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Türkiye | CBRT reducing hawkishness with a high level of prudence

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- The Central Bank of the Republic of Türkiye (CBRT) kept the policy rate (one-week repo, 46%) and the width of the interest rate corridor (44.5%-49%) the same, surprising the market expectation of a cut in the upper bound of the corridor.
- Despite the improvement in the inflation trend in recent months (including June), the CBRT remains completely cautious against potential effects of the geopolitical developments and the rising protectionism in global trade on the external side, and inflation expectations and pricing behavior staying above the targets on the domestic front.
- The communication saying that 'the monetary policy stance to be tightened' is changed to "all monetary policy tools will be used effectively", in case a significant and persistent deterioration in inflation is foreseen. Given the similar change back in September 2024, we understand the CBRT might be getting prepared for an easing also in the policy rate but this time with a higher level of prudence highlighting the effort to adjust the policy rate on a meeting-by-meeting basis with a focus on the inflation outlook.
- The reference of monetary transmission mechanism to be supported via additional macroprudential measures, in case of unanticipated developments in credit and deposit markets, might be referred to a preference of some fine-tuning in a targeted way in those macro-pru while keeping real interest rates relatively high.
- Given the increased uncertainties on geopolitics added to the domestic factors, the CBRT preserves its flexibility on the funding rate by not changing the width of the corridor. Following the normalization in funding via the policy rate as of June 12th, we expect the CBRT to pursue a carefully calibrated rate-cutting cycle starting from July with 300bps.

Uncertainties ahead requires cautiousness and the CBRT delivers it

After the additional tightening following the April MPC meeting, the CBRT had funded the market mostly via the ON lending rate (upper bound of the corridor, 49%) until June 12th. Thereafter, we have started to observe a normalization in funding via the policy rate and the cost of funding has declined implicitly by 300bps since then. Nevertheless, the CBRT has continued funding the market with lack of TL liquidity in order not to allow the excess liquidity to push the cost of funding to below the policy rate, which we think signals a lesson learned from the CBRT on financial stability. Keeping the asymmetric width of the interest rate corridor also underlines a high level of prudence against many uncertainties against both inflation and foreign currency (FC) flows, allowing flexibility to be used if needed in both directions.

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On price stability, the underlying monthly inflation trend, as the average of six indicators followed by the CBRT, came at closer to 2% in May, which we expect to decelerate further to below 2% in June (with 1.4%-1.8% monthly CPI), as also underlined by the CBRT. Much tighter financial conditions (compounded cost of funding of 58% vs. annualized inflation trend of 31-32%) being transmitted into a slow-down in economic activity (nearly 0% Q0Q growth in 2Q25, according to our latest nowcasts) and domestic demand together with lower energy prices have resulted in a faster improvement in inflation trend since March, despite the currency shock in mid-March and the worsening inflation expectations since then. However, the most recent upsurge in geopolitical risks leading to a price hike of around 20% in oil after end May, inflation expectations of market participants staying above even the upper bound of the CBRT forecast range (29.9% vs. 19-29% for end 2025), uncertainties about food inflation (because of the agricultural frost), and postponed administered price hikes require a cautious stance. Today's communication of the CBRT did not show a complacency about the recent gains on inflation outlook, which is again very positive to restore credibility and foster gains over the inflation expectations, accordingly.

On financial stability, in the case of dollarization and flow of reserves, we evaluate a very delicate balance of risks due to some days of volatility and weaker than expected accumulation so far despite the recovering tourism inflows. The level of net international reserves excluding swaps stood at nearly $US30bn as of yesterday, improving from $US12.9bn on April 28th, but still remaining below $US66bn on March 18th (just before the domestic political shock). In the case of credit flows, credit growth caps keep monthly loan growth below inflation, though the sector tries to compensate growth via non-capped items, still generating 30% in both trend and annual growth. In this respect, in the last inflation report presentation, the CBRT had highlighted two potential paths for future monetary stance: (i) keeping real interest rates relatively high, while easing credit growth caps moderately - possibly in a targeted way, particularly towards SMEs, and (ii) credit conditions staying tight for longer, while allowing for lower real rates over time. We assess the CBRT more likely to follow the first option with a carefully calibrated rate-cutting cycle starting as of July, at a time when real interest rates would be historically high. Today's reference of monetary transmission mechanism to be supported via additional macroprudential measures, in case of unanticipated developments in credit and deposit markets, might be referred to a preference of some fine-tuning in a targeted way in those macro-pru, parallel to what we think.

Overall, we evaluate today's decision as a positive step where they both remain cautious against uncertainties ahead and also open the room to take the opportunity of further improvements in the underlying inflation trend, accumulation of reserves, and policy credibility, which can help anchor inflation expectations going ahead. Yet, we remain prudent on our inflation projections (31% by end 2025) due to uncertainties about the level of real rates, food inflation, energy and future administered price hikes. Therefore, we expect the CBRT to continue funding via mainly the policy rate (46%) in June and later continue with policy rate cuts of 300bps in July and September, and 200bps in October and December, before reaching ultimately 36% at the end of 2025.

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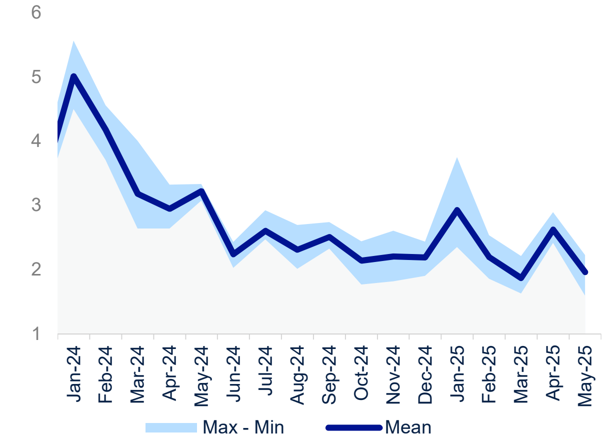
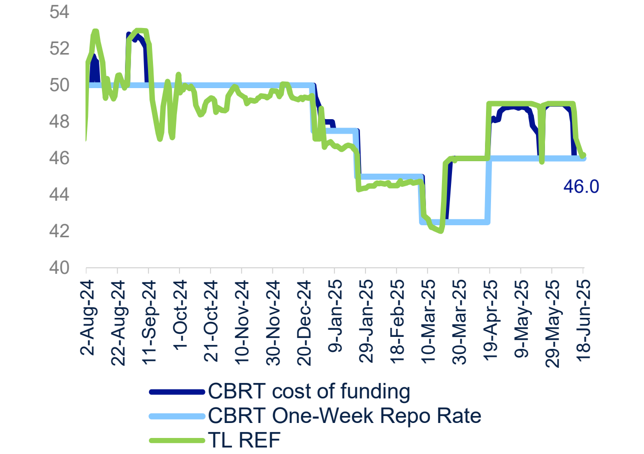
Figure 1. Consumer Inflation Indicators* (seasonal adj., monthly)



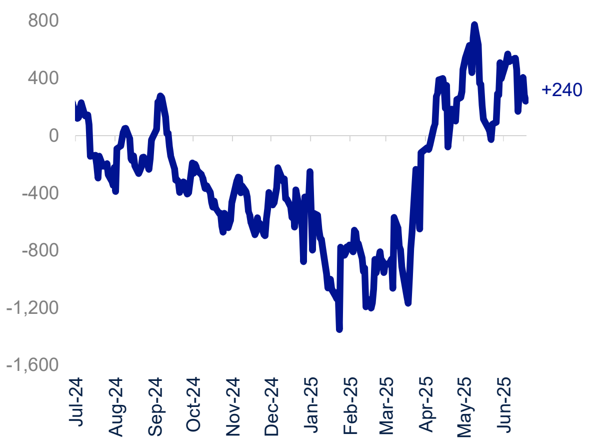
Source: Garanti BBVA Research, TURKSTAT
* Mean represents the average of different trend indicators including seasonally adjusted B, C, SATRIM, Median, inflation excluding volatile items and dynamic factor. The highlighted area shows the maximum and minimum range.

Figure 2. CBRT Cost of Funding & BIST TL REF Rate (%, simple)



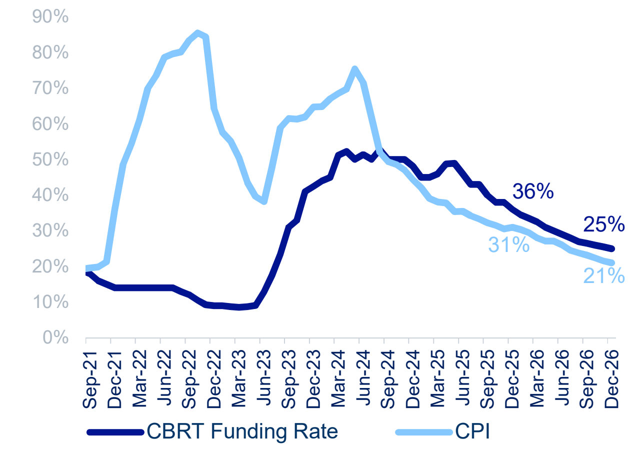
Source: Garanti BBVA Research, CBRT

Figure 3. CBRT Net Funding (bn TL)



Source: Garanti BBVA Research, CBRT

Figure 4. CBRT Funding Rate & CPI Forecasts (%)



Source: Garanti BBVA Research, TURKSTAT, CBRT

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