

Macro-note – Industrial Production

Industrial production (IP) contracted by 2.9 per cent month-on-month in May, whilst year-on-year output remained unchanged. The month-on-month contraction in output and the base effect are putting pressure on year-on-year output, whilst IP continues to underperform the growth figures.

Abdulkadir DOGAN

Chief Economist

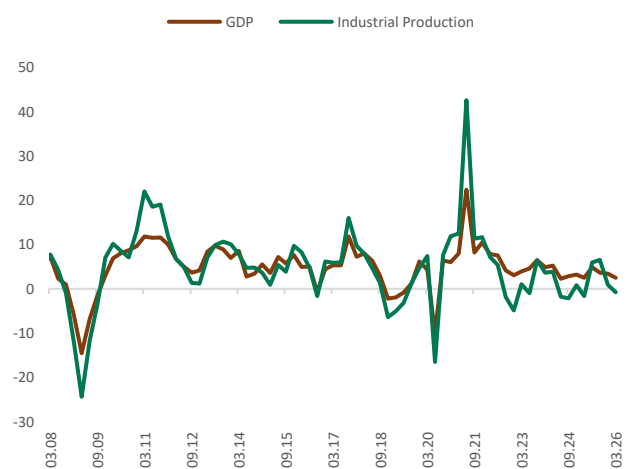
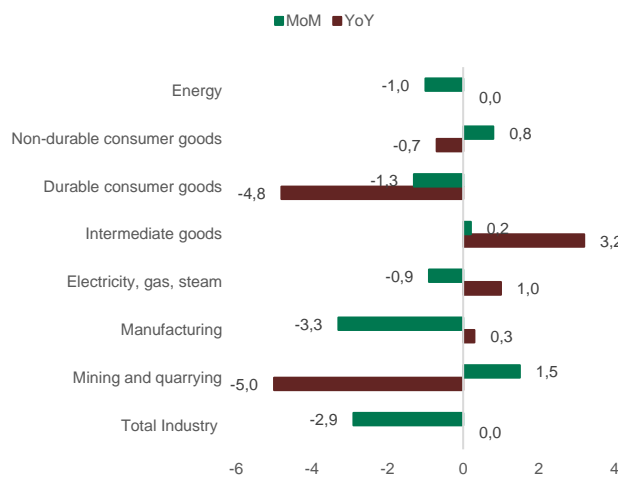
adogan@sekeryatirim.com.tr

(+90) 212 334 33 33/313

According to industrial production index data, seasonally and calendar-adjusted production fell by 2.9 per cent in May compared with the previous month. Year-on-year production, however, remained unchanged at 0 per cent. Our expectation was for a month-on-month decline in May and for the steady trend in year-on-year production to continue. We can therefore say that there was a slight negative deviation from our expectations. It is evident that volatility in industrial production (IP) continues. In the first quarter, production data diverged negatively from GDP growth. We attribute this to the tight monetary policy having a marked downward effect on both production and demand figures. The driving force behind growth, however, stems from the vigor of the services sector and the ongoing atmosphere of demand. As the cautious tightening stance in monetary policy continues, a situation will emerge where both growth and production figures are set to fall further and converge. This will lead us into an environment where the negative output gap persists for some time. However, the situation felt particularly in the first quarter and at the start of the second quarter reflects the impact of global shocks rather than domestic demand. Geopolitical developments have both pushed up prices of intermediate goods and raw materials and dampened production by creating uncertainty regarding demand. This ranks among the most undesirable scenarios for the economy: a contraction in production despite rising prices. We believe this effect will gradually subside as geopolitical developments stabilize. We believe the second shock to production and orders stems from the shift in the global monetary policy stance. Interest rate rises in developed economies and forward-looking inflationary concerns are keeping risks to current demand and production alive. In our baseline scenario at the start of the year, we had anticipated that economic activity and industrial companies would show a more positive performance from the first quarter onwards. The negative supply shock triggered by unforeseen geopolitical developments has caused these expectations to be postponed. In such a scenario, we believe it is the right decision for the CBRT to maintain its hawkish stance and support the long-standing fight against inflation through further tightening. The decline in oil prices and the easing of geopolitical risks will limit the impact of unforeseen shocks on domestic inflation. Under this scenario, we expect the CBRT to have more room to maneuver regarding interest rate cuts, with scope for reductions of approximately 400 basis points by the end of the year. Provided there is no further unforeseen shock to inflation, we expect to close the year at around 28 per cent, in line with the CBRT's forecasts. The CBRT's interest rate decision in July will be critical in this regard. Current developments suggest that the central bank may scale back the tightening it initiated in the wake of geopolitical events. Consequently, the market will once again be funded by the policy rate rather than the lending rate. In a more favorable scenario, the possibility remains that leading indicators will signal a downturn in the core inflation trend, paving the way for a limited rate cut. Whilst both possibilities remain on the cards, the core inflation trend and the central bank's forward guidance could trigger a shift in direction across all macroeconomic variables, from the monetary policy stance to IP and the current account balance. In this context, our base scenario points towards a modest recovery in IP in the second half of the year and a revival of upward price momentum for industrial companies in the financial markets.

In May 2026, the mining and quarrying sector index fell by 5.0 per cent compared with the same month of the previous year, the manufacturing sector index rose by 0.3 per cent, and the electricity, gas, steam and air-conditioning production and distribution sector index rose by 1.0 per cent. In terms of monthly changes, the mining and quarrying sector index rose by 1.5 per cent compared with the previous month, the manufacturing sector index fell by 3.3 per cent, and the electricity, gas, steam and air conditioning production and distribution sector index fell by 0.9 per cent. This reflects the situation in the production of durable consumer goods and in long-term employment and demand. There has been a marked decline and negative divergence. In the manufacturing sector, however, IP remains at roughly the same levels. On the other hand, there has been a recent downturn in high-tech products. Energy production is showing a more positive trend due to recent geopolitical risks. We expect this to gradually subside.

Table 1: Industrial Production Rate of Change (%) **Graph 1: Industrial Production and GDP Growth (YoY %)**



In summary, IP contracted by 2.9 per cent month-on-month in May, whilst year-on-year production remained unchanged at 0 per cent. The weakness on the production side indicates that future positive shocks to inflation are not at the desired level. Whilst the supply side remains stable, even minor changes in demand can push inflation upwards. The cumulative effect of the second quarter remains positive, but there is no sign of momentum at the targeted level. The momentum of the recovery in production will also make positive contributions to the disinflation program from the supply side. Positive developments in the geopolitical landscape will also contribute to production and orders. In the first quarter, growth figures diverged from production. We are entering a period in which this gap is set to narrow in favor of industrial production. We emphasize here that any new decisions and measures taken will prompt updates to our forecasts.

ŞEKER INVEST RESEARCH

Şeker Yatırım Menkul Değerler A.Ş.
 Büyükdere Cad. No: 171 Metrocity
 A Blok Kat 4-5 34330 SİSLİ /İST
 TURKEY

TEL: +90 (212) 334 33 33
 Fax: +90 (212) 334 33 34
 E-mail: research@sekeryatirim.com
 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.tr
Burak Demirbilek	Utilities	+90 (212) 334 33 33-128	bdemirbilek@sekeryatirim.com.tr
Atasav Can Tuglu	Food & Beverages, Automotive, Retail, Aviation	+90 (212) 334 33 33-334	atuglu@sekeryatirim.com.tr
Basak Kamber	Glass, Pharmaceutical, Defense, Telcos, Cons. Dur.	+90 (212) 334 33 33-251	bkamber@sekeryatirim.com.tr
M. Mucahid Yıldırım	Banking	+90 (212) 334 33 33-150	myildirim@sekeryatirim.com.tr
Yusuf Kemal Erdekli	Cement, Conglomerates, Real Estate	+90 (212) 334 33 33-115	verdekli@sekeryatirim.com.tr
O. Furkan Ozdemir	Iron & Steel, Oil- Gas & Deriv.	+90 (212) 334 33 33-245	oozdemir@sekeryatirim.com.tr

Economy & Politics

Abdulkadir Dogan	Chief Economist	+90 (212) 334 91 04	adogan@sekeryatirim.com.tr
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Institutional Sales

Deniz Keskin	Trader	+90 (212) 334 33 36	dkeskin@sekeryatirim.com.tr
Kerim Culum	Trader	+90 (212) 334 33 33-316	kculum@sekeryatirim.com.tr

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