Macro-note – Industrial Production

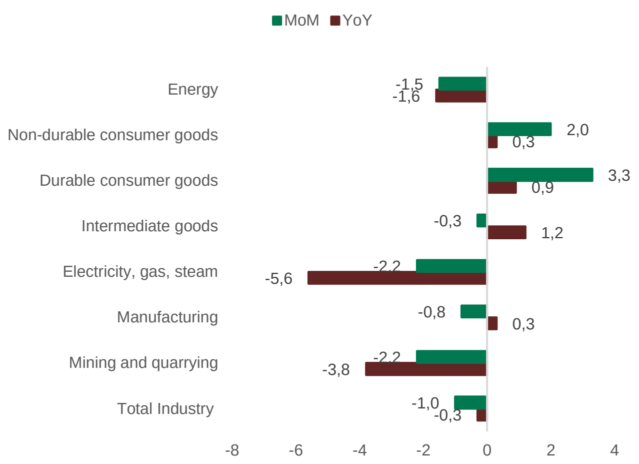
Industrial production falls by 1 per cent month-on-month in July, whilst contracting by 0.3 per cent year-on-year. Despite our expectations of a modest month-on-month recovery in July, this contraction indicates that we are entering the third quarter against a backdrop of negative production trends.

Abdulkadir DOGAN
Chief Economist
adogan@sekeryatirim.com.tr
(+90) 212 334 33 33/313

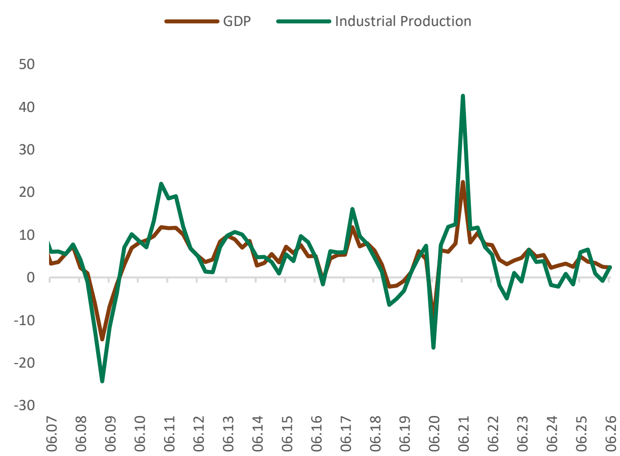
According to industrial production index data, seasonally and calendar-adjusted production fell by 1 per cent in July compared with the previous month. With this figure, annual production contracted by 0.3 per cent. We had expected a modest recovery in July for industrial production, which has continued its volatile but subdued trend. The actual figures, however, suggest that we have, on the contrary, started the third quarter in a negative climate in terms of production. In particular, there is a marked divergence between production data and the manufacturing sector on the one hand, and the services and agriculture sectors on the other. Whilst economic activity remains buoyant in the services sector—where we see the clearest reflection of inflation—agriculture is still recovering from last year's frost damage. However, when considering both its contribution to growth and its prolonged near-flat trajectory, there is a negative divergence in industrial production. We have highlighted the local and global dynamics of this in our previous reports. With the tight stance in domestic monetary policy and expectations, compounded by global uncertainty and geopolitical tension, the expected recovery in industrial production is not materializing. In particular, a negative atmosphere has prevailed for some time in sectors we monitor closely—such as the manufacturing industry and durable consumer goods—which form the cornerstone of long-term growth and the labor market. We observed this in the details of the second-quarter growth data as well. An examination of the composition of growth, rather than merely the slowdown itself, reveals the extent to which monetary policy has affected production. Ensuring that the economy, which is growing led by the services sector, shifts onto a healthy and sustainable path is also crucial for the labor market. Employment growth in production-oriented sectors not only creates added value but also contributes to the disinflation process. On the other hand, whilst wage increases in the services sector contribute to growth, they also have a structure that fuels inflation. Anchoring expectations is crucial to breaking this cycle. In this environment, where the dynamics fueling economic activity are closely tied to the monetary policy stance for the coming period, verbal guidance from the CBRT will be a lifeline for the manufacturing sector. In this context, with inflation at around 30 per cent where price rigidities are clearly evident, we believe there is a need for positive internal shocks. This is because the current economic climate is characterized by a period in which negative external shocks are pushing inflation dynamics upwards. In particular, there is a need for positive internal shocks to counterbalance the energy shocks arising from geopolitical tension. In the final quarter, sector-specific loans supporting production and the easing of access to finance will also pave the way for the fight against inflation to be led by production. Whilst our baseline scenario for 2026 industrial production at the start of the year was disrupted by global shocks, we believe this will be implemented, albeit with a delay, from the final quarter onwards. Neither are the targeted developments in the underlying trend of inflation in place for the CBRT to begin cutting interest rates, nor do developments in the global commodities market support this scenario. Under our scenario, in which cautious interest rate cuts will be introduced from October onwards, we forecast that 2027 will support growth through a production-led recovery. Industrial production and pent-up demand across sectors will gradually pick up from September onwards.

In July 2026, the mining and quarrying sector index fell by 3.8 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 fell by 5.6 per cent. In terms of monthly changes, the mining and quarrying sector index fell by 2.2 per cent compared with the previous month, the manufacturing sector index fell by 0.8 per cent, and the electricity, gas, steam and air conditioning production and distribution sector index fell by 2.2 per cent. Whilst the impact of falling prices in energy production was felt in July, there was a slight recovery in durable and non-durable consumer goods. Whilst the manufacturing sector continues to perform weakly, the weakness in domestic demand for intermediate goods is also noteworthy. We observe that industrial production, which diverged negatively from growth in the second quarter, is now converging with growth figures. However, although this seasonal effect is positive, the general trend indicates that the divergence between growth and production persists.

Table 1: Industrial Production Rate of Change (%)



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



In summary, whilst industrial production fell by 1 per cent month-on-month in July, year-on-year production contracted by 0.3 per cent. The first half of the year concluded with industrial production falling short of expectations. 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 momentum of the recovery in production will also make positive contributions to the disinflation programme from the supply side. Positive developments in the geopolitical landscape will also contribute to production and orders. From the final quarter of the year onwards, we will enter a period in which industrial production and growth figures are expected to converge. We would like to emphasize that any new decisions and measures taken will necessitate updates to our forecasts.

ŞEKER INVEST RESEARCH

Şeker Yatırım Menkul Değerler A.Ş.
Buyukdere Cad. No: 171 Metrocity
A Blok Kat 4-5 34330 SİSLİ /IST
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**	yerdekli@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

Institutional Sales

Deniz Keskin	**Trader**	**+90 (212) 334 33 36**	dkeskin@sekeryatirim.com.tr

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