

## Macro note – MPC Rate Decision

**The Central Bank of the Republic of Türkiye (TCMB) kept its policy rate unchanged at 37%, in line with expectations. The slight decline in the core inflation trend in May suggests that further tightening is not required, whilst volatility and high levels in energy prices indicate that geopolitical risks remain a factor in any potential rate cut.**

**Abdulkadir DOGAN**

Chief Economist

[adogan@sekeryatirim.com.tr](mailto:adogan@sekeryatirim.com.tr)

(+90) 212 334 33 33/313

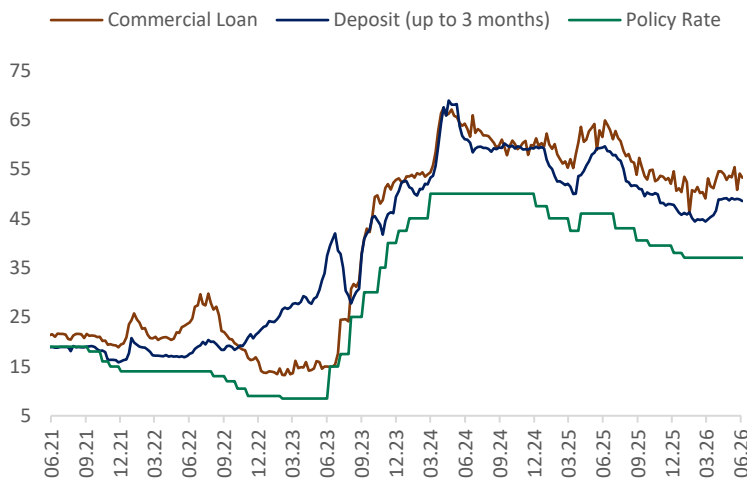
At its meeting this month, the CBRT Monetary Policy Committee (MPC) kept the policy rate steady at 37%, in line with market expectations. The decision announced was in line with both market and our own expectations. Although limited, there were also market expectations that the policy rate would be raised to 40%. However, the decline in the core inflation trend has shown that this option is not necessary. Under current conditions, the fact that market funding is being conducted at the upper band is already being interpreted as a sufficiently tight monetary policy and an implicit interest rate hike. In this environment where monetary policy is sufficiently tight, the downward impact of lagged effects on expectations will be observed. Therefore, maintaining flexibility by conducting funding at the upper band and keeping interest rates steady is a sound decision. The improvement in the underlying trend of inflation, albeit limited, has eased the central bank's position. However, the persistence of geopolitical risks has increased uncertainty regarding interest rate cuts. The most notable aspect of this month's Monetary Policy Committee decision was the volatile and high trajectory of energy prices resulting from geopolitical developments. The inflation outlook, which has been pushed upwards via the cost channel, is set to ease somewhat due to the weakening of economic activity and the slowdown in growth. We believe the CBRT's wait-and-see policy is appropriate for assessing the direction and magnitude of this net effect. The renewed escalation of tensions in the Middle East has increased the risk of upward inflationary pressure via energy prices, whilst also leading central banks to tighten policy once again. We anticipate that this situation, which has strengthened the likelihood of interest rate hikes, will remain on the markets' agenda for some time, albeit to a limited extent. Although price movements in the oil market continue at elevated levels, we observe futures market pricing that suggests the war will end in the medium term. The positive effects of the central bank's long-standing tight stance have been disrupted by supply-side global shocks. Consequently, the market-driven tightening and expectations of interest rate cuts have been postponed for the time being. However, from the perspective of policymakers, the negative consequences of an early interest rate cut could outweigh the short-term positive effects. Consequently, maintaining a cautious, tight stance to assess the outcomes of the long-standing disinflation policy is a prudent decision. We anticipate closing the year at around 32 per cent, with a total of 500 basis points of interest rate cuts, in an environment where global and domestic risks are contained.

The details of the decision statement outline the rationale for the tight stance and current developments. According to this, "Following the rise in the first months of the year, the underlying trend of inflation, which increased in April partly due to energy prices, eased somewhat in May. Volatility and high levels in energy prices persist as a result of uncertainties arising from geopolitical developments. While first-quarter data indicate that economic activity continues to slow, leading indicators point to a persistent weakness in domestic demand. The effects of geopolitical developments on the inflation outlook through the cost channel, economic activity and the expectations channel are being closely monitored.

The tight monetary policy stance, which will be maintained until price stability is achieved, will reinforce the disinflation process through the demand, exchange rate and expectations channels. The Monetary Policy Committee will determine the steps to be taken regarding the policy rate by taking into account inflation outcomes, the underlying trend and expectations, in a manner consistent with intermediate targets and ensuring the tightness required for disinflation. Monetary policy decisions are taken with a focus on the inflation outlook, on a meeting-by-meeting basis and with a cautious approach. Should there be a significant and persistent deterioration in the inflation outlook, the monetary policy stance will be tightened. The Council has emphasized its cautious stance against upside risks to inflation.” While growth and domestic demand are pulling inflation downwards, the supply and cost channels are creating upward pressure. Assuming the impact of the cost channel is temporary, expectations are that inflation will converge towards forecast levels as demand is curbed. The monetary policy stance is also being adjusted in this direction.

In summary, in today’s interest rate decision, the Central Bank kept the policy rate unchanged at 37%, in line with expectations. The effects of geopolitical risks, energy prices and global uncertainties on inflation are being closely monitored. Furthermore, it was reiterated that decisions would be made on a meeting-by-meeting basis and with a focus on inflation, and it was emphasised that monetary policy would be tightened should the inflation outlook deteriorate significantly and persistently. The current macroeconomic outlook is one where demand-driven inflation is under control, whilst supply-side inflation is deemed temporary. We would like to highlight that improvements in this area could lead to interest rate cuts exceeding expectations. The CBRT, which is effectively utilizing its primary policy instrument whilst also managing liquidity through complementary macroprudential measures, continues to maintain its resolute stance in the fight against inflation. In this context, provided there are no further shocks in local or global markets, we anticipate that cautious and gradual interest rate cuts will continue until the end of the year. We would like to emphasize that should new supply- or demand-side shocks occur, further adjustments to the policy rate stance may be required.

**Graph 1: Policy, Loan, and Deposit Rates (%)**



Source: CBRT, SEKER Invest

## ŞEKER INVEST RESEARCH

Şeker Yatırım Menkul Değerler A.Ş.  
Buyukdere Cad. No: 171 Metrocity  
A Blok Kat 4-5 34330 SİSLİ /İST  
TURKEY

TEL: +90 (212) 334 33 33  
Fax: +90 (212) 334 33 34  
E-mail: [research@sekeryatirim.com](mailto:research@sekeryatirim.com)  
Web: <http://www.sekeryatirim.com/english/index.aspx>

For additional information, please contact:

Research

Kadir Tezeller	Head	+90 (212) 334 33 81	<a href="mailto:ktezeller@sekeryatirim.com.tr">ktezeller@sekeryatirim.com.tr</a>
Burak Demirbilek	Utilities	+90 (212) 334 33 33-128	<a href="mailto:bdemirbilek@sekeryatirim.com.tr">bdemirbilek@sekeryatirim.com.tr</a>
Atasav Can Tuglu	Food & Beverages, Automotive, Retail, Aviation	+90 (212) 334 33 33-334	<a href="mailto:atuglu@sekeryatirim.com.tr">atuglu@sekeryatirim.com.tr</a>
Basak Kamber	Glass, Pharmaceutical, Defense, Telcos, Cons. Dur.	+90 (212) 334 33 33-251	<a href="mailto:bkamber@sekeryatirim.com.tr">bkamber@sekeryatirim.com.tr</a>
M. Mucahid Yıldırım	Banking	+90 (212) 334 33 33-150	<a href="mailto:myildirim@sekeryatirim.com.tr">myildirim@sekeryatirim.com.tr</a>
Yusuf Kemal Erdekli	Cement, Conglomerates, Real Estate	+90 (212) 334 33 33-115	<a href="mailto:yerdekli@sekeryatirim.com.tr">yerdekli@sekeryatirim.com.tr</a>
O. Furkan Ozdemir	Iron & Steel, Oil- Gas & Deriv.	+90 (212) 334 33 33-245	<a href="mailto:oozdemir@sekeryatirim.com.tr">oozdemir@sekeryatirim.com.tr</a>

Economy & Politics

Abdulkadir Dogan	Chief Economist	+90 (212) 334 91 04	<a href="mailto:adogan@sekeryatirim.com.tr">adogan@sekeryatirim.com.tr</a>
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Institutional Sales

Deniz Keskin	Trader	+90 (212) 334 33 36	<a href="mailto:dkeskin@sekeryatirim.com.tr">dkeskin@sekeryatirim.com.tr</a>
Kerim Culum	Trader	+90 (212) 334 33 33-316	<a href="mailto:kculum@sekeryatirim.com.tr">kculum@sekeryatirim.com.tr</a>

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