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Macro-note – Industrial Production

Industrial production increases by 3.4% mom and 2.5% yoy in March. While the monthly momentum has picked up, annual production remains subdued.

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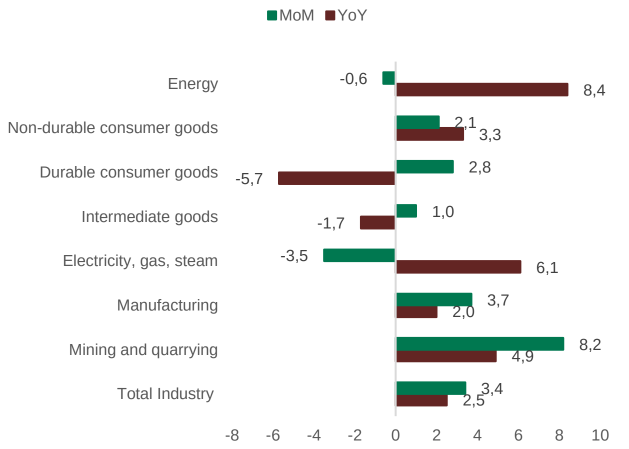
According to industrial production index data, seasonally and calendar adjusted production increased by 3.4% mom in March. Thus, annual production rose by 2.5% (previous 1.9% decline). Our expectation for industrial production was for a flat to negative outlook. We thought that the recovery would become more pronounced in the second quarter of the year. The political developments in March and the global economic outlook brought an update to these expectations. In particular, the further tightening in monetary policy direction necessitated a downward revision to our previous expectations for production for the rest of the year. We expect production in the manufacturing industry and durable goods to slow down significantly. On the other hand, we expect a limited decline in the production of high-tech products, which have become indispensable in export markets. In the current situation, we think that monthly recoveries peaked in March. For the rest of the year, we expect a calm monthly course and an outlook that will support the negative output gap in annual production. For companies and sectors with a high debt burden, we expect financing expenses to be an important item that will have a contractionary effect until the end of the year.

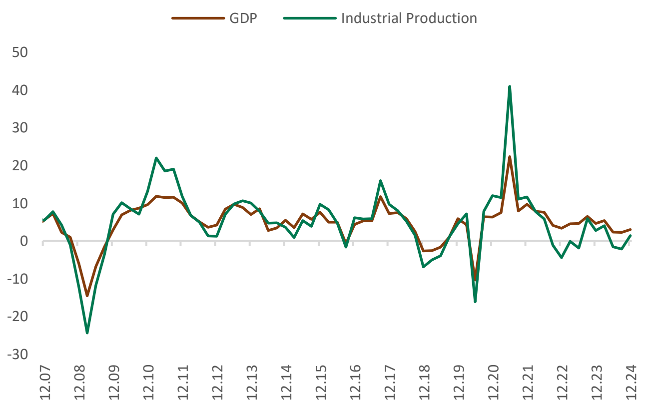
Both the local and global agenda in March brought forecast revisions in growth and production data. In order to curb the volatility in financial markets caused by both shocks, a series of measures by policymakers led to financial tightening. Our expectation of a gradual reduction in interest rates until the end of the year was also disrupted. The CBRT's move to widen the interest rate corridor upwards followed by the increase in the policy rate weakened expectations for production momentum. Considering the April inflation data and volatility in the markets, we think that the additional tightening decision was appropriate. However, it is inevitable that the high course of interest rates will put additional pressure on the real sector in terms of both production and financing. The pressure on sectors and companies with high financing costs will continue for a while. We estimate that this additional tightening decision against supply-side shocks may delay the recovery in the real economy by about a quarter. On the global front, the ongoing tariff wars also add to the negative pressure on production expectations. In developed countries, inflation is likely to remain high for a while and therefore, the continuation of tight monetary policy weakens export-oriented production in particular. However, the continuation of interest rate cuts in the European region will provide a positive, albeit limited, contribution to sectors exporting to the region. The resolution of global concerns and improvement in the inflation outlook may bring an update in our expectations. If the impact of the CBRT's latest decision on May-June inflation is as expected, we expect the interest rate cut cycle to continue at the same pace.

When we analyze the sub-sectors; In March, the mining and quarrying sector index increased by 4.9%, manufacturing industry index increased by 2.0% and electricity, gas, steam and air conditioning production and distribution sector index increased by 6.1% compared to the same month of the previous year. At monthly change levels, the index for the mining and quarrying sector increased by 8.2%, the index for the manufacturing industry sector increased by 3.7% and the index for the electricity, gas, steam and air conditioning production and distribution sector decreased by 3.5% compared to the previous month. One of the main objectives of the economic administration was 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. 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 %)



In sum, industrial production rose by 3.4% mom and 2.5% you in March. We think that the recovery in March tested the peaks in terms of monthly data. Uncertainty in main export markets and slowing demand remain another factor limiting the recovery in production. We expect that the slowdown in both domestic and external demand will 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. We believe that it is premature to comment on the impact of the recent domestic and global volatility and we would like to emphasize that the May-June period is of critical importance. While year-end growth forecasts remain below potential growth, the slowdown in some sectors has become more pronounced. Weakening production and recession concerns in global markets may mitigate the impact of the slowdown in domestic production. A coordinated tightening in monetary and fiscal policies will bring about price stability and financial stability. For 2025, we have slightly lowered our expectations for production and industrial recovery. We would like to underline that new decisions and implementations will prompt updates to our forecasts.

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