

## Macro-note – Industrial Production

**Industrial production rises by 5% mom and 7% yoy in December. We expect the gradual improvement in production to continue with the introduction of interest rate cuts and the revival in economic activity.**

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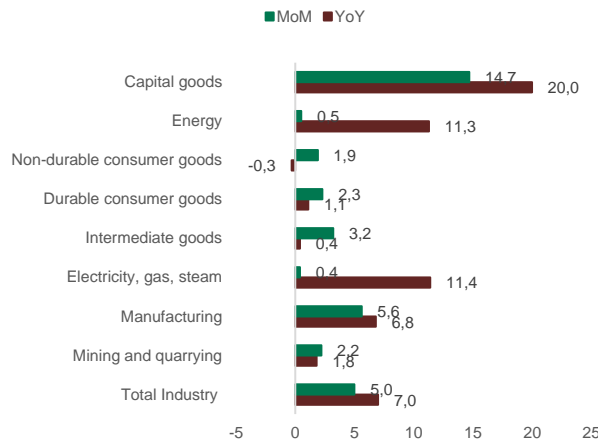
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According to industrial production index data, seasonally- and calendar-adjusted production increased by 5% mom in December. Thus, annual production growth was realized as 7% (previous 1.6%). Our expectation for Industrial Production was for a recovery in the monthly data and a strong base effect in the annual data. Especially with the pricing of the interest rate cuts that started in December and the expectations channel coming into play, we are entering a period where the long-standing negative outlook in production will be reversed. In this sense, we can say that the data was in line with our expectations. The output gap in production activity had reached negative levels as a result of the ongoing tight monetary policy in the fight against inflation. Considering the CBRT forecasts and the path of interest rate cuts, we estimate that the output gap will gradually improve after testing the lowest levels by the end of 2025. Therefore, even if production and growth recover slightly with interest rate cuts, it will take time to return to pre-2023 levels. This policy choice is a consequence of the decisive fight against inflation. On the other hand, we can say that there will be a positive divergence especially in sectors that feel the tight monetary stance in a significantly negative way. 2024 was a period in which industrial production decoupled relatively negatively from GDP data. In 2025, we expect a calm course in growth and a limited recovery in industrial production. While domestic indicators have started to recover, the outlook for trading partners remains negative. If foreign demand also contributes positively to the positive mood at home, production data may improve beyond forecasts. We note that this scenario is not far from the decline in geopolitical risks and interest rate cuts. The measures taken in Europe to support production are a particular indicator of this. While monetary tightness continues, liquidity arrangements to support production do too. The privilege introduced for commercial loan growth will also contribute to production activity. We have long experienced a period in which industrial companies were negatively differentiated in financial markets. This was due to 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 in which the industry decouples positively with the revival in economic activity. If the interest rate cut cycle of the CBRT continues in line with market expectations, the production and industrial sectors will experience a significant recovery in profit margins and sales volumes. The negative shock to all these positive expectations is the US tax and tariff regulations. This development, which weakens both inflation and foreign demand, has the potential to disrupt global trade.

Analyzing the sub-sectors; in December, the mining and quarrying sector index increased by 1.8% yoy, the manufacturing industry sector index increased by 6.8% and the electricity, gas, steam and air conditioning production and distribution sector index increased by 11.4%. At monthly change levels, the index for the mining and quarrying sector increased by 2.2%, the index for the manufacturing industry sector increased by 5.6% and the index for the electricity, gas, steam and air conditioning production and distribution sector increased by 0.4% compared to the previous month. While developments in manufacturing reflected the positive mood, the weak course in intermediate goods suggests that the recovery is not at the expected level. We observe that production in durable and non-durable goods is far from the desired levels in monthly and annual series. This is a consequence of the retreat in demand. One of the main objectives of the economic administration has been to reduce price pressures by cooling demand. In the current situation, the pullback in demand is relatively smaller than the slowdown in production (supply). This supports our thesis of low growth and relatively high inflation. By 2025, we expect this gap to gradually close and inflation to be more subdued as we move towards balanced growth figures.

Table 1: Industrial Production Rate of Change (%)



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



The revival in domestic production activities will start to make a positive supply-side contribution to pricing behavior. We experienced an even more positive realization than our expectation that monthly production data would experience a limited recovery after the CBRT interest rate cut signals. We can say that the negative atmosphere in real sector expectations has partially dissipated. Uncertainty regarding monetary policy has diminished, and a monetary and exchange rate policy has been designed to support production in 2025. The harmonization of the output gap with price mechanisms and the calming of demand inflation are among 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 have made price stability and cutting domestic demand a higher priority.

In sum, industrial production increased by 5% mom in December and closed 2024 with an annual increase of 7%. The slowdown in economic activity had pulled inflation figures down slightly and production indicators down significantly throughout the year. Uncertainty in the main export markets and slowing demand were other factors weighing on output. We expect the slowdown in both domestic and external demand to gradually have the expected consequences on inflation. 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 certain sectors has become more pronounced. Weakening production and recession concerns in global markets may mitigate the impact of the slowdown in domestic production. Coordinated tightening in monetary and fiscal policies will bring both price and financial stability. With the reduction in financing costs and the revival in domestic demand, we expect positive sentiment towards industrial companies throughout 2025. We would like to underline that new decisions and implementations will prompt updates to our forecasts.

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