

Macro: Signals of a sector-wide slowdown are getting stronger in the second quarter

Business Tendency Survey, Real Sector Confidence Index and Capacity Utilization Rate for May indicate that the weak course in production and demand for the manufacturing industry have continued in the second quarter of the year. Recently, increased volatility/uncertainties due to domestic and international developments have had negative repercussions on expectations. The declines in total orders and export orders as well as the deterioration in domestic and foreign market expectations confirm this assessment. The same outlook also applies to non-manufacturing sectors. In this framework, the data signal a slowdown across sectors in the second quarter. The CBRT's recent output gap forecast is also consistent with this outlook (below potential quarterly growth).

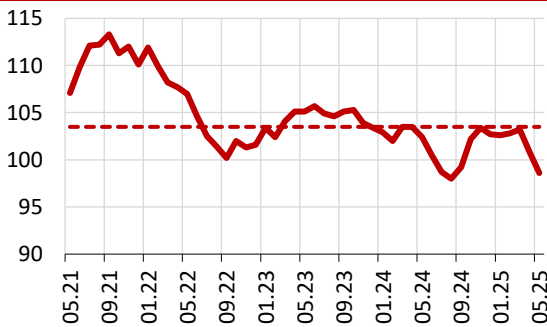
Confidence Indices

Real Sector Confidence Index (RSCI): In seasonally adjusted terms (s.a), following the significant decline in April, the RCI fell by 2.2 points to 98.6 in May and remained below its historical average (Chart 1). This suggests that weakening signals became more evident for the manufacturing industry. This was mainly driven by the declines in total orders and stocks of finished goods, total orders for the next 3 months and export orders. We think that this outlook stemmed from the uncertainties and volatilities caused by domestic developments in the second half of March and global developments in early April.

Sectoral Confidence Indices (SCI): Sectoral confidence indices, which posted a quarterly increase in the first quarter of the year, posted a slight improvement in May after a sharp monthly decline in April, but remained below the first-quarter average (Chart 2). Although the **services** confidence index rose by 1 point mom to 110.5 in May, it remained below its previous quarter average. This rise was driven by the improvement in business conditions and the demand outlook for services over the last 3 months, while the deterioration in expectations for the next 3 months limited the improvement in the headline index. **Retail** confidence index recorded a limited increase of 0.6 points in May following the significant declines in March and April. The limited recovery in retail confidence was mainly driven by the declines in the current inventory level and the expected business volume in the next 3 months sub-indices. In the **construction** sector, there was a recovery in questions regarding the expectations.

Thus, services, retail and construction confidence indices all remained below their historical averages. Hence, the data signal a sector-wide slowdown in activity. The CBRT's output gap forecasts released today are in line with this outlook (below potential quarterly growth).

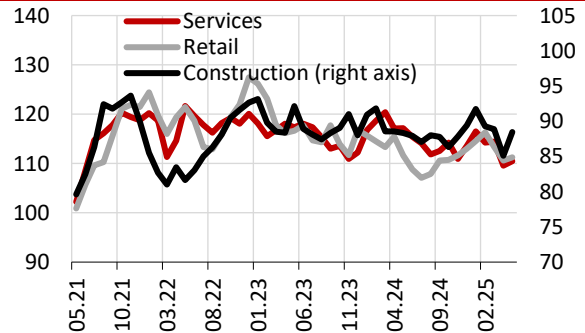
Chart 1. Real Sector Confidence Index (seasonally adjusted)*



* Dashed line shows 2007-2019 average.

Source: CBRT

Chart 2. Sectoral Confidence Indices (seasonally adjusted)

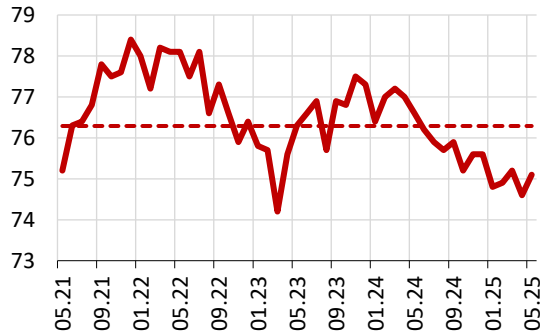


Source: TURKSTAT

Capacity Utilization Rate (CUR)

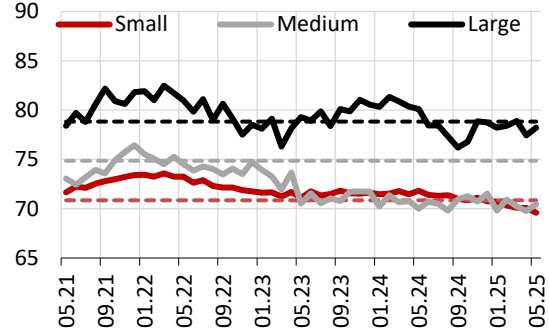
The CUR (s.a.) rose by 0.5 points mom to 75.1% in May, but still remaining 1.2 points below its historical average and signaling that the underlying trend in the manufacturing industry have weakened (Chart 3). In terms of scale, the CUR increased in large and medium-sized firms, while it decreased in small-sized firms, reaching its lowest level since December 2020 (Chart 4). Compared to historical averages, CUR remains significantly below average for medium-sized firms, while it is slightly below average for small and large-sized firms. Across goods groups, there were limited increases except for capital goods. The CUR for durable consumption goods increased by 0.1 points this month, following a 0.8-point decline in the previous month. After consecutive decreases in March and April, the CUR for intermediate goods remained flat in May, maintaining its weak outlook below its historical average. Thus, the CUR, which has been on a downward trend since the first quarter of 2024, could not fully compensate for the significant decline in April, indicating that manufacturing industry activity continued to weaken in the second half of the year.

Chart 3. Capacity Utilization Rate (seasonally adjusted, %)*



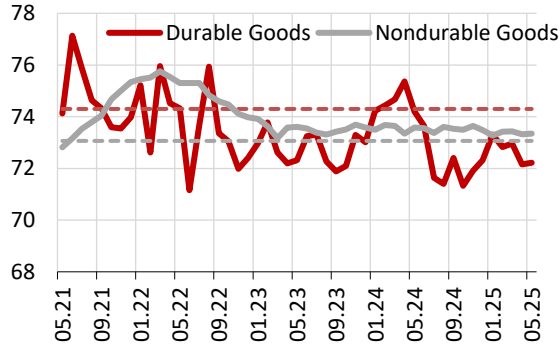
* Dashed line shows 2007-2019 average.
Source: CBRT

Chart 4. Capacity Utilization Rate (by firm-scale, seasonally adjusted, %)*

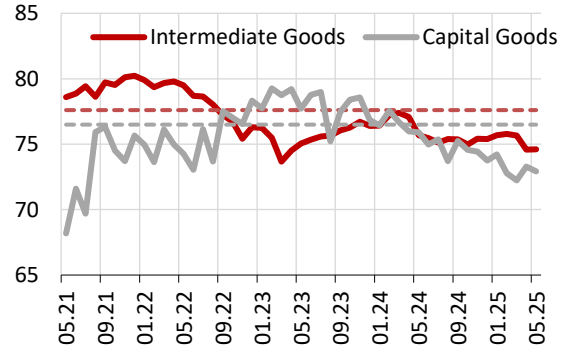


* Dashed lines show 2007-2019 average of each series.
Source: CBRT, Akbank

Chart 5 and 6. CUR (by main industrial groups, seasonally adjusted, %)*



* Dashed lines show 2007-2019 average of each series.
Source: CBRT, Akbank



In sectoral detail, the increases in the CURs of basic metals, vehicles and clothing sectors were the main drivers of the total manufacturing industry CUR increase. The CUR of **basic metal** industry increased by 1.1 mom in May, reaching the highest level of the last 3 months, but remained 4.7 points below its historical average. **Transport equipment's** CUR, which declined continuously in the December 2024-February 2025 period, increased by 0.9 in May, maintaining its upward trend of the last 3 months. In the **clothing** sector, the CUR increased by 1.1 points on a monthly basis. The CUR in the **chemicals** sector increased by 0.8 points mom, while the CUR in the manufacture of **pharmaceuticals** rose by 1 point. On the other hand, the CUR of the **textile** sector, the main supplier of the clothing sector, decreased by 1.7 mom and fell below 70% for the first time in 2 years (since the

earthquake). The CUR of the **machinery** sector, which has been declining continuously for the last 5 months, decreased by 0.8 points compared to the previous month and was calculated at 70%, the lowest level since September 2020.

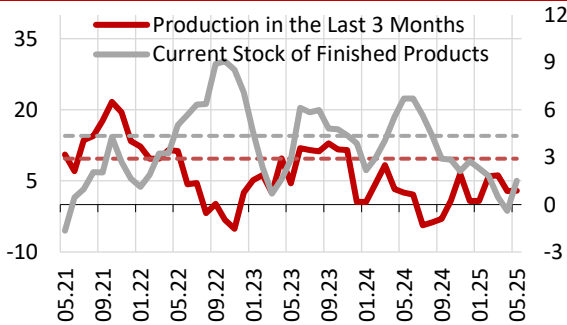
Business Tendency Survey

The **last 3-month production volume** question remained flat in May after declining in April and is 6.8 points below its long-term average (Chart 7). Across goods groups, durable goods have been on a downward trend for the last two months; the sharp decline in May was noteworthy. Nondurable goods have decreased for the third consecutive month, while intermediate goods and capital goods have increased. On a scale basis, there is a decline in medium-sized firms.

Current stock of finished products increased across all goods groups, with the most significant increase in capital goods and large-scale firms. However, inventories continued to remain significantly below historical averages in all sectors according to long-term averages except for capital goods (Chart 7).

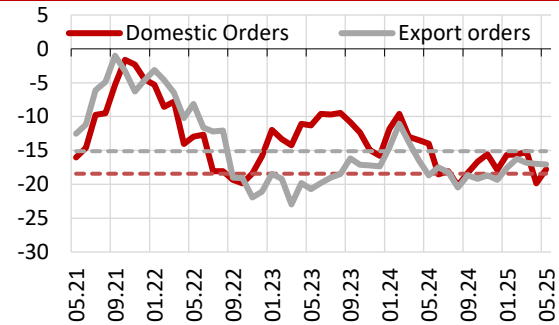
After a mom decline in April, **registered orders** increased in May and remained above their historical averages, pointing to some recovery in domestic demand. **Export orders** have declined for the last three months and remained weak compared to historical averages (Chart 8). **Domestic orders** decreased significantly in durable goods. They increased in capital and non-durable consumption goods. In the export market, orders increased in intermediate goods and decreased in capital goods.

Chart 7. Production in the Last 3 Months (s.a., increase-decrease) and Stocks of Finished Products (s. a., above-below normal)*



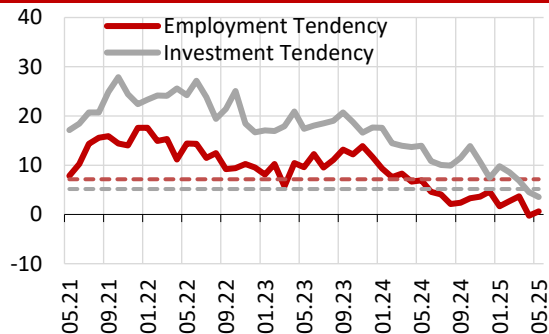
* Dashed lines show 2007-2019 average of each series.
Source: CBRT, Akbank

Chart 8. Registered Orders (seasonally adjusted, above-below normal, %)*



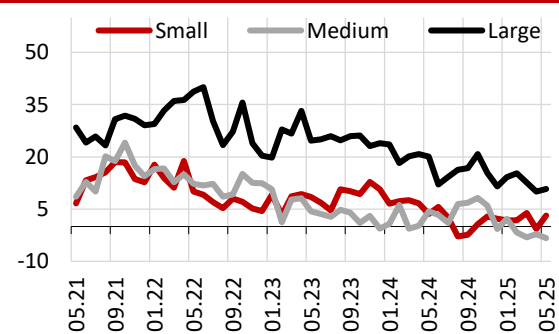
* Dashed lines show 2007-2019 average of each series.
Source: CBRT, Akbank

Chart 9. Employment and Investment Tendency (seas. adj., increase-decrease, %)



* Dashed lines show 2007-2019 average of each series.
Source: CBRT, Akbank

Chart 10. Investment Tendency (by firm-scale, seas.adj., increase-decrease, %)



Source: CBRT, Akbank

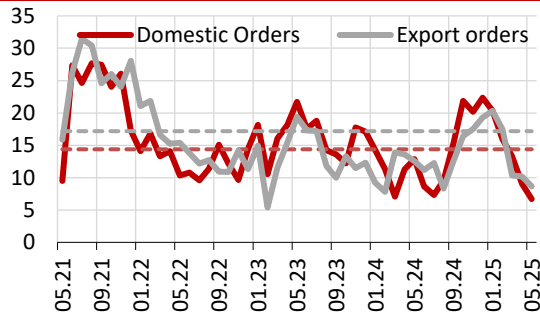
The **employment tendency** decreased on a monthly basis in April but increased in May. The **investment tendency** has been decreasing for the last four months (Chart 9). It is noteworthy that the longer-term trend in both questions is also downwards. The employment tendency increased across

all scales, but declined significantly in durable goods. Investment tendency increased in all scales except medium-sized firms. Across goods groups, that of capital goods decreased sharply, while nondurable consumption and intermediate goods increased and durable consumption goods decreased (Chart 10).

Manufacturing firms' expectations for **export orders** continued to decline. **Domestic order** expectations have also been declining for the last five months (Chart 11). Both export and domestic orders have been below their long-term averages for the last three months.

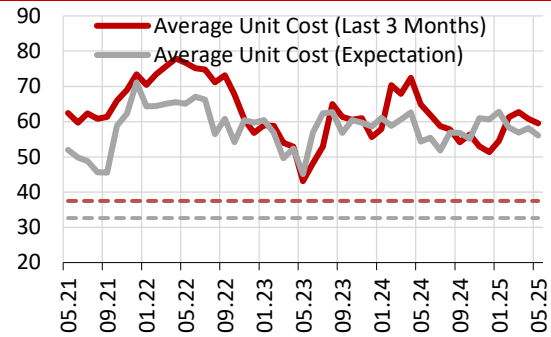
Among the questions on **costs and pricing**, expectations for the next 3 months declined again in May (Chart 12). **Annual PPI inflation expectations** of the manufacturing industry for the next 12 months decreased by 0.5 points mom to 38.4%. The expectation is well above the current PPI annual inflation (22.5%). Considering the expected course of commodity prices and the exchange rate levels in line with macro targets, we think that this expectation is quite high.

Chart 11. Expectations for Orders in the next 3 Months (seas. adj., increase-decrease, %)*



* Dashed lines show 2007-2019 average of each series.
Source: CBRT, Akbank

Chart 12. Average Unit Labor Cost (seas. adj., increase-decrease, %)*



* Dashed lines show 2007-2019 average of each series.
Source: CBRT, Akbank

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