current account balance since late 2025 — which may reflect an overvalued exchange rate — is not severe enough to escalate into a balance-of-payments crisis requiring tighter exchange controls².

As is usually the case, the exchange rate and domestic bond yields came under far greater pressure than in most other emerging markets. The lira depreciated by 5.5%, compared with a median of 3.2% for other EM currencies. The yield on 5-year domestic government bonds rose by 390 basis points, compared with a median of 45 basis points in other EMs, and accelerating inflation accounts for only a tiny fraction of this difference³. However, at the same time, the 5-year CDS spread

¹ Hot money consists of sovereign debt securities denominated in local currency and stocks held by non-residents. It amounts to approximately USD 60 bn. The coverage ratio based on international reserves is therefore 2.5.

² According to the IMF, the cyclically adjusted current account deficit was just 1% of GDP in 2025. Assuming an elasticity of the current account balance with respect to the real exchange rate (RER) of 0.25 (according to the IMF), the RER adjustment needed to clear the cyclically adjusted deficit is therefore only 4%.

³ The increase of the year-on-year rise in consumer prices, stood at 110bps between February and May for Türkiye, compared with a median of 80 basis points for the major emerging economies.

Economic forecasts

	2022	2023	2024	2025	2026e	2027e
Real GDP growth, %	5.4	5.0	3.3	3.6	3.1	3.5
Inflation, CPI, year average, %	72.3	53.9	58.5	34.9	30.7	23.8
Central gov. balance / GDP, %	-0.9	-5.1	-4.7	-2.9	-3.8	-3.5
Gen. Gov. debt / GDP, % (EU standards)	26.3	24.9	20.8	21.7	22.4	23.3
Current account balance / GDP, %	-5.0	-3.7	-1.0	-1.9	-2.2	-2.2
External debt / GDP, %	41.9	37.9	33.9	35.7	35.2	35.6
Forex reserves, USD bn	82.9	92.7	90.9	77.0	89.8	98.3
Forex reserves, in months of imports	2.6	2.9	3.0	2.3	2.5	2.6

e: ESTIMATES & FORECASTS

SOURCE: BNP PARIBAS ECONOMIC RESEARCH

TABLE 1

Activity indicators

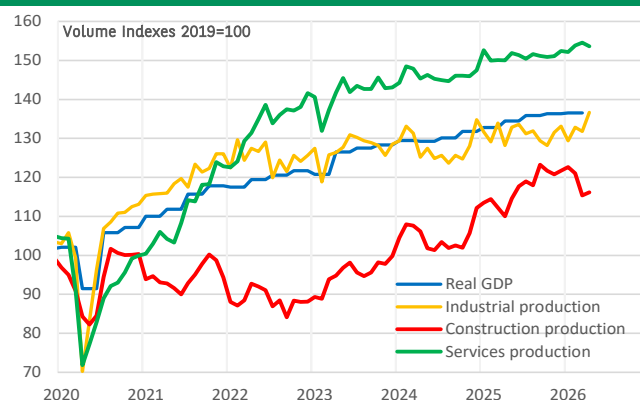


CHART 1

SOURCE: TURKSTAT

has narrowed by 10 basis points since 22 July (to 220 basis points); investors have not reassessed the risk of default on government debt.

The risk of a disruption to hydrocarbon supplies is very limited, as Russia is the main supplier (46 per cent for oil and 43 per cent for gas).



As regards to fertilizers, Oman is a major supplier to Türkiye (20% of the domestic market) but, unlike its Gulf neighbors, Oman has not been affected by the blockade of the Strait of Hormuz.

However, the consequences of the oil crisis are driving the pressure on the lira and domestic interest rates. According to joint estimates by the central bank and the Treasury, a rise in the price of Brent crude of USD 15 per barrel from a level of USD 65 (i.e. a set of assumptions similar to our own for the period 2025–2026) has a very significant impact on the key macroeconomic variables⁴.

The central bank's revision of its inflation forecasts (to take account of the impact of the oil shock, see Chart 2), the subsequent tightening of monetary policy, and the Finance Minister's warning about a potential budgetary slippage have dampened investor sentiment. Financial volatility is also being fueled by the AKP's strategy of sidelining all serious rivals in the presidential elections.

MONETARY TIGHTENING TO CONTAIN INFLATION

Headline inflation accelerated in April but fell back in May, meaning that the average monthly increase for March–May was lower than that for February (2.6% compared with 3%). The main reason for this is that a sliding-scale system was introduced to limit the impact of rising Brent prices on retail oil prices⁵. This helped to offset the very sharp rise in the price of fresh produce. Year-on-year, the rate of disinflation levelled off rather than accelerated (32.6% in May compared with 31.5% in February).

Pressures are more evident in core inflation but are much less pronounced than in 2023 following the invasion of Ukraine (Chart 2). The more moderate depreciation of the exchange rate has played a significant part in this. The slowdown in private consumption may also have been a factor.

In its latest inflation report, published in May, the central bank (CBRT) has revised its inflation forecasts for 2026 and 2027 quite significantly⁶.

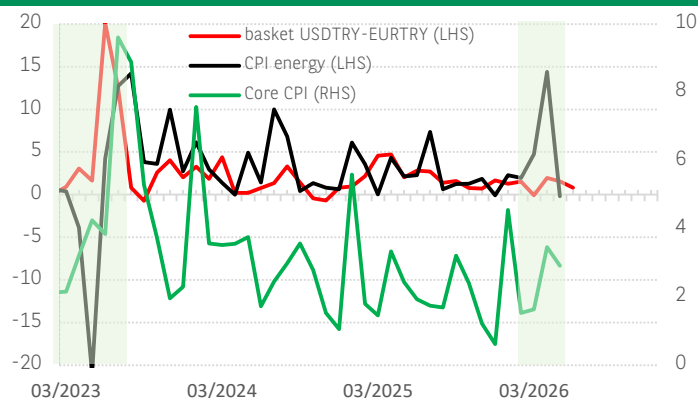
As a result, monetary policy has become more restrictive; the CBRT, which cut its key interest rate by 250bp between December and February, has left it unchanged at 37% since then. Its interventions in the foreign exchange market to support the lira have reduced lira liquidity in the money market. Finally, bank refinancing has been at the overnight lending rate (40%).

FISCAL SLIPPAGE: NOTHING SERIOUS

In the wake of the oil crisis, the budget deficit is set to widen; however, as with the external accounts, the deterioration is likely to be limited and, in any event, will not exceed the warning threshold (commonly 5% of GDP) — far from it.

On a 12-month cumulative, the central government deficit — which had reached a low of 2.2% of GDP in February — widened to 3.1% in May. However, excluding interest payments, the balance — which had turned into a surplus in January — remains slightly positive.

Energy retail prices, exchange rate and core inflation



It has narrowed since March due to a fall in revenue (as a percentage of GDP) rather than a rise in primary expenditure. Interest payments (3.5% of GDP) increased by 0.4 pp of GDP in 2025, whilst, at the same time, the debt-to-GDP ratio continued to fall to 22% of GDP. The reason for this is the appreciation of the real exchange rate (by around 15% on average per year since 2022), which, on its own, has been driving down the debt-to-GDP ratio for several years⁷.

Even assuming a budget overspend of 3.8% of GDP this year (the Ministry of Finance's latest estimate is 3.5%), the debt would rise only marginally.

Finally, the oil crisis poses no threat whatsoever to the central government's ability to service its external debt, even without support from the Gulf states. The Treasury has already issued nearly 10.25 bn in international bonds and lease certificates denominated in USD or EUR since the start of the year. The government's hard-currency deposits at the CBRT stand at USD 15.4 bn end May which cover the USD 10 bn in interest and principal that the Treasury must repay between June and December. In the meantime, the economic slowdown should enable the central bank to replenish its foreign exchange reserves.

Article completed on 10 July 2026

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⁴ Between -0.5 and -1.2 percentage points (pp) in growth, between 2.8 pp and 3.5 pp of additional inflation, an increase in the current account deficit of between 0.7 and 1.1 pp of GDP, and a widening of the budget deficit by 0.4 pp of GDP.

⁵ Conversely, regulated electricity and natural gas tariffs have risen significantly, not only for businesses but also for the 12–13% of households whose consumption exceeds a predetermined threshold by 75%, thereby disqualifying them from subsidies.

⁶ In February, the CBRT forecasted an inflation rate of 16% by the end of 2026, 9% by the end of 2027 and 8% by the end of 2028. In May, these figures have been revised up to 26%, 15% and 9%.

⁷ The increase in the interest burden (as a percentage of GDP) stems from an average real interest rate on domestic debt denominated in TRY, which returned to positive territory in 2025.



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