Macro: No surprise from the CBRT; a "wait-and-see" period in monetary policy under high uncertainty

The CBRT kept the policy rate unchanged at 37.0%, in line with expectations. Overnight lending and borrowing rates were also maintained at 40.0% and 35.5%, respectively. Thus, the interest rate cut cycle that had continued since July has been interrupted following the increase in uncertainty after geopolitical developments. Previously, the CBRT reacted quickly to geopolitical developments by suspending 1-week repo auctions, withdrawing the excess TL liquidity in the market (≈ TRY1.2 trillion) through sterilization tools and raising the effective funding rate to 40%.

Evaluations:

- **Uncertainty regarding the effects that will work in opposite directions on inflation through the cost channel and the demand channel has been highlighted.** The emphasis and tone regarding the inflation outlook leave the impression that supply-side inflation may be tolerated. In this context, we evaluate the emphasis on the fact that the inflation trend in February remained flat on a monthly basis rather than being elevated, and the fact that inflationary effects outside the scope of the sliding-scale (échelle mobile) mechanism (i.e., commodity pressures excluding fuel) were not mentioned.

- **The condition for additional tightening was changed from "significant deviation from the interim target" to "persistent deterioration in the inflation outlook."** Making the condition regarding under what circumstances additional tightening would be implemented more ambiguous is another important signal of tolerance toward supply-side inflation. It appears that the CBRT will adopt a data-driven approach that reacts after seeing inflation figures, rather than a proactive policy response.

- **The March decision contains a new signal regarding the monetary policy reaction function.** Recall that CBRT had responded to the rapid reserve losses in March 2024 and March 2025 with surprise interest rate hikes. However, this time the same reaction was not given to the reserve loss as the dollarization tendency of domestic residents remained weak. The view that the policy rate is an instrument to control the FX demand of domestic residents, and the assessment that the interest sensitivity of foreign capital may be low in a global risk-off environment, appear to have been effective in the decision.

- **There is a possibility that geopolitical developments may last long enough to force the CBRT into additional rate hikes.** If the oil price is $90, the inflationary effect that cannot be eliminated through the sliding scale mechanism (≈2 points) is offset by the 3-point monetary tightening implemented in the first stage. However, developments in the region have the potential to keep oil prices above $90 for a prolonged period. In addition, uncertainty regarding the magnitude of commodity pressures outside the scope of the sliding scale mechanism (freight, fertilizer, jet fuel, etc.) is quite high. Besides inflation, situations where the oil price exceeds $100 increase market stress and, if the erosion in reserves continues, raise the risk of a spiral of foreign outflows and FX demand from domestic residents. Against these risks, it appears that the CBRT has set a policy implementation and communication that will take action as developments unfold.

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