Macro: A cautious stance supports credibility 'despite signs of a slowdown in domestic demand and an improvement in inflation trend'

The CBRT kept the policy rate unchanged at 37.0%, in line with the expectations. 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.

CBRT exited the " state of emergency" mode—prompted by geopolitical tensions—by announcing on August 23 that it would resume one-week repo auctions. Consequently, the weighted average funding cost, which had stood at 40% since March, fell to 37% by the last week of August.

Although (i) the partial improvement in inflation trend during the July-August period continued into September, (ii) the weakening domestic demand exerted a restraining effect on inflation, (iii) domestic residents maintained a strong preference for the Turkish lira, and (iv) reserve losses incurred during the period of war were largely recouped—thereby creating room for a limited calibration of monetary policy that would not alter the *ex-post* real interest rate—the geopolitical outlook appears to have been a decisive factor in maintaining a cautious stance.

Statements in the text indicating that realized data and leading indicators point to a decline in the underlying inflation trend—and that cost pass-through remains limited due to demand conditions—can be interpreted to mean that domestic economic conditions support an interest rate cut, provided that external conditions linked to the war allow for it. On the other hand, the emphasis placed on monitoring the impact of geopolitical developments on the inflation outlook reduces the likelihood of a premature policy move; this is because demand conditions are currently able to only partially contain cost pressures, and inflation expectations remain above the new medium-term target.

In summary, developments in the region are narrowing the scope for monetary policy—partly through the channel of commodity prices and expectations—while simultaneously making the economic slowdown and its effects more palpable. Through its MPC decision, the most significant message the CBRT conveyed to the markets was: "I am maintaining my cautious stance despite slowing domestic demand and improving inflation." This inflation-focused, cautious stance—adopted particularly as growth weakens—further bolsters credibility by reinforcing the perception of seriousness and determination regarding disinflation.

In this context, we believe we are passing through a period that offers a significant opportunity for the CBRT to continue building credibility. This is because we assess that we are in a phase of the business cycle where the CBRT can markedly enhance its control over inflation expectations—unlike the periods of strong monetary tightening and subsequent rate-cutting cycles seen in March 2024 and March 2025, when reserve dynamics, rather than inflation itself, were the primary drivers.

Evaluations:

- ***"Despite monthly fluctuations, recent inflation figures and leading indicators suggest that the underlying trend of inflation is decelerating."***
    - Monthly CPI inflation came in at 1.84% in August—remaining below our expectations, just as it had in July—while seasonally adjusted (s.a.) monthly inflation remained flat at 2.3%. Regarding exclusion-based core indicators, monthly inflation (s.a.) for indices B and C stood at 2.0% (previously 2.0% and 2.2%, respectively); meanwhile, for distribution-based core

indicators, monthly median and trimmed inflation rates were 1.7% and 1.6%, respectively (previously 1.5% and 1.4%). Distribution-based core indicators reflected the effects of the economic slowdown in August, continuing the trend seen in July. (Macro: Inflation Developments – August 2026).

- Based on the prices we have compiled and our models, we project monthly inflation at 2.3% and annual inflation at 30.3%—a decline of 1.2 percentage points—for September. Accordingly, seasonally adjusted monthly inflation stands at 1.9%, down from 2.3% in August, and is converging toward distribution-based trend indicators.

- ***"Data on economic activity as well as the limited pass-through of supply shocks to domestic prices confirm the weakness in domestic demand."***

    - During the July–August period, inflation remained relatively moderate compared to previous months and years—despite sharp increases in fuel prices—thereby providing the first indications of the restraining impact of demand conditions, particularly on core goods. Our projections suggest that this outlook persists in September. Indeed, our output gap estimates appear to have entered disinflationary territory for the first time since the onset of the pandemic.

    - The course of the war and the magnitude of the expected positive contribution from the agricultural sector in the coming period will be decisive for the overall annual growth rate. We anticipate that financial conditions will continue to constrain economic activity in non-agricultural sectors, while the favorable trend in agricultural product supply will provide significant support to GDP growth. Accordingly, we maintain our growth forecast for 2026 at 3.0%.

- ***"Elevated energy prices amid geopolitical developments pose an upward risk to the inflation outlook. The impact of geopolitical developments on the inflation outlook through the cost channel, economic activity and expectations is closely monitored."***

    - Fuel prices rose by a cumulative 28.5% during the March–August period. As of August, we estimate the cumulative impact of fuel prices on inflation to be around 4 percentage points. It appears that the fuel price increase—which stood at 11.2% in August—will continue at a similar rate in September, driven by sharp rises in oil prices and refinery margins. Nevertheless, the fact that September inflation also appears relatively moderate based on data from the first ten days reflects the limiting effect of demand conditions on cost pass-through.

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