Macro-note – Industrial Production

In January, industrial production (IP) decreases by 2.3% mom and rises by 1.2% yoy. IP will record a gradual recovery throughout 2025, despite periodic slowdowns.

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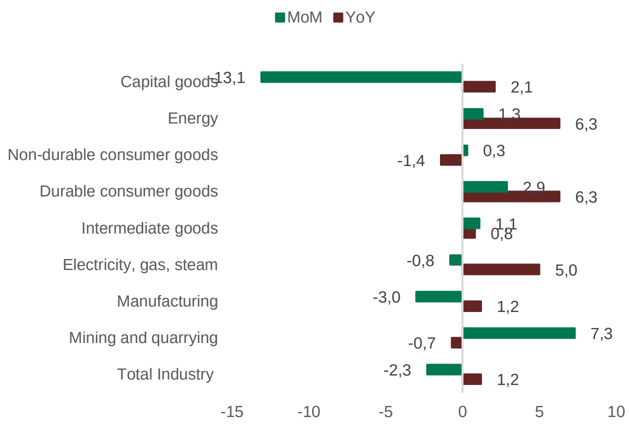
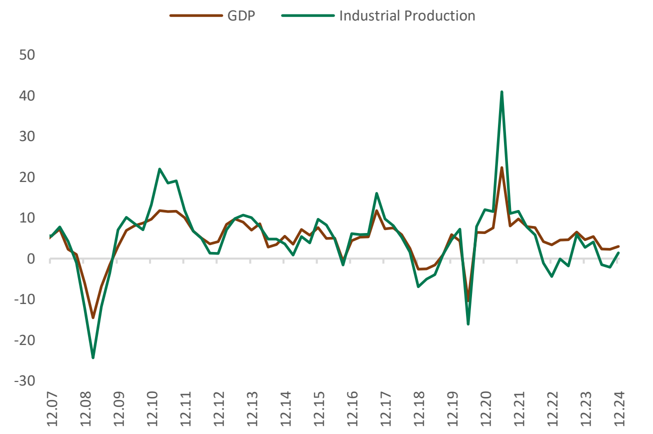
According to industrial production (IP) index data, seasonally and calendar adjusted production fell by 2.3% mom in January. Thus, annual production growth declined to 1.2% (previous 7%). Our expectation for IP was for a moderate recovery and rebalancing following the December data. When we look at the actual figures, the monthly decline was led by the manufacturing industry. As an indicator, we consider the manufacturing industry a threshold for sustainable and healthy production indicators. In this context, we believe that January's slowdown will be an exception. In this sense, we can say that the data was in line with our expectations. Production indicators across the economy are below their potential levels and the output gap is in negative territory. This cooling in economic activity is the result of a policy choice, and its long-term benefit will be to achieve sustainable inflation. Taken together, 2025 is likely to be a year in which economic growth slows but industrial production recovers. Given the CBRT forecasts and the path of interest rate cuts, we expect the output gap to gradually improve after testing the lowest levels by the end of 2025., Sectors that have significantly felt the negative impact of the tight monetary stance since June 2023 will perform relatively better in this period. While the domestic market remains calm, recent developments in global markets have gone far beyond our forecasts. In particular, mounting trade wars indicate that inflation may remain on the agenda for a while. This is a sign that interest rate cuts may be shelved for a short period of time. On the other hand, if these developments are a temporary shock, the recovery trend in the markets will continue. If foreign demand also contributes to the positive mood in Turkey, production data may improve beyond forecasts. While monetary tightness continues, liquidity arrangements to support production do too. The privilege on commercial loan growth will also contribute to production activity. We have experienced a long period of negative divergence of industrial companies in financial markets, which was a compound effect of 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 CBRT's interest rate cut cycle 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. If the US protectionist policies are met with an equally harsh response from its trading partners, global economic activity may slow down to a limited extent. On the other hand, price pressures caused by supply shocks may keep inflation above forecasts for a while. The March-April period will be a critical one for the new US administration and the sustainability of these policies.

When we analyze the sub-sectors; In January, the mining and quarrying sector index decreased by 0.7%, the manufacturing industry index increased by 1.2% and the electricity, gas, steam and air conditioning production and distribution sector index increased by 5.0% compared to the same month of last year. At monthly change levels, the index for mining and quarrying sector increased by 7.5%, the index for the manufacturing industry sector decreased by 3.0% and the index for the electricity, gas, steam and air conditioning production and distribution sector decreased by 0.8% compared to the previous month. Despite the limited recovery in durable and non-durable goods, the sharp contraction in the manufacturing industry led to the loss of momentum in January. One of the main objectives of the economic administration was to reduce price pressures by cooling demand. In the current situation, however, 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 will 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 %)



Considering the developments in inflation dynamics, we still expect the interest rate cut cycle to continue. We can say that the negative atmosphere in real sector expectations has partially dissipated. Unless there is an external shock to monthly inflation, we expect the production recovery to continue for the rest of the year in parallel with the interest rate cuts. Uncertainty regarding monetary policy has diminished, and a monetary and exchange rate policy that will support production in 2025 has been built. The harmonization of the output gap with price mechanisms and the calming of demand inflation are 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 domestic demand restraint a higher priority. Financially, supporting production activity through the commercial credit channel also sends messages that production will recover relatively, even if the tight stance continues for a while.

In sum, IP fell by 2.3% mom in January, bringing the annual increase down to 1.2%. In particular, the slowdown in the manufacturing industry led to a significant decline in production. Uncertainty in the main export markets and slowing demand remain another factor weighing on production. We expect that the slowdown in domestic and external demand will gradually have the expected effects 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 price stability and financial stability. With the reduction in financing costs and the revival in domestic demand, we expect positive sentiment among industrial companies throughout 2025. We underline here that new decisions and implementations will prompt updates to our forecasts.

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