1. Overview

Economic activity posted a significant domestic demand-driven recovery in the third quarter of 2020, owing to the strong credit impulse. While economic recovery was widespread across most sectors, activity remained weak in services groups hardest hit by the pandemic. The postponed demand stepped in quickly amid a strong credit impulse, and private consumption and investment expenditures increased significantly in the third quarter. Meanwhile, the contribution of net exports to growth recorded its historic lows due also to the weak course of tourism.

Data flows following the national income data pointed to a stronger course in economic activity. The strong uptrend in industrial production as well as in turnover in trade and services continued in the October-November period. Indicators for sales and orders significantly exceeded their pre-pandemic levels and long-term trends. Durable consumption goods orders signaled that demand conditions were buoyant due to the cumulative effects of the credit expansion. Investment demand increased further in the last quarter and manufacturing industry firms' propensity to invest strengthened. In light of these data, evaluations of the cyclical state of the economy suggest that aggregate demand conditions are at inflationary levels. The stronger-than envisaged course of economic activity in the second half of 2020 led to a significant upward revision in the output gap forecasts.

Although the negative impacts of the pandemic restrictions on the economy were limited compared to the second quarter of last year, the slowdown in services and related sectors and the uncertainties regarding their short-term outlook continue. Looser restrictions compared to the early phases of the pandemic, along with changing consumption patterns, limit the adverse effects of restrictions on activity and the labor market. Indeed, job losses in sectors with high physical contact can be offset, albeit partially, by increases in employment in the information-communication and transport-storage sectors. Uncertainties surrounding domestic and external demand, primarily in the services sector, persist and depend on the course of the pandemic.

The domestic demand that strengthened due to the cumulative effects of high credit growth during the pandemic, continues to have an adverse effect on the current account balance and inflation. The strong credit impulse boosted imports through the channels of both domestic demand and inflation expectations and dollarization, and became an important driver of the deterioration in the current account balance in 2020. Although economic activity in our foreign trade partners has been slowing due to the recent increases in Covid-19 cases, the fact that pandemic restrictions do not cover the manufacturing industry activities supports the outlook for exports. On the other hand, a partial deceleration is observed in the import demand, while gold imports are still above their historical averages. The limiting effect on domestic demand and imports of the recent slowdown in loans due to tightening financial conditions is projected to be more pronounced in the upcoming period which is expected to improve the current account balance.

Domestic demand conditions, cumulative cost effects- in particular the exchange rate-, increasing international food and other commodity prices and high levels of inflation expectations continue to affect the inflation outlook adversely. Consumer inflation overshot the October Inflation Report forecasts. Having remained almost flat around 12% during the first ten months of 2020, consumer inflation increased in the last quarter due to an apparent rise in core goods and food inflation, and stood at 14.60% at the end of the year. The increase in core goods inflation was driven by demand conditions on the back of the strong credit impulse, as well as cost pressures led by exchange rates and international commodity prices. While goods and services items with weak demand conditions due to the pandemic contained consumer inflation, inflation remains high in groups that are relatively more sensitive to credit and exchange rate developments. Against this background, while core inflation indicators continue to increase, the tendency to raise prices has become widespread across sectors.

On the back of the effects of the strong monetary tightening, demand and cost factors that affect inflation are expected to weaken gradually. However, developments in international commodity prices, supply constraints that became more discernible in certain sectors, along with the recent wage and administered price adjustments, remain significant to the medium-term inflation outlook. Despite the appreciation of the Turkish lira, increasing commodity prices and supply constraints that became more evident in some sectors cause producer inflation to remain on the rise. Due to the drought and protective food policies, international food commodity prices have increased drastically. The hikes in industrial metal and oil prices are having an effect on core goods and energy groups. As for the administered prices, despite the increases in electricity, natural gas and raw milk reference purchase prices, the tax adjustment in tobacco products played a role in the short-run outlook of inflation. It is assessed that the considerable rise in the minimum wage compared to the inflation target will affect inflation adversely through the channels of services prices in particular and increasing inflation rigidity.

Factors that affected the inflation outlook in the period following the October Inflation Report signaled the need to maintain the tight monetary policy stance for an extended period. Although the lagged effects of the deceleration that started in loans are expected to become more pronounced in the upcoming period, annual inflation rates are judged to remain high for a few more months due to the short-term supply-side factors. Maintaining the tight monetary stance resolutely will serve as a buffer against external and temporary volatilities in inflation expectations, pricing behavior and financial market developments. Besides the current information set, if any new information arrives pointing to the risk of inflation expectations and pricing behavior diverging from the medium-term disinflation path, additional tightening will be implemented decisively.

Citing a price stability-oriented monetary policy as critical to also containing macrofinancial risks since November, the CBRT announced that it would decisively implement a full-fledged inflation targeting strategy. As of the first week of November, the CBRT strongly communicated that it would adopt a policy stance that takes into account the existing risks and gives priority to disinflation. Accordingly, the CBRT implemented a transparent and strong monetary tightening within a simple operational framework in November and December in order to eliminate risks to the inflation outlook, contain inflation expectations and rapidly restore the disinflation process. Monetary policy decisions were supported by a communication policy emphasizing that the CBRT would determine its policy stance only with a focus on price stability. At the January MPC meeting, the CBRT stated that the tight monetary policy stance will be maintained “for an extended period” until strong indicators point to price stability and a permanent fall in inflation, and “additional monetary tightening would be delivered if needed”, thus providing strong forward guidance and enhancing policy predictability.

The strong communication regarding monetary policy tightening and price stability had positive implications for the markets, and financial indicators improved. Enhancing policy predictability by adopting a price stability-oriented and simple operational framework has led to a fall in the risk premium, exchange rate volatility and long-term interest rates and a rise in capital inflows since November (Box 1.1). Moreover, as the monetary policy tightening steps became clearer, the deterioration in inflation expectations slowed significantly and reversed in January. In fact, the absence of a major change in medium-term inflation expectations following the November inflation rate, which was above market expectations, and the minimum wage increase in December, is an important indicator that a price stability-oriented monetary policy communication is effective in managing expectations. The pass-through from higher policy rates into deposit and loan rates shows that the monetary transmission mechanism works effectively. The alignment of deposit rates with policy rates is key to achieving the desired change in residents' portfolio preferences. The decisive implementation of the tight monetary policy in line with the 5-percent medium-term inflation target will cause the inflation expectations to become compatible with the target, exchange rate pass-through to decline to reasonable levels and inflation rigidity to go down.

In order to contain existing macrofinancial risks, it is essential that loans and domestic demand move towards a moderate path. Loans have been slowing significantly as the monetary transmission mechanism works effectively. Personal loans are monitored closely, and targeted macroprudential tools applicable in this regard are discussed with the relevant stakeholders. The decelerating impact of the strong monetary tightening implemented in November and December MPC meetings on credit and domestic demand is expected to become more evident; hence, the effects of demand and cost factors on inflation are envisaged to wane gradually.

The monetary policy stance will be formulated in a way to gradually converge to the medium-term inflation target. Since monetary policy decisions influence aggregate demand and inflation with a lag, it is more effective to have the policy stance set in line with inflation forecasts. In this regard, the forecasts announced in Inflation Reports will also be a “forecast target” and will serve as interim targets by being a reference to inflation expectations. In other words, to steer expectations more efficiently while converging to the medium-term target, the reference values that will guide economic units regarding the future trend of inflation are the inflation forecasts for the short term and the inflation targets for the medium term.

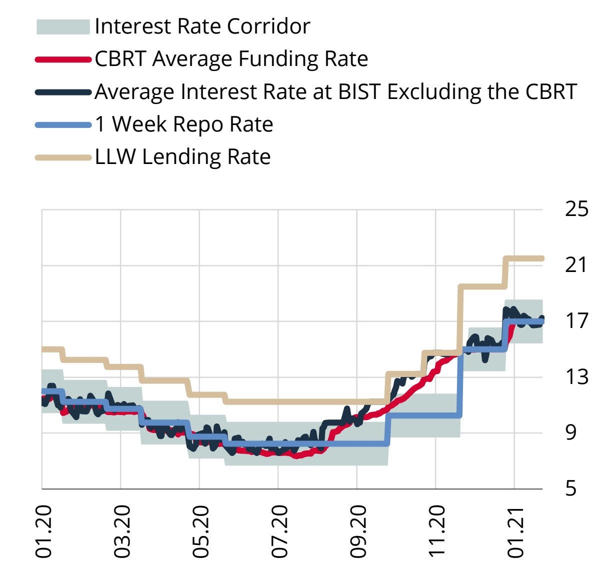
In 2021, the CBRT will implement a full-fledged inflation targeting strategy and make monetary policy decisions in pursuit of the primary objective of price stability. All factors affecting inflation will be taken into account, and the tightness of monetary policy will be decisively sustained until there are strong indicators that point to price stability and a permanent fall in inflation. The monetary policy communication will be strengthened by adhering to transparency, accountability and predictability principles.

1.1 Monetary Policy Decisions

The tightening steps taken towards liquidity management in August to contain inflation expectations and risks to the inflation outlook were maintained in November. Accordingly, effective from 3 November 2020, banks' borrowing limits at the CBRT Interbank Money Market were reduced to zero, and overnight repo transactions via the quotation method against TL-denominated lease certificates in the scope of Open Market Operations (OMO) were suspended. In addition, the Turkish lira interest rate applied to the Turkish Lira Currency Swap Market and the Turkish Lira Gold Swap Market was raised to 13.25% from 11.75%. With the tightening measures taken in response to the pandemic, the weighted average funding cost increased by approximately 750 basis points to 14.87% from July to November (Chart 1.1.1).

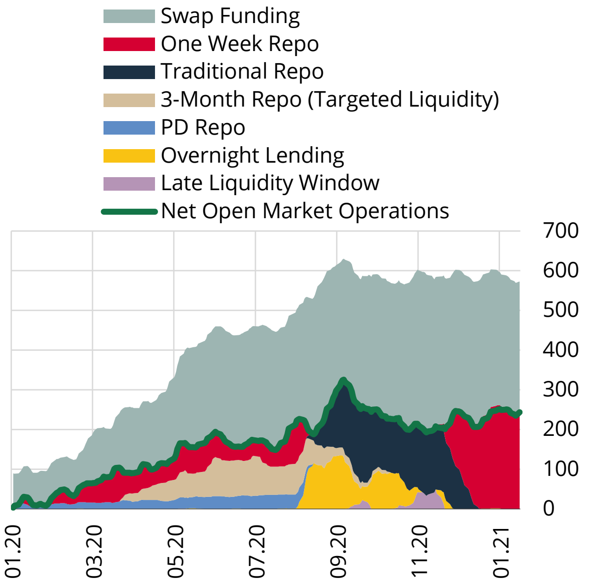
To eliminate risks to the inflation outlook, contain inflation expectations and restore the disinflation process in the shortest possible time, the CBRT delivered a transparent and strong monetary tightening and raised the policy rate to 15% from 10.25% in November. In addition to monetary tightening, it decided to adopt a simple operational framework to enhance transparency and predictability, and to provide all short-term funding at the one-week repo rate, which is the main policy rate. Accordingly, on 20 November 2020, the CBRT started to provide funding via one-week quantity repo auctions, the main monetary policy tool, instead of traditional-method repo auctions with one-month maturity and Late Liquidity Window (LON) facilities that were employed previously. Following the simplification of the operational framework, the liquidity composition also became simplified as the traditional repo auctions matured. In the current reporting period, the funding need of the system was met through TL currency swap transactions at the CBRT and BIST, in addition to the OMO funding. In this context, the Turkish lira interest rate applied on the Turkish Lira Currency Swap Market and the Turkish Lira Gold Swap Market was set as the one-week repo auction rate. The amount of swap transactions, which was TRY 373 billion as of 30 October 2020, decreased to TRY 320 billion as of 22 January 2021. In the same period, the net OMO funding posted an increase to TRY 254 billion from TRY 223 billion (Chart 1.1.2). As stated in the Monetary and Exchange Rate Policy for 2021 document, the share of swap transactions in the funding need of the system has declined within market conditions, and the share of OMO funding has increased with respect to the previous Report period.

Chart 1.1.1: CBRT Rates and Short-Term Interest Rates (%)



Sources: BIST, CBRT

Chart 1.1.2: CBRT Open Market Operations and Swap Transactions (One-Week Moving Average, TRY Billion)



Source: CBRT

In its November meeting, the MPC assessed the need for a revision in the reserve requirement policy in order to enhance the effectiveness of the monetary transmission mechanism in line with the primary objective of price stability. Accordingly, the CBRT decided to repeal the reserve requirement practice that links the reserve requirement ratios and remuneration rates to real loan growth rates, and apply the same reserve requirement ratios and remuneration rates to all banks. The simplification of the reserve requirement policy contributed to increasing the transparency and predictability of monetary policy. In addition, hikes in Turkish lira and foreign currency reserve requirement ratios supported the CBRT's monetary stance and the monetary transmission mechanism.

In December, taking into account the end-2021 forecast target, the CBRT decided to implement a strong monetary tightening. In the MPC meeting on 24 December 2020, the policy rate (one-week repo auction rate) was increased to 17% from 15%. Including in the decision minutes a new expression regarding the forecast target, the MPC reinforced the message in the Monetary and Exchange Rate Policy for 2021 that read "the targets announced by the CBRT via Inflation Reports will serve as interim targets and a reference to inflation expectations".

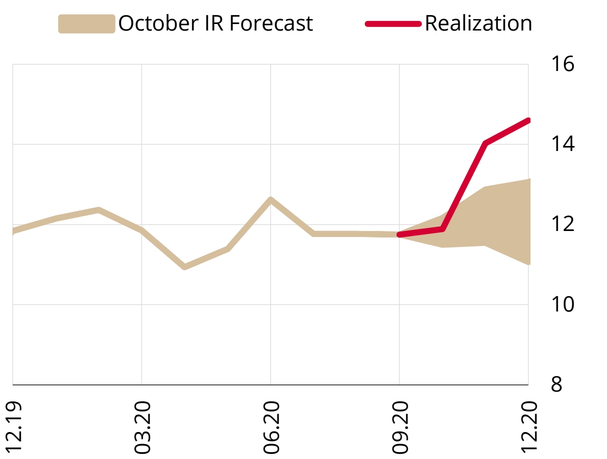
At the meeting of the Monetary Policy Committee on January 21, 2021, clear messages were given to enhance the predictability of the tight monetary policy stance, while the one-week repo auction interest rate, which is the policy rate, was kept constant at 17%. The CBRT strengthened its tight monetary policy stance by stating in the decision minutes that the tightness of the monetary policy stance will be maintained "for an extended period" until strong indicators point to price stability and a permanent fall in inflation and that "additional monetary tightening will be delivered if needed". The CBRT also included in its MPC decision the indicators that will be closely monitored for the course of inflation, thereby strengthening its communication with economic agents in terms of forward guidance.

In the current reporting period, steps towards effective functioning of financial markets continued. Additional flexibility introduced by the BRSA in derivatives transactions stood as a factor that increased flexibility in banks' Turkish lira and foreign currency liquidity management. The coordinated manner in which the BRSA regulations accompanied the tightening in monetary policy contributed to the deceleration in credits and to the effective functioning of the transmission channel (Table 1.1).

1.2 Medium-Term Projections

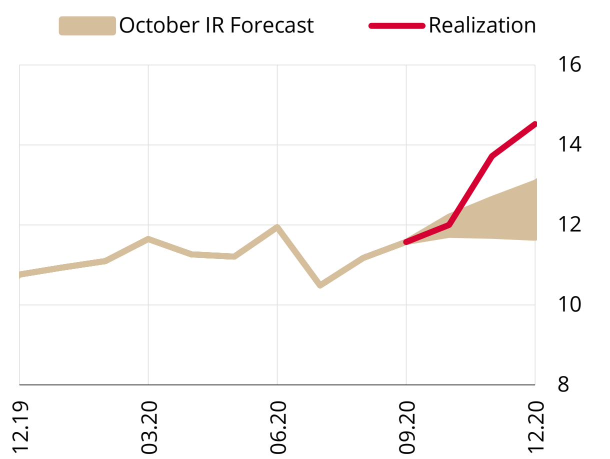
In the final quarter of 2020, consumer inflation stood at 14.6%, materializing above the upper bound of the forecast range in the October Inflation Report. In this period, the B index, which is one of the core indicators, also followed a similar course (Charts 1.2.1 and 1.2.2). Due to the rapid recovery in domestic demand, cumulative cost effects, in particular the exchange rate effects, and the developments in food prices, inflation was higher than projected.

Chart 1.2.1: October CPI Inflation Forecast and Actual Inflation* (%)



Sources: CBRT, TURKSTAT.
* Shaded area denotes the 70% confidence interval for the forecast.

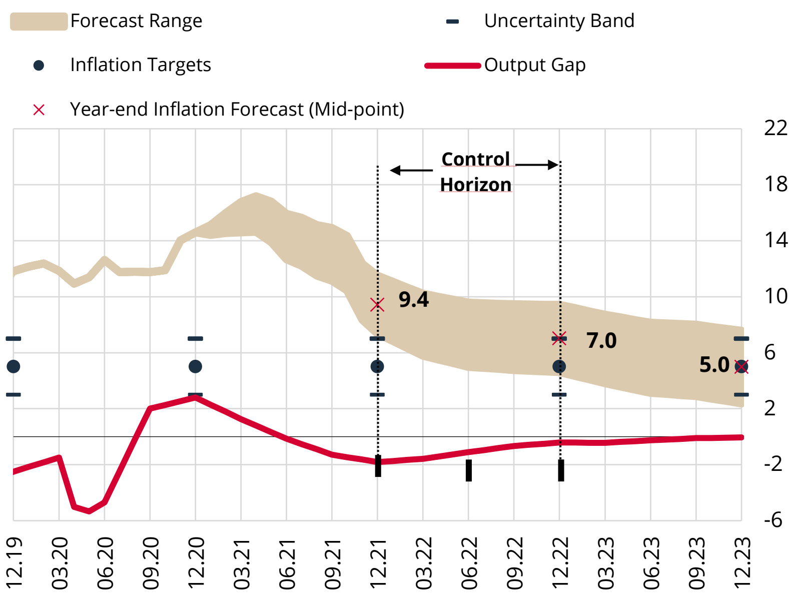
Chart 1.2.2: October Forecast and Actual Rates for Inflation Excl. Unprocessed Food, Energy, Alcohol-Tobacco and Gold (B Index)***** (%)



Sources: CBRT, TURKSTAT.
* Shaded area denotes the 70% confidence interval for the forecast.

Based on the revisions in the assumptions for Turkish lira-denominated import prices and oil and food prices accompanied by the effects of the tight monetary policy stance to be maintained until there are strong indicators that point to a permanent fall in inflation and price stability, inflation forecasts have been kept unchanged. Accordingly, inflation is projected to be 9.4% at the end of 2021, and fall to 7% at the end of 2022 before stabilizing around 5% in 2023, which is the medium-term target. With a 70% probability, inflation is expected to be between 7.3% and 11.5% (with a mid-point of 9.4%) at end-2021 and between 4.6% and 9.4% (with a mid-point of 7%) at end-2022 (Chart 1.2.3).

Chart 1.2.3: Inflation and Output Gap Forecasts*



Sources: CBRT, TURKSTAT.

* Shaded area denotes the 70% confidence interval for the forecast

The tightness of monetary policy stance towards the 5 percent inflation target will be determined as follows. The level between the realized/expected inflation rate path and the monetary policy rate path until the 5 percent target is reached will be set by aiming for a strong disinflationary balance; this balance will be preserved continuously. Besides the current information set, if any new information arrives pointing to the risk of inflation expectations and pricing behavior diverging from the medium-term target path, additional front-loaded tightening will be implemented.

Forecasts are based on the assumption that a pandemic-led shock will not arise in global growth as well as that the external demand outlook, and the recovery in Turkey-specific risk perceptions will continue amid improvements in the global risk appetite. Intensified efforts on vaccination against the Covid-19 virus accompanied by the expectations that advanced economies will maintain their expansionary monetary and fiscal stance increased the global risk appetite in the last quarter of 2020. Moreover, the low interest rate environment in advanced and emerging economies is expected to last for a long time. Projections also rely on an outlook in which maintaining the tight monetary policy stance within a simple framework until there are strong indicators that point to price stability and a permanent fall in inflation will contribute further to the improvement in the country risk premium.

Economic activity is slowing down recently owing to the effects of pandemic-related measures and monetary tightening. Following the strong rebound in the third quarter of the year amid alleviated pandemic-related restrictions and the strong credit impulse, economic activity displayed a robust course in the last quarter as well. Although the lagged effects of the slowdown in credits are expected to become more significant in the upcoming period, annual inflation may continue to move upwards for a few more months due to the supply-side inflationary factors that are quite effective in the short run. Increasing commodity prices despite the appreciation of the Turkish lira, and supply constraints that became more evident in some sectors cause producer inflation to remain on the rise. As for the administered prices, as opposed to the rise in electricity, natural gas and raw milk reference purchase prices, the tax adjustment in tobacco products played a role in the short-term inflation outlook. The additional inflation rigidity to be led by the minimum wage through the services prices in particular, necessitates an extended period of a tight monetary policy stance compared to past projections. The tight monetary stance will serve as a significant buffer against external and temporary volatilities in the context of inflation expectations, pricing behavior and financial market developments. Moreover, due to cumulative effects of the monetary stance on demand conditions the output gap is expected to contribute to disinflation in the second half of the year.

1.3 Key Risks to Forecasts

The outlook underlying the medium-term projections presented in the Inflation Report is based on the Monetary Policy Committee's judgments and assumptions. The major downside and upside macroeconomic risks that may lead to a change in the baseline projections and the associated monetary policy stance are as follows.[1]

Uncertainties regarding the course of the pandemic and the recovery in global economy have declined to some extent since the previous reporting period, owing to the favorable developments in vaccines and treatment. However, uncertainties over the rate of the spread of the virus as well as the effective use of the vaccine keep downside risks to the growth outlook alive.

The uptrend that has recently become more evident in international food and other commodity prices led by global demand developments and the recovery in economic activity pose upside risks to the inflation outlook. Secondary effects of supply-side inflationary factors on expectations and their interaction with financial indicators will be monitored closely.

The uptrend in the global inflation in 2021 creates uncertainties pertaining to the timing and speed of normalization in expansionary monetary policies in advanced economies. This may in turn lead to volatilities in the global risk appetite and capital flows towards emerging economies.

As the cumulative effects of the rapid credit growth of 2020 continue on domestic demand, the decelerating effects of monetary tightening may not be observed fast enough and this may delay the disinflation process. Residents' demand for FX/gold continues and sensitivity of portfolio preferences to negative news keeps the risks that may lead to a delay in the disinflation process alive. Exogenous factors, which may push credit growth upwards particularly in retail loans and sub-items and curtail the tight monetary stance transmission, may deteriorate inflation outlook via total demand, the current account balance and external financing, and risk premium channels.

Sectoral divergences that surfaced due to the pandemic dynamics and the macro policy mix are expected to continue in the normalization process as well. During the normalization process that will start once the effects of the pandemic wane on a global scale, the likely recovery in domestic demand and tourism may exert an upside pressure on inflation rates of certain goods and services items that were adversely affected by the pandemic such as clothing and footwear, accommodation, education, entertainment and culture, package tours etc. Sectoral divergences in demand conditions and closures, and measures introduced to maintain employment due to the pandemic make it harder to measure output gap and unit labor costs, and increase uncertainties with respect to inflation forecasting.

Year-end and medium-term inflation expectations hovering above the target levels keeps risks to inflation outlook in place via the pricing behavior channel. The sharp increase in the minimum wage coupled with the uptrend observed in international commodity prices may delay the improvement in inflation trend despite the relatively stable exchange rates. Against this backdrop, the short-term uptrend in inflation may adversely affect medium-term inflation expectations and pose a risk of slowdown in the speed at which expectations converge to forecast targets.

The disinflation process may be delayed, should the path of administered prices and tax adjustments significantly exceed the path envisaged in this Report due to the increase in public financing needs in relation to measures to contain the effects of the pandemic. Endorsement of inflation targets by all stakeholders and commitment to the price stability efforts with a common understanding and public accord, along with determination of macro policies in a coordinated manner in line with the projected disinflation path, will strengthen the effectiveness of the monetary policy.

[1] Evaluations of how and through which channel these risks may affect the inflation forecasts cited in the previous section are summarized in Table 3.2.2 in Chapter 3.

Table 1.1: Monetary Policy Actions

Date	Institution	Policy Decision
2 November 2020	CBRT	▪ In the scope of tightening steps taken for liquidity management, effective from 3 November 2020, banks' borrowing limits at the CBRT Interbank Money Market were reduced to zero, and overnight repo transactions via the quotation method against TL-denominated lease certificates in the scope of Open Market Operations were suspended.
3 November 2020	CBRT	▪ The Turkish lira interest rate applied to the Turkish Lira Currency Swap Market and the Turkish Lira Gold Swap Market was raised to 13.25% from 11.75%.
11 November 2020	BRSA	▪ The regulatory capital limitations were eased for derivative transactions carried out by banks with non-residents in which banks pay TRY and receive FX in exchange at the maturity date.
19 November 2020	CBRT	▪ The operational framework was simplified and the CBRT decided to provide all funding through the main policy rate, which is the one-week repo auction rate. ▪ Banks were allowed to borrow from the Central Bank Interbank Money Market within their limits applicable on 17 August 2020 and from Borsa Istanbul's Repo and Reverse Repo Market and Committed Transactions Market, and utilize the overnight repo facility provided through quotation against TL denominated lease certificates at the Open Market Operations.
20 November 2020	CBRT	▪ The Turkish lira interest rate applied on the Turkish Lira Currency Swap Market and the Turkish Lira Gold Swap Market was raised to 15.00% from 13.25%.
24 November 2020	BRSA	▪ The Asset Ratio (AR) calculation practice was terminated and all BRSA resolutions regulating the AR were repealed as of 31.12.2020.
25 November 2020	CBRT	▪ The total limit of outstanding Turkish lira currency swap transactions conducted via the traditional (multi-price) auction method was raised from 50% to 60% of banks' total transaction limits at the Foreign Exchange and Banknotes Markets.
27 November 2020	CBRT	▪ The CBRT decided to repeal the reserve requirement practice that links the reserve requirement ratios and remuneration rates to real loan growth rates, and apply the same reserve requirement ratios and remuneration rates to all banks. Moreover, the CBRT decided to decrease the commission rate applied to reserve requirements maintained against USD-denominated deposit / participation fund liabilities to 0% from 1.25%.
30 November 2020	BRSA	▪ The regulatory capital limitation imposed on TL placements, TL deposits, TL repo and TL loans made by banks to non-resident financial institutions was eased.
25 December 2020	CBRT	▪ The CBRT raised the TL interest rate on Turkish Lira currency swap transactions to 17% from 15%.

Box 1.1

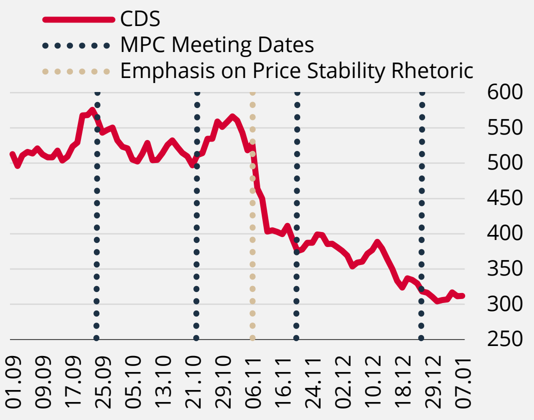
Recent Monetary Policy Decisions and Their Effects on Financial Indicators

This box examines the effects of monetary policy decisions in the September-December period on inflation compensation, the CDS premium and long-term interest rates. Under an inflation targeting regime, central banks tighten monetary stance by raising the short-term policy interest rates in case of deterioration in the inflation outlook. Monetary tightening is expected to slow down economic activity by reducing aggregate demand in the short term.

Saving and investment decisions depend heavily on long-term interest rates. Therefore, achieving permanent decline in inflation and price stability will enhance production capacity in the economy as it will bring low interest rates and a predictable investment environment. In times of high and volatile inflation, tight monetary policy practices aiming at price stability can reduce long-term interest rates by lowering inflation expectations and country risk premium.

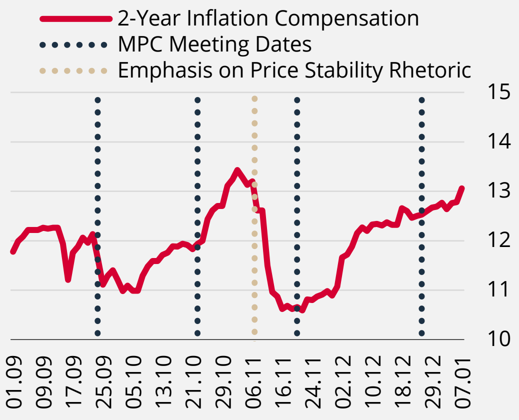
The vigorous recovery achieved in the economy with the rapid expansion in monetary aggregates and credits led to a deterioration in the external balance and inflation outlook. Accordingly, the CBRT increased the policy rate by 200 basis points at the MPC Meeting on September 24, 2020. After the decision, the risk premium of Turkey began to decline and 2-year inflation compensation, which can be described as a measure of inflation expectations derived from market rates, decreased by almost 1 percentage point (Charts 1 and 2). Thus, while short-term market rates increased in line with the policy rate, long-term market rates declined significantly (Chart 3). Therefore, this monetary policy step can be evaluated as an "expansionary tightening".

Chart 1: Turkey's 5-Year CDS Premium
(Basis Points)



Source: Bloomberg.

Chart 2: 2-Year Inflation Compensation
(%)



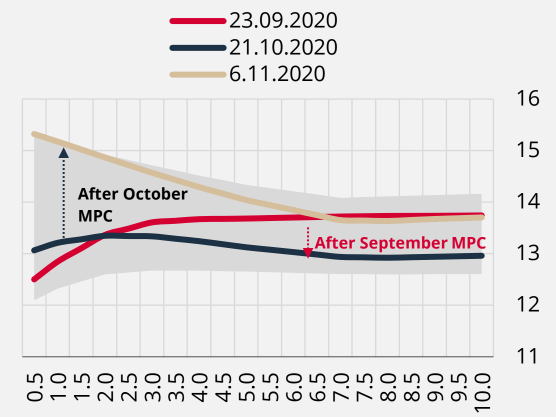
Source: Bloomberg.

Contrary to the rate hike predicted in the surveys conducted by various institutions prior to the MPC meeting in October, the CBRT left the interest rates unchanged and signaled that the additional monetary tightening that may be required would be carried out through liquidity management. After the decision, the country risk premium rose to the levels before the September MPC Meeting, while the inflation compensation also displayed a rapid upward trend. Similar to the increase in the risk premium, long-term interest rates also increased to pre-September MPC meeting levels, while short-term interest rates rose significantly owing to the additional tightening through liquidity management. The upsurge in interest rates across all maturities through inflation expectations and risk premium channels indicates a limiting effect of the October MPC decision on economic activity unlike the September decision.

In November, the country risk premium and inflation expectations decreased notably with the CBRT's adoption of a simple monetary policy framework accompanied by a rhetoric that prioritizes price stability. As a result, market rates fell by almost 1 percentage point in short terms and 2 percentage points in long terms in November (Chart 4). While the decline in the country risk premium continued, inflation compensation remained flat due to the implementation of a simple operational framework at the November MPC Meeting and the hike in the policy rate to converge to the actual money market interest rates. In the ensuing period, inflation compensation increased slightly due to the rapid increase in headline inflation. This increase was also reflected in market rates.

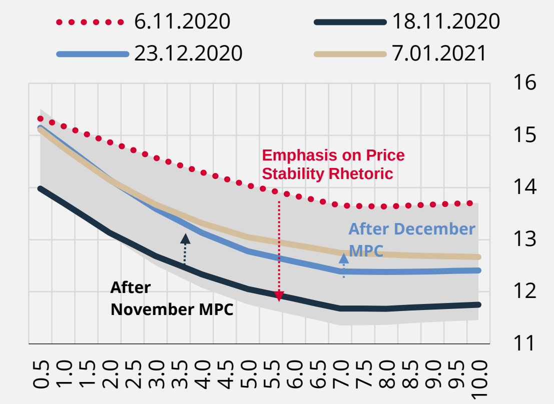
In order to limit the risks to the inflation outlook, the CBRT increased the policy rate by another 200 basis points at the MPC meeting in December. The country risk premium responded positively to this decision, but the increase in inflation expectations continued, albeit limited. While this increase was partially reflected on long-term market rates, interest rates remained flat in the short and medium terms.

Chart 3: Treasury Yield Curve
(%, 1 Sep.– 6 Nov. 2020 Period)



Sources: Bloomberg, CBRT.
* Shaded region represents the lowest and highest yields for the period between 1 September and 6 November 2020.

Chart 4: Treasury Yield Curve
(%, 6 Nov. 2020 – 7 Jan. 2021 Period)



Sources: Bloomberg, CBRT.
* Shaded region represents the lowest and highest yields for the period between 6 November 2020 and 7 January 2021.

Considering the response lag, the decisive monetary policy stance is expected to alleviate the headline inflation in the upcoming period, which in turn improves the inflation outlook. In fact, the decline in the country risk premium by more than 200 basis points since the beginning of November indicates that the belief in economic stability has strengthened. Establishing a low inflation environment permanently will support the decrease in the country risk premium and long-term interest rates and will positively affect economic activity.