Macro: Reescalation of geopolitical tensions limit the policy space

The CBRT kept the policy rate unchanged at 37.0%, in line with the updated expectations following the reescalation of geopolitical tensions in recent days. Overnight lending and borrowing rates were also maintained at 40.0% and 35.5%, respectively. No change was made to the statements regarding the monetary policy stance.

Following the peace agreement between the U.S. and Iran, as oil prices moved back close to their pre-war levels, expectations regarding inflation and the policy rate had evolved in a more favorable direction. Indeed, domestically, steps had begun to be taken for the transition from the "state of emergency" mode to the "gradual normalization" phase; within this framework, the ban on short selling in equities was lifted, while it was announced that the sliding scale mechanism, which limits the pass-through of developments in energy prices to domestic fuel prices, would be phased out over three months. During the same period, market expectations had begun to form that one-week repo auctions could resume following the July MPC meeting.

However, with the interruption of the peace process and the renewed increase in energy prices postponed expectations of policy rate cuts following monetary policy simplification. Since the June meeting, the CBRT has continued to accumulate reserves, largely compensating for the losses incurred after the war, and although domestic residents' preference for the Turkish lira has remained strong, the outlook regarding energy prices and refinery margins, together with the weakening of the sliding-scale mechanism, appears to have been effective in maintaining a cautious stance.

We assess that the statement with the strongest signaling value in the text is the change from "recent data point to a the slowdown in domestic demand" to "recent data confirm the slowdown in domestic demand." This change indicates that the CBRT maintains a bias toward rate cuts, while the decision itself shows that global conditions do not currently allow for such a move. Accordingly, provided that oil prices retreat once again, an intention to move to the 37% policy rate in a single step is inferred. In this context, subject to the course of oil prices, the Inflation Report Presentation on 13 August appears to have gained importance in terms of a new policy signal. Should appropriate conditions emerge, apart from a return to one-week funding within the operational framework, we maintain our assessment that there will be no room for a reduction in the policy rate until year-end.

Evaluations:

- ***"The underlying trend of inflation decreased slightly in June. Leading indicators suggest that the underlying trend will rise temporarily in July."***
  - In June, monthly inflation came in at 0.99%, in line with expectations, while seasonally adjusted (s.a.) monthly inflation slowed from 1.88% to 1.75%. Among exclusion-based core indicators, monthly inflation (s.a.) for B and C was 2.1% and 2.0%, respectively (previously 2.3% and 2.2%); among distribution-based core indicators, the median and trimmed-mean monthly inflation rates were 1.86% and 1.91%, respectively (previously 1.85% and 1.87%) (Macro: Inflation Developments – June 2026).
  - Based on the prices we have collected and our models, we estimate that in July, with the renewed increase in fuel prices and the impact of some administered price adjustments, monthly inflation will be around 2.0%, while annual inflation will remain broadly flat; seasonally adjusted monthly inflation is expected to rise to around 2.4%.

- ***"As a result of the growing uncertainty amid geopolitical developments, energy prices started trending up again. The impact of geopolitical developments on the inflation outlook through the cost channel, economic activity and expectations is closely monitored."***

    - Through the sliding scale mechanism, the pass-through of increases in oil prices to fuel prices was substantially limited during the March–June period. Together with the decline at the end of June, the cumulative increase over the March–June period fell to 11.5% (it would have been 28.7% without the sliding scale mechanism). As of June, we estimate the cumulative impact of fuel prices on inflation to be between 3.0 and 3.5 percentage points.

    - With the gradual phase-out of the equalization mechanism over the next three months, the mechanism's protection against energy price shocks has diminished. Supported by the increase in refinery margins, diesel prices appear likely to post a more pronounced increase, pushing fuel prices up by around 4.0% in July. If prices remain unchanged, a similar increase is expected in August. In addition, if no changes are made to the implementation, the insulating effect of the sliding scale mechanism will weaken further in August. Under these conditions, should LPG prices—which tend to respond with a longer lag—also increase, fuel prices are likely to record a strong increase in August.

- ***"Recent data ~~point to a slowdown in economic activity, and leading indicators suggest a continued weak course~~ <u>confirm the ongoing weakening</u> in domestic demand."***

    - We assess that the statement with the strongest signaling value in the text is this change, which indicates that the CBRT maintains a bias toward rate cuts, while the decision itself shows that global conditions do not currently allow for such a move. Accordingly, provided that oil prices retreat once again, an intention to move to the 37% policy rate in a single step is inferred. In this context, subject to the course of oil prices, the Inflation Report Presentation on 13 August appears to have gained importance in terms of a new policy signa.

    - Looking ahead, the course of the war and the magnitude of the positive contribution expected from the agricultural sector will be key determinants of growth during the year. We expect financial conditions to continue restraining economic activity in non-agricultural sectors; on the other hand, the favorable course of agricultural output is expected to provide a notable contribution to GDP growth. Accordingly, we maintain our 2026 growth forecast at 3.0%.

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