Macro-note – Industrial Production

Industrial production (IP) falls by 1.8% month-on-month in July to record a 5% year-on-year increase. We expect production data to cool off for the remainder of the year and follow a more stable course compared to the first half...

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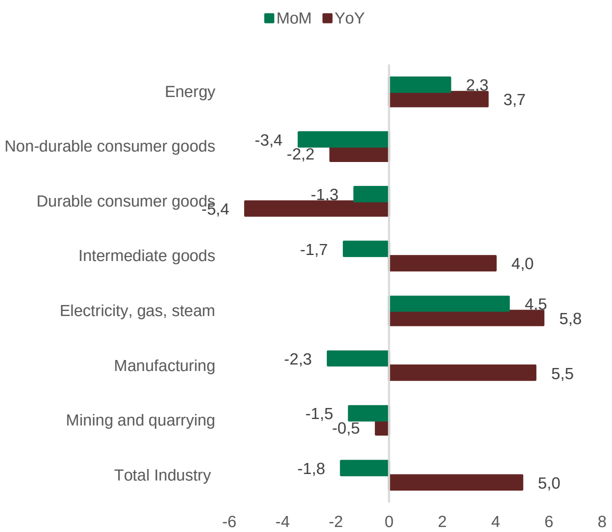
According to industrial production index data, seasonally and calendar-adjusted production fell by 1.8% in July compared to the previous month. The slowdown in monthly production brought annual production growth down to 5% (from 8.5%). Production data, which recorded a strong recovery in the second quarter with the approach of interest rate cuts, had contributed significantly to growth. Although political and geopolitical developments in March slowed this momentum, we can say that growth was achieved, led by production. We expect a slowdown in production due to the possibility of the pace of interest rate cuts remaining lower than expected, as well as to the forecast of a calmer inflation outlook for the rest of the year. The fact that the output gap will remain in negative territory also supports this scenario. In the same base scenario, we had thought that the recovery in production data would become more pronounced in the second quarter of the year. Due to the impact of these external shocks, we have revised our expectations for production data by one quarter. Given the current outlook, monthly data continues to fluctuate and remain flat. However, positive stagnation is an indication that the worst is behind us in terms of production. Nevertheless, we had previously stated in our reports that we were testing peak levels in annual production momentum and that the equilibrium would be around 5%. The actual results support these forecasts. The interest rate cuts that began in July have afforded some breathing space in terms of companies' financing costs. We believe this outlook will continue for the remainder of the year and that companies with high TL debt burdens will be positively affected during this process. As developments in monetary policy will indirectly impact on the expectation channel in industrial production, we expect the positive momentum in production data to continue until the end of the year, based on the expectation of continued interest rate cuts. Although this baseline scenario remains robust, political turmoil and global polarization could limit the positive impact of interest rate cuts on production. In this context, we emphasize that the CBRT, which prioritizes a cautious stance, may ease its monetary policy accordingly.

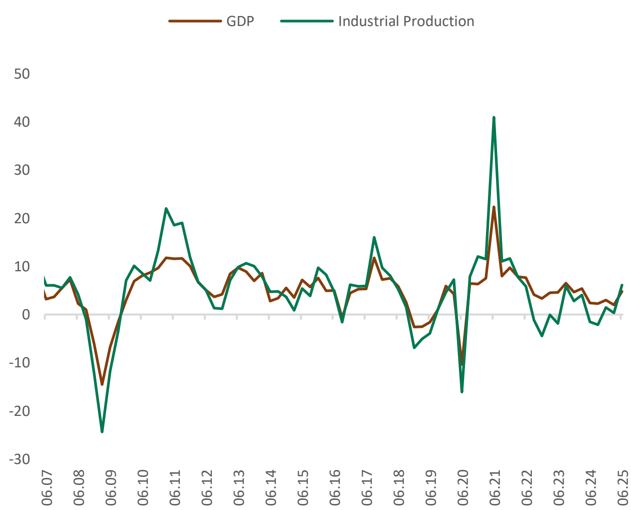
While the monetary policy stance will remain tight from mid-2023 onwards, the disinflation process is opening up room for maneuver for economic management. The CBRT, which began its cycle of interest rate cuts in July, gave the real sector a deep breath of fresh air. Although the fact that interest rate cuts are inflation-focused and meeting-based shows that risks are still alive, developments on the price side are limiting these risks. The inflation outlook for the past three months shows that significant progress has been made towards the disinflation target. In July, strong interest rate cuts until the end of the year formed our base scenario. However, the political agenda and domestic market uncertainty have prompted an updating of this scenario in the form of a limited and cautious reduction path. As the CBRT also considers the tightness of real interest rates, the outlook for inflation expectations may influence the policy stance. Interest rate cuts from the Fed and ECB will also contribute positively to the outlook for production and manufacturing. The resolution of global concerns and the improvement in the inflation outlook may lead to an update in our expectations. We see this expectation strengthening in global markets and production data. If there is no supply-side pressure from this area, domestic production data will also adapt to this new situation over time. We believe that economic activity will take on a more vibrant outlook for the rest of the year. Although borrowing costs, particularly in yield curves and bond yields in financial markets, create short-term risks, we believe this will have a limited impact on production.

When we examine the sub-sectors, in July 2025, the mining and quarrying sector index decreased by 0.5% compared to the same month of the previous year, the manufacturing industry sector index increased by 5.5%, and the electricity, gas, steam, and air conditioning production and distribution sector index increased by 5.8%. In terms of monthly changes, the mining and quarrying sector index decreased by 1.5% compared to the previous month, the manufacturing sector index decreased by 2.3%, and the electricity, gas, steam, and air conditioning production and distribution sector index increased by 4.5%. Interest rate cut expectations will be reflected in production data, albeit with a delay. Although the strong momentum in the second quarter of the year will be more subdued in the third and fourth quarters, it will remain positive. Barring any external shocks to prices and production data, the fruits of the tight stance implemented since 2023 will be reaped. We expect manufacturing and industrial production to stabilize at around 4.5-5%, approaching potential growth.

Table 1: Industrial Production Rate of Change (%)



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



In summary, industrial production declined by 1.8% month-on-month in July and recorded a 5% increase year-on-year. The search for balance in production continues. We expect the slowdown in both domestic and external demand to gradually yield the expected results on inflation. The alternative cost of achieving the price stability target, or at least a cooling cycle in the overheated economy, will be to sacrifice growth targets. We believe it is too early to comment on the impact of recent domestic and global volatility. Year-end growth forecasts remain below potential growth, while the slowdown in some sectors has become more pronounced. The easing of production and recession concerns in global markets may mitigate the impact of the slowdown in domestic production. Coordinated tightening of monetary and fiscal policies will bring price and financial stability. We have lowered our expectations for recovery in production and industry in 2025, albeit to a limited extent. We would like to emphasize that new decisions and implementations will prompt updates to our forecasts.

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