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Central Bank of Turkey stays on hold, citing geopolitics

Turkey s central bank kept the policy rate unchanged, maintaining a cautious stance amid heightened geopolitical uncertainty and lingering inflation risks as oil prices rise again

The Central Bank of Turkey in Istanbul

At its July meeting, the CBT left its policy rate (the one-week repo rate) unchanged again at 37%. The interest rate corridor was also left unchanged, with the upper and lower bounds remaining at 40% and 35.5%, respectively, in line with expectations. As a result, the Bank will continue to fund through the upper bound of the corridor, as the repo window has remained closed since the start of the US-Iran conflict.

Before the recent flare-up of geopolitical tensions in the Gulf, the prevailing expectation was that the CBT would begin easing through its liquidity tools, allowing the effective cost of funding to fall from 40% to 37%, either gradually or through full normalisation. This view was driven by fading financial stability concerns and an improved macroeconomic outlook following the memorandum of understanding between the US and Iran.

Reserves recovered markedly until the recent escalation, with the CBT purchasing around US$25bn in June and July combined, according to our calculations (adjusted for swaps and gold prices). The recovery was supported by an increase in carry-trade positions and renewed portfolio inflows.

The policy outlook has shifted in recent days, with rising geopolitical uncertainty pushing oil prices close to US$100 per barrel from the US$70-75 range seen during the ceasefire. In its MPC statement, the Bank maintained a cautious stance, citing the renewed rise in energy prices and the return of financial stability concerns.

The CBT has continued to keep an eye on both the growth and inflation outlook. The Bank acknowledged that recent leading indicators point to a continued weakening in domestic demand. Elevated borrowing costs, expectations that interest rates will remain higher for longer, and recent tightening in macroprudential measures seem to be translating into a more marked slowdown this year. This should help limit the risk of broad-based second-round effects from higher energy prices.

The CBT also acknowledged the slight decline in the underlying inflation trend in June, while highlighting a temporary rise in July as implied by leading indicators. In seasonally adjusted terms, a measure closely followed by the CBT, July inflation will likely rise back above 2%, moving closer to its average level over the past two years. This is likely to reflect administered price increases and the gradual unwinding of the sliding-scale tariff mechanism, which will reduce the economy's ability to absorb higher oil prices. Against this backdrop, the central bank has remained cautious and “highly attentive to upside risks” given that the inflation expectations have remained elevated. According to the July market participants' survey, expectations for 2026 and 2027 recorded a slight increase to 29.2% and 21.5%, respectively. Expectations for the next 12 and 24 months stood at 24.0% and 17.8%.

Regarding forward guidance, the CBT provided no indication of when it might begin to ease the effective cost of funding. It reiterated its prudent, meeting-by-meeting approach and kept the door open to further tightening if necessary. The Bank also left its messaging on the macroprudential framework and liquidity management unchanged, signalling that a cautious approach in both areas will remain in place.

Overall, all policy options continue to be available for the CBT. This approach signals a clear intention to preserve flexibility in policymaking depending on changing geopolitical conditions. In the near term, we expect the CBT to remain in wait-and-see mode before deciding whether to lower the effective cost of funding towards the policy rate. A renewed agreement in the US-Iran conflict could create scope for the Bank to normalise the effective funding rate as early as August or September, depending on developments in inflation and reserve dynamics.

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