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TURKEY

Turkish central bank holds, keeping an eye on inflationary risks

Turkey's central bank held the policy rate unchanged at 37%, which implies that it finds the current stance sufficient. While the decision signals a clear intention to preserve flexibility, the bank has remained cautious, being attentive to inflationary risks



Fatih Karahan, Governor of the Central Bank of Turkey

At its June rate-setting meeting, the Central Bank of Turkey (CBT) maintained its policy rate (1-week repo rate) at 37%, and kept the interest rate corridor stable at 450 basis points, with the upper and lower bands remaining at 40% and 35.5%, respectively. Ahead of the meeting, there were two likely moves from the CBT: holding the policy rate flat and continuing to provide funding from the upper band of the interest rate corridor, or raising the policy rate to the current effective cost of funding level with a 300bp hike in the corridor structure as, according to the governor, they normally do not prefer a prolonged wide gap between these two rates. The market consensus, and ING's position, leaned towards the first option, with few calls for the latter.

We think the CBT has continued to keep an eye on both the growth and inflation outlook; the bank acknowledged that first quarter GDP points to a slowdown in economic activity (to 0.1% QoQ and 2.5% YoY), while recent leading indicators imply continued domestic demand

weakness. Accordingly, elevated borrowing costs, the expectations that interest rates will remain higher for longer, and the most recent CBT step toward a stricter macroprudential framework by further reducing loan growth caps may translate into a more marked slowdown this year.

The CBT also acknowledged the slight decline in underlying inflation in May, while emphasising ongoing risks to the outlook on the back of geopolitical developments and high and volatile energy prices. So the bank has remained cautious and “highly attentive to upside risks” given that the war has driven an upward shift in inflation expectations as the current backdrop increases the risk of second-round effects. According to the market participants' survey in May, the expectations for 2026 and 2027 rose significantly to 28.9% and 21.1%, respectively. The expectation for the next 12 and 24 months, on the other hand, deteriorated to 23.8% and 18.4%.

While domestic demand growth weakness likely extends the CBT's patience, other drivers that support its June rate decision are no signs of retail FX dollarisation, recent stability in gross reserves and net reserve position.

Regarding the forward guidance, the CBT also continued to signal that the current monetary policy stance will be maintained in the near term. It reiterated a prudent meeting-by-meeting approach and is keeping the door open to further tightening if needed. It also kept the messages regarding the macroprudential framework and liquidity management unchanged, indicating that a cautious approach in these areas would be preserved.

Overall, all policy options continue to be available to the CBT. This approach signals a clear intention to preserve flexibility in policymaking depending on changing geopolitical conditions.

In the near term, we think the CBT will remain in a wait-and-see mode before deciding whether to reduce the effective cost of funding back towards the policy rate. A possible deal in the US-Iran conflict in the summer will likely create room for the bank to normalise the effective funding rate depending on inflation and reserve dynamics.

Currently, we see end-year inflation slightly below 30% and the one-week repo rate at 35%, with risks tilted to the upside.

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