FMM Business Conditions Survey

MANUFACTURING ACTIVITY SLOWS DOWN IN 2H2022, OUTLOOK REMAINS CAUTIOUS FOR 1H2023

Issue No. 1/2023 Released on March 16, 2023

KEY RESULTS:	
BUSINESS ACTIVITY – 2H2022	☑ Business conditions soften ☑ Current local sales grow faster than export sales ☑ Production cost high, but moderating ☑ Capital investment scales down ☑ Labour intake picks up
BUSINESS ACTIVITY – OUTLOOK 1H2023 and 2023 IN GENERAL	☑ Slower local sales, export sales and CAPEX expected ☑ Production cost, capacity utilisation and recruitment to slow down ☑ Labour costs expected to increase moderately or significantly for most respondents ☑ 36% of respondents expect global economic conditions to deteriorate moderately ☑ 31% of respondents anticipate moderate improvement in domestic economic conditions ☑ Top 3 risks to business recovery and growth: input cost pressures, higher energy cost and fluctuations in the Ringgit ☑ 41% of respondents estimate higher revenue and profits by 1-24% ☑ Top 5 investments to boost competitiveness: new product development, automation, upskilling and retraining of existing workers, export market expansion, and adoption of green technology/energy efficiency measures
GENERAL	☑ 59% of respondents able to meet their foreign worker needs and obtain quota approval ☑ 66% of respondents aware of RCEP and CPTPP, but 77% have not started utilising them yet ☑ The 4th increase in OPR by BNM in November 2022 increases the cost of production of 55% of respondents ☑ 59% of respondents believe now is too early to gauge performance of new Government, but 33% see positive changes

Weak external demand, especially from key trading partners, further escalation of geo-political tensions and the impact of China's zero-Covid policy, among others, have likely weighed on the Malaysian manufacturing sector. Reflecting this is the results of the latest FMM Business Conditions Survey which showed a moderation in manufacturing activities in 2H2022. Local and export sales, as well as production levels had remained subdued, while capacity utilisation, production cost and capital investment lost further growth momentum, but employment had picked up in recent months. Looking ahead, the manufacturing sector is expected to grow at a slow pace in 1H2023 in tandem with the slowing global economy.

Indicators	FMM Business Conditions Index Values							
	Current (Compared to 6 months ago)				Looking Forward (Next 6 months)			
	1H2021	2H2021	1H2022	2H2022	2H2021	1H2022	2H2022	1H2023
Business conditions	65	107	109	**107**	60	**122**	94	**92**
Local sales	56	94	99	**98**	51	**113**	90	**91**
Export sales	71	96	91	**91**	68	**111**	89	**84**
Production volume	61	105	102	**102**	62	**122**	98	**97**
Capacity utilisation	59	101	104	**99**	60	**117**	100	**94**
Capital investment	78	105	109	**104**	81	**125**	113	**112**
Number of employees	82	99	100	**112**	87	**121**	117	**113**
Cost of production	165	174	182	**166**	166	**179**	177	**166**

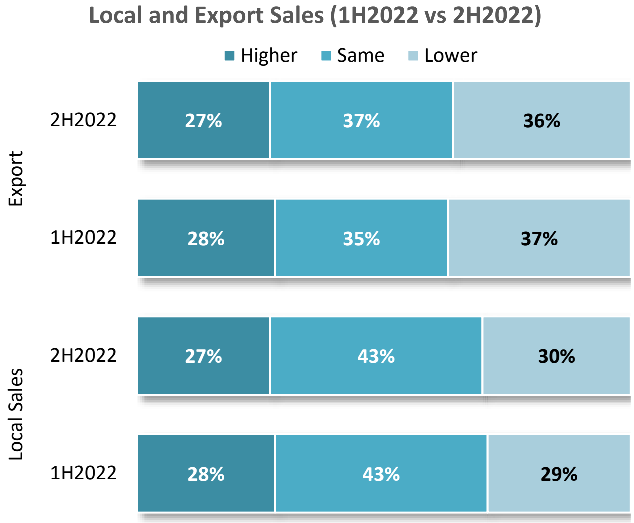
BUSINESS CONDITIONS MODERATING

Activity in the manufacturing sector had held up fairly well, albeit slower, in 2H2022. This is shown by the latest business activity index which, at 107, had remained above the 100-point optimism threshold, but lost two points from 1H2022. Most (37%) respondents believed that their business activity in 2H2022 had remained the same as in 1H2022, while 35% reported an increase in theirs and 28% stated otherwise.

Local and Export Sales Steady

For the whole of 2022, overall sales have remained generally steady, although local sales had grown at a faster pace than export sales. This squares with the latest data by Bank Negara Malaysia which reported that domestic-oriented industries (11.3%) had grown faster than their export-oriented counterparts (6.8%) in 2022.

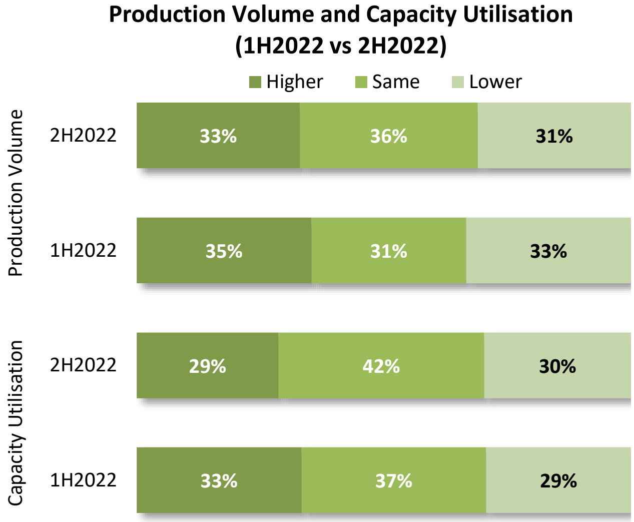
In 2H2022, the current indexes for local sales and export sales stood at 98 and 91, respectively, little changed from 1H2022. Among those who sold domestically, 27% reported higher sales, while 43% had managed to maintain their sales in 2H2022. Exports also rose for 27% of those who export, with another 37% saying their exports have remained the same during this period. Poor sales affected more of those who export than those who sell locally, with 36% and 30% confirming this, respectively



Production Volume Stable, Capacity Utilisation Down

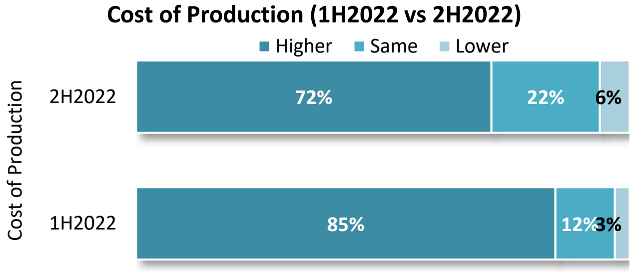
Production had remained relatively stable, while capacity utilisation had trended down in 2H2022, a sign that labour productivity had increased in recent months. Suggesting this is the latest current production index which had remained at its 1H2022's level of 102, with 33% and 36% of the respondents having expanded or retained their production volume in 2H2022, respectively.

The current index for capacity utilisation dipped just below the optimism level to 99 in 2H2022, losing five points from the prior period. 29% of the respondents increased their capacities lately, down from 33% in 1H2022.



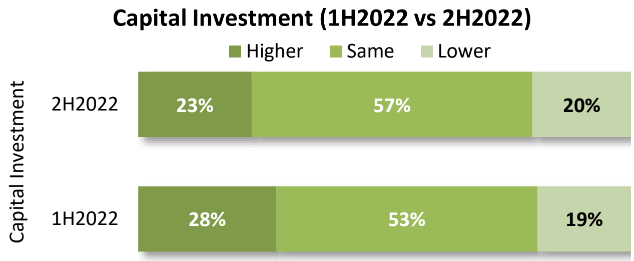
Cost of Production Eases

Manufacturing cost had eased in 2H2022, as depicted by the decline in the current cost of production index to a two-year low of 166. 72% of the respondents reported higher production costs, down from the preceding period's 85%. Those who managed to keep their costs lower in 2H2022 had also doubled from the 3% tabulated in 1H2022.



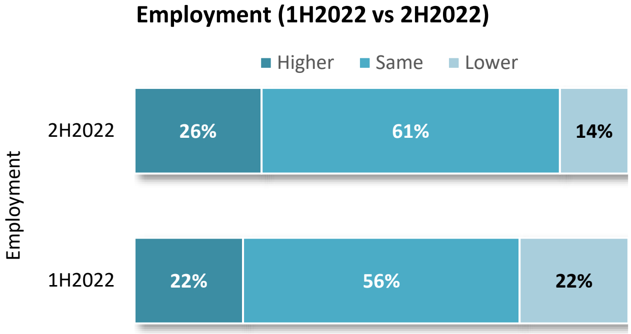
Capital Investment Scales Down

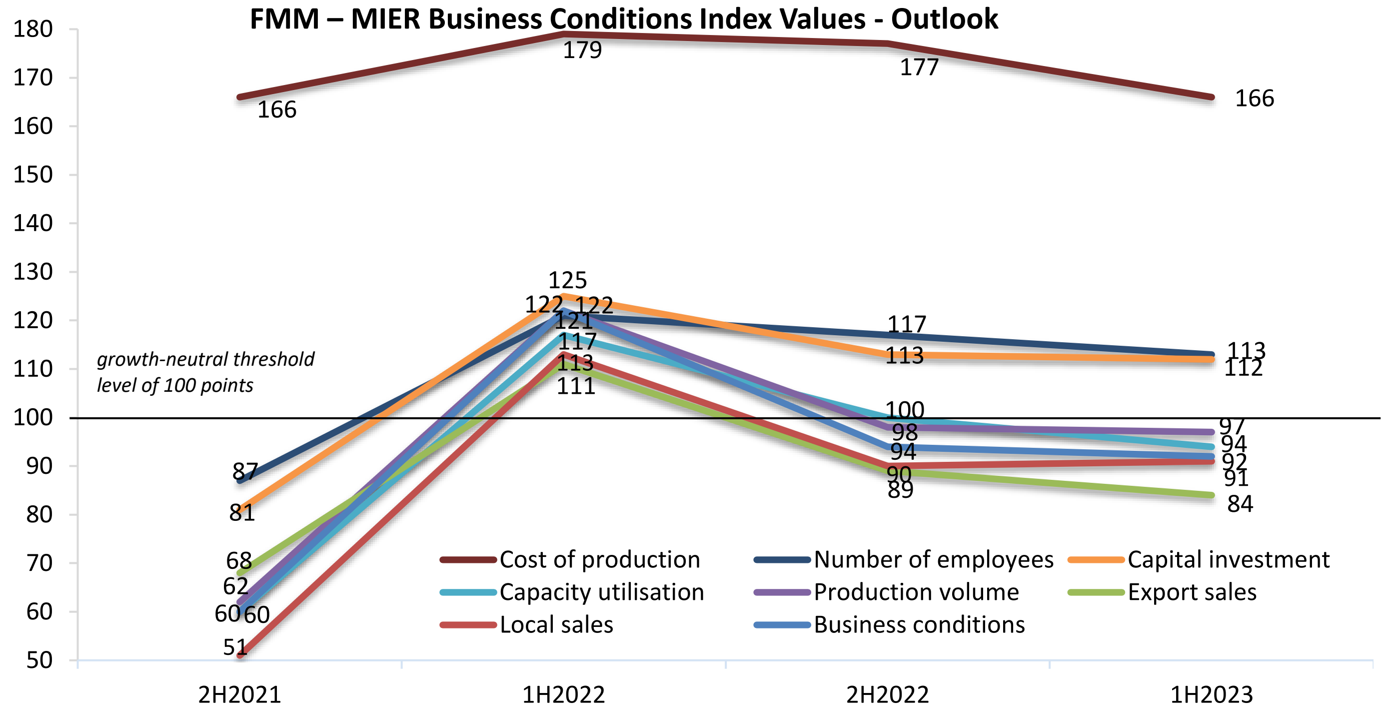
The latest current capital investment index retreated five points from the previous survey to 109, an implication that capital investment (CAPEX) had waned recently. 23% increased their CAPEX in 2H2022, while such expenditure had remained the same for another 57% of the respondents, compared to 28% and 53% in 1H2022, respectively.



Employment Beefs Up

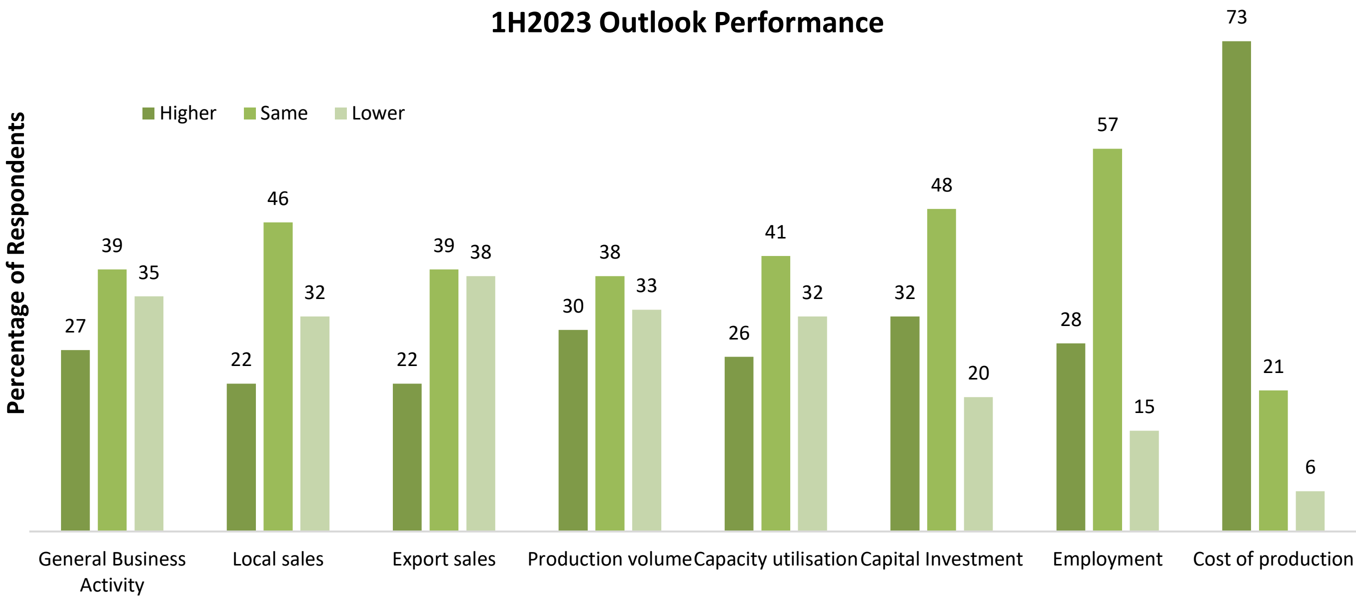
Employment was the only current index that registered an increase in 2H2022 compared to six months ago. At 112, this index had gained 12 points from 1H2022, indicating that recruitment in the manufacturing sector had picked up recently. Labour intake rose for 26% of the respondents in 2H2022, up from 22% in 1H2022 and 20% in 2H2021. While 61% put hiring and retrenchment on hold for now, another 14% reduced their headcount, down from 1H2022's 22%.





PRAGMATIC OUTLOOK FOR 1H2023

The manufacturing sector shows further signs of moderating as manufacturers continue to brace for challenging business conditions to persist in the coming months. Attesting to this are the forward-looking indicators which are suggesting a slowdown in capacity utilisation, capital investment, hiring and a relatively tame outlook on production for 1H2023. It is also likely that inventory levels may be moderated in line with the current trends in demand. Except for cost of production, capital investment and employment, all the other indexes had also registered below the demarcation level of optimism, further surmising the slow outlook going forward.



For the second survey in a row, the expected index for business activity had stayed below the optimism threshold. At 92, this index had lost two points from the prior survey, inferring that business activity is expected to slow further in 1H2023. 27% of the respondents projected a pick-up in business activity soon, down from 29% previously. Majority (39%) believed that their business activity will remain stable in the coming months, while 35% had responded negatively.

The latest expected index for local sales is higher than that for export sales. At 91 and 84, respectively, it suggests that local sales are expected, once again, to be ahead of export sales in early 2023. Notwithstanding this, both indexes had remained below the optimism threshold for the second survey in a row, implying that a slowdown in sales is expected on both the local and external fronts. 22% of the respondents who are domestic-oriented projected higher sales in the coming months, while 46% responded neutrally and 32% negatively. For those who are export-oriented, 22% were positive in their near-term sales outlook, down from 26% previously.

With sales expectations looking cautious, plans for production and capacity utilisation are similarly prudent. Not only have both these indexes in the latest survey fallen from the preceding survey to 97 and 94, respectively, but their position below the optimism threshold also indicates that a slowdown in both of them is imminent in the coming months as well. 30% of the respondents planned to step up their production volume soon, while 26% planned on increasing their capacities in 1H2023, down from 32% and 31% previously, respectively.

The expected index for cost of production fell for the second consecutive survey to 166, inferring that production costs are expected to moderate in the coming months, but remain at elevated levels amid persistent cost and demand pressures. 73% projected higher production costs soon, down from 81% previously.

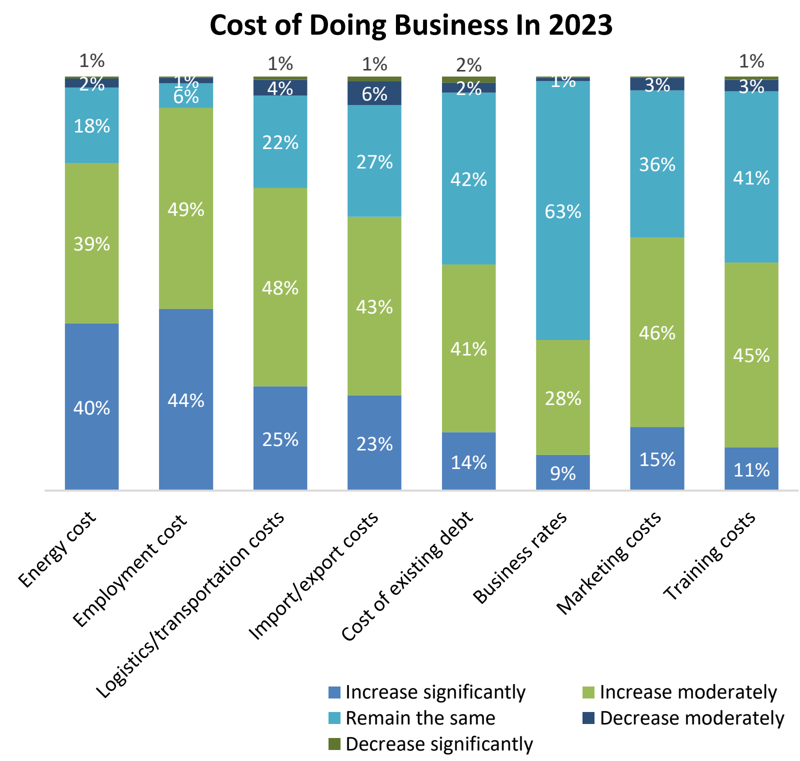
Capital investment is expected to be relatively flat in 1H2023, as indicated by the expected index for capital investment which, at 112, is little changed from the previous survey's 113. 32% in the latest survey are contemplating increasing their capital expenditure (CAPEX) sometime soon, marginally down from 33% in the previous survey.

Labour intake in the manufacturing sector will continue in 1H2023, albeit at a slower pace. This is shown by the expected index for employment which fell to 113 from the 117 previously. 28% of the respondents planned to recruit more workers soon, while 57% are planning to retain their existing workforce for now, compared to the preceding survey's 33% and 50%, respectively.

COST OF DOING BUSINESS IN 2023

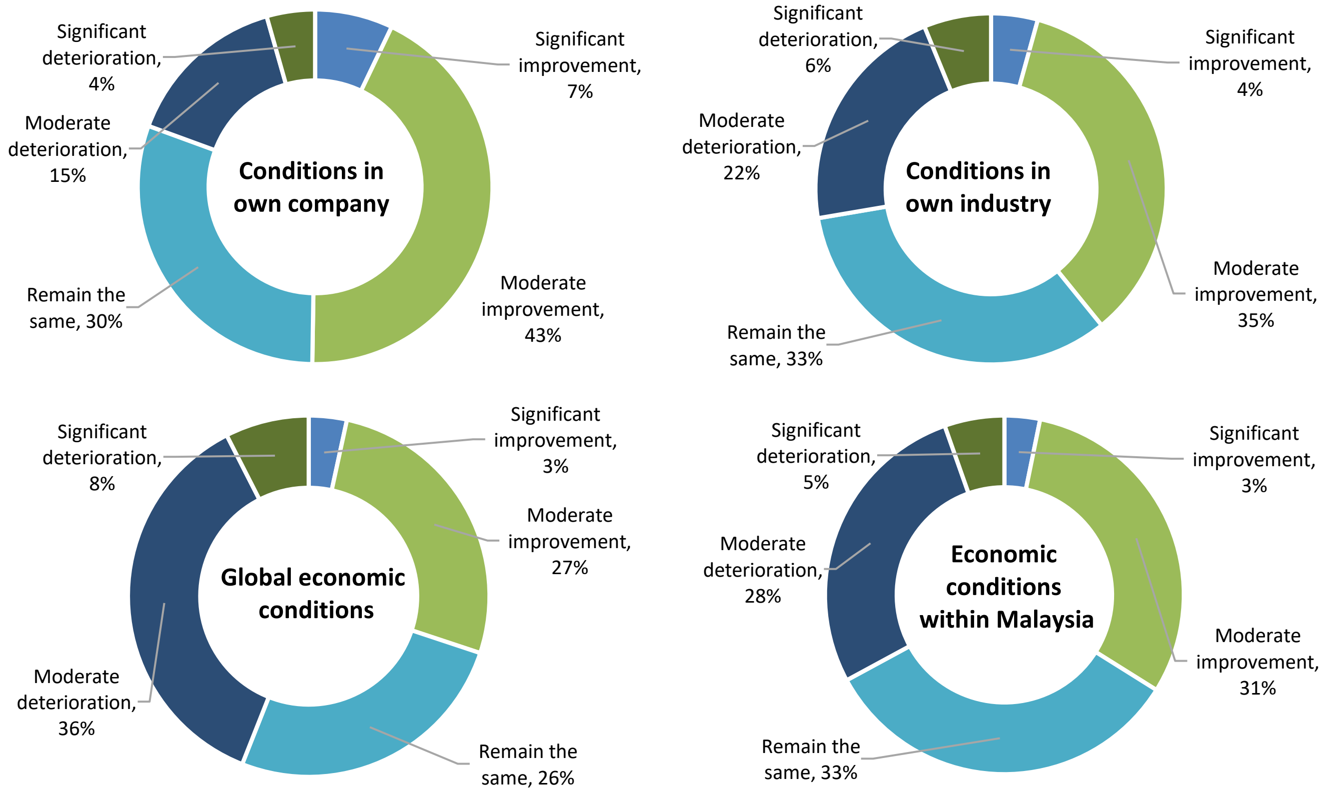
For 2023, labour costs (including higher wages, labour shortage, employee retention schemes, employee benefits, etc.) are expected to increase moderately or significantly for most respondents, while business rates (assessment, quit rent, licenses, etc.) are expected to remain the same for most as well.

The top five expected areas of moderate cost increases are employment, logistics/transportation, marketing, training and import/export costs, as anticipated by 49%, 48%, 46%, 45% and 43% of the respondents, respectively. For those expecting their costs to increase significantly, labour cost topped the list once again, with 44% of the respondents predicting this. Energy cost (fuel, gas, electricity) is next, followed by logistics/transportation and import/export costs.



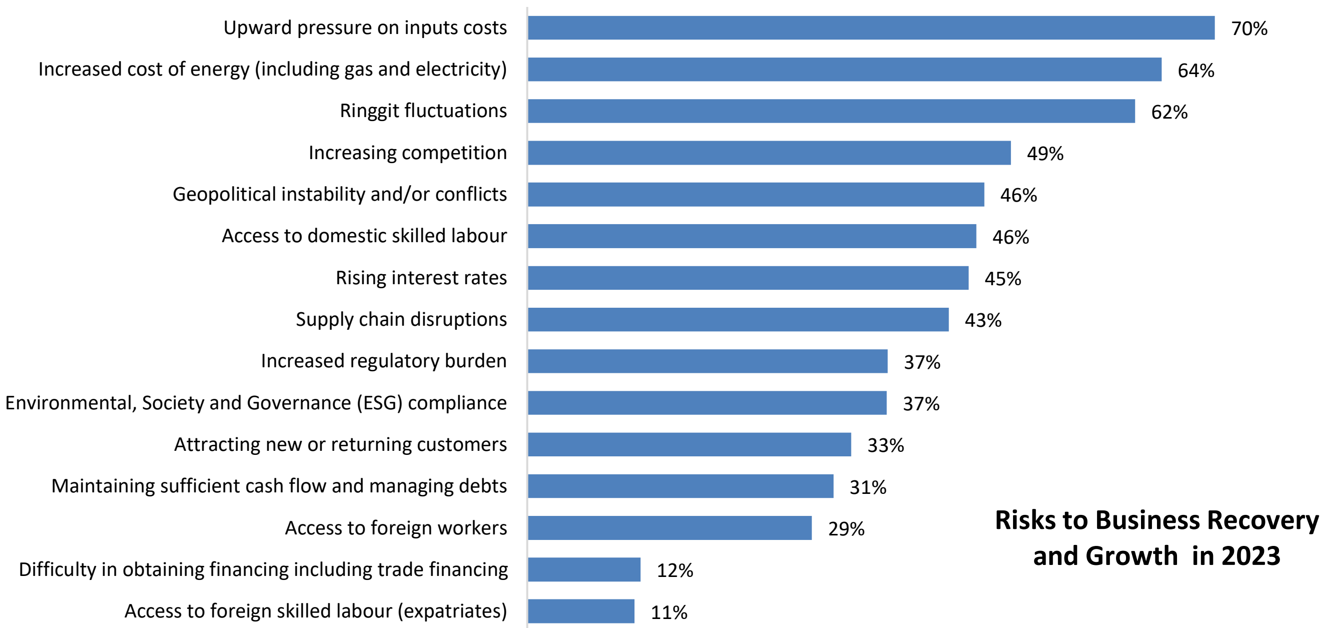
BUSINESS CONFIDENCE LEVEL

When asked about the changes that are expected within their own company, industry, and domestic and global economic conditions in 2023 compared to 2022, most respondents believed that conditions in their own company (43% responses) and industry (35%) will improve moderately. In terms of global economic conditions, most (36%) are expecting a moderate deterioration in 2023, but 27% foresee a moderate improvement instead. Domestic economic conditions, according to most (33%) respondents, will likely remain the same in 2023, but 31% are more forward-looking, saying they will improve moderately sometime soon.



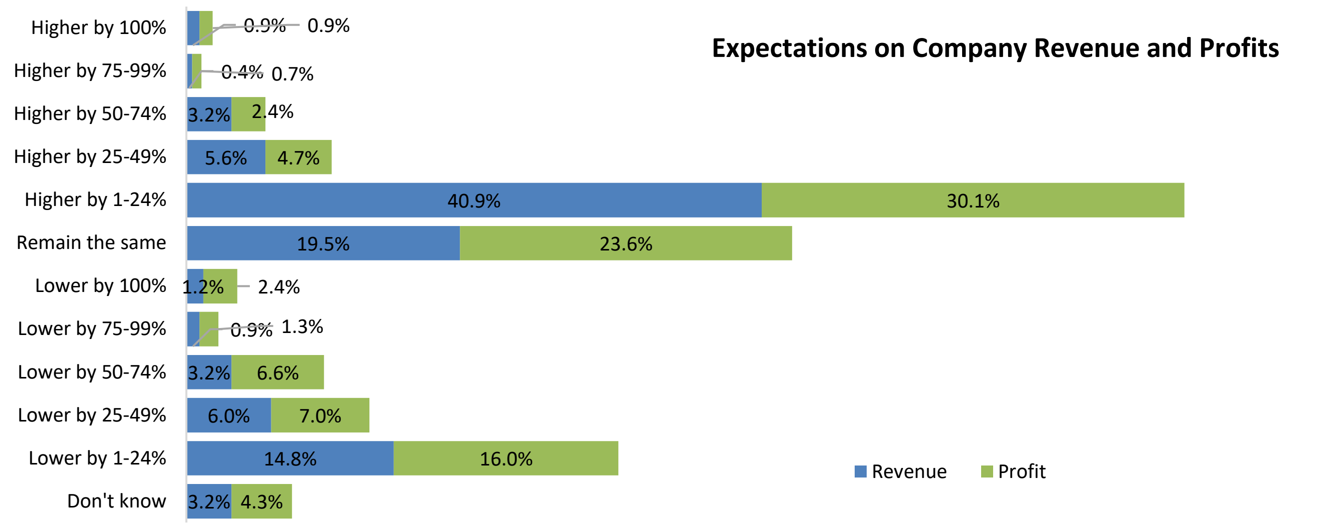
RISKS TO BUSINESS RECOVERY AND GROWTH IN 2023

The top three risks to business recovery and growth in 2023 within the global and domestic economies are input cost pressures, higher energy cost (including gas and electricity) and fluctuations in the Ringgit, as indicated by 70%, 64% and 62% of the respondents, respectively. The next five biggest risks, in descending order by response, are expected to be rising competition, access to domestic skilled labour, geopolitical tensions, rising interest rates and supply chain disruptions, with responses received totalling 43%-49%. Access to foreign skilled labour and difficulty in obtaining financing (including trade financing) were least of the risks concerned by respondents.



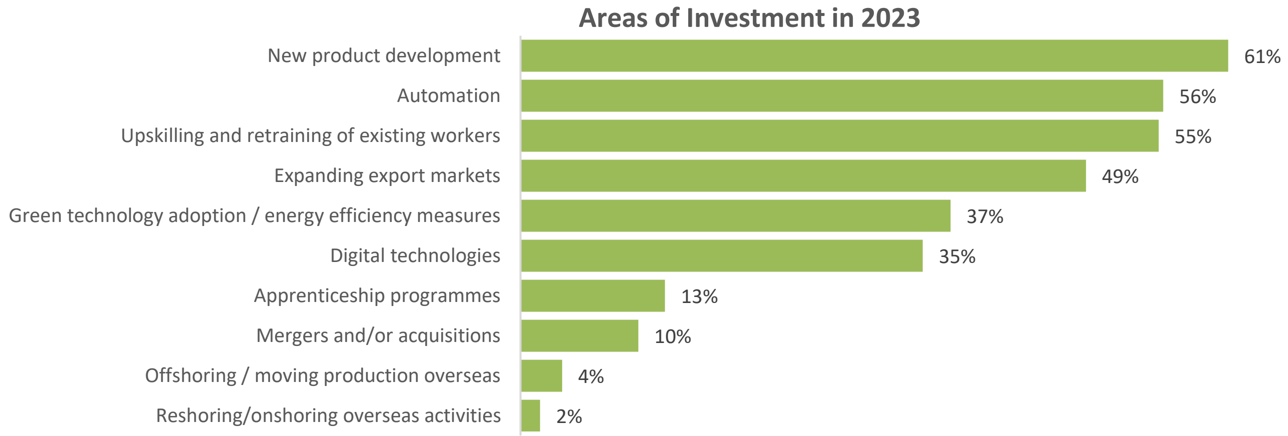
EXPECTATIONS ON COMPANY REVENUE AND PROFITS

Relative to 2022, most respondents are expecting their revenue and profits to increase by 1-24% in 2023, with 41% and 30% stating so, respectively. While no change in revenue and profits is expected by 19% and 24% of the respondents, respectively, another 15% are estimating their revenue to be lower by 1-24%, with the same quantum expected by 16% for their profits in 2023 as well.



AREAS OF INVESTMENT IN 2023

In the next twelve months, to boost their competitiveness, the top five investments that majority of the respondents are planning to venture into are new product development, automation, upskilling and retraining of existing workers, export market expansion, and adoption of green technology/energy efficiency measures.



MEETING HUMAN CAPITAL NEEDS

When asked if they have been able to meet their foreign worker needs and obtain their quota approval, more than half (59%) of the respondents replied affirmatively. While most (40%) of them were subject to long wait time to obtain their calling visa (Visa Dengan Rujukan) (VDR) from the Immigration Department, there were also those (27%) who experienced a smooth and fast processing of their VDR. In terms of sourcing for workers at the source country, one-third of the respondents were able to do so easily, but 21% begged to differ.

Of the 8% who were not able to meet their foreign worker needs and obtain their quota approval, most attributed it to the slow approval process and lengthy process that included many conditions to be fulfilled as well. 13% have yet to bring in workers due to the current slowdown.

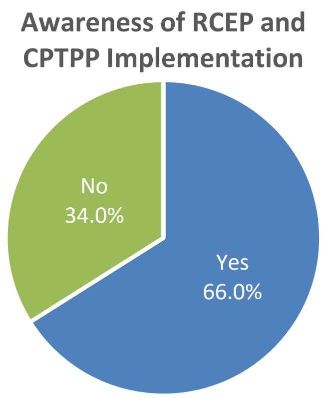
In addressing their skilled worker needs, more than half of the respondents faced difficulties in recruiting and retaining such workers. While the former is due to shortage of supply, lack of right skills set, etc., the latter is due to job-hopping, head-hunting by other employers, performance below expectations, etc.

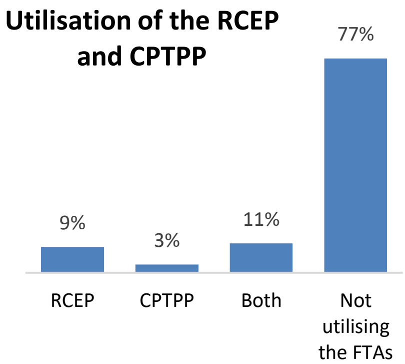
Amid the challenges faced, many respondents are willing to collaborate with education and skills training institutions to offer work-integrated learning programmes (internships, apprenticeships, place and train schemes), as well as in curriculum development. Many are also willing to increase their investment on upskilling and re-skilling of their existing staff.

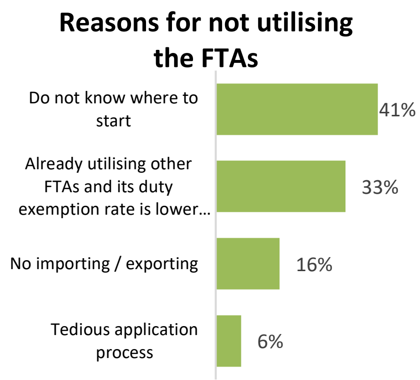
TAPPING ON MULTI-LATERAL TRADE AGREEMENTS

Malaysia has implemented both the Regional Comprehensive Economic Partnership (RCEP) and Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) agreements in March and November 2022, respectively. While 66% are aware of these free trade agreements (FTAs), only 11% are utilising both FTAs, while the RCEP and CPTPP are utilised by 9% and 3% of the respondents, respectively.

More than three-quarters of the respondents have not started utilising these FTAs yet. Most (41%) cited reasons of not knowing where to start, suggesting a lack of information or policy direction on these FTAs among respondents. Another 33% attributed their non-utilisation of the RCEP and CPTPP to their current utilisation of other FTAs and their lower duty rates

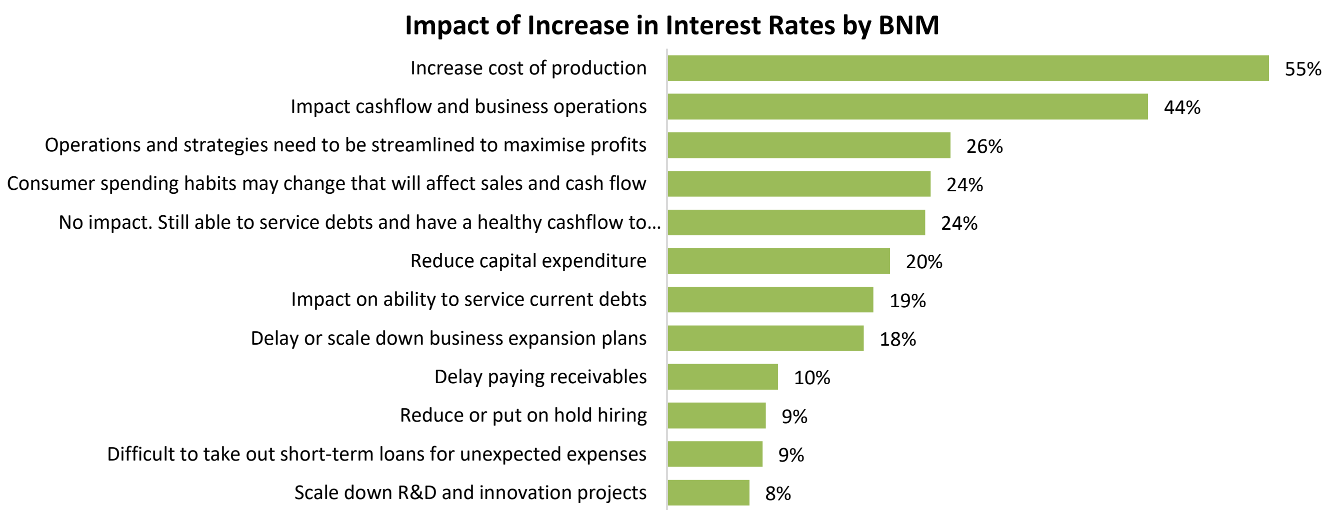






IMPACT OF INCREASE IN INTEREST RATES BY BNM

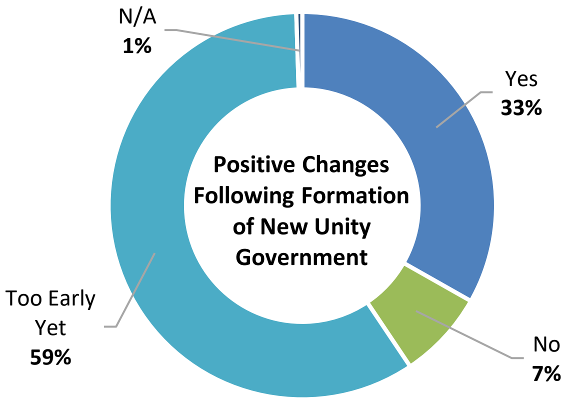
In November 2022, BNM raised its overnight policy rate (OPR), for the fourth time, by another 25 basis points to 2.75%. According to 55% of the respondents, the increase had increased their cost of production. The cashflow and business operations of 44% were affected, while 26% had to streamline their operations and strategies to maximise profits. 24% were concerned that a possible change in consumer spending habits will affect their sales and cashflow, while 20% had to reduce their CAPEX. The ability to service current debts had also impacted 19% of the respondents, but 24% were still able to service their debts with a healthy cashflow to support their operations and business expansion.

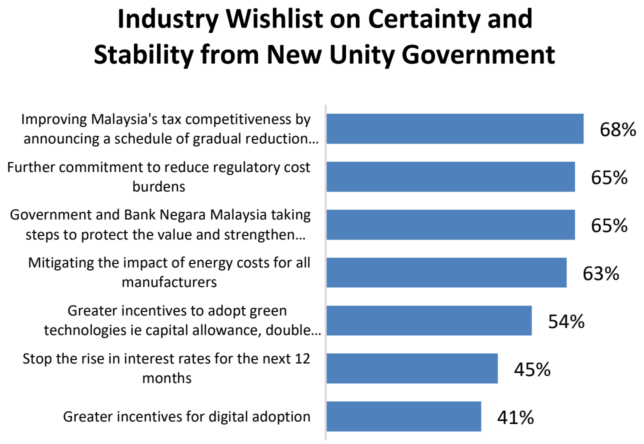


VIEW ON THE NEW UNITY GOVERNMENT ADMINISTRATION

Following the 15th General Elections and formation of the new Government, respondents were asked if they have started seeing positive changes. Majority (59%) opined that it is too early now to gauge, although 33% responded favourably.

In terms of certainty and stability, most (68%) respondents hope that the new Government would improve Malaysia's tax competitiveness through a gradual reduction in corporate tax rates. Steps should also be taken by the Government and BNM to strengthen the Ringgit and protect its value, while the impact of energy costs for all manufacturers should be mitigated. Respondents also look forward to greater incentives from the new Government for the adoption of green technologies and digitalisation, with a pause in interest rate hikes for the whole of 2023.





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 2H2022 was conducted from January 18 to February 28, 2023 and received 745 responses, of which 64.7% were SMEs (based on full-time employees), with 202, 118 & 103 responses from Klang Valley, Johor & Perak respectively. The top three industries for responses were: Food, Beverage & Tobacco (15% of respondents); Chemicals & Chemical Products (13.4%); and Electrical & Electronics (11.5%).

Federation of Malaysian Manufacturers (FMM)
Wisma FMM, No 3 Persiaran Dagang, PJU 9
Bandar Sri Damansara, 52200 Kuala Lumpur
Tel: 603-62867200 Fax: 603-62741266
Website: www.fmm.org.my
Enquiries: Business_Environment@fmm.org.my