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Why Does Central Bank Credibility Weaken without Collapsing? Evidence from Shifting Monetary Policy Priorities

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Abstract

The conventional view of central bank credibility assumes that persistent deviations from inflation targets eventually lead to a near-complete collapse of credibility. This study re-examines this proposition in the context of economies where monetary policy priorities shift under political dominance, using Türkiye as a case study. First, the evolution of central bank credibility is analysed using a multidimensional framework that combines target-based measures, expectation pass-through, dynamic anchoring, forecast uncertainty, and probability-based distributional indicators. The findings show that, although credibility deteriorated substantially, it did not disappear. While inflation expectations drifted away from official targets, they did not become completely detached from central bank communication, remaining systematically bounded within a predictable range. In the second stage, these findings are interpreted within a framework of political dominance, in which the de facto objectives of monetary policy are reweighted from price stability toward growth and employment. The study argues that, under such conditions, central bank credibility may persist not as an inflation-targeting anchor but as a credibility floor that reflects the predictability and internal consistency of the policy regime. In doing so, the paper offers a new conceptual perspective on monetary policy credibility.

Key words: Credibility; Credibility Floor; Policy Prioritisation; Policy Reweighting; Misery Index

JEL Codes: E52, E58, E61

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1. Introduction

Over the past two decades, Türkiye has offered a revealing case for understanding how central bank credibility evolves when monetary policy becomes politically dominated. Following the adoption of implicit inflation targeting in the early 2000s and its formalisation in 2006, inflation declined rapidly to single-digit levels. This period is widely associated with a relatively coherent policy framework in which the Central Bank of the Republic of Türkiye (CBRT) operated under a clear inflation-centred mandate, supported by a stabilising macro-policy mix and a communication strategy that strengthened predictability and anchored expectations (Demiralp, Kara & Özlü, 2012).

From the mid-2010s onwards, however, the institutional and political environment changed markedly. Increasing political influence over monetary policy decisions and the weakening of effective policy autonomy gradually widened the gap between the CBRT's *de jure* mandate and its *de facto* policy priorities. After 2017, repeated exchange-rate shocks, heightened uncertainty, and a persistent tension between price stability and short-term growth and employment considerations pushed the economy into a regime of high and volatile inflation (Demiralp & Demiralp, 2019; Gayaker et al., 2021). This regime shift became most visible during 2021–2022, when policy easing coincided with a sharp acceleration in inflation, which exceeded 80 percent in 2022.

Under standard interpretations of inflation targeting, such outcomes would be expected to coincide with a near-complete collapse of central bank credibility. Yet Türkiye's experience points to a puzzle: credibility weakened sharply, but it did not vanish. Even when inflation remained far above official targets, professional forecasters' expectations did not drift arbitrarily away from the CBRT's published projections. Instead, expectations appeared to cluster systematically near the upper bounds of the Bank's forecast intervals, suggesting neither full trust nor outright dismissal. In other words, the CBRT appeared to lose its capacity to tightly anchor expectations to a target, while still retaining a residual signalling role that appeared to prevent complete de-anchoring.

This paper argues that the puzzle can be addressed by shifting the analytical lens from 'credibility under a fixed inflation mandate' to 'credibility under political dominance.' In politically dominated settings, deviations from price stability do not necessarily reflect policy inconsistency from the viewpoint of economic agents. Rather, they may reflect a *de facto* reweighting of objectives -such as growth, employment, credit expansion, or exchange-rate considerations- while the central bank continues to communicate a *de jure* inflation-centred narrative. Once this *de jure-de facto* gap becomes persistent and widely recognised, the meaning of credibility changes: credibility is no longer solely about delivering low inflation, but about the perceived consistency and predictability of policy within the politically redefined regime. In such a regime, the central bank may remain credible as an implementing agent of politically assigned priorities, even as it becomes less credible as an inflation-targeting institution. This distinction suggests that high inflation can coexist with a 'credibility floor' if private agents believe that policy will tolerate high inflation under political priorities, while still limiting the risk of hyperinflation or a complete loss of macroeconomic control.

The central hypothesis of this study is, therefore, that Türkiye's recent experience reflects not a linear collapse of credibility, but a transformation of credibility under political dominance. Specifically, we posit that (i) conventional expectation-based credibility measures should display a pronounced deterioration after the mid-2010s and especially after the policy shift of 2021; (ii) nonetheless, credibility indicators should not converge to values consistent with fully unanchored expectations, because private agents internalise a lower bound on the authorities' tolerance for inflation; and (iii) this persistence is observable in the structure of forecast disagreement and uncertainty, particularly in the tendency of private expectations to remain bounded relative to the CBRT's published forecast distributions.

To evaluate these conjectures, the paper adopts a two-stage empirical strategy. In the first stage, credibility is measured using established approaches from the literature, complemented by two

additional statistical indicators, with the aim of assessing whether credibility in Türkiye exhibits signs of a complete collapse or instead stabilises at a lower bound. This stage is deliberately diagnostic: the objective is to document the time variation of credibility and to examine whether, even during episodes in which inflation deviates markedly from the central bank's forecasts, credibility falls to extremely low levels or remains bounded. In the second stage, the analysis turns to interpretation. Having established that credibility weakened substantially without fully evaporating, the paper investigates the potential reasons behind this outcome. In particular, it examines whether the observed credibility dynamics are consistent with a politically induced shift in policy priorities, whereby inflation targeting was temporarily subordinated to employment and growth considerations. Drawing on comparative evidence from inflation, unemployment, and policy behaviour, this stage links the presence of a credibility floor to political dominance and a reweighting of the central bank's effective objective function. By structuring the analysis in this way, the paper distinguishes between measuring credibility outcomes and explaining their underlying institutional and political drivers.

2. Literature Review: Credibility Measurement, Political Dominance and Conditional Anchoring

2.1. Credibility as an Unobservable and Measured Construct

Central bank credibility is inherently unobservable. It cannot be directly read from policy instruments or inflation outcomes, but must instead be inferred from the behaviour of expectations, interest rates, and forecast responses. For this reason, the credibility literature has developed a variety of empirical proxies that translate credibility into measurable relationships. While these approaches differ in methodology, they share a common objective: to infer the degree to which private agents believe that the central bank will act consistently with its stated policy commitments.

A first strand of the literature defines credibility through the alignment between inflation expectations and the central bank's announced target. Originating with Cukierman and Meltzer (1986), this approach interprets persistent deviations of expected inflation from the target as evidence of a credibility gap. Building on this logic, Bomfim and Rudebusch (2000) formalise long-term inflation expectations as a weighted average of the inflation target and past realised inflation. The weight attached to the target is interpreted as a credibility parameter: the stronger the anchoring of expectations to the target rather than to past inflation, the higher the credibility attributed to the central bank. This class of models therefore conceptualises credibility as target-based anchoring, and has been widely applied in both advanced and emerging economies (Ehrmann, 2014; Łyziak & Paloviita, 2017; Buono & Formai, 2018; de Mendonça, 2018; Hogen & Okuma, 2025; among others).

A second strand of the literature shifts attention from distance-to-target measures toward the insulation of expectations from shocks. In the influential contribution of Gürkaynak, Levin and Svensson (2005), credibility is inferred from the sensitivity of long-term inflation expectations to macroeconomic and monetary policy surprises. The underlying premise is that while short-term expectations may respond to shocks, a credible central bank prevents these shocks from contaminating longer-horizon expectations. Weak or statistically insignificant responses of long-term expectations are therefore interpreted as evidence of strong anchoring. Jochmann, Koop, and Potter (2010) refine this framework by focusing on the pass-through from short-term to long-term inflation expectations, arguing that credibility can be assessed by the degree to which short-horizon movements propagate across maturities. In highly credible regimes, this pass-through is weak; in low-credibility regimes, it is strong.[1]

A further branch of the literature departs from expectation-based identification and instead examines credibility through its implications for interest rates. Following Goodfriend (1993), Çakmaklı and Demiralp (2020) argue that in chronically high-inflation environments, conventional expectation-

[1] See also; Beechey, Johannsen & Levin (2011); Gefang, Koop & Potter (2012); Nautz & Strohsal (2015); Alkan (2018); Çiçek & Alkan (2023)

based measures may fail to capture incremental credibility changes, because expectations become mechanically tied to realised inflation. They propose an alternative definition in which credibility is measured by the central bank's ability to lower long-term interest rates through policy actions. Their findings for Türkiye document a pronounced deterioration in credibility over time, consistent with weakening anchoring under sustained inflationary pressures.

Taken together, these approaches highlight two important features of the credibility concept. First, credibility is multidimensional: it may manifest through target alignment, shock insulation, expectation pass-through, or interest rate responses. Second, credibility is time-varying and regime-dependent, responding to institutional arrangements, policy consistency, and macroeconomic conditions. However, a common implicit assumption across much of this literature is that the central bank operates under a relatively stable mandate, with price stability occupying a dominant and persistent role. Once this assumption is relaxed, the interpretation of credibility measures becomes less straightforward.

2.2. From Fiscal Dominance to Political Dominance: *De Jure–De Facto* Mandates and Credibility Transformation

The classical fiscal dominance framework explains inflationary outcomes by emphasising the constraints imposed by public debt sustainability on monetary policy. Under fiscal dominance, the central bank may be compelled to accommodate fiscal needs even if price stability remains its formal objective. This literature has been instrumental in demonstrating that inflation outcomes cannot be understood solely as reflections of central bank preferences, but must also incorporate fiscal constraints.

Recent experience, however, suggests that fiscal dominance alone is insufficient to explain post-inflation-targeting dynamics in many economies. In several cases, monetary policy outcomes appear to be shaped less by debt arithmetic than by political priorities and direct political pressure (Gavin & Manger, 2023). This has led to a growing body of work emphasising political dominance as a distinct constraint on monetary policy, operating through the reweighting of policy objectives rather than through fiscal solvency concerns (Binder, 2020; see also Vasicek et al., 2023).

A central element of this perspective is the distinction between *de jure* and *de facto* mandates. While central bank laws may continue to prioritise price stability, actual policy implementation may place increasing weight on growth, employment, credit expansion, or exchange-rate objectives. In such settings, legal measures of central bank independence may remain unchanged even as effective autonomy erodes. Binder (2020) explicitly demonstrates that de jure independence indices fail to capture political pressure in practice, constructing instead a narrative-based measure of de facto political interference. His findings indicate that political pressure tends to bias policy toward accommodation and higher inflation, even in the absence of formal institutional change.

Similarly, Vasicek et al. (2023) stress the growing importance of the *de jure-de facto* gap in evaluating central bank independence in the post-crisis era. While rejecting the notion of a universal collapse of independence, they highlight that political and economic pressures have become increasingly salient, reshaping how mandates are interpreted and implemented. In this context, independence becomes a matter of practice rather than statute.

The mechanisms through which political dominance operates are further clarified by Gavin and Manger (2023), who model central bank-government interactions as a form of crisis bargaining. Their analysis shows that populist governments often exert public pressure on central banks without altering legal frameworks, increasing the likelihood of accommodative policy responses. Political pressure thus becomes an endogenous component of the policy regime rather than an external disturbance. Importantly, these pressures also operate through expectations and credibility channels: even when central banks resist formally, the perception of political dominance can weaken anchoring.

Goodhart and Lastra (2018) place these developments in a broader institutional context, arguing that the expansion of central bank mandates after the global financial crisis of 2007-8 intensified distributional consequences and political contestation. As central banks became involved in broader macroeconomic stabilisation tasks, the traditional consensus supporting strict inflation targeting and independence weakened, creating space for political challenges. In such environments, deviations from strict price stability may reflect political trade-offs rather than technical policy failure.

This literature suggests a crucial reinterpretation of credibility under political dominance. When the *de facto* objective function shifts, credibility should not be assessed solely by inflation outcomes or target deviations. Instead, credibility reflects the perceived consistency between the policy regime that is communicated and the regime that is actually implemented -and the extent to which private agents recognise and internalise this consistency. Under political dominance, a central bank may lose credibility as an inflation-targeting institution while retaining credibility as an agent implementing politically defined priorities.

2.3. Credibility Floors and Conditional Anchoring

Sections 2.1 and 2.2 jointly suggest that credibility dynamics under political dominance cannot be adequately captured by a binary distinction between "anchored" and "unanchored" expectations. While the credibility measurement literature focuses on how expectations relate to targets, shocks, or policy signals, we argue that the effective policy regime itself may change through a reweighting of objectives, even in the absence of formal institutional reform. When these two perspectives are combined, a more nuanced outcome emerges: credibility may weaken substantially without collapsing entirely.

In politically dominated regimes, persistent deviations from inflation targets do not necessarily imply that private agents disregard the central bank altogether. Instead, agents may internalise the *de jure–de facto* mandate gap and adjust their expectations to the perceived boundaries of policy tolerance. In such settings, credibility no longer operates as a tight inflation-targeting anchor but may persist as a credibility floor -a lower bound below which expectations do not fall, reflecting the belief that the authorities will tolerate high inflation but not a complete loss of macroeconomic control. Expectations in this case are not fully anchored, yet not fully unmoored; rather, they exhibit conditional anchoring, responding asymmetrically to policy signals depending on the prevailing political and macroeconomic context.

This interpretation has direct implications for empirical analysis. If credibility has collapsed, standard credibility indicators should converge toward values consistent with full de-anchoring, and expectations should display unbounded behaviour relative to central bank signals. If, instead, a credibility floor exists, credibility measures should deteriorate but stabilise at intermediate levels, while expectations remain systematically bounded -albeit displaced- relative to central bank forecasts. Distinguishing between these two outcomes requires moving beyond single-measure assessments and examining the joint behaviour of multiple credibility indicators.

Accordingly, the empirical analysis is structured to distinguish between two competing credibility outcomes. If credibility in Türkiye has collapsed, conventional indicators should point to full de-anchoring, with inflation expectations exhibiting unbounded divergence from central bank signals. If, instead, credibility has weakened without evaporating, the data should reveal a deterioration that stabilises at intermediate levels, accompanied by expectation dynamics that remain systematically bounded relative to the CBRT's forecasts. The empirical strategy therefore proceeds by first documenting the time variation of credibility using multiple complementary measures, and then interpreting the resulting patterns through the lens of political dominance, asking whether bounded credibility is consistent with a reweighting of policy objectives rather than with random or shock-driven de-anchoring.

The remainder of the study follows this structure: the next section introduces the data used in the empirical analysis; then Section 4 presents the methodological framework and estimation results, while the final section concludes by discussing the implications of the findings for understanding central bank credibility under politically dominated policy regimes.

3. Data

This study employs a comprehensive set of survey-based, forecast-based and macroeconomic data to analyse the evolution of monetary policy credibility in Türkiye under conditions of political dominance. The data are selected to capture not only the alignment between inflation expectations and official targets, but also the degree of uncertainty, dispersion and boundedness of expectations relative to the CBRT communicated inflation outlook. The full sample covers the period from 2002:1 to 2025:2. For certain exercises, the effective sample is shorter due to data availability and horizon-specific matching requirements.

Inflation and Inflation Expectations

Actual inflation is measured using year-on-year consumer price inflation (CPI), obtained from the CBRT's data delivery system.[2] CPI inflation serves as the realised outcome against which expectations and forecasts are evaluated throughout the analysis.

Inflation expectations are drawn from the CBRT Survey of Market Participants, which provides survey-based expectations of professional forecasters at multiple horizons. Consistent with the credibility literature, the analysis focuses on the 12-month-ahead inflation expectation as a measure of short- to medium-term expectations, and the 24-month-ahead expectation as a proxy for longer-term inflation expectations.[3] The evolution of actual inflation, 12-month-ahead inflation expectations, and 24-month-ahead inflation expectations is jointly presented in Figure 1.

Survey-based expectations are preferred over market-based measures for several reasons.[4] As emphasised by Gülşen and Kara (2021), survey expectations provide a direct measure of agents' beliefs, are less sensitive to fluctuations in market liquidity, and do not require adjustments for inflation risk premia. These advantages are particularly relevant for emerging market economies, where financial market depth is limited and risk premia can be highly volatile. While some studies argue that survey-based credibility measures may become mechanically linked to realised inflation in

[2] Year-on-year CPI inflation is computed using seasonally adjusted monthly CPI series. Seasonal adjustment is performed using the TRAMO–SEATS procedure, after which annual inflation is calculated as the twelve-month percentage change in the adjusted index.

[3] While 12-month-ahead inflation expectations from the CBRT Survey of Market Participants are available from 2002:1 onward, 24-month-ahead expectations are reported only from 2006:4. Accordingly, empirical exercises involving long-term expectations are conducted over a shorter sample, whereas analyses based on 12-month-ahead expectations exploit the full available time span.

[4] The choice between survey-based and market-based inflation expectations has been widely debated in the credibility literature. While market-based measures are often argued to be less prone to reporting biases and to incorporate information at high frequency (Gürkaynak, Levin and Svensson, 2005; Gürkaynak et al., 2020), their interpretation as pure measures of inflation expectations may be problematic. As emphasised by Faust and Wright (2013), bond prices and other market instruments embed not only expectations but also time-varying risk premia, liquidity conditions and market distortions, particularly during periods of financial stress.

In contrast, survey-based expectations provide a direct assessment of economic agents' beliefs and are less sensitive to market liquidity or risk-premium fluctuations. Gülşen and Kara (2021) argue that these features make survey-based measures especially suitable for emerging market economies, where financial markets are relatively shallow and risk premia are volatile. Although Çakmaklı and Demiralp (2020) caution that expectation-based credibility measures may lose informational content in high-inflation environments due to weak anchoring, this study deliberately relies on survey data in order to examine whether expectations become fully unanchored or instead remain systematically bounded relative to central bank signals.

high-inflation environments (Çakmaklı & Demiralp, 2020), this study deliberately retains survey data precisely because the research question concerns how expectations behave when anchoring weakens. Survey data allow for a direct examination of whether expectations become fully unmoored or instead remain bounded relative to central bank signals.

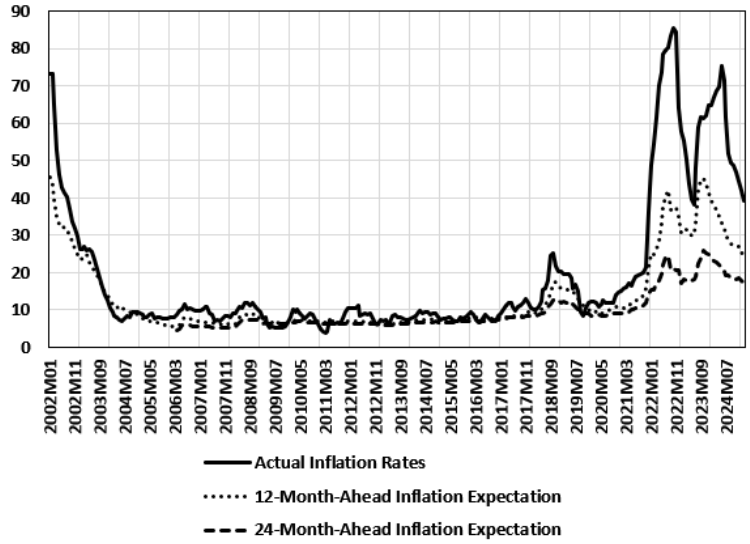


Figure 1: Actual Inflation and Inflation Expectations

Central Bank Forecasts and Confidence Intervals

To characterise the policy stance communicated by the central bank to the public, this study uses inflation forecasts published in the Inflation Reports of the CBRT. These reports provide the medium-term inflation outlook through point forecasts accompanied by uncertainty bands (fan charts), which convey the central bank's assessment of forward-looking risks. The analysis employs the lower and upper bounds of the 70 percent confidence intervals reported in the Inflation Reports as a key dataset representing the central bank's inflation projections. These intervals are derived from the forecast distributions presented in the reports and correspond to the range within which inflation is assessed by the CBRT to fall with a 70 percent probability. The evolution of the 70 percent confidence intervals for the 12-month-ahead and 24-month-ahead inflation projections is shown in Figure 2 and Figure 3, respectively.

Because the numerical values of these confidence intervals are not systematically tabulated across all Inflation Reports, the relevant bands are obtained from the graphical presentations (fan charts) published in the reports. For each report, the lower and upper bounds corresponding to the relevant forward-looking horizon are extracted from the figures using a pixel-reading technique based on the chart axes, digitised, and compiled into time-series form. This approach is widely used in the literature when central bank forecast bands are reported graphically and allows such information to be incorporated into empirical analysis.

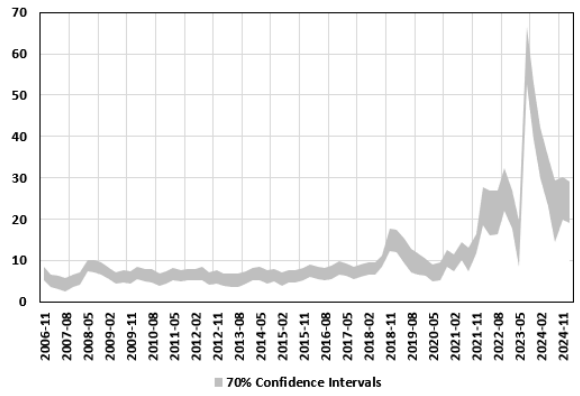


Figure 2: The 70 Percent Confidence Interval for 12-Month-Ahead Inflation Expectations (2006:11–2025:2)

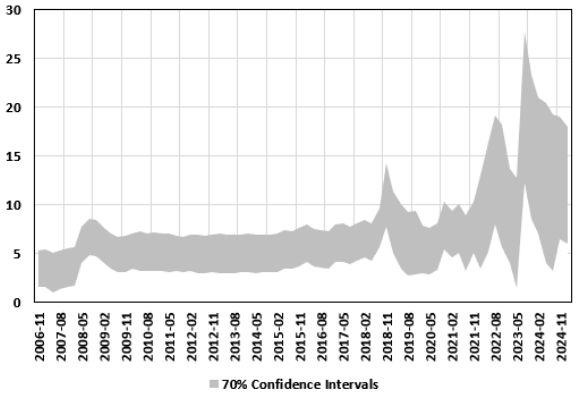


Figure 3: The 70 Percent Confidence Interval for 24-Month-Ahead Inflation Expectations (2006:11–2025:2)

Survey-Based Probability Distributions of Expectations

Going beyond mean survey expectations, this study also makes use of histogram-based probability distribution data on inflation expectations published as part of the CBRT Survey of Market Participants. In addition to reporting average inflation expectations, the CBRT disseminates the relative frequencies (percentage shares) of respondents whose expectations fall within predefined histogram classes (bins). This presentation allows not only the central tendency of expectations but also their cross-sectional structure and concentration across expectation ranges to be observed for each period.

These histogram-based distribution data are visualised in Figure 4 and Figure 5. In both figures, the horizontal axis denotes time (months), while the vertical axis reports the percentage frequencies corresponding to each expectation range, with frequencies summing to 100 percent. Each vertical slice (column) in the figures corresponds to a cross-sectional histogram of inflation expectations at a given point in time, viewed from above. When these time-specific histograms are placed side by side and colour-coded according to relative frequencies, the resulting visualisation takes the form of a heatmap representation of histogram-based expectation distributions over time, allowing the joint evolution of the location and concentration of expectations to be traced in a compact and intuitive manner. The CBRT began publishing these distributional data from 2013:6 for 12-month-ahead expectations and from 2017:11 for 24-month-ahead expectations. To further illustrate the density and evolution of the distribution, a colour scale ranging from red (highest frequencies) to green (lowest frequencies) is applied.

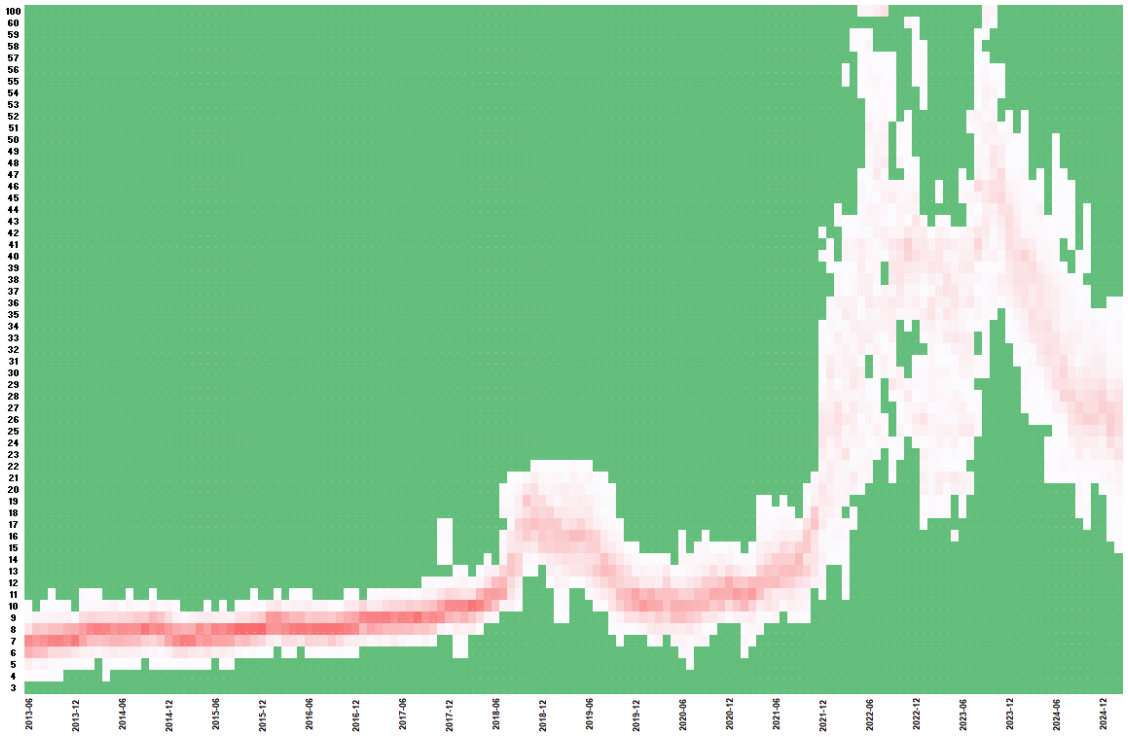


Figure 4: Distribution of 12-Month-Ahead Inflation Expectations Across Survey Bins (2013:6–2025:2)

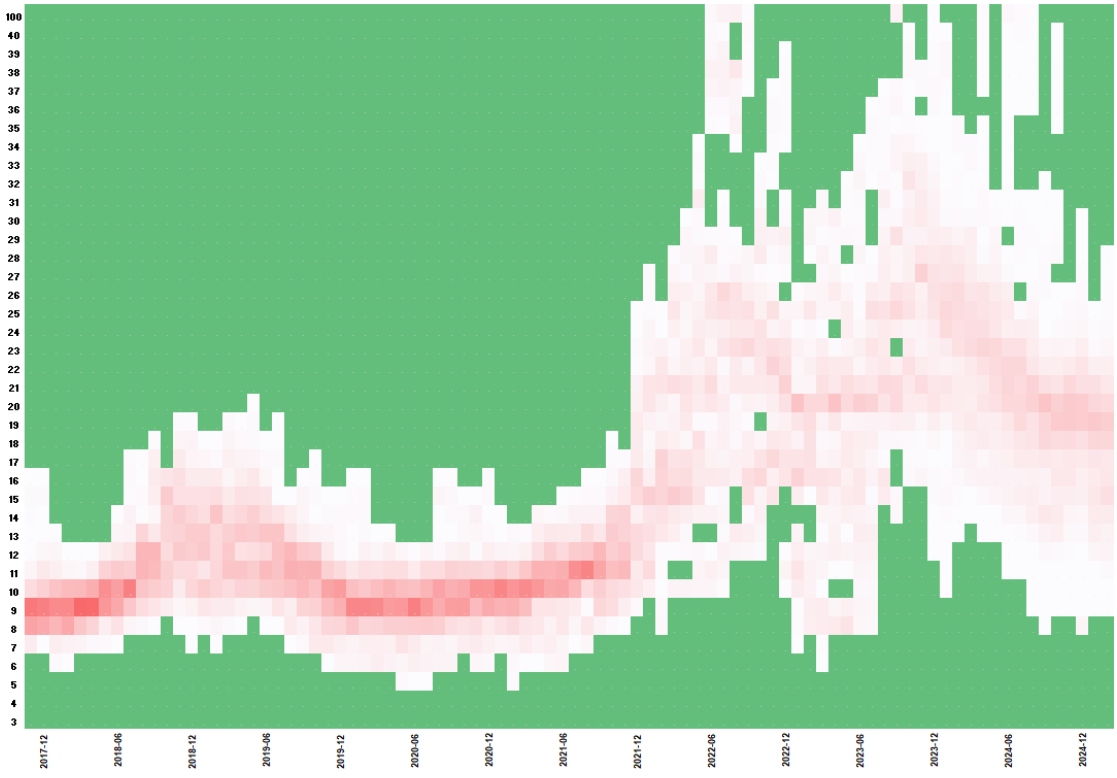


Figure 5: Distribution of 24-Month-Ahead Inflation Expectations Across Survey Bins (2017:11–2025:2)

Labour Market Data

To support the interpretation of credibility dynamics within a broader macroeconomic and political context, the analysis also draws on labour market data. In this regard, the study employs the broad unemployment rate obtained from official labour force statistics published by the Turkish Statistical

Institute (TURKSTAT) (Figure 6). The choice of the broad unemployment measure is motivated by the fact that it captures labour market slack more comprehensively than the narrow definition of unemployment, as it includes not only the officially unemployed but also individuals in time-related underemployment, discouraged workers, and those who are not actively searching for a job but remain available for work. This broader measure is particularly informative during periods of heightened economic uncertainty and shifting policy priorities, when labour market conditions may not be adequately reflected by headline unemployment rates alone. The unemployment series is used in a descriptive and interpretative capacity rather than as an input to formal econometric estimation.

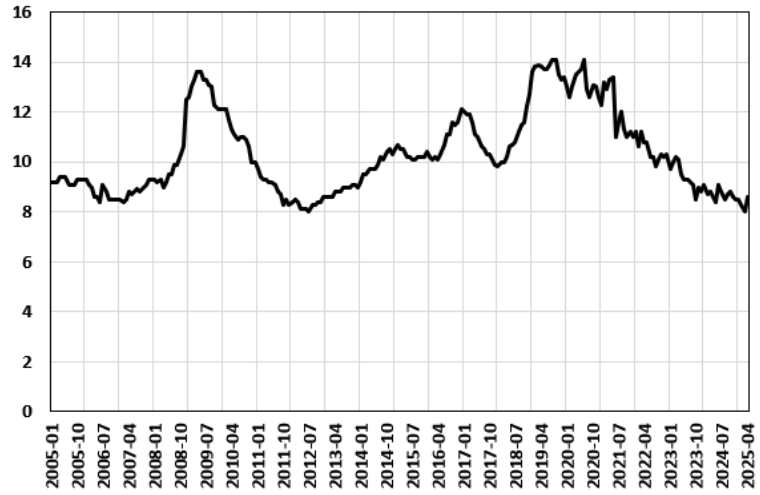


Figure 6: Broad Unemployment Rate (2005:1–2025:2)

Constructed Indicators: Misery Index

In addition to the raw data series, this study constructs a simple weighted Misery Index that combines inflation and unemployment rates. In its classical definition, the Misery Index is the sum of the inflation rate and the unemployment rate, with increases in the index interpreted as indicating a deterioration in overall social welfare. The weighted Misery Index used in this study, however, is designed as a backward-looking diagnostic tool that facilitates the interpretation of observed credibility patterns in light of potential shifts in policy priorities. The index is not intended as a structural estimate of the central bank's loss function, but rather as an illustrative numerical exercise aimed at making visible how the relative importance assigned to inflation and unemployment may vary across different sub-periods.

In constructing the index, inflation and unemployment rates are not combined using equal weights. The underlying rationale is that a one-percentage-point increase in the unemployment rate does not necessarily imply the same welfare loss as a one-percentage-point increase in the inflation rate. To identify the relative weighting structure between the two variables, the study adopts a framework that can be interpreted as the total derivative of a policy loss function in which penalties for inflation and unemployment are jointly embedded. Within this framework, the inflation and unemployment weights that generate comparable levels of "misery" across different sub-periods are determined numerically. In particular, the weighting scheme that produces comparable misery levels between the high-inflation–low-unemployment cluster observed during 2022–2024 and earlier observations implies a relative weight of 18 to 1 in favour of unemployment. Based on this weighting,

the weighted Misery Index is computed by multiplying the observed unemployment rate by 18 and adding the corresponding monthly inflation rate. The resulting index series is presented in Figure 7.[5]

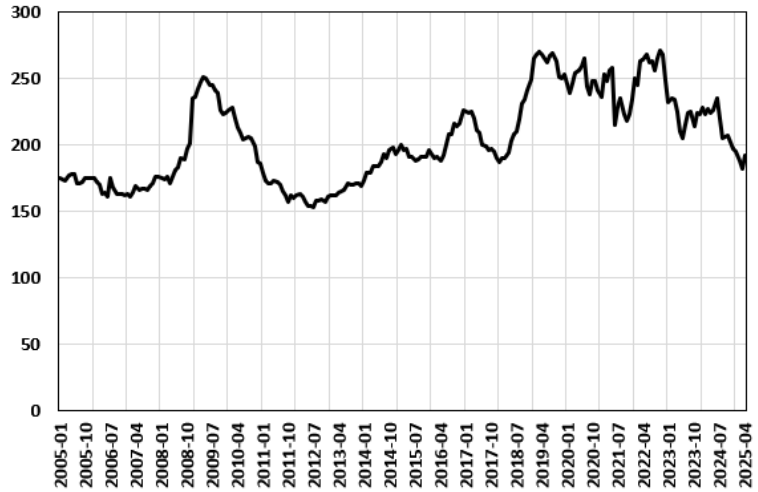


Figure 7: Misery Index (2005:1–2025:2)

4. Empirical Analysis

4.1. Measuring Credibility: Collapse or Floor?

This section provides the first empirical assessment of monetary policy credibility in Türkiye, with the explicit objective of distinguishing between two competing interpretations: a complete collapse of credibility versus the persistence of a lower bound, or credibility floor. Consistent with the conceptual framework developed in the *Introduction*, the purpose of this section is strictly diagnostic. Rather than offering a structural explanation at this stage, the analysis focuses on documenting how credibility evolves over time and on whether standard credibility indicators converge toward values consistent with full de-anchoring.

The empirical strategy rests on a core insight from the credibility literature: although credibility itself is unobservable, it leaves systematic traces in the way inflation expectations are formed. To capture these traces in a way that is informative about "collapse" versus "floor," the section measures credibility using a set of complementary approaches rather than relying on a single proxy. Specifically, credibility is assessed through five distinct yet related empirical lenses: (i) target-based credibility measures that quantify the relative weight of announced inflation objectives versus past realised inflation in expectation formation; (ii) transmission-based measures that examine the pass-through from short- to long-horizon inflation expectations; (iii) dynamic anchoring indicators derived from time-varying expectation responses; (iv) uncertainty-based measures that compare the dispersion of private-sector forecasts with the central bank's communicated forecast bands; and (v) probability-based metrics that evaluate the extent to which survey expectations fall within the confidence intervals of the CBRT's published inflation outlook. Evaluating these measures jointly allows us to assess whether credibility deteriorates toward patterns consistent with full de-anchoring, or whether it stabilises at intermediate levels that are consistent with a credibility floor.

[5] Having set the weight of inflation to unity, the spreadsheet exercise involves picking the weight of unemployment that makes the difference between the pre- and post-2022 misery values as close as possible to zero.

Credibility Gap: A Time-Varying Bomfim–Rudebusch Framework

To operationalise the collapse-versus-floor distinction, the analysis begins with a time-varying version of the credibility gap framework originally proposed by Bomfim and Rudebusch (2000). In this class of models, inflation expectations at a given horizon are expressed as a weighted average of the central bank's announced inflation target and past realised inflation. The weight assigned to the target is interpreted as a credibility parameter, capturing the extent to which private agents regard the central bank's commitment as informative for future inflation outcomes. Formally, inflation expectations formed at time t for horizon k are specified as;

$$\pi_{t+k}^{e} = \lambda_t \pi_t^{T} + (1 - \lambda_t)\pi_{t-1} \quad (1)$$

where π_{t+k}^{e} denotes expected inflation k periods ahead, π_t^{T} represents the inflation target announced by the central bank, and π_{t-1} is lagged realised inflation. The parameter $\lambda_t \in [0,1]$ measures credibility: values close to unity indicate that expectations are primarily anchored to the target, while values close to zero imply that expectations are almost entirely backward-looking.

The principal strength of this framework lies in its ability to translate credibility -an inherently unobservable concept- into a measurable parameter by directly quantifying the relative importance of announced targets versus past inflation in expectation formation. However, the fixed-parameter version of the model is ill-suited to environments characterised by regime shifts, political interference, and changing policy priorities, as it implicitly assumes a stable credibility structure over time. Credibility in such settings is unlikely to evolve smoothly or remain constant over long horizons. For this reason, the present study adopts a time-varying parameter (TVP) specification and estimates the model in a state-space form using the Kalman filter. The empirical implementation follows the framework developed by Demertzis, Marcellino, and Viegi (2008) [and Van der Cruijsen and Demertzis (2011)] and subsequently applied to the Turkish economy by Çiçek, Akar, and Yücel (2011), extended here to cover a longer sample and recent high-inflation episodes.[6] Within this setting, the credibility parameter λ_t is allowed to evolve endogenously over time, enabling the identification of both gradual shifts and discrete turning points in credibility across different inflation regimes. Periods in which λ_t remains high and stable are interpreted as episodes of reinforced confidence in the central bank's target, whereas sustained declines are associated with phases of weakening credibility. The estimated time path of λ_t is presented in Figure 8.

The TVP estimates reported in Figure 8 point to a clearly regime-dependent and non-monotonic evolution of credibility. Following the transition to the inflation targeting regime in the early 2000s, the credibility of the central bank increased rapidly: the estimated credibility parameter rose from values around 0.5 to levels close to 0.9 within a short period. Although credibility declined temporarily during the 2006 exchange-rate shock and the 2008 global financial crisis, these episodes did not result in a persistent erosion. Instead, the credibility coefficient recovered swiftly and continued to increase until the end of 2013. After this point, credibility began to decline gradually. The downward trend became more pronounced after the first quarter of 2017, coinciding with the intensification of political discourse surrounding the central bank's interest rate decisions, with the credibility parameter falling toward values around 0.6. A partial recovery followed, but this improvement proved short-lived. With the adoption of unconventional and widely perceived as irrational monetary policy practices in the final quarter of 2021, credibility once again deteriorated and stabilised at levels close to 0.6. Importantly, this period was characterised by realised inflation persistently and substantially exceeding the CBRT's published inflation forecasts. Despite this sustained and sizeable forecast failure, the credibility parameter did not converge toward very low

[6] Owing to space limitations in the main text, the technical details of the empirical implementation of the TVP credibility model, including the state-space representation, estimation strategy, and filtering procedure, are documented in Appendix 2.

values. Instead, it stabilised along a relatively flat trajectory, consistent with what can be described as a credibility floor. Even under conditions of extremely high and volatile inflation, the estimated coefficients suggest that private agents did not abandon the central bank's signals altogether. Finally, following the appointment of a new policy team in July 2023 and explicit communication signalling a departure from the previous unconventional policy framework, credibility entered a renewed upward phase.

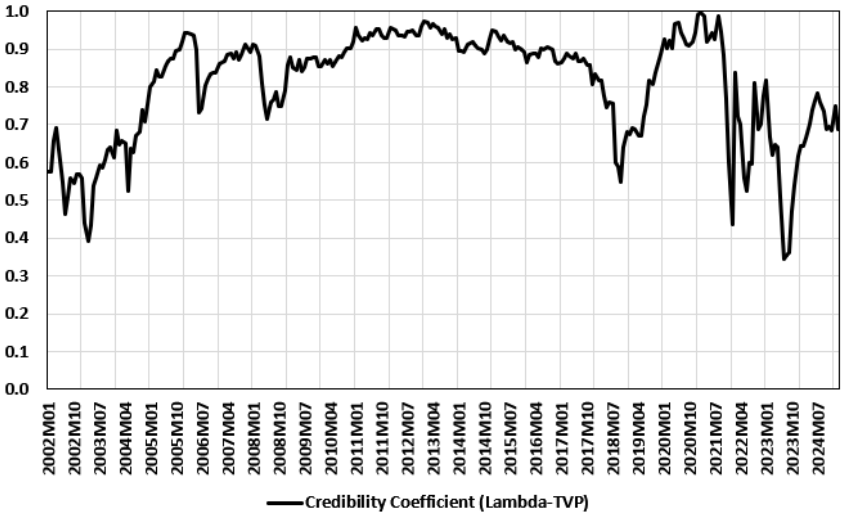


Figure 8: The Time-Varying Evolution of the Credibility (λ_t) of the CBRT

Taken together, the credibility gap estimates provide a first diagnostic assessment of the collapse-versus-floor distinction. While the target-based credibility parameter exhibits pronounced deterioration during periods of unconventional policy and heightened political pressure, it does not display the behaviour that would be expected under full de-anchoring. Instead, expectations remain only partially backward-looking, suggesting that credibility weakens without collapsing entirely. However, as this framework infers credibility solely from the relative weight assigned to targets versus past inflation, it cannot fully capture how expectations propagate across horizons or how anchoring operates beyond target alignment. To assess whether the evidence for bounded credibility extends to other dimensions of expectation formation, the analysis next turns to a transmission-based approach that examines the pass-through from short- to longer-horizon inflation expectations.

Transmission-Based Credibility: A Rolling VAR Interpretation of the Jochmann-Koop-Potter Approach

While target-based credibility measures provide valuable information on the extent to which inflation expectations align with official objectives, they do not fully capture how expectations interact across horizons. Credibility may weaken even when expectations remain partially aligned with targets, if short-term inflation news increasingly spills over into longer-term beliefs. For this reason, the literature has emphasised transmission-based credibility measures that focus on the extent to which disturbances in short-horizon expectations propagate to longer horizons. From this perspective, credibility is reflected not in the level of expectations itself, but in the degree to which longer-horizon expectations are insulated from short-term fluctuations.

The conceptual basis for this approach is provided by Jochmann, Koop, and Potter (2010), who study the relationship between short- and long-horizon inflation expectations through an inflation pass-through coefficient. In their framework, changes in long-horizon expectations are related to changes in short-horizon expectations, and the resulting coefficient serves as an indicator of anchoring. Low values of the pass-through coefficient are consistent with strong anchoring, while higher values indicate weaker anchoring and greater susceptibility of long-term expectations to short-term

movements. This framework provides a natural basis for assessing credibility in terms of expectation transmission rather than target alignment. Formally, the pass-through relationship can be expressed as in Eq.2.

$$\Delta\pi_t^L = \beta_t \Delta\pi_t^S + \varepsilon_t \quad (2)$$

where $\Delta\pi_t^S$ denotes changes in short-horizon inflation expectations, $\Delta\pi_t^L$ represents changes in longer-horizon expectations, and β_t captures the degree of transmission between the two. The magnitude of β_t therefore reflects the extent to which short-term expectation shocks affect longer-term beliefs: values of β_t close to zero indicate a high degree of credibility, as long-horizon expectations remain insulated from short-term disturbances, whereas values approaching unity correspond to a situation of near-complete pass-through, consistent with severely weakened or effectively absent credibility.

While Jochmann et al. (2010) estimate this relationship within a time-varying parameter state-space framework, the present study adopts a VAR-based rolling-window approach that is more closely aligned with its diagnostic objective. Rather than modelling the stochastic evolution of the pass-through coefficient explicitly, the analysis traces how the transmission from short- to long-horizon inflation expectations evolves across different policy regimes. Short-term expectations are proxied by 12-month-ahead inflation expectations, while 24-month-ahead expectations are used to represent long-term beliefs. Credibility is assessed by examining how strongly shocks to short-horizon expectations transmit to longer horizons, with stronger transmission interpreted as weaker anchoring. Empirically, a bivariate VAR model is estimated using rolling windows of 36 periods.[7] For each window, impulse response functions are computed, and the response of 24-month-ahead inflation expectations to a one-unit shock in 12-month-ahead expectations at the 18th horizon is extracted from the IRF tables. These responses are then assembled into a time series capturing the evolving degree of pass-through over time. For ease of interpretation, the inverse of this series is plotted in Figure 9, so that values closer to zero correspond to higher central bank credibility.

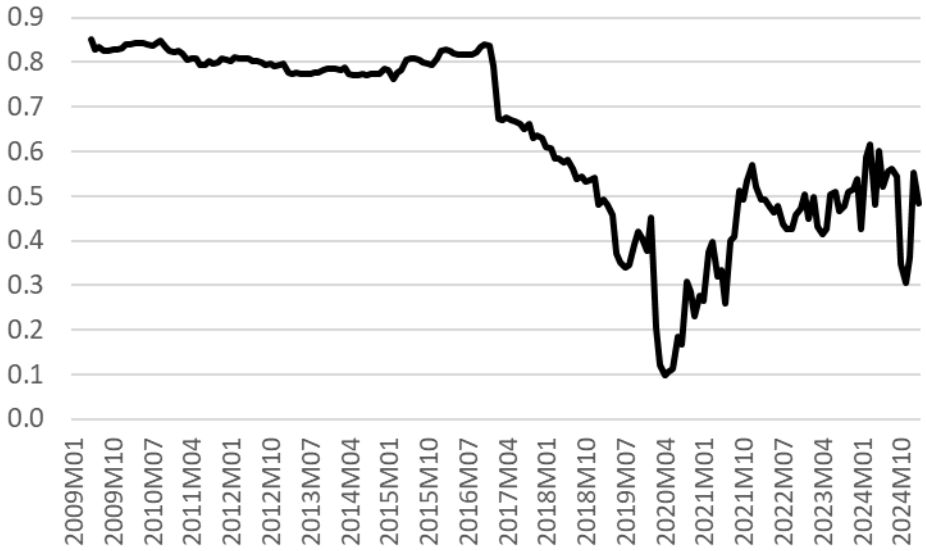


Figure 9: Rolling Window VAR-Based Credibility Coefficients

Figure 9 presents the rolling-window estimates of the transmission-based credibility indicator derived from the VAR framework and reveals a clear regime-dependent pattern. During the period from 2009 to 2017, the estimated pass-through coefficient remains persistently close to zero,

[7] Due to space limitations in the main text, the technical details of the rolling-window VAR exercise are available from authors upon request.

fluctuating around values of approximately 0.05. Such low values indicate a high degree of credibility, as shocks to short-horizon inflation expectations generate only limited spillovers to longer-horizon expectations. In this phase, long-term beliefs appear to be effectively insulated from short-term fluctuations, consistent with strong anchoring. Once observations from 2017 enter the rolling estimation window, a pronounced deterioration in credibility becomes visible. The pass-through coefficient rises steadily, reaching values close to 0.18 by 2020. This increase signals a weakening of the central bank's ability to contain the transmission of short-term inflation news to longer horizons. After 2020, the indicator shows a partial recovery: the pass-through coefficient declines and stabilises around levels close to 0.10 during the 2020–2023 period, and remains broadly at this level thereafter. Despite this improvement, credibility does not return to its pre-2017 levels. Instead, the post-2020 period is characterised by a lower but stabilised degree of anchoring, pointing to a persistent erosion rather than a temporary disruption.

A particularly informative comparison emerges between the 2017-2020 and 2020-2023 sub-periods. Although the latter period is marked by substantially higher inflation and greater macroeconomic turbulence, the estimated pass-through coefficient is lower -around 0.10 compared to values approaching 0.18 in the earlier phase. In other words, the transmission of short-term inflation expectations to longer horizons is weaker during 2020–2023, implying relatively stronger credibility. This pattern suggests that, even as realised inflation deviated sharply from the inflation paths communicated in the CBRT's Inflation Reports, economic agents did not interpret these deviations as random policy failure. Instead, expectations appear to have adjusted in a systematic manner, consistent with the perception that the central bank was prioritising objectives other than price stability. Credibility thus weakened but did not collapse, giving rise to a lower yet persistent credibility floor.

Taken together, the transmission-based evidence supports the collapse-versus-floor distinction identified in the target-based analysis. Although the pass-through coefficient rises markedly after 2017, it does not converge toward values consistent with fully unanchored expectations. Instead, credibility deteriorates and then stabilises at intermediate levels, even during periods of extremely high inflation. The partial recovery observed after 2020, despite large and persistent deviations from the CBRT's announced inflation paths, indicates that long-horizon expectations remained only partially exposed to short-term inflation dynamics. This pattern suggests that credibility weakened without collapsing, consistent with the existence of a credibility floor rather than complete de-anchoring.

Forecast-Uncertainty-Based Credibility: Expectations Relative to Central Bank Forecast Bands

While target-based and transmission-based measures provide complementary evidence on the evolution of credibility, both approaches remain silent on how private-sector expectations are distributed relative to the uncertainty communicated by the central bank itself. In particular, these measures do not directly assess whether private agents continue to form expectations within the probabilistic space defined by the central bank's forecasts, or whether expectations drift beyond the boundaries of the policy maker's communicated outlook. To address this dimension, the analysis next adopts a forecast-uncertainty-based approach that evaluates credibility by comparing the dispersion of private-sector inflation expectations with the forecast uncertainty bands published by the CBRT.

The underlying idea of this approach is straightforward. A credible central bank is expected not only to influence the central tendency of expectations, but also to shape the range of outcomes that economic agents regard as plausible. When credibility is high, private expectations should remain largely contained within the confidence intervals of the central bank's forecast distributions. Persistent positioning of expectations outside these bands -especially at longer horizons- signals a weakening of credibility, as agents no longer perceive the central bank's outlook as an informative guide to future inflation risks. The resulting patterns obtained from this analysis are visualised in Figure 10 for 12-month-ahead inflation expectations and in Figure 11 for 24-month-ahead expectations.

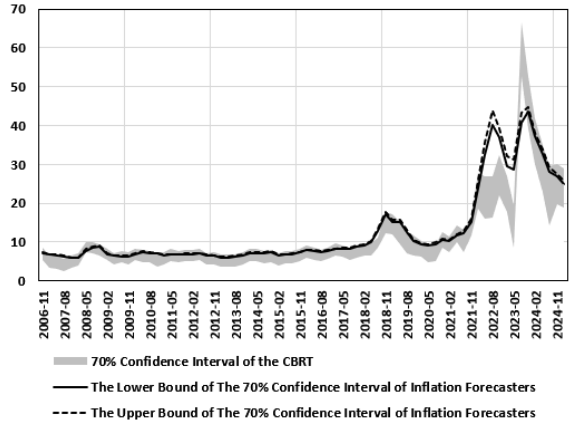


Figure 10: The 70 Percent Confidence Intervals of the CBRT and Forecasters for 12-Month-Ahead Inflation Expectations (2006:11–2025:2)

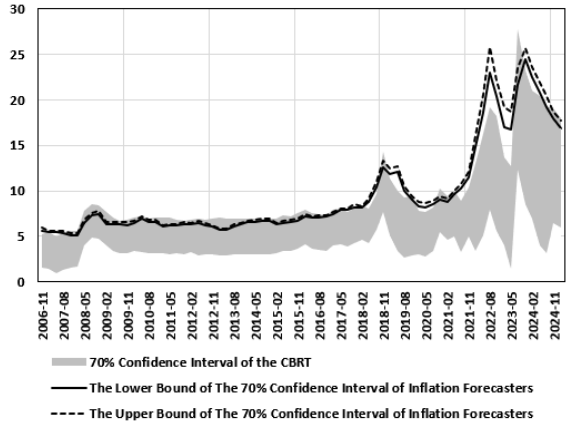


Figure 11: The 70 Percent Confidence Intervals of the CBRT and Forecasters for 24-Month-Ahead Inflation Expectations (2006:11–2025:2)

An examination of Figure 10 reveals a clear and persistent pattern in 12-month-ahead inflation expectations. The lower and upper bounds of the 70 percent confidence interval for professional inflation forecasters' expectations evolve within a markedly narrower range compared to the corresponding 70 percent confidence interval of the CBRT's inflation forecasts. This indicates that private-sector agents perceive relatively limited uncertainty surrounding the short-term inflation outlook. More importantly, throughout most of the sample period, the forecasters' confidence interval remains tightly clustered around the upper bound of the CBRT's forecast band. This systematic positioning suggests that economic agents interpret the central bank's communicated outlook not as a central projection, but as a lower benchmark that is consistently adjusted upward in forming expectations.

From 2018 onwards, this configuration begins to change. In particular, following the adoption of the low-interest-rate policy stance in the final quarter of 2021, both the lower and upper bounds of the private sector's 70 percent confidence interval move above the upper bound of the CBRT's forecast band. Nevertheless, the magnitude of this divergence does not point to a complete breakdown in the relationship between private expectations and the central bank's communicated outlook. Instead, expectations remain concentrated within a relatively narrow range just above the CBRT's forecast interval. This behaviour indicates that, even in the short horizon, expectations did not become fully unanchored, thereby providing support for the credibility floor hypothesis.

A similar but more pronounced pattern emerges when the analysis is extended to 24-month-ahead inflation expectations, as shown in Figure 11. Up to 2018, the upper bound of the private sector's confidence interval closely tracks the upper bound of the CBRT's forecast band, suggesting that long-term inflation expectations remained broadly anchored. Beyond this point, however, private-sector expectations shift in a more systematic and persistent manner above the CBRT's upper band. Despite this shift, the deviation remains bounded and does not indicate complete disengagement from the central bank's projections. Instead, long-term expectations appear to have adjusted in line with a reassessment of the policy regime, internalising a sustained tolerance for higher inflation while still respecting implicit limits to policy discretion. Taken together, the evidence from both short- and long-horizon expectations indicates that credibility in Türkiye weakened substantially, yet did not collapse. Rather, it appears to have been redefined at a lower but persistent level, consistent with the notion of a credibility floor.

Taken together, the forecast-uncertainty-based evidence further reinforces the collapse-versus-floor distinction established by the previous measures. While private-sector expectations

increasingly deviate from the CBRT's forecast bands after 2018—and especially following the policy shift of late 2021—this divergence remains bounded rather than explosive. Expectations systematically reposition above the upper bound of the central bank's communicated uncertainty, yet they do not disperse arbitrarily or detach completely from the forecast framework. Instead, both short- and long-horizon expectations continue to cluster within a relatively narrow range, indicating that the central bank's inflation outlook retains informational relevance even as credibility weakens. This pattern suggests that credibility erosion manifests not through a loss of influence over the perceived range of plausible outcomes, but through a re-anchoring of expectations at a higher level of tolerated inflation. Consistent with the earlier findings, the uncertainty-based approach thus confirms that credibility in Türkiye weakened substantially without collapsing, supporting the existence of a persistent credibility floor rather than full de-anchoring.

Probability-Based Credibility: The Distribution of Expectations Relative to Central Bank Forecasts

While the forecast-uncertainty-based approach evaluates credibility by comparing the range of private-sector expectations with the uncertainty communicated by the central bank, it remains silent on how expectations are distributed within or outside this range. In particular, confidence intervals summarise dispersion but do not reveal whether expectations cluster near specific regions of the central bank's forecast distribution. To address this dimension, the analysis next adopts a probability-based credibility measure that exploits the full cross-sectional distribution of inflation expectations reported in the Survey of Market Participants. The underlying premise of this approach is that credibility is reflected not only in whether expectations fall within the central bank's forecast bands, but also in how expectations are concentrated relative to these bands. When credibility is high, a large fraction of expectations should lie within the confidence intervals communicated by the central bank, and the distribution should be centred around the forecast path. By contrast, persistent mass accumulation outside the forecast bands -especially at their upper edge- signals a weakening of credibility, as agents revise the probability they assign to outcomes consistent with the central bank's outlook.

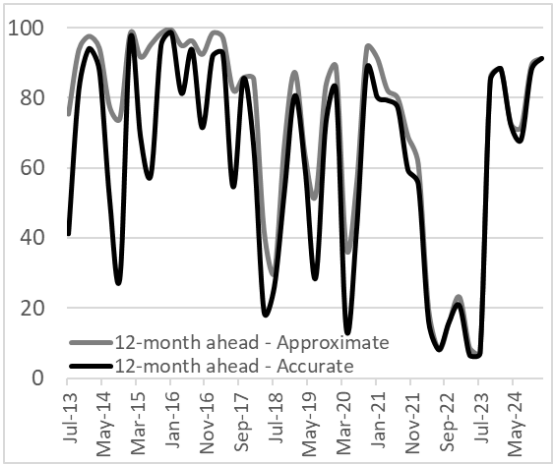


Figure 12: Probability-Based Credibility for 12-month Ahead Inflation Expectations

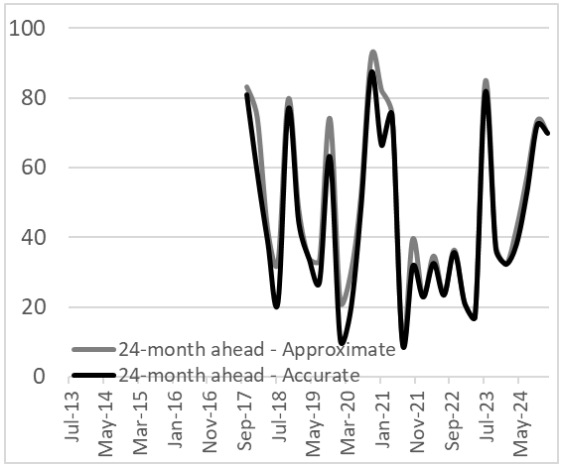


Figure 13: Probability-Based Credibility for 24-month Ahead Inflation Expectations

Empirically, the analysis exploits the histogram-based probability distributions published alongside the CBRT Survey of Market Participants. For each survey period, the CBRT reports the percentage shares of respondents whose inflation expectations fall into predefined expectation bins. These relative frequencies are matched with the lower and upper bounds of the 70 percent confidence intervals reported in the Inflation Reports, ensuring that survey expectations and central bank forecasts refer to the same horizon (12-month-ahead or 24-month-ahead). Two versions of the probability-based credibility indicator are constructed: an approximate measure that assigns full

probability mass to bins whose midpoints fall within the forecast interval, and an accurate measure that accounts for partial overlaps between bins and the confidence interval.[8] The resulting probability-based credibility measures are visualised in Figure 12 for 12-month-ahead expectations and in Figure 13 for 24-month-ahead expectations.

Figures 12 and 13 illustrate the time evolution of the probability-based credibility indicators derived from the distributional approach. By construction, these indicators exhibit short-term fluctuations; however, when their longer-run behaviour is considered, periods of relatively high credibility can be clearly distinguished from episodes of credibility deterioration. The evidence indicates that credibility erosion becomes particularly pronounced around mid-2021, while a gradual restoration emerges from early 2024 onwards. A comparative examination of the two figures reveals that the recovery in credibility based on 12-month-ahead inflation expectations is noticeably stronger than that based on 24-month-ahead expectations. This finding suggests that short-horizon expectations respond more quickly to changes in the monetary policy stance, whereas the re-anchoring of longer-horizon expectations proceeds more slowly and remains more limited. The probability-based approach thus highlights that credibility does not erode and recover symmetrically across horizons, but instead evolves in a horizon-dependent manner.

Overall, the evidence obtained from the probability-based measures is consistent with the findings from the forecast-uncertainty-based analysis. In both cases, inflation expectations do not detach completely from the inflation outlook communicated by the central bank, even during periods of severe credibility erosion. Rather, expectations adjust within bounded limits, indicating that the central bank retains influence over the perceived range of plausible inflation outcomes. These findings support the central argument of the paper that credibility in Türkiye weakened substantially without collapsing, lending further support to the existence of a persistent credibility floor.

4.2. Interpreting the Credibility Floor: Political Dominance and *De Facto* Policy Reweighting

The empirical evidence presented in Section 4.1 establishes a clear stylised fact: monetary policy credibility in Türkiye deteriorated markedly after the mid-2010s and especially following the policy shift of 2021, yet it did not collapse. Across multiple and conceptually distinct credibility measures, expectations weakened, shifted upward, and became less tightly anchored, but they remained bounded and systematically related to the signals communicated by the central bank. This section turns from measurement to interpretation and asks why credibility eroded in this particular way. Specifically, it argues that the persistence of a credibility floor can be understood as the outcome of political dominance operating through a reweighting of the central bank's effective policy objectives rather than through a breakdown of expectation formation.

Under standard inflation-targeting frameworks, credibility is closely tied to the ability of the central bank to deliver price stability and to align expectations with an explicit inflation target. Persistent and large deviations from the target would therefore be expected to result in a near-complete loss of credibility. However, this prediction relies on the assumption that the inflation target continues to represent the dominant objective guiding policy decisions. Once this assumption is relaxed, the interpretation of credibility changes fundamentally. In politically dominated regimes, deviations from price stability need not be perceived as policy failure or inconsistency; instead, they may reflect a deliberate shift in priorities, where inflation control is temporarily subordinated to other objectives such as growth, employment, credit expansion, or exchange-rate considerations.

In the Turkish case, the legal framework governing monetary policy has remained formally unchanged since the early 2000s. The CBRT's law continues to define price stability as the primary objective, allowing support for growth and employment only insofar as this does not conflict with

[8] The formal construction of the approximate and accurate probability-based credibility measures, including the treatment of partial bin overlaps and weighting schemes, is available from the authors upon request.

inflation control. Yet the empirical patterns documented in Section 4.1 suggest that private agents increasingly perceived a divergence between the *de jure* mandate and the *de facto* policy regime. From this perspective, credibility weakened not because the central bank's signals became meaningless, but because their content was reinterpreted. Inflation forecasts, communication, and policy actions were no longer read as strict commitments to disinflation, but as conditional statements embedded within a politically redefined set of priorities.

This reinterpretation provides a natural explanation for the existence of a credibility floor. When agents believe that the central bank operates under political dominance, they may revise their beliefs about the acceptable range of inflation outcomes without abandoning the central bank as a reference point altogether. In such a setting, credibility no longer reflects confidence in the delivery of low inflation, but confidence in the consistency of the regime itself. Expectations remain bounded because agents internalise an implicit lower bound on policy discipline: while high inflation may be tolerated, a complete loss of macroeconomic control or a transition toward hyperinflation is not. As a result, expectations drift upward but do not become arbitrarily dispersed or detached from official forecasts.

The behaviour of expectations documented in Section 4.1 is consistent with this interpretation. The clustering of expectations near or above the upper bounds of the CBRT's forecast intervals, the stabilisation of credibility indicators at intermediate levels, and the partial insulation of longer-horizon expectations from short-term shocks all point toward a regime in which policy signals retain informational value, albeit of a different kind. Rather than anchoring expectations to a fixed target, the central bank appears to anchor them to a politically determined tolerance range. Credibility thus survives not as a nominal anchor, but as a regime-consistency anchor.

Importantly, this interpretation also helps reconcile the coexistence of extremely high inflation with relatively orderly expectation dynamics. If credibility had collapsed entirely, one would expect expectations to become unbounded, disagreement to explode, and long-horizon beliefs to respond one-for-one to short-term inflation news. None of these outcomes are supported by the evidence. Instead, expectations adjust in a systematic and state-dependent manner, consistent with agents learning about and adapting to a new policy regime rather than disregarding policy altogether. In this sense, Türkiye's recent experience is better characterised as a transformation of credibility rather than its disappearance. The central bank lost credibility as an inflation-targeting institution, but retained credibility as an implementing agent of politically defined priorities. This distinction is central to understanding why credibility weakened without collapsing and motivates the next step of the analysis. The following section therefore examines how this reweighting of policy objectives is reflected in observable macroeconomic outcomes, focusing on inflation-unemployment dynamics and a simple revealed-preference exercise to shed further light on the nature of the credibility floor.

4.3. Conditional Anchoring and Revealed Policy Preferences: Inflation–Unemployment Dynamics

Regime Shifts in Inflation–Unemployment Dynamics

Having established that monetary policy credibility in Türkiye weakened substantially without collapsing, this section turns to the joint behaviour of inflation and unemployment to provide an intuitive interpretation of this pattern. Rather than estimating a structural model, the analysis deliberately adopts a simple, backward-looking perspective, returning to the raw macroeconomic data. The objective is not to identify causal mechanisms, but to assess whether observed inflation–unemployment dynamics are consistent with a regime in which inflation was temporarily tolerated in pursuit of labour-market objectives. This approach serves as a bridge between the credibility measures documented in Section 4.1 and the political-dominance interpretation developed in Section 4.2.

Figures 14–17 present the joint evolution of annual CPI inflation and the broad unemployment rate across four sub-periods, each corresponding to a distinct macroeconomic and institutional configuration. Taken together, these figures offer a compact visual summary of how policy priorities and macroeconomic outcomes evolved over time, and how shifts in these priorities may have shaped expectation formation.

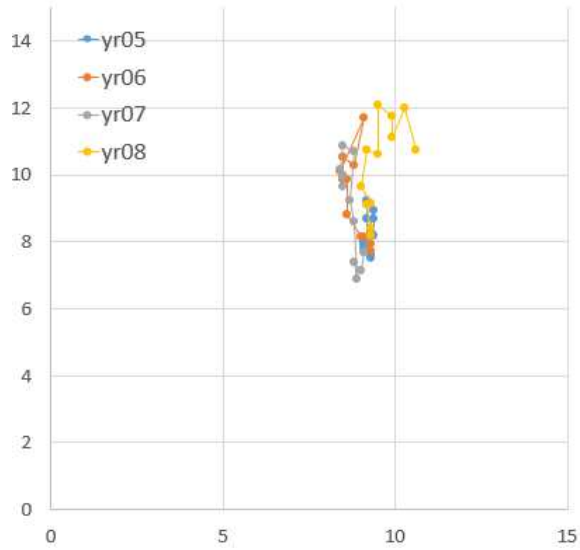


Figure 14: 2005-2008: Inflation Targeting in Effect

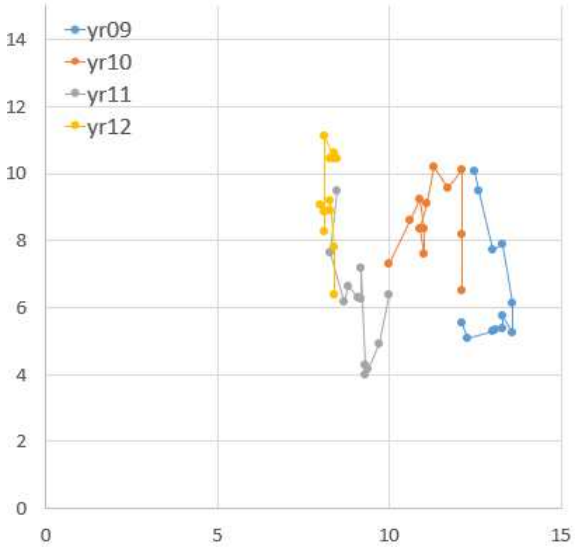


Figure 15: 2009-2012: Growing via Construction

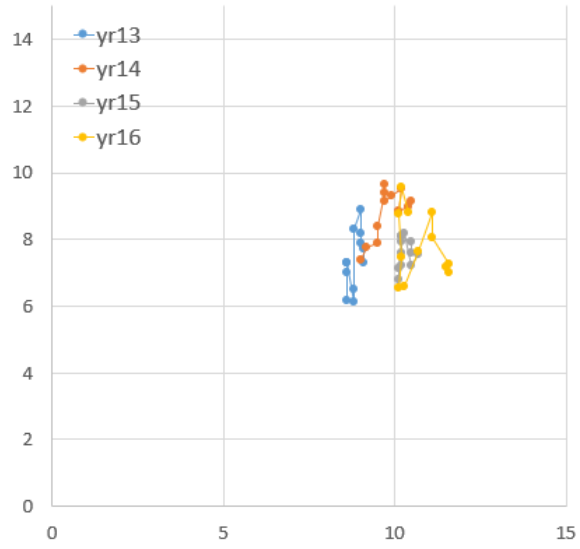


Figure 16: 2013-2016: More Construction

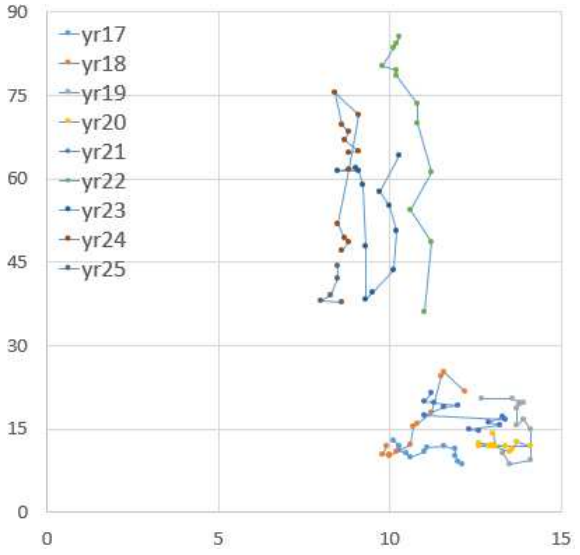


Figure 17: 2017-2025: Major Switch

[All Panels: Vertical Axis: Annual CPI Inflation (%), Horizontal Axis: Broad Unemployment Rate (%)]

Figure 14, which corresponds to the period 2005–2008, illustrates the early years of full-fledged inflation targeting. This phase is characterised by relatively disciplined inflation dynamics and a stabilising relationship between inflation and unemployment, supported by a macroeconomic framework that combined monetary discipline with a degree of fiscal restraint. Despite the exchange-rate turbulence of 2006 and the upward revision of inflation targets in 2008, the overall configuration suggests that price stability remained the dominant policy objective. In this period, credibility measures are expected to perform well, as macroeconomic outcomes broadly align with the central bank's stated mandate. Moving forward in time, Figure 15, covering the 2009–2012 period, reflects

the growing role of construction-driven growth strategies. During this phase, unemployment declines while inflation remains relatively contained, indicating that employment gains were achieved without an immediate and pronounced inflationary cost. Although fiscal discipline appears weaker than in the preceding period, inflation control is not abandoned. Rather, the figure suggests a transitional regime in which growth and employment objectives gain prominence while inflation targeting remains operative.

A further shift becomes visible in Figure 16, corresponding to the 2013-2016 period. Here, the deterioration of unemployment alongside relatively stable inflation signals growing tensions within the policy framework. From the perspective of a competitively authoritarian regime, rising unemployment may become increasingly politically costly, calling for a greater reliance on fiscal and credit-based instruments. Although inflation does not yet spiral upward, the configuration hints at a weakening of the stabilisation role of monetary policy and at the emergence of pressures that would later intensify. The most pronounced break is observed in Figure 17, which focuses on the 2017-2025 period following the transition from a parliamentary to a presidential system. This figure can be read as the macroeconomic scorecard of the new institutional arrangement. Two distinct sub-periods are clearly identifiable. Between 2017 and 2021, inflation is kept below approximately 25 percent, but this comes at the cost of persistently high unemployment. This configuration suggests that, at least initially, inflation sensitivity remained a binding constraint, even as political pressures intensified.

The post-2021 period displays a markedly different pattern. Inflation rises sharply and follows a highly structured trajectory: a near-vertical increase during 2022, a pronounced U-shaped pattern in 2023, and an almost vertical decline during 2024, followed by further disinflation in early 2025. At the same time, unemployment declines steadily throughout this period. Leaving aside controversies surrounding data compilation, such smooth and monotonic movements in year-on-year inflation are difficult to reconcile with a narrative of policy drift or loss of control. Instead, the trajectories observed in Figure 17 suggest a deliberate tolerance for high inflation, conditional on improvements in labour-market outcomes. This interpretation helps rationalise the credibility patterns documented earlier. If economic agents perceive that inflation is being tolerated rather than inadvertently missed, high inflation does not necessarily signal policy incoherence. Instead, it reflects a predictable policy trade-off under political dominance. Expectations therefore adjust upward but remain bounded, consistent with the presence of a credibility floor. Inflation is allowed to rise, but it is not allowed to explode; unemployment falls, but within a regime that still imposes implicit limits on macroeconomic instability.

To formalise this intuition, the analysis next turns to a simple revealed-preference exercise based on a weighted Misery Index. Rather than estimating a full policy loss function, this exercise treats inflation and unemployment as jointly penalised outcomes and asks what relative weights would render recent high-inflation–low-unemployment observations comparable to earlier regimes. The resulting weighting structure provides a transparent illustration of how policy priorities may have been rebalanced during the period of political dominance, shedding further light on why credibility weakened without collapsing.

Revealed Policy Preferences and the Misery Index

The inflation–unemployment configurations discussed above suggest that the post-2021 period cannot be interpreted solely as a breakdown of stabilisation policy. Instead, the patterns observed in Figure 17 point to a systematic rebalancing of policy objectives, in which inflation was tolerated conditional on improvements in labour-market outcomes. To make this interpretation more transparent, this subsection introduces a simple revealed-preference exercise based on a weighted Misery Index. The purpose is not to estimate a structural policy loss function, but to provide an intuitive numerical illustration of how inflation and unemployment may have been implicitly traded off under political dominance. To this end, Figure 18 reproduces the inflation-unemployment configuration for the 2017-2025 period shown earlier in Figure 17 and serves as the reference panel for the Misery Index exercise.

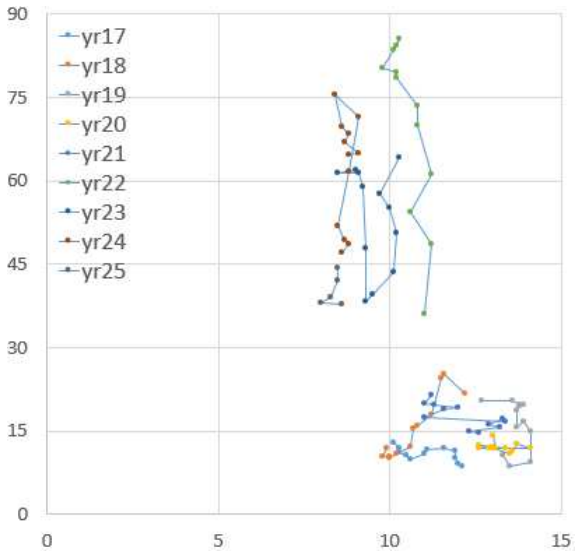


Figure 18: 2017-2025: Major Switch (Figure 17)

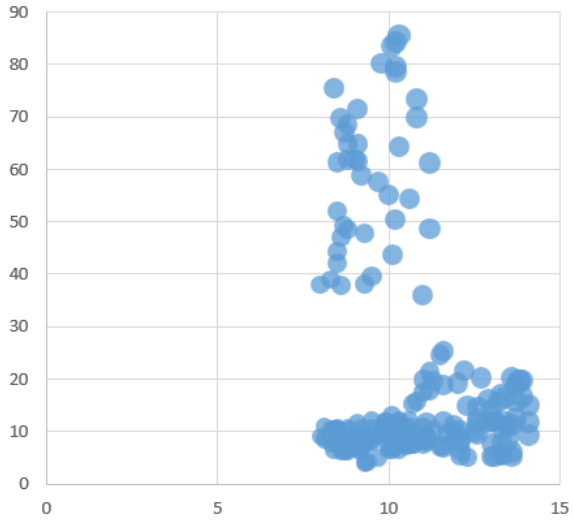


Figure 19: Misery Index Exercise

The Figure 18 highlights two clearly distinguishable clusters. The first cluster corresponds broadly to the 2017-2021 period, characterised by relatively contained inflation and persistently high unemployment. The second cluster covers the 2022-early 2024 period, marked by exceptionally high inflation combined with a sustained decline in unemployment. The coexistence of these two configurations within a short time span suggests a fundamental shift in the effective weighting of policy objectives rather than a gradual or purely stochastic deterioration in policy performance.

In its classical formulation, the Misery Index assigns equal weights to inflation and unemployment, implicitly assuming symmetric welfare costs. Such symmetry is unlikely to be appropriate in politically dominated regimes, where unemployment may carry disproportionate political, social, and distributional salience. The weighted Misery Index employed here therefore allows the relative importance of inflation and unemployment to differ. The exercise seeks weights that generate comparable levels of overall "misery" across the two clusters identified in Figure 18, under the simple assumption that the policymaker would aim to maintain broadly similar levels of aggregate economic discomfort while shifting emphasis toward labour-market outcomes.

The outcome of this exercise is summarised in Figure 19, which presents the weighted Misery Index corresponding to the inflation–unemployment combinations shown in Figure 18. The configuration that aligns the two clusters implies a markedly asymmetric weighting structure. In this numerical exercise, unemployment receives a substantially higher weight than inflation, with the relative weight required to equalise implied misery levels amounting to approximately 18 to 1 in favour of unemployment. This result should not be interpreted as a precise structural estimate, but rather as a stylised representation of the trade-offs implicit in observed policy outcomes. Importantly, the Misery Index exercise also indicates that the tolerance for inflation was not unbounded. Inflation during the 2022-early 2024 period followed a relatively smooth and controlled trajectory, suggesting that while high inflation was accepted, a complete loss of macroeconomic control was not. This finding is consistent with the expectation-based evidence documented in Section 4.1: expectations shifted upward, but remained bounded.

Taken together, the revealed-preference analysis reinforces the central argument of the paper. Once economic agents internalised the implicit reweighting of objectives, high inflation ceased to be interpreted as a signal of policy incoherence. Instead, it became a predictable outcome of a politically dominated regime in which employment considerations temporarily outweighed price stability. Expectations therefore adjusted in a systematic and conditional manner, giving rise to a credibility floor rather than a full collapse of monetary policy credibility.

5. Conclusion

This paper examined the evolution of monetary policy credibility in Türkiye under conditions of increasing political dominance. Using a multi-dimensional empirical framework, it documented a pronounced deterioration in credibility after the mid-2010s and especially following the policy shift of 2021. Yet the evidence consistently rejects the notion of a complete credibility collapse. Across target-based, transmission-based, uncertainty-based and probability-based indicators, expectations weakened and shifted upward but remained bounded and systematically related to the signals communicated by the central bank. These patterns point to the existence of a credibility floor rather than full de-anchoring.

The central contribution of the study lies in reinterpreting credibility dynamics through the lens of political dominance and *de jure-de facto* mandate divergence. Conventional credibility frameworks implicitly assume a stable inflation-centred objective function, under which persistent target misses should lead to a breakdown of anchoring. Türkiye's recent experience challenges this logic. The empirical results show that private agents did not interpret sustained high inflation as random policy failure, but as the outcome of a reweighted policy regime in which inflation control was temporarily subordinated to employment and growth considerations. This reinterpretation explains why expectations clustered near the upper bounds of central bank forecast distributions, why long-horizon expectations remained partially insulated from short-term shocks, and why credibility indicators stabilised at intermediate levels. The analysis of inflation-unemployment dynamics and the Misery Index exercise further support this view by revealing an implicit and asymmetric weighting of policy objectives during the high-inflation period. Credibility, in this context, did not disappear; rather, it transformed. The central bank lost credibility as a strict inflation-targeting institution, but retained credibility as an implementing agent within a politically defined tolerance range. Expectations therefore adjusted conditionally, reflecting regime consistency rather than target commitment.

These findings have broader implications for how credibility should be assessed in politically dominated policy environments. Credibility erosion need not manifest as complete de-anchoring; instead, it may result in bounded, state-dependent expectation dynamics. Future research should explore how such credibility floors evolve across countries and whether they can be reversed through institutional or political realignment. For policymakers, the results highlight that restoring low inflation credibility requires not only technical policy adjustments, but also a realignment between stated mandates and effective policy priorities.

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