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TURKEY

Turkey's central bank resumes rate cuts and signals more to come

At the July MPC meeting, the Central Bank of Turkey restarted policy rate cuts with more aggressive easing than expected. The Bank also signalled that rate cuts would continue, though the size of the steps may change



The Central Bank of Turkey in Istanbul

At its July Monetary Policy Committee (MPC) meeting, the Central Bank of Turkey (CBT) resumed interest rate cuts, reducing the policy rate by 300 basis points to 46%. This move was more aggressive than our expectation and the consensus forecast of a 250bp cut. The bank signalled that easing would continue, although the magnitude of future steps may vary.

This decision came on the heels of last month's adjustment, in which the CBT lowered the effective cost of funding from the upper bound of the interest rate corridor to the policy rate. Despite some improvement in inflation-related risks, the corridor's asymmetric structure remained unchanged - indicating that the CBT aims to retain flexibility in response to potential shocks that might exert unexpected pressure on foreign exchange and reserves.

Last month, the CBT shifted away from a tightening stance, which paved the way for July's rate cut. The forward guidance, along with a downside surprise in headline inflation driven by core goods and a notable recovery in reserves since early May, helped build consensus around the continuation of rate cuts. However, several developments argued for a more gradual

easing cycle, including: i) a 25% increase in natural gas prices and automatic tax adjustments expected to add roughly one percentage point to July's headline inflation, ii) higher withholding taxes on deposits and mutual funds reducing returns for deposit holders, given the CBT's sensitivity to local dollarisation trends, and iii) a recent slowdown in reserve accumulation. Despite these factors, the CBT still proceeded with a larger-than-expected cut.

While markets had anticipated a more measured approach, the July statement reflected the bank's growing confidence in the outlook. According to the CBT, indicators for the second quarter suggest that the disinflationary impact of domestic demand has strengthened. In the most recent Market Participants Survey, inflation expectations for the end of 2025 also declined to 29.7%, while the 12-month and 24-month ahead forecasts were revised down to 23.4% and 17.1%, respectively. In tandem with the larger rate cut, the CBT also softened its tone by removing the previous phrasing that "...all monetary policy tools will be used decisively..."

Nonetheless, the bank acknowledged a temporary deterioration in the inflation trend in July and emphasised that future rate decisions will be data-driven and determined meeting-by-meeting. It reiterated its commitment to adjusting the policy rate in a way that maintains the tight monetary stance required for the projected disinflation, taking into account actual inflation data, its underlying trend, and expectations. The reinforced focus on the size of future actions, combined with largely unchanged forward guidance, underscores the CBT's cautious approach and ongoing uncertainty around the magnitude of rate cuts at the remaining meetings of the year.

In summary, recent data support continued easing given i) improving inflation expectations, ii) signs of slowing economic activity, and iii) renewed foreign capital inflows and a decline in domestic FX demand, which have bolstered the CBT's foreign exchange reserves. After the easing, real interest rates have remained significantly elevated on both an ex-post and ex-ante basis. We expect the year-end policy rate at 35.0%.

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