Macro-note – Industrial Production

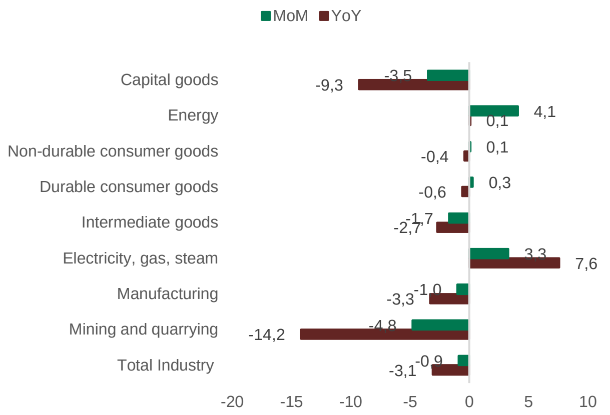
Industrial production contracts by 0.9% mom and 3.1% yoy in October. The relationship between GDP and industrial production has weakened with the recent decline in production data...

Abdulkadir DOGAN
Chief Economist
adogan@sekeryatirim.com.tr
(+90) 212 334 33 33/313

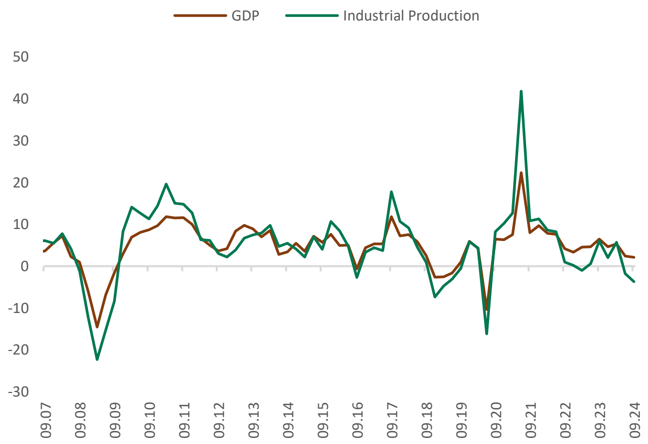
According to industrial production index data, seasonally- and calendar-adjusted production fell by 0.9% mom in October. Thus, annual production contracted by 3.1% (previous contraction of 2.3%). On a monthly basis, industrial production has been hovering below the potential production level for a long time. This is evident from both the slowdown in the economy and the negative output gap data that has persisted for two quarters. The slowdown in economic activity and the return of demand-side growth to its normal course was one of the medium-term objectives of the tight monetary policy. The decline in demand-side inflation to the desired levels, which was particularly noted in the latest inflation report, shows that these targets are gradually being realized. The cost to the economy will be to sacrifice production and growth for a while. On the other hand, the ongoing buoyancy in the services sector, albeit at a slower pace, is causing a divergence in growth and inflation indicators. In the current situation, we are faced with a slowing economy and relatively high inflation. Although pricing behavior and expectations suggest that inflation will remain above CBRT forecasts, we believe that lagged effects will pull expectations down over time. A slowdown in production, especially at these levels, will have a significant impact on inflation dynamics. We have experienced a period of negative divergence of industrial companies in financial markets for a long time. This was the compound effect of both financing costs and the weakening in production. we anticipate that this cycle will reverse as of the first months of 2025, and that we will enter a period of positive divergence of industry with the revival in economic activity.

When we analyze the sub-sectors; In October, the index of mining and quarrying sector decreased by 14.2% compared to the same month of the previous year, the index of manufacturing industry sector decreased by 3.3% and the index of electricity, gas, steam and air conditioning production and distribution sector increased by 7.6%. At monthly change levels, the mining and quarrying sector index decreased by 4.8%, the manufacturing industry index decreased by 1.0% and electricity, gas, steam and air conditioning production and distribution sector index increased by 3.3% compared to the previous month. The positive divergence in the energy sector is a result of the fall in oil prices and the partial recovery in global indicators. However, the contraction in both monthly and annual data in the manufacturing industry is directly or indirectly reflected in all factors of production. The flat course of the monthly and annual series of durable and non-durable goods production suggests that there has not yet been a significant slowdown in core goods groups that affect inflation. One of the main objectives of the economic administration was to reduce price pressures by cooling demand. In the current situation, however, the retreat in demand is relatively lower than the slowdown in production (supply). This supports our thesis of low growth and relatively high inflation. As of 2025, we expect this gap to gradually close and inflation to follow a calmer course as we move towards balanced growth figures.

Table 1: Industrial Production Rate of Change (%)



Graph 1: Industrial Production and GDP Growth (YoY %)



2024 will be a period when the tight monetary policy has the most pronounced impact on growth and production indicators. Both the uncertainty in global economies and the domestic outlook point to a slowdown in both domestic and external economic activity. If the tight stance is maintained in Turkey, the weakening in domestic demand may be partially compensated by foreign demand and prevent a sharp decline in production. In this context, the slowdown beyond our expectations suggests that growth and production will be significantly sacrificed this year. The narrowing of the output gap into negative territory in the second and third quarters is one of the main indicators of this. As stated in CBRT reports, 2024 will be the year of disinflation and 2025 the year of rebalancing. As macro-financial stability is considered as a whole, the imbalance in the budget, current account balance and other macro indicators has made price stability and cutting domestic demand a higher priority. In the remaining period of the year, we anticipate that sectors/companies with strong equity and high exports will differentiate positively.

In sum, industrial production contracted by 3.1% yoy in October, indicating a slowdown in production indicators beyond expectations. The slowdown in economic activity has limited downward pressure on inflation figures, but significantly on production indicators. Uncertainty in the main export markets and slowing demand are other factors that also weigh on production. We anticipate that the slowdown in both domestic and external demand will have the expected effects on inflation gradually. The alternative cost of achieving the price stability target, or at least a cooling cycle in an overheated economy, would be to sacrifice growth targets. While year-end growth forecasts remain below potential growth, the slowdown in some sectors will become more pronounced. Weakening production and recession concerns in global markets may mitigate the impact of the slowdown in domestic production. Industrial companies that actively use Turkish Lira borrowing facilities and have high leverage and low exports will face a difficult period for the rest of 2024. A coordinated tightening in monetary and fiscal policies will bring price stability and financial stability. We underline that new decisions and implementations will bring updates to our forecasts.

ŞEKER INVEST RESEARCH

Şeker Yatırım Menkul Değerler A.Ş.	TEL: +90 (212) 334 33 33
Buyukdere Cad. No: 171 Metrocity	Fax: +90 (212) 334 33 34
A Blok Kat 4-5 34330 SİSLİ /IST	E-mail: research@sekeryatirim.com
TURKEY	Web: http://www.sekeryatirim.com/english/index.aspx

For additional information, please contact:

Research

Kadir Tezeller	Head	+90 (212) 334 33 81	ktezeller@sekeryatirim.com
Burak Demirbilek	Utilities, Defense Industry	+90 (212) 334 33 33-128	bdemirbilek@sekeryatirim.com
Sevgi Onur	Banks	+90 (212) 334 33 33-150	sonur@sekeryatirim.com
Engin Değirmenci	Cement	+90 (212) 334 33 33-201	edegirmenci@sekeryatirim.com
A. Can Tuğlu	Food & Bev., Retail, Auto, Aviation, Oil&Gas	+90 (212) 334 33 33-334	atuglu@sekeryatirim.com
Esra Uzun Özbaskın	Telcos, Iron & Steel, Cons. Dur.	+90 (212) 334 33 33-245	euzun@sekeryatirim.com
Başak Kamber	Glass	+90 (212) 334 33 33-251	bkamber@sekeryatirim.com

Economy & Politics

Abdulkadir Doğan	Chief Economist	+90 (212) 334 91 04	adogan@sekeryatirim.com

Institutional Sales

Batuhan Alpman	Head	+90 (212) 334 91 01	balpman@sekeryatirim.com
Deniz Keskin	Trader	+90 (212) 334 33 36	dkeskin@sekeryatirim.com
Soner Bayram	Trader		

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