FMM Business Conditions Survey

MANUFACTURING ACTIVITY SLOWS FURTHER IN 1H2023, OUTLOOK REMAINS CHALLENGING FOR 2H2023

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KEY RESULTS:	
BUSINESS ACTIVITY – 1H2023	☑ Business conditions sluggish in 1H2023 ☑ Current local and export sales down ☑ Production volume, production cost and capacity utilisation shift lower ☑ Capital investment and employment less active
BUSINESS ACTIVITY – OUTLOOK 2H2023 and 2023 IN GENERAL	☑ Slowdown in business conditions and local sales in 2H2023 ☑ Export sales to remain slow in 2H2023 ☑ Production volume and capacity utilisation to shrink on lower sales expectations ☑ Capital investment to moderate in the near term ☑ Lower production cost and employment in 2H2023
GENERAL BUSINESS ACTIVITY – OUTLOOK 2H2023 and 2023 IN GENERAL	☑ Business growth for 2H2023: 41% of respondents to maintain their current position for now, 27% to streamline their production lines ☑ In 1H2023, most costs increase by up to 20%, with labour, maintenance of machinery and raw materials comprising the top three cost increases ☑ In 1H2023, costs of water, maintenance of machinery, logistics and energy ranged up to 5% of total operating costs for 56-70% of respondents ☑ As % of total revenue up to 1H2023, more respondents report higher operating costs of >50% during Covid and post-Covid periods than pre-Covid period ☑ For 2H2023, cautious optimism for company and industry conditions, unfavourable expectations for global and domestic economic conditions
GENERAL	☑ For 2024, economic outlook cautiously optimistic ☑ Renminbi (RMB) top choice of most respondents as alternative currency to the USD ☑ 63% of respondents not aware of mandatory regulation on CBAM and EUDR ☑ Introduction of legislation on setting credit term limits for SMEs: 33% in favour; 35% not in favour ☑ BNM's fifth OPR hike in May 2023 increases operating costs of most (41%) respondents by 1-3%, and another 19% by 4-6% ☑ OPR hike impacts cash flow and business operations of 67% of respondents ☑ If increase in OPR too costly to finance, 37% willing to accept longer repayment period, 30% not willing to ☑ Should OPR increase further by 25 basis points by end 2023, the impact on most business revenues and profits is expected to be minimal (less than 30%)

Results of the latest FMM Business Conditions Survey indicate that the Malaysian manufacturing sector had slowed down further in 1H2023. External headwinds such as the sluggish trade flows and global growth, recessionary trends in Europe, China's fragile economic rebound, the Federal Reserve's monetary policy and heightened geopolitical tensions have likely continued to challenge the manufacturing sector. Domestic issues are equally challenging such as the uptrend in inflation, shortage of raw materials and supply chain disruptions, which have continued to put pressure on the costs of doing business.

In the 1H2023 survey, not only had all the indicators included in the survey declined from the previous survey, all of them, except cost of production and employment, had also registered readings below the 100-point optimism threshold, an indication that overall business conditions in 1H2023 had been subdued. Going forward, the sector is pragmatically on cautious mode, likely in anticipation of the persistently weak external conditions, and clearer domestic economic policies and directions from the government to help spur higher investments and Malaysia's growth momentum.

Indicators	FMM Business Conditions Index Values							
	Current (Compared to 6 months ago)				Looking Forward (Next 6 months)			
	2H2021	1H2022	2H2022	1H2023	1H2022	2H2022	1H2023	2H2023
Business conditions	107	109	107	66	122	94	92	86
Local sales	94	99	98	71	113	90	91	81
Export sales	96	91	91	66	111	89	84	88
Production volume	105	102	102	69	122	98	97	86
Capacity utilisation	101	104	99	68	117	100	94	87
Capital investment	105	109	104	95	125	113	112	100
Number of employees	99	100	112	101	121	117	113	101
Cost of production	174	182	166	157	179	177	166	148

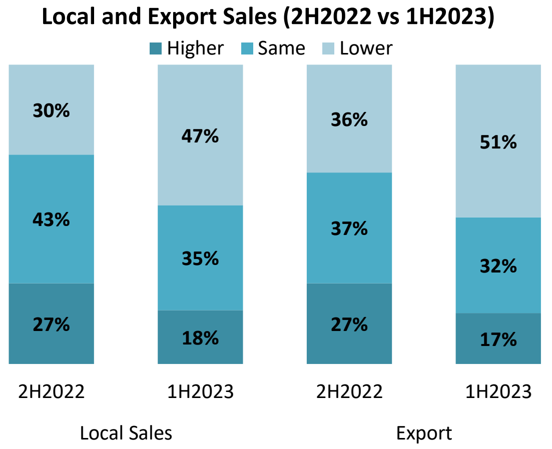
BUSINESS CONDITIONS SLUGGISH

Manufacturing activity was lacklustre in recent months, as shown by the current business activity index. From a reading of 107 in 2H2022, the index plummeted 41 points to stand at only 66 in 1H2023, the lowest level recorded since 1H2021. Lower activity was reported by 54% of the respondents, almost doubling the 28% in 2H2022. This is also the highest proportion tabulated in two years. Another two-year low of only 20% responded positively, while activity has remained the same for 27% of the respondents in 1H2023.

Local and Export Sales Slow Down

Sales were weak in 1H2023, both at home and abroad. Reflecting this is the latest current indexes for local sales and export sales which fell to their two-year low of 71 and 66, respectively. With 47% of those who sell locally experiencing lower sales in 1H2023 and 51% of those who export reporting the same, these are the largest proportions received in two years.

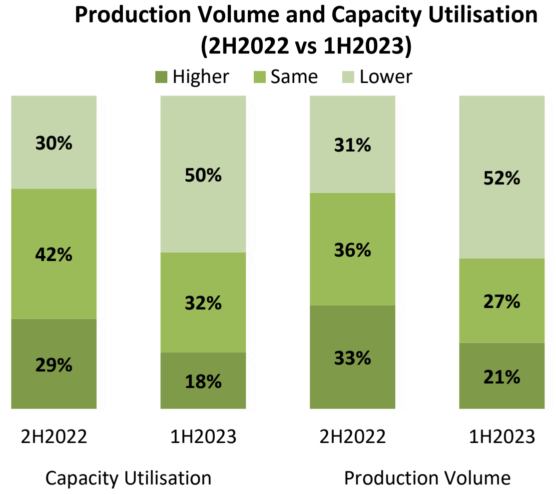
Higher local sales were disclosed by a two-year low of 18% of the respondents, while a three-year low of 17% of those who export also reported higher sales in 1H2023.



Production Volume and Capacity Utilisation Shift Lower

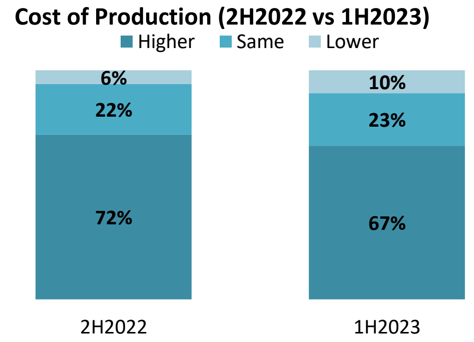
Weak new orders and sales, among others, have likely dampened production volume and capacity utilisation in 1H2023. This is shown by the latest current indexes for production volume and capacity utilisation which, at 69 and 68, respectively, had shrunk to their lowest levels since 1H2021.

Lower production volume was reported by 52% of the respondents in 1H2023, while 50% also reduced their capacity utilisation during the same period, both of which are the highest proportions obtained since 1H2021. Two-year low proportions were also noted among those who responded positively; 21% expanded their volume of production in 1H2023, while 18% increased their capacities at the same time.



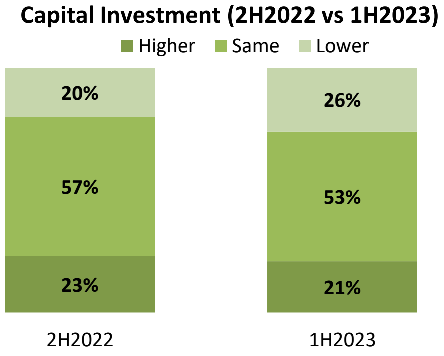
Cost of Production Trends Down

Manufacturing costs eased further in 1H2023, as denoted by the decline in the current cost of production index to 157, its lowest level since 2H2020. Although most of the respondents continued to incur higher costs of production in 1H2023, the proportion has decreased, for the second consecutive survey, to 67%. For the first time since 2H2020, those who managed to keep costs down had reached a double-digit proportion of 10% in 1H2023.



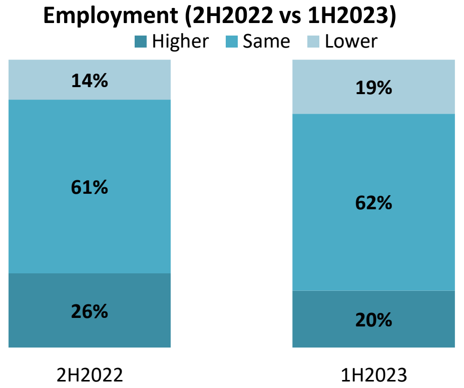
Capital Investment Wanes Further

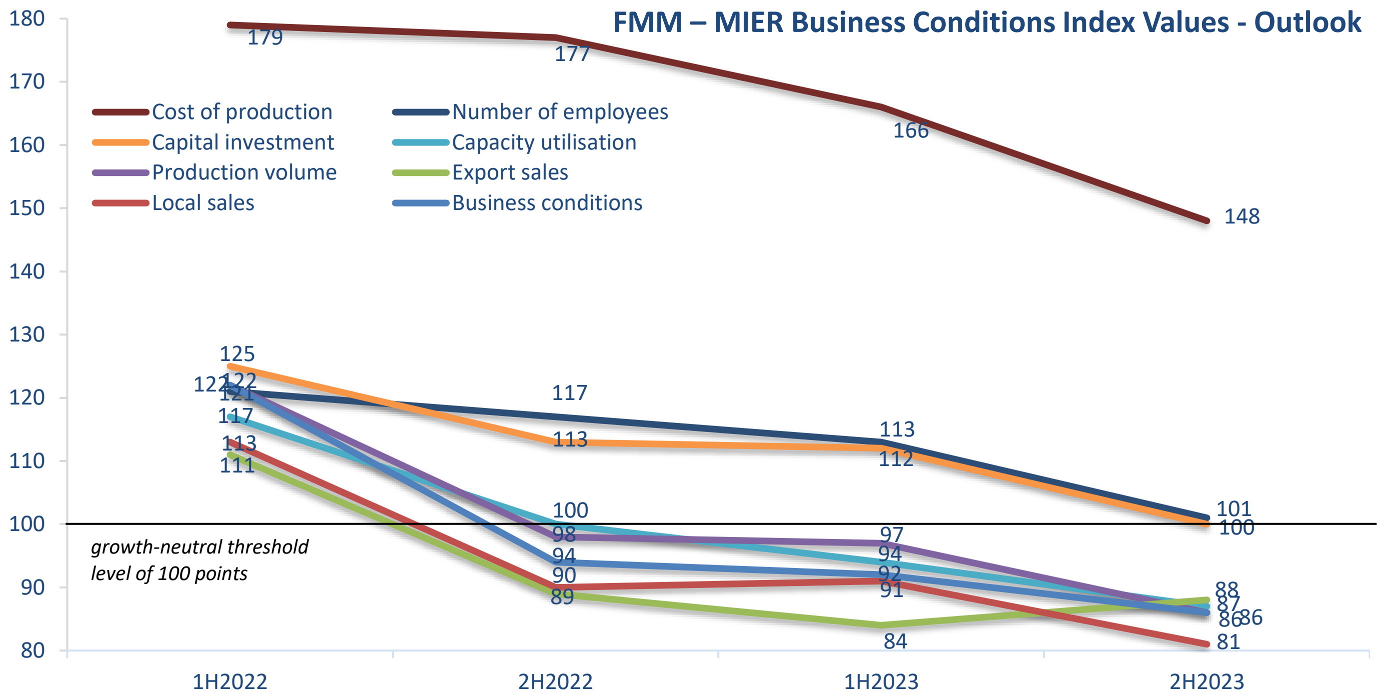
Having stayed above the optimism threshold for three surveys in a row since 2H2021, the current capital investment index had fallen below the optimism threshold in 1H2023, inferring that capital investment (CAPEX) had moderated recently. Only 21% increased their CAPEX in 1H2023, the lowest proportion since 1H2021. 53% had retained their CAPEX, down from 57% in the prior survey, while 26% reduced their expenditure, up from 2H2022's 20%.



Employment Less Active

Recruitment in the manufacturing sector was generally less active in 1H2023. This is shown by the latest current employment index which, at 101, had lost 11 points from the previous survey. 20% of the respondents increased their hirings in recent months, while 62% had maintained their existing workforce. 19% reduced their headcount recently, up from14% in 2H2022.

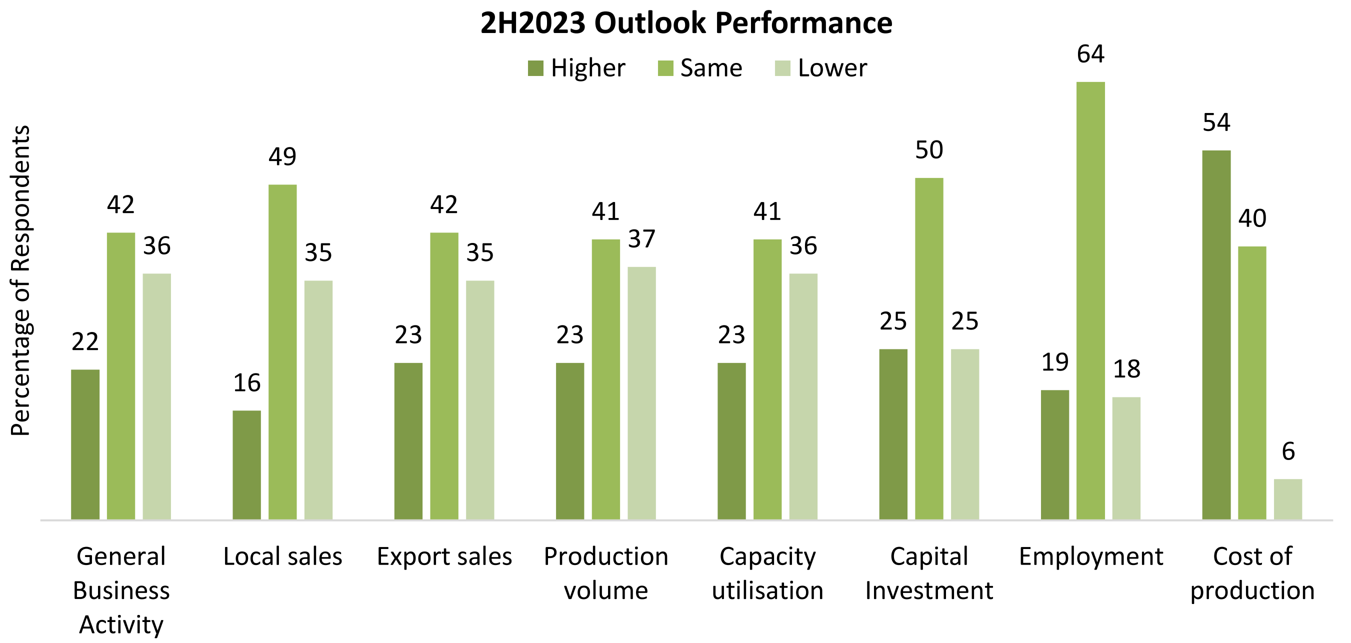




CHALLENGING OUTLOOK FOR 2H2023

With risks in the global economy tilted towards the downside and flagging external demand still weighing on the Malaysian economy, the manufacturing sector's six-month business outlook remains cautious and pragmatic. All forward-looking indicators had remained below the optimism threshold, an implication that business conditions, local sales, production volume, capacity utilisation, production cost, CAPEX and employment are expected to remain slow for the rest of 2023.

With the exception of the expected index for cost of production which fell to its lowest level in three years, the latest expected indexes for business activity, local sales, production volume, capacity utilisation, capital investment and employment had also dipped to their two-year lows, a further reflection of the manufacturing sector's temperate expectations going forward.



The latest expected business activity fell six points to 86 from the previous survey, with 22% of the respondents looking forward to an improvement in business conditions soon. 42% do not foresee any changes anytime soon, while 36% responded negatively.

The expected local sales index lost ten points to 81, while the expected export sales index rose four points to 88, signalling a faster pace of export sales to domestic sales in the coming months. 16% of those who sell locally expected an increase in sales soon, down from 22% previously. Of those who export, 23% projected higher near-term sales, while 49% responded neutrally and 35% adjusted their forecast lower.

Production volume is expected to be scaled down in anticipation of slower sales. The index for expected production volume fell to 86 from 97 previously, with 23% of the respondents planning to increase their production volume in 2H2023, down from 30% previously. Another 37% will reduce theirs soon, up from 33% in the last survey.

Capacity utilisation is expected to ease in tandem with the lower expectations of production volume and sales. The latest expected capacity utilisation index fell to 87 from the former survey's 94. 23% and 36% planned to increase and reduce their capacities in the coming months, respectively, compared to 26% and 32% previously, respectively.

With production volume set to shrink soon, the cost of production is also expected to reduce further in 2H2023, as indicated by the latest index for expected cost of production. Declining for the third time since 1H2022, this index settled at 148 currently. While costs are expected to increase for 54% of the respondents in the coming months (73% previously), 40% anticipated their costs to remain the same for now.

The latest expected index for capital investment, at 100, is at the optimism threshold, but it had lost twelve points from the prior survey, implying that CAPEX is expected to hold its own in 2H2023, albeit at a slower pace. One-quarter of the respondents planned to beef up their CAPEX soon, the third consecutive reduction in proportion since 1H2022.

Manufacturing employment is expected to remain passive in the coming months, as denoted by the latest index for expected employment which fell for the third consecutive survey to 101. 19% of the respondents planned to increase their headcount soon, while 64% are putting employment plans on hold for now, and 18% are contemplating retrenchment before the year is out.

BUSINESS GROWTH IN 2H2023

To maintain the growth of their businesses for 2H2023, amid persistent cost and demand pressures, most (41%) respondents are planning to maintain their current 1H2023 position for 2H2023. 27% are considering streamlining their production lines, while 18% will likely engage in high-growth projects. Only 8% are interested in digitalising their businesses.

COST OF DOING BUSINESS

With the numerous increases in the costs of doing business arising from both domestic and external factors, including government policies, respondents were asked for a breakdown of their costs, namely, labour, energy, water, raw materials, logistics, and maintenance of machinery in 1H2023.

Cost profile as at June 2023 (% of total operating costs)

In the last six months, most of the costs incurred by respondents, except labour and raw materials, ranged up to 5% of their total operating costs. Water topped the list, followed by maintenance of machinery, logistics and energy, as indicated by 56%-70% of the respondents. Specifically, this quantum was reported by 70% of the respondents for water, while maintenance of machinery, logistics and energy were indicated by 68%, 64% and 56% of the respondents, respectively.

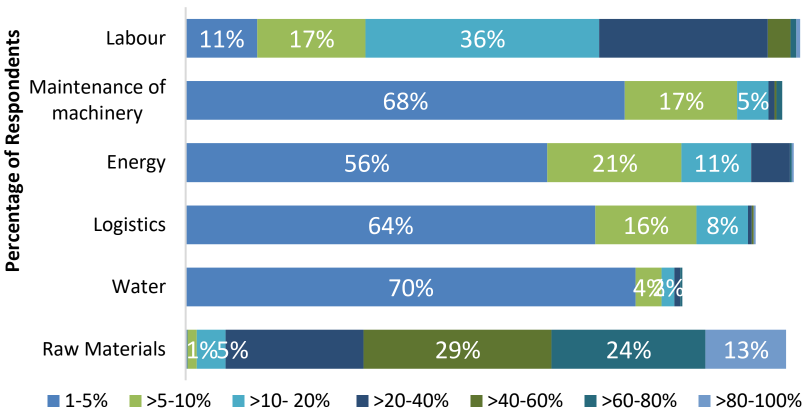
Labour costs incurred by most (36%) respondents comprised >10-20% of their total operating costs. The case for raw materials is more widespread, whereby most (29%) of the respondents estimated the cost of their raw materials in 1H2023 at >40-60% of their total operating costs, while 24% assessed theirs at >60-80% and 13% at >80-100%.

Cost profile as at June 2023 as % total operating costs (TOC)

Costs	1-5% of TOC	>5-10% of TOC	>10- 20% of TOC
	% respondents		
Labour	11	17	**36**
Maintenance of machinery	**68**	17	5
Energy	**56**	21	11
Logistics	**64**	16	8
Water	**70**	4	2

Cost	1-20%	>20-40%	>40-60%	>60-80%	>80-100%
	% respondents				
Raw materials	6	21	29	24	13

Cost profile as at June 2023 (% of total operating costs)



Cost movement in 1H2023

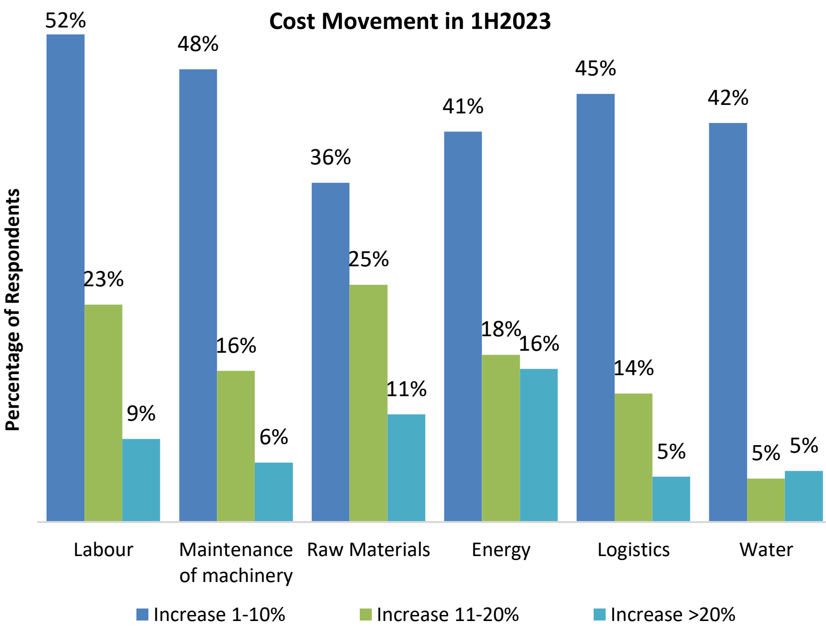
As at June 2023, most of the costs incurred by respondents had increased by up to 20%, with labour, maintenance of machinery and raw materials comprising the top three cost increases.

A breakdown shows that labour costs had increased by up to 10% for 52% of the respondents, while 23% reported a jump of 11-20% and 9% saw an increase in their costs by more than 20%. Maintenance of machinery had increased by up to 10% and 11%-20%, for 48% and 16% of the respondents, respectively.

42% and 41% of the respondents also reported higher water and energy costs of 1-10%, respectively. Increases of more than 20% for energy were disclosed by 16% of the respondents of which majority (62%) reported increases of between 21-50%.

Cost movement in 1H2023

Costs	(Increase 1-10%) % respondents	Increase 11-20% % respondents	Increase 1-20% % respondents
Labour	52	23	**75**
Maintenance of machinery	48	16	**64**
Raw materials	36	25	**61**
Energy	41	18	**59**
Logistics	45	14	**59**
Water	42	5	**47**



Company's operating cost by year (% of total revenue)

Operating costs, as a percentage of total revenue, were generally higher (more than 50%) during the Covid and post-Covid periods (2020-22) than the pre-Covid years of 2018-19. 51-55% of respondents reported operating costs of 50% and above of total revenue during the Covid and post-Covid years, while smaller proportions of 46-49% estimated theirs to be less than 50% of total revenue during these periods.

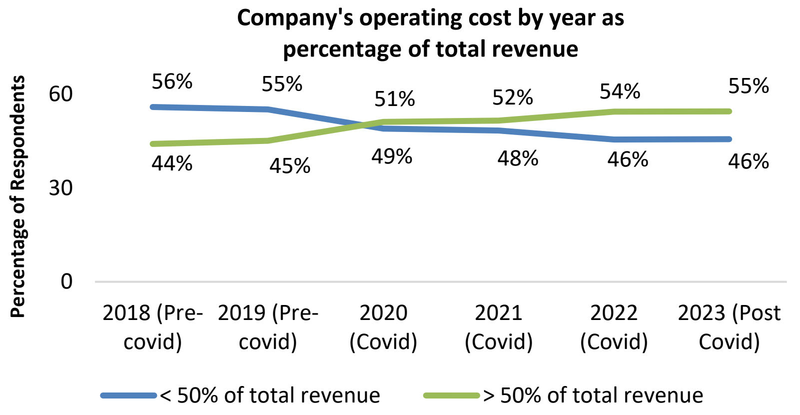
Overall cost increases were higher during the pre-Covid years of 2018-19 than the Covid and post-Covid years from 2020-23. Those experiencing more than 10% cost increases had more than doubled during the post-Covid period from 2022-23 compared to the pre-Covid period from 2018-19.

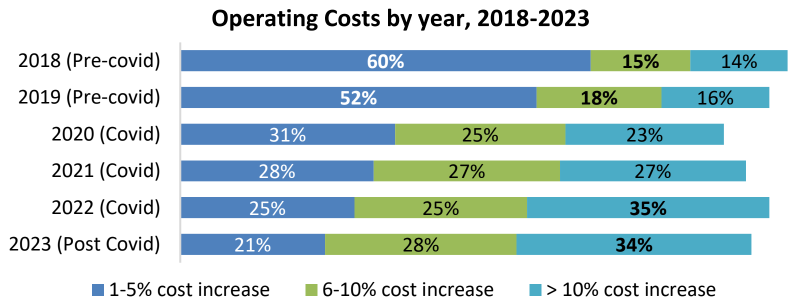
Operating costs by year, 2018-2023

Period	>10% cost increase % respondents
2018 (pre-Covid)	14
2019 (pre-Covid)	16
2020 (Covid	23
2021 (Covid)	27
2022 (post-Covid)	35
2023 (post-Covid)	34

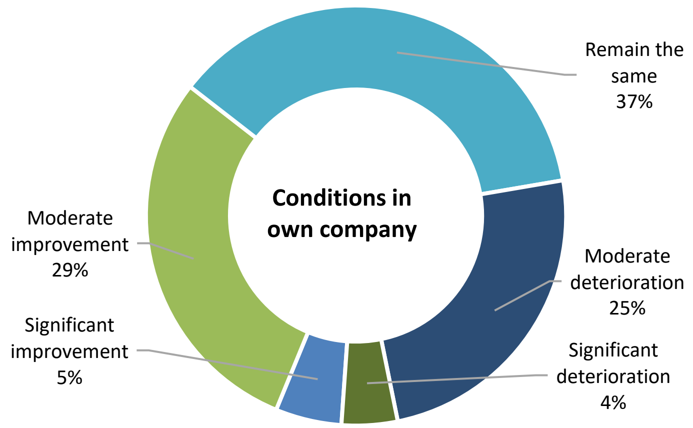
Operating costs by year as % of total revenue

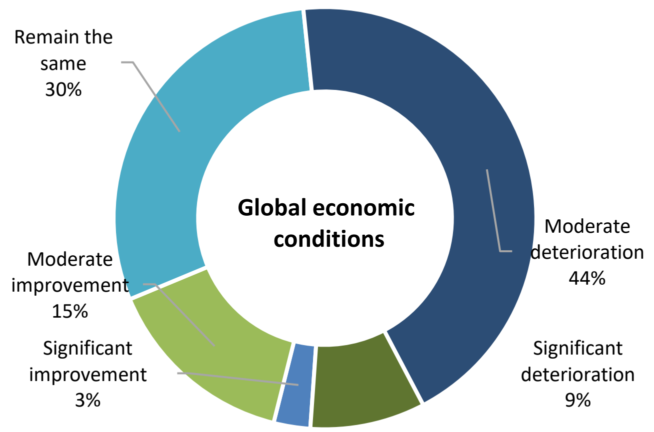
Period	< 50% of total revenue % respondents	> 50% of total revenue % respondents
2018 (pre-Covid)	56	44
2019 (pre-Covid)	55	45
2020 (Covid	49	51
2021 (Covid)	48	52
2022 (post-Covid)	46	54
2023 (post-Covid)	46	55

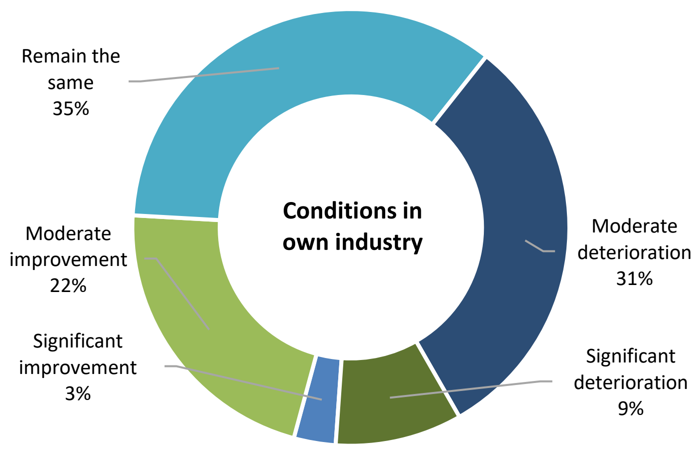


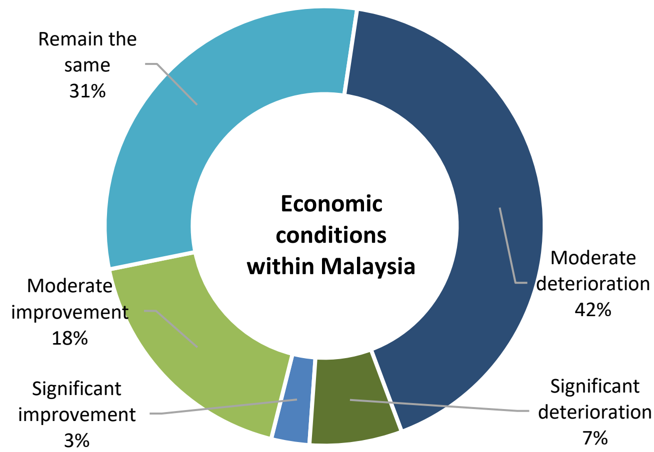


BUSINESS CONFIDENCE IN 2H2023 vis-à-vis 1H2023







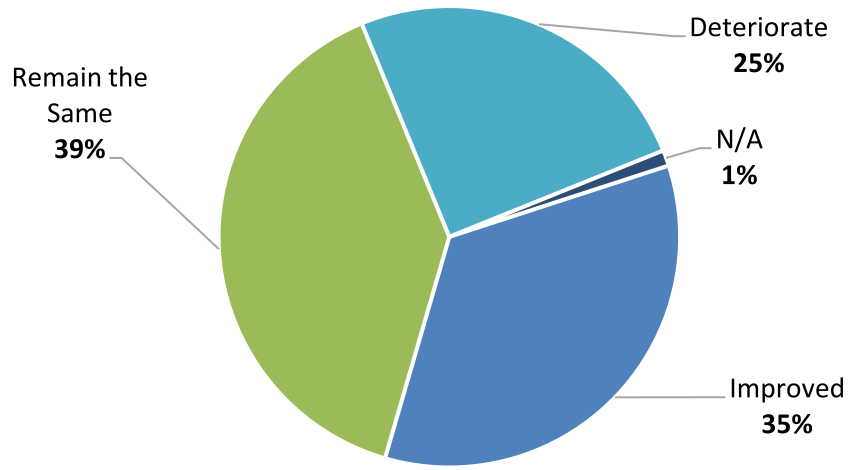


The survey also sought the views of respondents on their expectations within their own company, industry, global economic conditions and economic conditions within Malaysia in 2H2023 vis-à-vis 1H2023. Cautious optimism was observed for company and industry conditions, whereas responses to global and domestic economic conditions were generally unfavourable.

Among those who responded positively, 29% are expecting conditions in their own company to improve moderately, while 37% do not foresee any change anytime soon. On conditions in their industry, 71% are anticipating moderate improvement or the same situation to remain in 2H2023. Negative responses were contributed by 44% of the respondents on the global economy which was anticipated to weaken moderately in 2H2023, with the same expectations being shared by 42% of the respondents for the domestic economy as well.

ECONOMIC OUTLOOK 2024

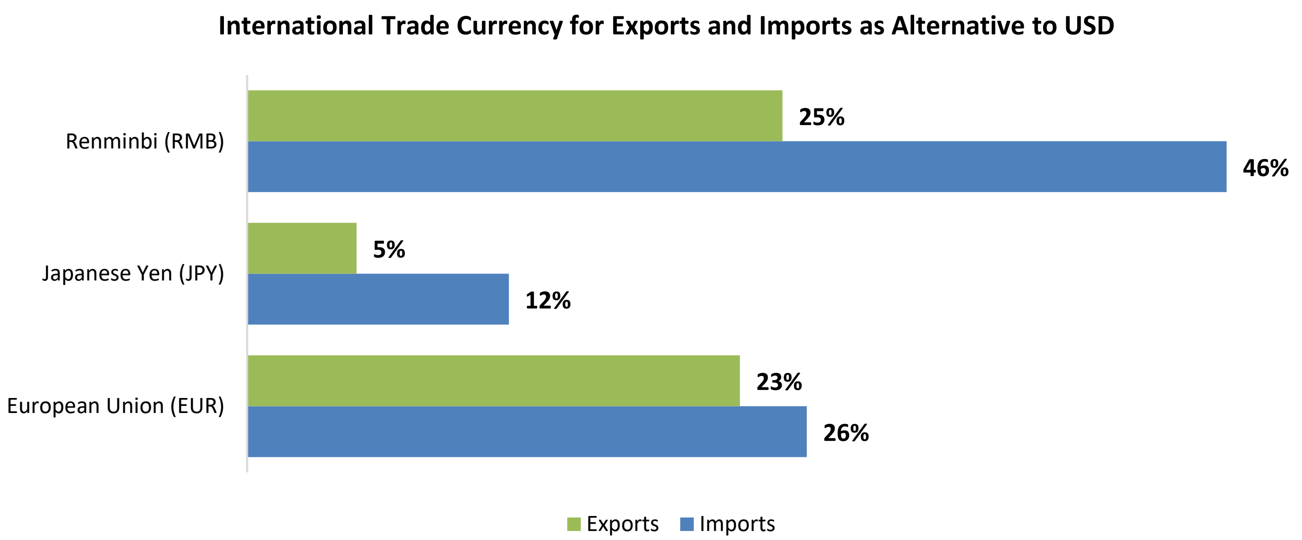
Expectations of most respondents on the economic outlook for 2024 are also cautiously optimistic, with 35% saying that the economy will improve in 2024, while 39% responded neutrally. 25% were pessimistic in this aspect.



INTERNATIONAL TRADE CURRENCY FOR IMPORTS AND EXPORTS

In line with the growing trend to move away from the US Dollar (USD) for trade, companies are exploring the use of alternative currencies for their imports and exports to reduce their reliance on the USD. For both exports and imports, the Renminbi (RMB) is the top choice of most respondents as an alternative currency to the USD, followed by the European Euro (EUR) and Japanese Yen (JPY).

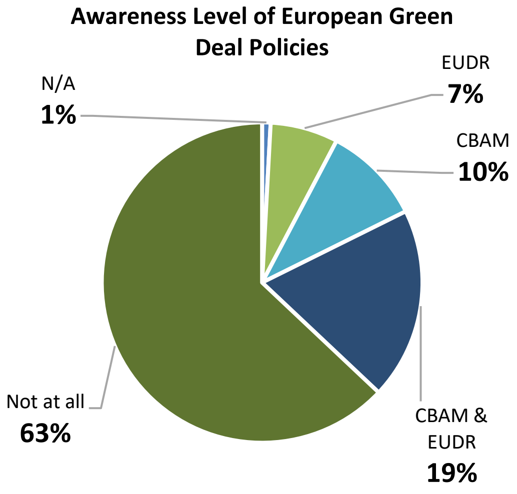
The two main reasons for respondents' selection of the alternative currencies are due to requests from foreign buyers to pay for export proceeds from Malaysia in other currencies, and foreign sellers only accept payment in other currencies for imports.

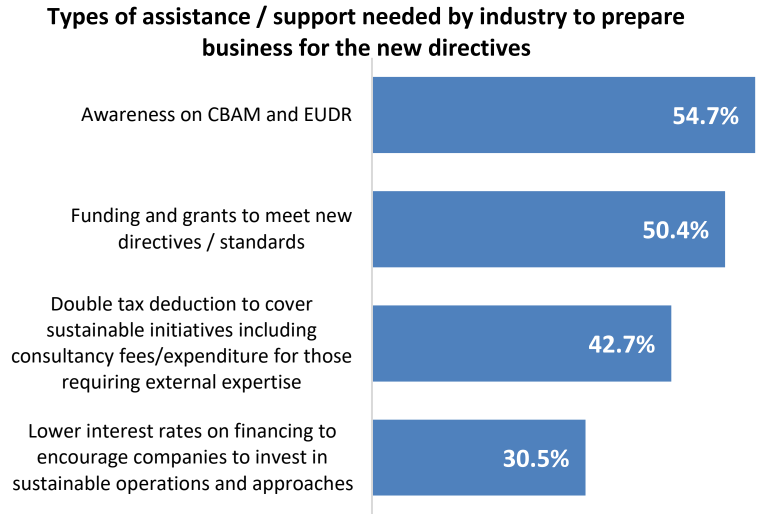


EUROPEAN GREEN DEAL POLICY

The new directives under the European Green Deal policy include the Carbon Border Adjustment Mechanism (CBAM) and EU Deforestation Regulation (EUDR) which was introduced by the EU Parliament. Respondents were asked if they are aware of the mandatory regulation on CBAM and the EUDR, to which only 19% said they are, but 63% are not. 10% are aware of the CBAM, while 7% know about the EUDR only.

In view that the CBAM and EUDR may impact their businesses, respondents were then asked of the type of support/assistance that they would need to prepare their businesses for the new directives. 55% believed they would need to increase their awareness on the CBAM and EUDR, while 50% would require funding and grants for this purpose. Double tax deduction was also suggested by 43% of the respondents to cover sustainable initiatives, including consultancy fees/expenditure for those requiring external expertise to meet those new directives. 31% proposed lowering interest rates on financing to encourage investments in sustainable operations and approaches.

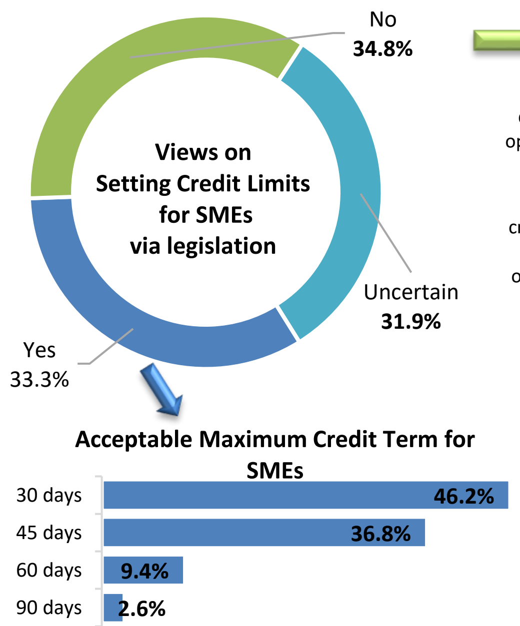


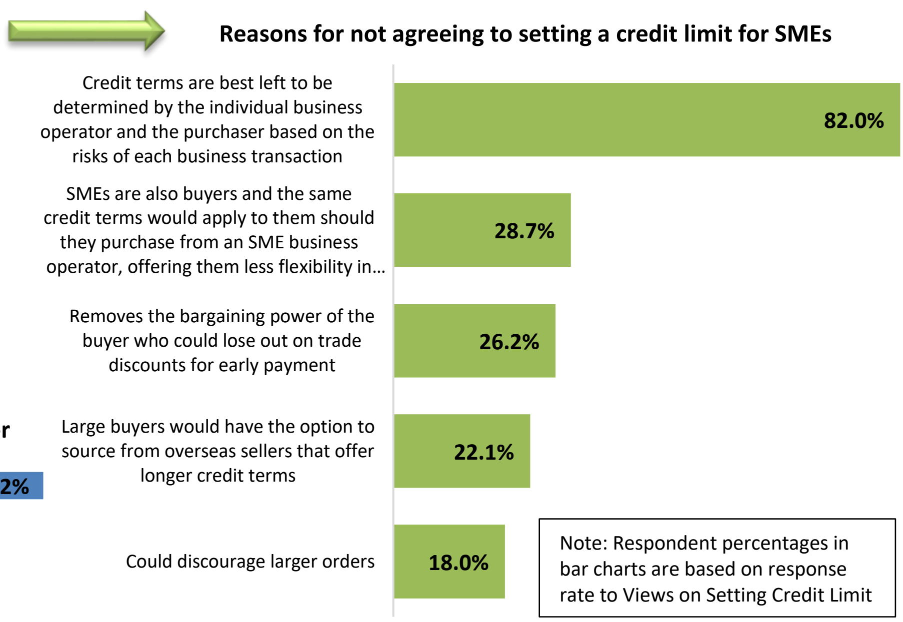


SETTING CREDIT TERM LIMITS FOR SMEs

Credit term is crucial to the liquidity of SMEs. Currently, the credit term on purchase in Malaysia is determined between buyer and seller as there is no legislation on the maximum credit term that a business operator, particularly SMEs, can impose on the buyer. When asked if such a legislation should be introduced in Malaysia, the views from respondents were mixed. 33% responded positively, adding that 30-45 days would be an acceptable maximum credit term that an SME can impose on their buyers.

Another 35% were not in favour of the legislation, with most saying that credit terms are best left to be determined by the individual business operator and the buyer, based on the risks of each business transaction. 32% were uncertain if the legislation should be introduced in Malaysia.





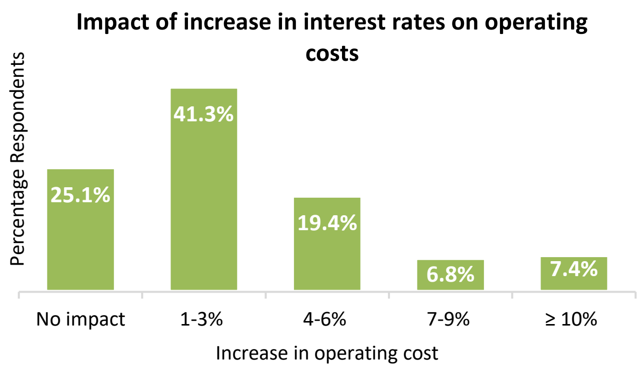
Note: Respondent percentages in bar charts are based on response rate to Views on Setting Credit Limit

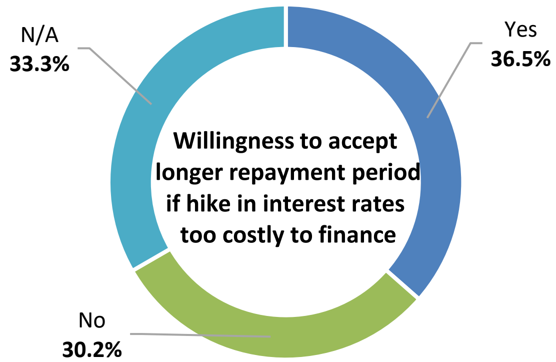
IMPACT OF INCREASE IN INTEREST RATES BY BNM

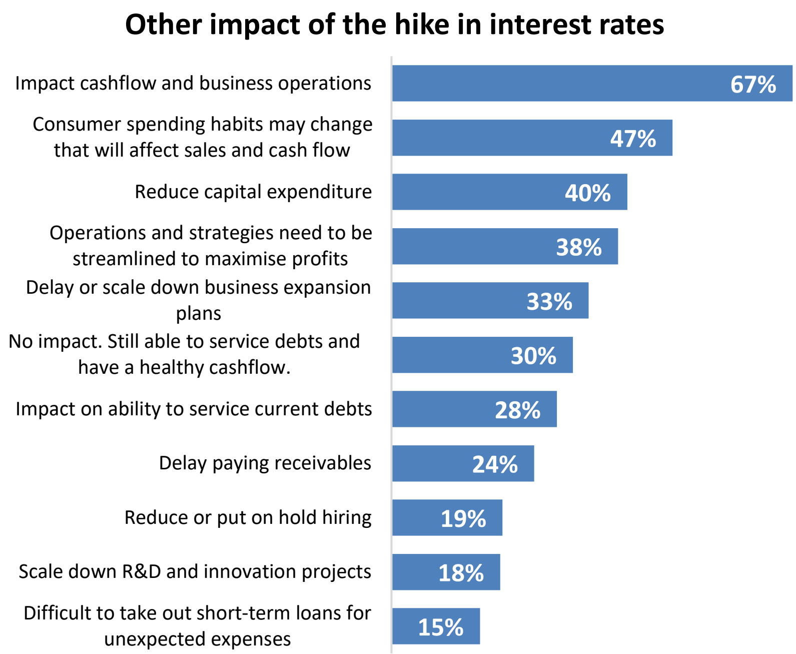
In May 2023, BNM raised its overnight policy rate (OPR) for the fifth time by another 25 basis points to 3.00%. The increase, according to most (41%) of the respondents, had pushed their operating costs up by 1-3%, while another 19% had to put up with higher costs of 4-6%. 25% were not affected by the latest increase.

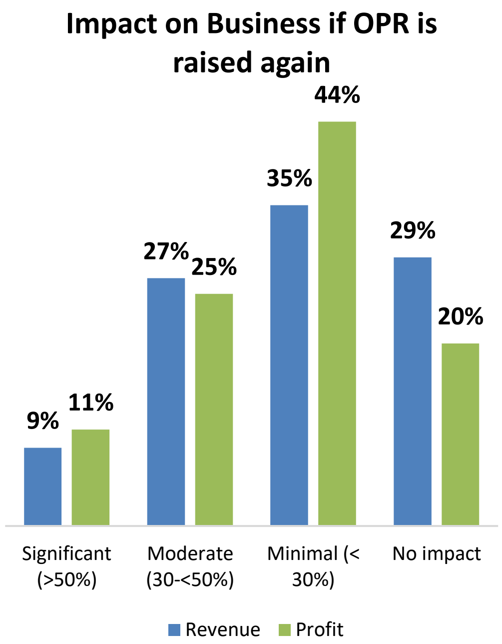
The increase is impacting companies in different ways. Among those companies affected by the increase, 67% said the rate hike had impacted their cash flow and business operations, while 47% are concerned that a possible change in their consumer spending habits will affect their sales and cash flow. 40% had to reduce their capital expenditure, and 38% had to streamline their operations and strategies to maximise profits.

As to whether respondents are willing to accept a longer repayment period if it is too costly for them to finance the current interest rate increase, 37% responded positively, but the feedback from 30% was negative. Should the OPR increase further by 25 basis points by end 2023, the impact on most business revenues and profits is expected to be minimal (less than 30%), as indicated by 35% and 44% of the respondents, respectively.









The FMM Business Conditions Index (FMM BCI) tracks the general state of the economy affecting business viability. The FMM BCI uses the current level of business activity as a proxy for current business conditions, compared to six months ago. Index values range from 0 to 200 points. A value above the growth-neutral threshold level of 100 points indicates an improvement or positive outlook, while that below the threshold indicates a worsening or negative outlook.

The FMM Business Conditions Survey 1H2023 was conducted from July 5 to August 18, 2023 and received 351 responses, of which 63.7% were SMEs (based on full-time employees), with 138, 57 & 36 responses from Klang Valley, Perak & Johor respectively. The top three industries for responses were: Chemicals & Chemical Products (14.0%); Food, Beverage & Tobacco (13.4% of respondents); and Electrical & Electronics (12.3%).

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