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Turkish Central Bank to buy additional bonds

The Turkish Central Bank has published its 2026 policy paper with limited changes in the main policy areas, including monetary policy, macroprudential policy framework, and TRY and FX liquidity management, while signalling plans to buy additional government bonds

We project 2026 inflation at 22%, with risks skewed significantly to the upside

Turkey's economy at a glance

- The most important new information in the policy paper is that the CBT aims to increase its OMO portfolio to a nominal TRY450bn in 2026. However, the amount is relatively small in comparison to domestic debt service in 2026 at TRY5,042bn (TRY2,700bn of which is principal).
- In the banking sector, TRY commercial lending trend has gained momentum since the end of October, driven by non-SME TRY commercial loans, which show signs of exhaustion in the recent data. Consumer credit growth also remains strong due to non-capped consumer segments, notwithstanding the high levels of interest rates.
- The CBT bought FX from the market in November and December, supporting both its gross and net reserves despite volatility in gold prices impacting its value of gold reserves. As of 26 December, the CBT's total reserves reached US$193.9bn, while net FX reserves, excluding FX swaps, stood at US$67.5bn, both close to their record high levels.

However, in the last few days of December, we witnessed a decline in reserves driven by CBT's FX sales and gold prices, pulling gross reserves and net position to US$189.1bn and US$62.3bn, respectively.

- While the December figure turned lower than expected for non-food prices, disinflation in 2025 was slower on the back of pricing pressures in food and difficulties in achieving services disinflation that requires marked improvement in price-setting behaviour and inflation expectations.
- We expect 2026 inflation at 22%, while risks are significantly on the upside. The December data should encourage the CBT to continue rate cuts of 150bp this month, but continuing inflation risks could keep the bank cautious with a lower 100bp cut, in our view. Inflation expectations, in addition to considerations regarding dollarisation and reserves, will determine CBT behaviour, going forward.

Quarterly forecasts

	3Q25	4Q25	1Q26F	2Q26F	3Q26F	4Q26F	1Q27F	2Q27F
Real GDP (%YoY)	3.7	4.2	4.4	3.8	3.5	4.2	5.0	4.6
CPI (eop, %YoY)	33.3	30.9	27.2	24.5	22.4	22.0	20.6	19.4
Central bank key rate (eop, %)	40.50	38.00	35.00	32.00	29.00	27.00	25.00	23.00
3m interest rate (eop, %)	42.58	40.10	34.81	31.94	28.99	26.48	25.23	23.36
10yr yield (eop, %)	31.54	28.89	27.52	26.07	24.53	23.57	21.41	20.36
USD/TRY exchange rate (eop)	41.57	42.94	45.14	47.22	49.17	51.00	53.05	55.06
EUR/TRY exchange rate (eop)	48.80	50.45	53.27	56.66	59.49	62.22	64.72	67.17

Source: Various sources, ING

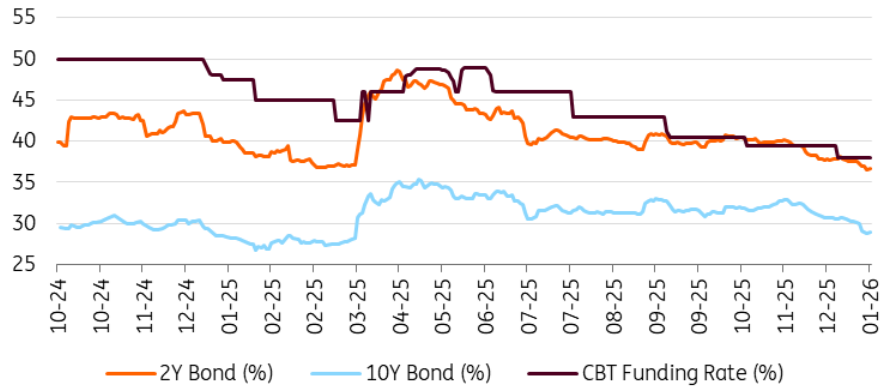
FX and rates outlook

The Turkish lira defended the crown of carry trades last year, and we do not expect significant changes here this year either. The lira should maintain the highest carry in the EM space. A cautious and ongoing CBT cutting cycle seems like the best possible option for the continuation of the current FX regime, and we do not think the central bank will rush to make any changes here.

Carry position sizes remain close to record sizes in our estimates and the market seems to have become accustomed to political noise, which minimises the risk of any fluctuations here for now. The CBT`s total reserves stood at US$193.9bn as of 26 December, while net FX reserves, excluding FX swaps, stood at US$67.5bn, both close to their record high levels, though both declined to US$189.1bn and US$62.3bn in the following week to 2 January. We expect USD/TRY to continue in an upward stable trend with 47.22 by mid-year and 51.00 by year-end.

The rates market continues to gradually steepen, although the OIS curve saw some pause in December but can be expected to resume in the new year. The short end has reached new lows, the lowest since the hiking period in the second half of 2023. The market is currently pricing in an end-year CBT rate somewhere in the range of 30.5-31.0%, which is still well above our forecast of 27%, and if disinflation continues as we expect (with inflation still above the CBT forecast), there should still be room at the front of the curve to price in more rate cuts. The start of the year should be favourable from an inflation perspective, but the second quarter could be more complicated, in our opinion, for the market.

Local bond yields vs CBT funding rate



Source: CBT, Bloomberg, ING

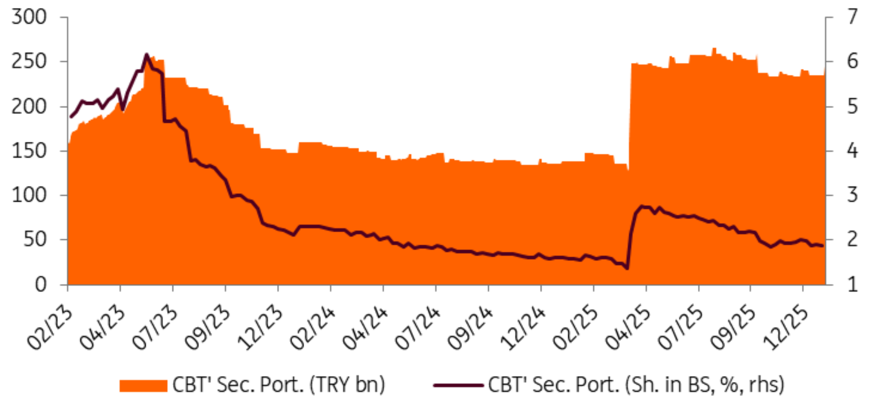
The CBT's 2026 policy

The CBT aims to increase its OMO portfolio to a nominal TRY450 bn in 2026, from the current volume of TRY262 bn, up by 72%. Considering TRY67.7bn (nominal) redemptions in 2026, total purchases will exceed TRY300bn, though quite small in comparison to domestic debt service in 2026 at TRY5.042bn (TRY2,700 of which is principal). This expansion will be spread over time without distorting the yield curve. Liquidity injected through portfolio purchases will be sterilised via deposit auctions and swap transactions to maintain net monetary tightness.

For the macro prudential policy framework, the bank stated that it would maintain the policy framework designed to prioritise TRY-denominated deposits and a long-term maturity structure for external funding in 2026. This does not show a revision at this stage for requirements on banks' liability side. For loans, the CBT said the limits for loan growth will continue to be revised throughout the year, showing further reliance on growth caps on lending.

Additional brief analysis of the policy paper reveals that MPC meetings were maintained at eight; the dates of the first four meetings of 2027 have already been announced. The current exchange rate regime will be maintained in 2026, which implies that TRY's gradual real appreciation will likely continue. While the paper also recognised the importance of international reserves, the CBT will continue to implement its reserve accumulation strategy.

CBT's Securities Portfolio (based on daily balance sheet)



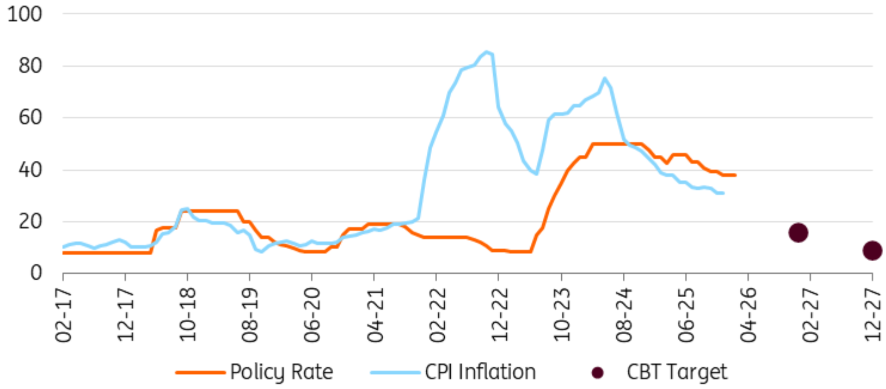
Source: CBT, ING

Disinflation dips below central bank’s forecast range

With monthly inflation at 0.9% MoM, which was slightly below consensus and our call (both at 1.0%), annual inflation in 2025 turned out to be 30.9% YoY (vs the CBT’s 31-33% forecast range in the latest inflation report) with a drop from 31.1% a month ago. Although December 2024 saw a 1.0% increase, the five-year average for December under the 2003-based index was 4.0%, highlighting that this year’s base effect was unfavourable.

Core inflation (CPI-C) rose by 0.6% MoM, bringing the annual rate down to 31.1% on the back of modest nominal TRY depreciation in addition to a slow pace of increase in the PPI that keeps costs for producers under control. In December, PPI stood at 0.75% MoM, showing an increase to 27.7% YoY vs a month ago. While the data imply a notable weakening in cost pressures in comparison to last year, which is also attributable to supportive currency developments, global commodity prices and particularly oil prices in the current geopolitical backdrop will likely remain the key determinant of the PPI trend in the period ahead.

Inflation outlook (YoY%)



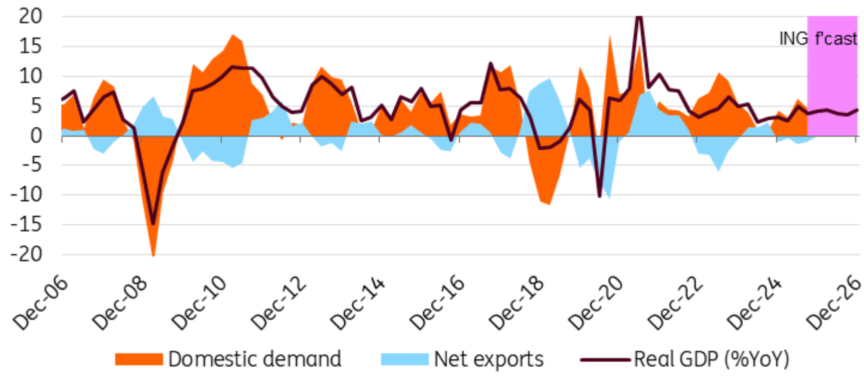
Source: TurkStat, CBT, ING

Signals of recovery in domestic demand

The latest indicators suggest that persistently high inflation expectations, combined with ongoing easing in financial conditions and the wealth effect from rising gold prices, continue to support domestic demand in the fourth quarter. The latest PMI survey also signalled improvements in customer demand, with some firms reporting stronger activity. Confidence indicators across the real sector, retail, and services further point to a recovery in demand conditions during the quarter.

On the supply side, production shows signs of improvement, though the pace remains slow. Capacity utilisation is gradually increasing; however, the fourth-quarter average remains below the 75% threshold in manufacturing. Meanwhile, the PMI, despite a gradual uptick in recent months, has stayed in contractionary territory since March 2024. October output increase in industry, services, and construction also remained sluggish.

Real GDP (%YoY) and contributions (ppt)



Source: TurkStat, ING

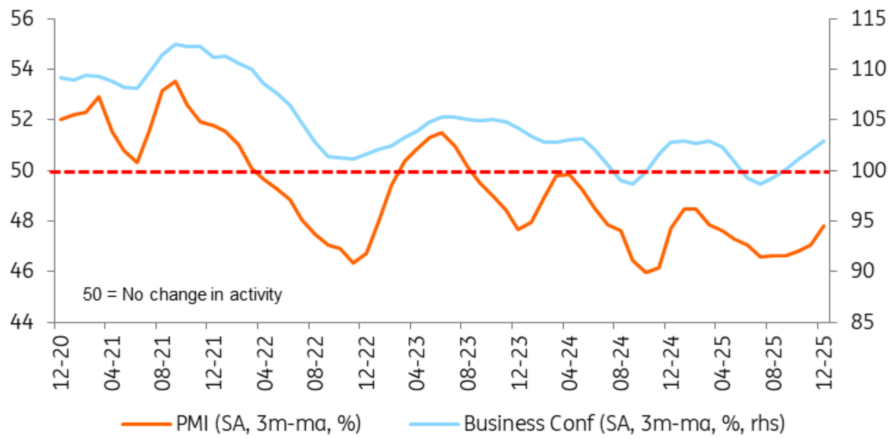
December PMI at an all-year high

The manufacturing sector (seasonally adjusted basis) PMI that has been below the 50 threshold since the first quarter of 2024 maintained a gradual recovery trend in December and reached the highest level of 2025, at 48.9 from 48.0 a month ago. While the figure is still in contractionary territory, it signals an easing of business conditions at the end of last year. The fourth-quarter average of 47.80 indicates a meaningful increase from 46.6 in the third quarter, supporting this view.

In the breakdown, the data show less pronounced moderation across key variables such as output, new orders and employment, thanks to improved customer demand. On the flip side, pricing pressures signalled some strengthening after easing in November.

Findings in the sectoral PMIs, on the other hand, released by the Istanbul Chamber of Industry, showed that half of the 10 sectors recorded an increase in their PMIs, while two of them positioned above the 50 level. However, PMIs in some key sectors, including chemicals, non-metallic minerals, machinery and metal products, declined in December. This implies that the recovery is not strong yet.

PMI & Business Confidence



Source: ICI, CBT, ING

Unemployment rate at 8.6% in November

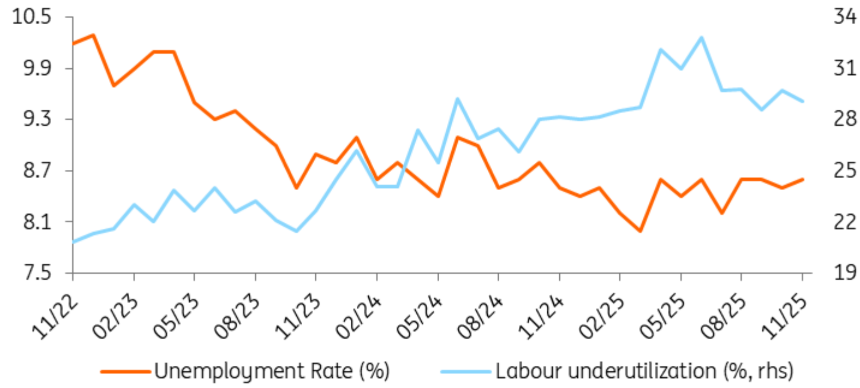
The unemployment rate edged up by 0.1ppt in November, reaching 8.6%. The headline figure has hovered within a narrow 8.5-8.6% band for the past four months. Employment rose by 75k compared to October, lifting the employment rate to 49.2%. Meanwhile, the labour force expanded by 128k, pushing the participation rate to 53.8%.

Among broader measures of labour market slack, the underutilisation rate – which combines time-related underemployment, the potential labour force, and the unemployed – fell by

0.6ppt month-on-month to 29.1%. Despite this decline, the indicator has remained above 28% since the start of the year, after hitting a historic peak of 32.8% in June amid recent volatility.

In summary, the Household Labour Force Survey shows that while the headline unemployment rate remains low, broader unemployment metrics paint a more challenging picture. Moreover, job creation has stagnated since early 2024, with November's employment level unchanged from February 2024.

Labour market outlook



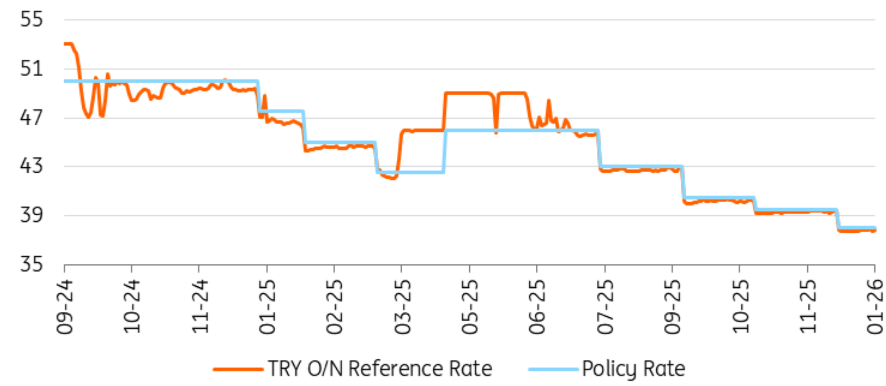
Source: TurkStat, ING

The central bank cuts rates by 150bp amid softer inflation

At its final rate-setting meeting of the year, the CBT implemented a larger cut of 150bp, compared to the more cautious 100bp reduction in October's MPC, driven by better-than-expected November headline inflation. Ahead of the meeting, consensus was evenly split between 100bp and 150bp.

The November inflation data was quite mixed. While the headline eased more than expected, with the downside surprise in food inflation and helped by favourable base effects, the underlying trend in the headline slightly declined, as acknowledged by the CBT in its rate-setting statement. However, the same indicator in both core and services inflation remained elevated without a meaningful improvement. This backdrop with a softer headline seemed to be one of the factors that encouraged the central bank to implement a bigger rate cut in December.

The policy rate vs. interbank O/N rate



Source: CBT, Bloomberg, ING

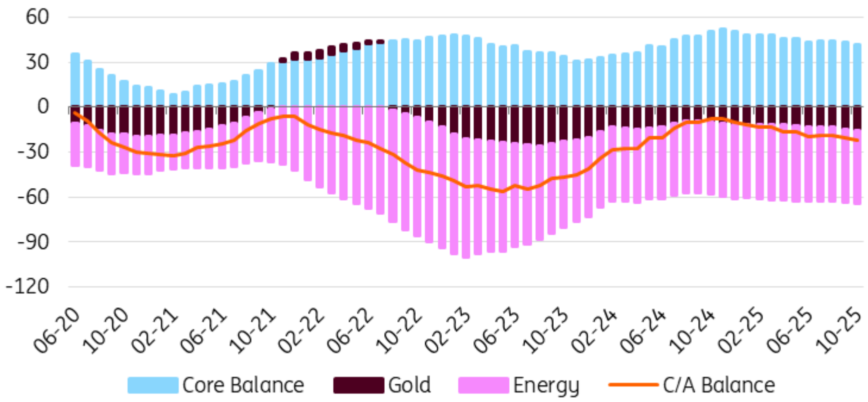
Current account continued to gradually widen in October

The current account posted a surplus of US$0.5bn, broadly in line with the market forecast. A closer look at the monthly figures shows that the surplus narrowed by roughly US$1.8bn compared to the same month last year, primarily due to a higher trade gap, which deteriorated from US$-3.5 bn to US$-6.0 bn.

This deterioration was mostly driven by a lower core trade surplus and worsening balance in net gold trade. However, a further increase in the services income, driven by growing transportation and tourism revenues, limited the decline in the current account surplus. As a result, the 12-month rolling current account deficit, which began rising in November of the previous year, maintained the uptrend and reached US$22.0bn, or approximately 1.6% of GDP, from US$20.3 bn a month ago.

On the capital account side, after a month of outflows in September following the political news, we saw quite weak inflows in October at US$1.1bn. With net outflows from errors and omissions of US$3.2bn, and considering the current account surplus, official reserves contracted by US$1.6bn.

Current account (12M rolling, US$bn)



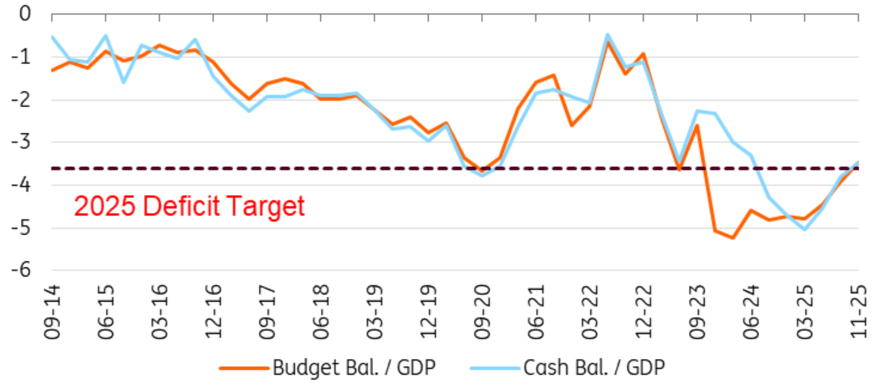
Source: TurkStat, CBT, ING

Budget deficit close to target in November

The budget posted a surplus of TRY169.5 bn in November, compared to a deficit of TRY16.6bn in the same month last year. By the end of November, the ratio of the last 12-month budget deficit to GDP stood at 3.5% (vs 3.6% for 2025), while the primary balance recorded a deficit of 0.1% of GDP. The programme-defined primary balance (excluding one-off revenues), on the other hand, indicates that the last 12-month programme-defined primary balance recorded a deficit equivalent to 0.7% of GDP.

In November, budget revenues rose by 51.1% YoY to TRY1.42tr. Tax collection accelerated with a 55.3% YoY increase, driven mainly by a surge in corporate tax revenues, which jumped by 77.5% YoY. There was also an acceleration in the annual growth of VAT and SCT collections among indirect taxes. Budget expenditures increased by 30.7% YoY in November, reaching TRY1.25tr. Non-interest expenditures were pulled down by a slowdown in goods and services procurement and current transfers.

Budget performance



Source: Ministry of Treasury and Finance, ING

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