BUSINESS CONDITIONS PICK UP IN 1H2022, CAUTIOUS OUTLOOK FOR 2H2022

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KEY RESULTS:

BUSINESS ACTIVITY – 1H2022	☑ Manufacturing activity improves ☑ Local sales higher than export sales ☑ 85% of respondents face higher production costs ☑ Higher capital investment ☑ Employment steady ☑ Top 3 increases in production cost: input cost of materials, labour costs and logistics ☑ 3 main obstacles to businesses: rising cost of raw materials, labour costs and logistics costs
BUSINESS ACTIVITY – OUTLOOK 2H2022	☑ Local sales and export sales expected to slow down ☑ Production volume and capacity utilisation to shift lower ☑ 57% of respondents to increase selling prices due to rising costs of raw materials, wages, and logistics ☑ Business recovery for 39% of respondents at pre-Covid level, 32% below pre-Covid level and 29% higher than pre-Covid level ☑ 3 main obstacles to businesses: rising cost of raw materials, labour costs and labour shortage
GENERAL	☑ 74% of respondents in favour of re-introduction of GST ☑ Most respondents impacted by the Ukraine-Russia conflict via increasing costs of raw materials, logistics and overall cost pass-through from suppliers/vendors ☑ OPR hike by BNM affects cashflow and business operations, and increases cost of production of respondents ☑ Top 3 wishes for Budget 2023: reduction in corporate and personal taxes, moderation in energy cost and re-introduction of the GST

In summary, notwithstanding the persistent external headwinds and domestic challenges, including rising inflationary pressures, the manufacturing sector has picked up some momentum in the first half of 2022. Most of the current indicators showed improvements from the previous survey, while the forward-looking indicators registered lower readings, a sign that manufacturers are taking a cautious stance as uncertainties in the global economy and tighter monetary conditions are expected to slow trade and the economy going forward.

Indicators	FMM – MIER Business Conditions Index Values							
	Current (Compared to 6 months ago)				Looking Forward (Next 6 months)			
	2H2020	1H2021	2H2021	1H2022	1H2021	2H2021	1H2022	2H2022
Business conditions	101	65	107	**109**	87	60	**122**	**94**
Local sales	88	56	94	**99**	74	51	**113**	**90**
Export sales	88	71	96	**91**	88	68	**111**	**89**
Production volume	101	61	105	**102**	91	62	**122**	**98**
Capacity utilisation	101	59	101	**104**	92	60	**117**	**100**
Capital investment	88	78	105	**109**	98	81	**125**	**113**
Number of employees	95	82	99	**100**	102	87	**121**	**117**
Cost of production	146	165	174	**182**	155	166	**179**	**177**

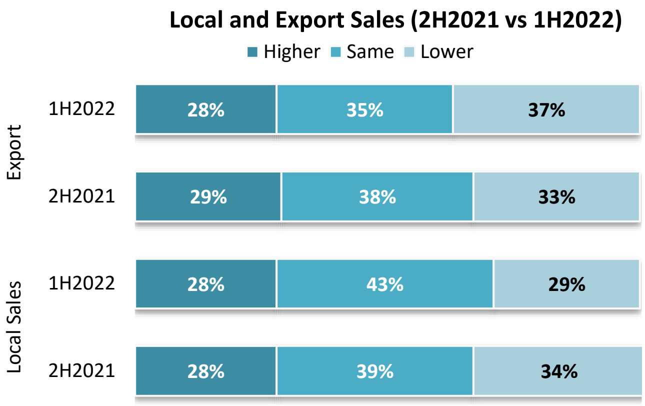
BUSINESS ACTIVITY IMPROVES

Improvements in business conditions in 2H2021 have continued into 1H2022. Reflecting this is the latest business activity index which edged up two points from 2H2021 to 109 in 1H2022. 38% of the 794 respondents reported an increase in business activity in 1H2022, up from 36% in the prior survey. A slowdown was experienced by another 29% of the respondents, the same proportion obtained in 2H2021.

Local Sales Higher Than Export Sales

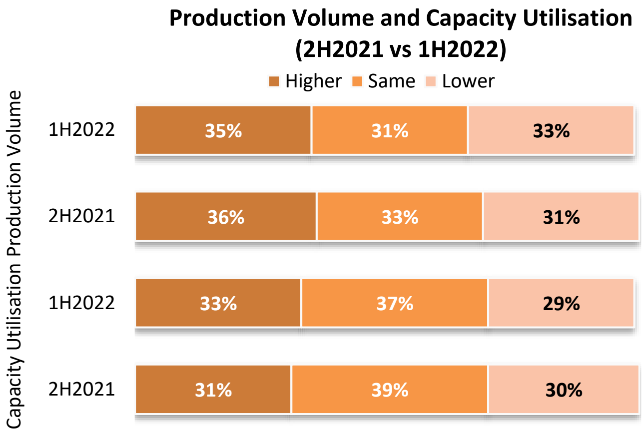
Local sales were ahead of export sales in recent months. This is shown by the index for current local sales which, at 99, had climbed five points from the previous period. While those who sold more domestically have remained the same as the prior survey's 28%, majority of those who were able to maintain their sales in 1H2022 have risen to 43% from 39% in 2H2021. Another 29% were hit by poor sales lately, down from 34% previously.

Conversely, the current export sales index lost five points from 2H2021 to 91, implying that exports have slowed down in 1H2022. While 37% exported less, exports rose for 28% of the respondents, and 35% saw no change in theirs.



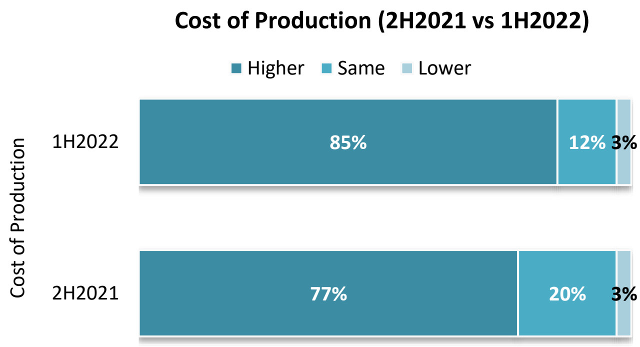
Production Volume and Capacity Utilisation Sustainable

Production and capacity utilisation have performed fairly well in 1H2022, with both indexes registering above the 100-point optimism threshold. While the current production index stood at 102, the current capacity utilisation index inched up three points to 101. Higher production was reported by 35% of the respondents, while 33% expanded their capacities in 1H2022.



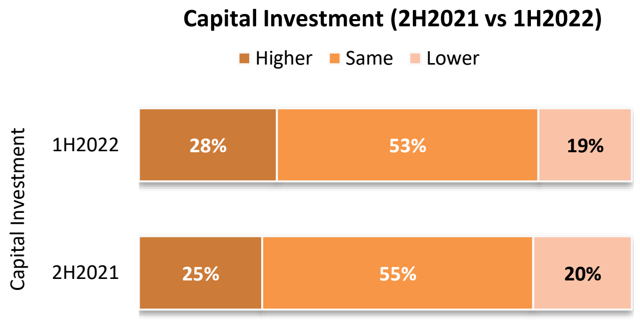
Production Cost Soars

Manufacturing cost gained further momentum in 1H2022. Indicating this is the current cost of production index which, at 182, has now replaced 2H2021's reading of 174 as the highest level since the inception of this survey in 1H2012. With 85% of the respondents reporting higher production costs in the latest survey, this is also the highest proportion received in this series, overtaking the preceding survey's 77% which was the highest on record then.



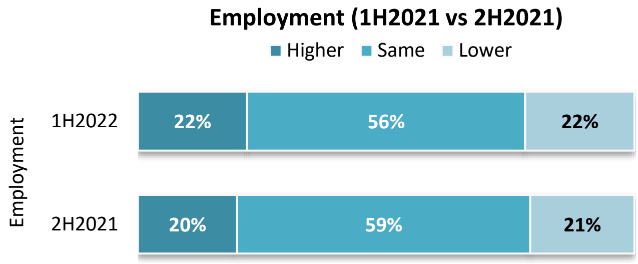
Capital Investment Beefs Up

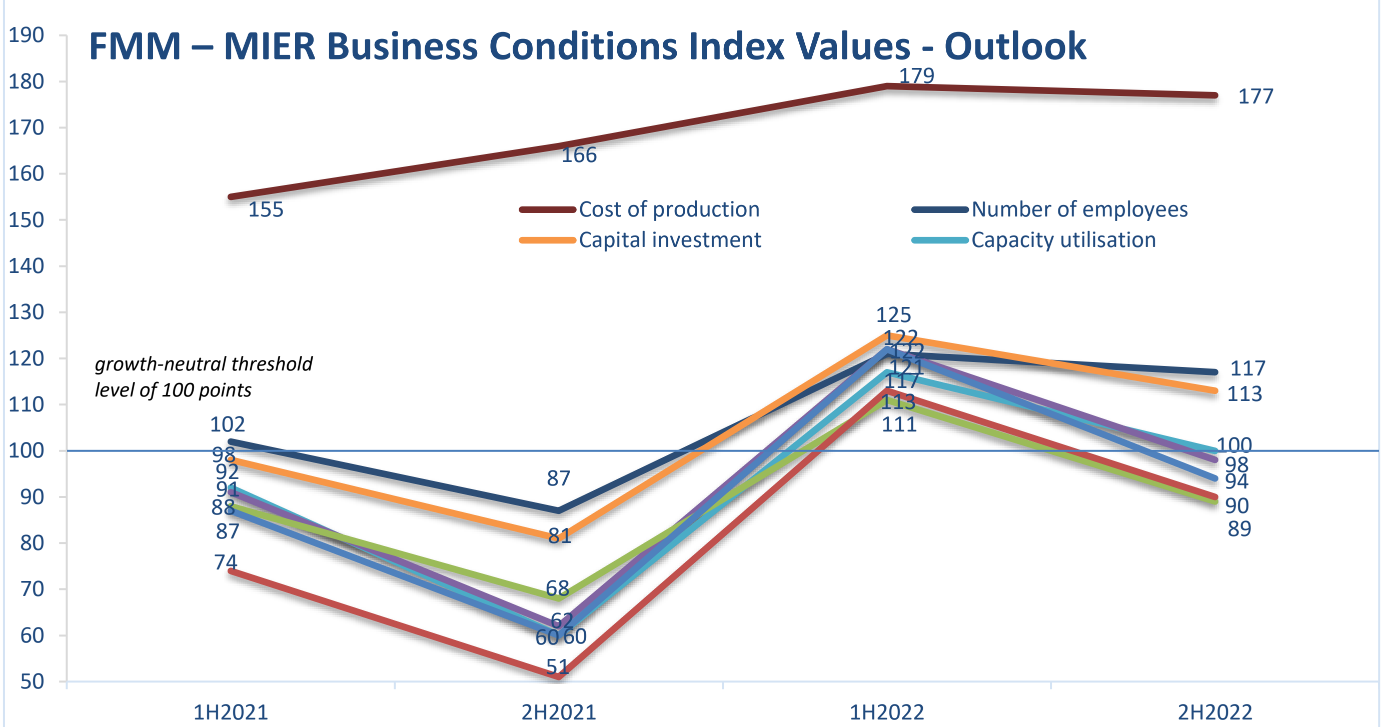
The latest current capital investment index advanced four points from the prior period to 109, suggesting that capital investment (CAPEX) has stepped up lately. 28% of the respondents injected additional CAPEX in 1H2022, up from 25% in 2H2021 and 14% in 1H2021. Another 53% have maintained their CAPEX in 1H2022, while 19% have cut back on such expenditure for now.



Employment Steady

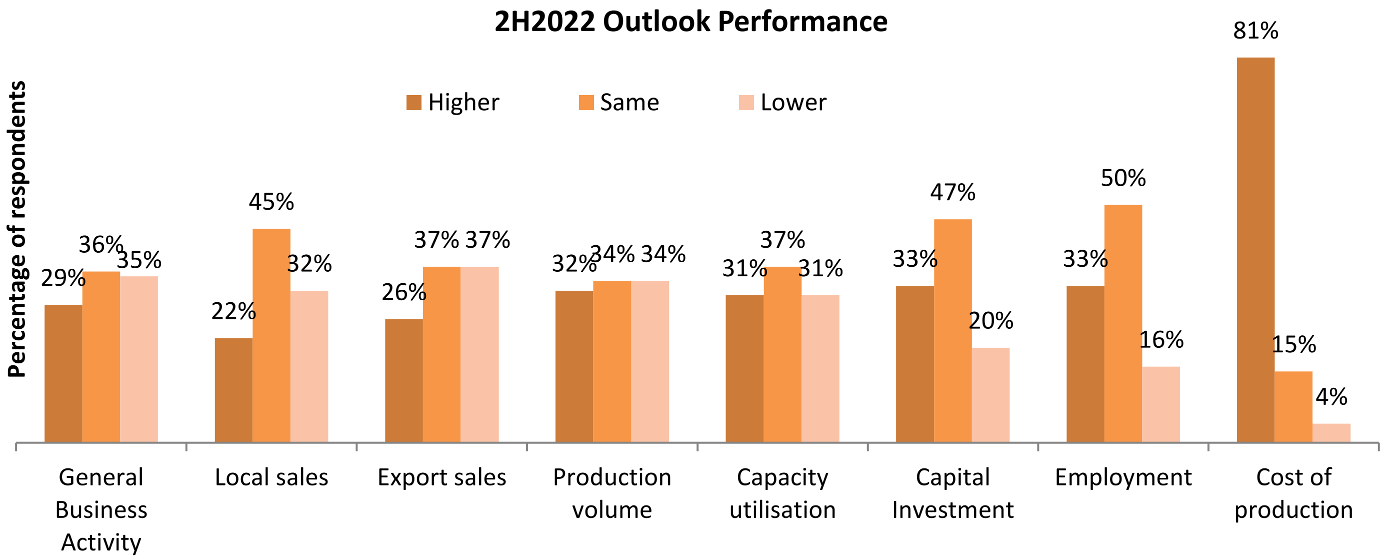
The current index for employment, at 100, is little changed from the previous survey's 99, inferring that hiring in the manufacturing sector has remained steady in recent months. 22% of the respondents increased their headcount in 1H2022, up from 20% in 2H2021 and 8% in 1H2021. While 56% have maintained their existing workforce, 22% have reduced headcount, compared to 59% and 21% in 2H2021, respectively.





CAUTIOUS OUTLOOK FOR 2H2022

Moving forward, manufacturers are taking a more pragmatic approach to the outlook of their businesses as economic challenges remain unabated for now. Across-the-board declines were charted in all the forward-looking indicators this time, with half of them falling below the 100-point optimism threshold, a postulation that the manufacturing sector will remain in cautious mode for the rest of 2022.



The index for expected business activity fell 28 points to below the optimism threshold at 94, suggesting that a slowdown in business activity is expected in 2H2022. Those who are anticipating lower business activity in the coming months have now doubled to 35% from the prior survey, while positive responses have fallen to 29% from 39% previously.

Both the indexes for expected local sales and export sales have also slipped below the optimism threshold in the latest survey, an inference of flagging sales expectations, both at home and abroad. The expected local sales index and export index, at 90 and 89, respectively, have lost 23 and 22 points, respectively, from the preceding survey. Higher local sales are expected by 22% of the respondents, down from 33% previously. Those expecting a decline in local sales by year-end have increased to 32% from 20% previously. For those who export, 26% have forecasted higher sales in 2H2022, while 37% foresee otherwise, compared to 33% and 22% in the prior survey.

Concomitant with the slower sales outlook, production and capacity utilisation are expected to slow down in the coming months as well. Reflecting this are the indexes for expected production and capacity utilisation which fell to 98 and 100 respectively, from the previous 122 and 117 respectively. 32% of the respondents are planning to increase their production volume soon, while 34% will reduce theirs, compared to 41% and 19% previously. Capacities will be expanded by 31% of the respondents in the months ahead, while another 31% will lower theirs, compared to the previous survey's 37% and 20% respectively.

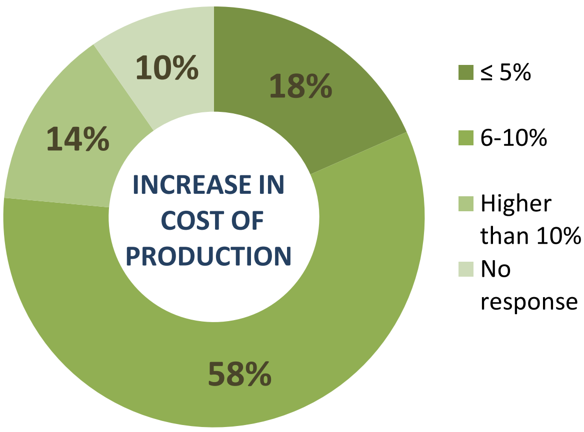
The index for expected cost of production fell marginally from the prior survey's all-time high of 179 to 177 currently, indicating that production costs are expected to remain high for the rest of 2022. 81% are bracing for further production hikes in the coming months, while 15% do not foresee any change in their costs anytime soon, and 4% are looking into lowering their costs by year-end.

Capital investment is expected to remain moderate in the near term, as depicted by the latest expected index for capital investment (CAPEX) which fell to 113 from 125 previously. 33% of the respondents are planning to increase their CAPEX soon, down from the previous survey's 39%, while 20% are contemplating smaller CAPEX budgets for the next few months, up from 14% previously.

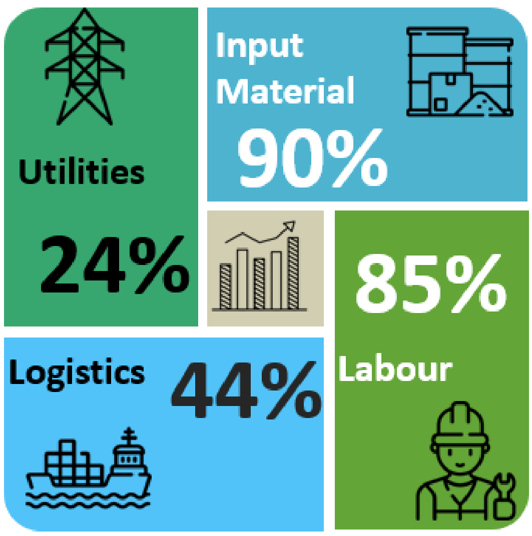
Notwithstanding some recruitment challenges, manufacturing recruitment is expected to remain active in 2H2022. This is reflected in the expected index for employment still being above the neutral threshold of 100 although it has declined to 117 from the prior survey's 121. 33% of the respondents will likely employ more workers soon, while 16% are planning to downsize their workforce, compared to 34% and 13% previously.

COST OF PRODUCTION

According to the Department of Statistics, salaries and wages in the manufacturing sector increased by 4.5% in April 2022 and is expected to increase further in May 2022 due to the rise in the minimum wage. The Producer Price Index (PPI) which can be used to gauge changes in prices paid by producers for inputs and service also increased by 10.1% year-on-year in May 2022.



As shown by the results of this survey, production cost has increased for 85% of the respondents in 1H2022. Among them, 58% opined that their total cost of production has increased by 6-10%, while 18% and 14 % assessed their increase to be up to 5%, and higher than 10%, respectively. As to whether they are able to pass their costs through or not, 53% said they were unable to.



Of the many increases of cost of production that respondents had to incur in 1H2022, the top three increases were input costs of materials, labour costs and logistics (mainly freight rates). Higher utility costs (electricity, energy/fuel, natural gas, water) have also been borne by many respondents lately.

BUSINESS RECOVERY IN 1H2022

Following the re-opening of the economy and opening up of the international borders, 39% respondents revealed that their business recovery to date is at the pre-Covid level, while that for 32% is below the pre-Covid level. Recovery for another 29% is believed to be higher than the pre-Covid level.

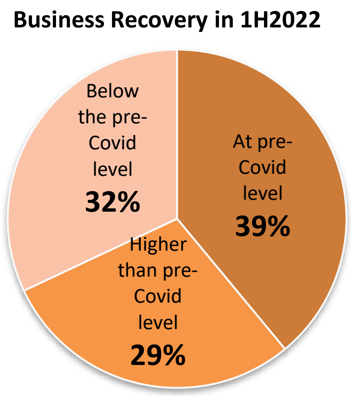
For those whose business recovery is higher than the pre-Covid level, 84% estimated their recovery to be 1-30% higher than the pre-Covid level. A breakdown shows that 29% have recovered by 1-10% higher than the pre-Covid level, while that for 36% and 19%, their recovery is estimated to be 11-20% and 21-30% higher than the pre-Covid level, respectively.

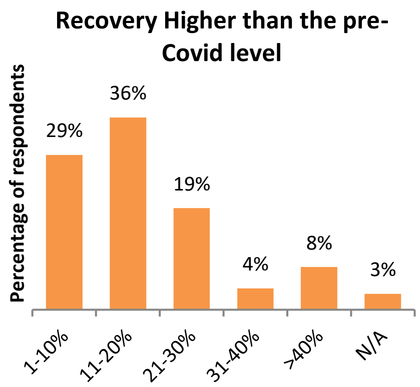
Where business recovery is below the pre-Covid level, 73% assessed their recovery at 1-30% lower than before. Among them, 17% have recovered by 1-10% below their pre-Covid level, while 26% and 30% believed their recovery is 11-20% and 21-30% below their pre-Covid level, respectively.

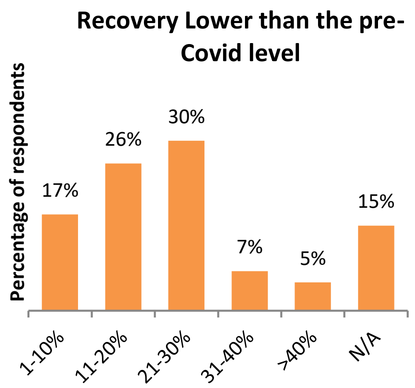
Obstacles to Business in 1H2022 and 2H2022

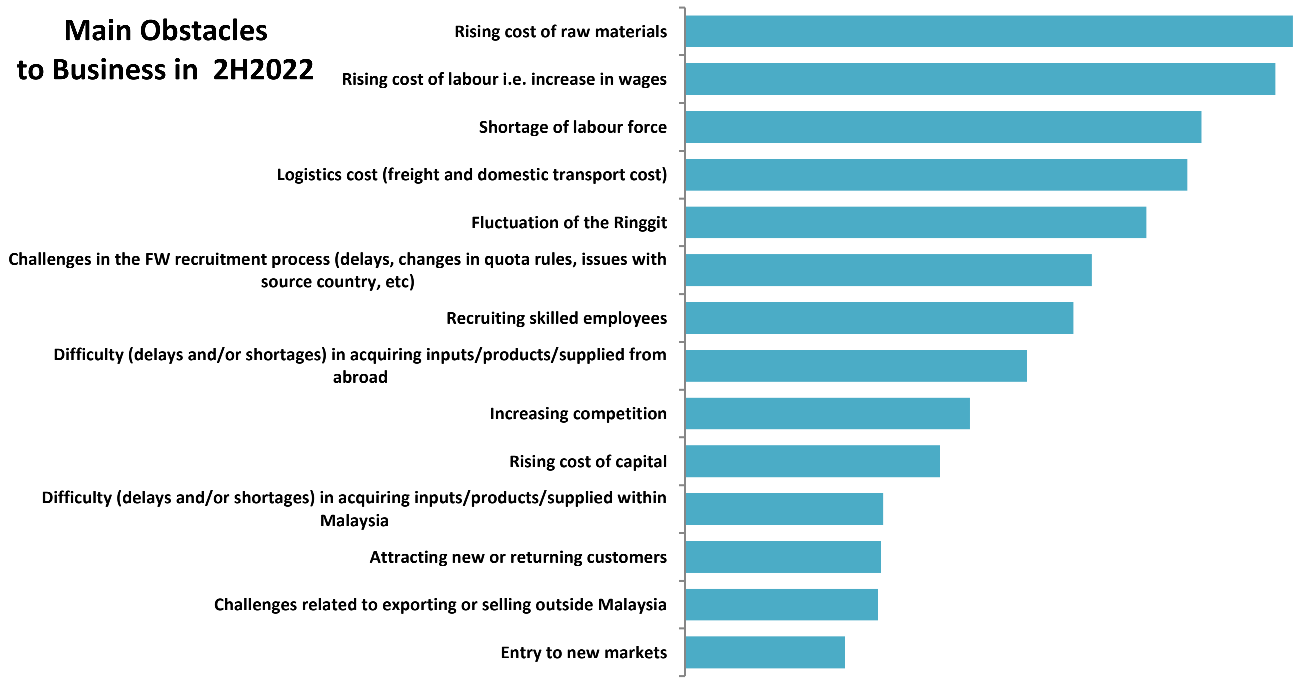
Over the last six months (1H2022), the main obstacle that respondents faced was rising cost of raw materials, followed by rising cost of labour, logistics cost (freight and domestic transport cost), shortage of labour and fluctuation of the Ringgit. Other obstacles indicated by respondents include the difficulty (delays and/or shortages) in acquiring inputs/products supplied from abroad and within Malaysia, as well as the challenges posed in the foreign worker recruitment process (delays, changes in quota rules, issues with source country, etc.).

In the next six months (2H2022), respondents will likely face the same obstacles as they did in 1H2022, with rising cost of raw materials and rising cost of labour expected to remain the top two obstacles for them. Third on the list in terms of responses is labour shortage, followed by logistics cost (freight and domestic transport cost) and, once again, the challenges in the foreign worker recruitment process (delays, changes in quota rules, etc).





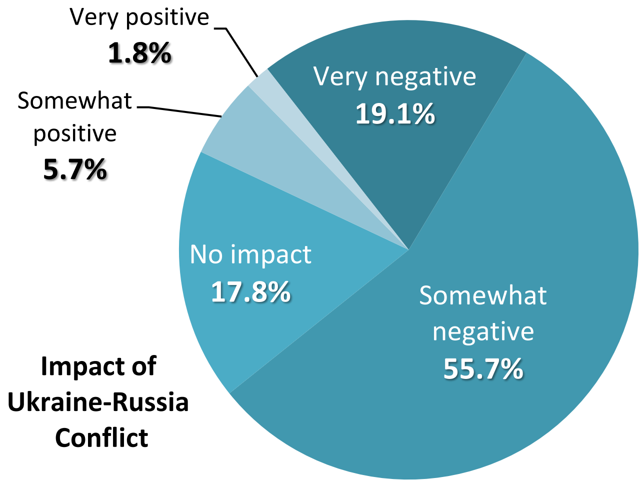


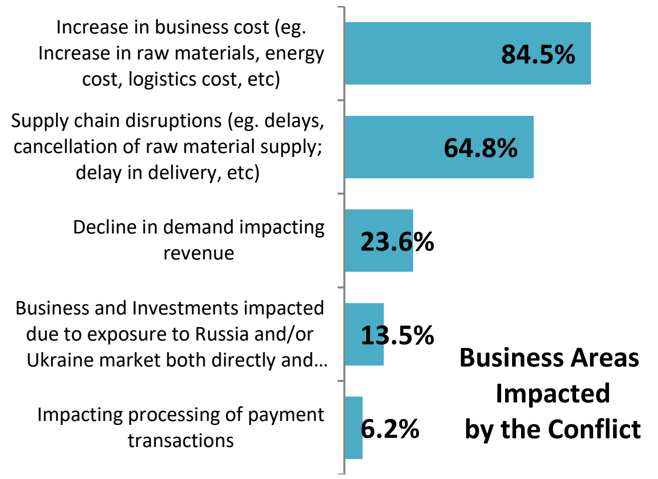


IMPACT OF UKRAINE-RUSSIA CONFLICT

Results of the survey showed that the Ukraine-Russia conflict has impacted most of the respondents in 1H2022, with 56% describing the impact on them as “somewhat negative”, while it is “very negative” for another 19% of the respondents. Only about 8% of the respondents were affected positively, but 18% were not impacted at all.

Of those who were impacted by the conflict, most (85%) were affected by the increase in business cost, with cost of raw materials topping their list, followed by logistics (shipping and delivery cost), and overall cost pass-through from suppliers/vendors. The second most popularly noted area arising from the conflict that impacted respondents was supply chain disruptions (delays, cancellation of raw material supply, delay in delivery) (65%). While a small proportion of respondents experienced a decline in demand that impacted their revenue (24%), there were also those whose business and investments were affected due to their exposure to the Russian and/or Ukrainian market, both directly and indirectly (14%).





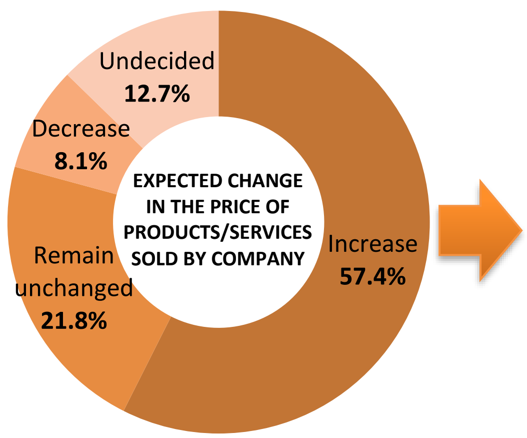
POTENTIAL IMPACT OF INTEREST RATE INCREASE

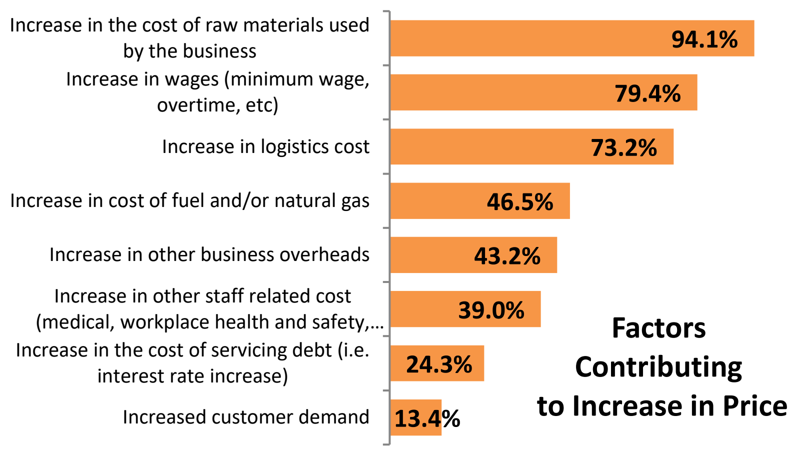
BNM has raised the overnight policy rate (OPR) by another 25 basis-points to 2.25%, following its OPR hike in May 2022. Among those impacted by the hike, most were of the view that the hike will increase their cost of production (46%) as well as impact their cashflow and business operations (45%). Close to 22% believed the hike will impact their ability to service their current debts, while 20% foresee a delay or scale-down in their business expansion plans. On a positive note, 28% of the respondents said the hike will have no impact on them as they will still be able to service their debts and their cash flow will be healthy enough to support their operations and business expansion plans.

PRICES IN THE NEXT 6 MONTHS

Over the next six months, 57% of the respondents will likely increase the selling price of their products/services, while 22% do not intend to adjust their prices anytime soon and 8% may revise their prices downwards.

Most of those contemplating price hikes contributed the impending increase to the rising cost of raw materials used by their businesses, as well as increase in wages (minimum wage, overtime, etc) and logistics costs





2023 BUDGET WISHLIST

With the Budget 2023 scheduled to be tabled on 7 October 2022, respondents were asked to list down their wishes. Of the numerous proposals put forth, the top three proposals were for a reduction in both corporate and personal taxes, moderation in energy cost (electricity and natural gas) and re-introduction of the GST, with many calling for a lower rate. Many respondents have also called for a strengthening of the Ringgit.

Other proposals suggested include the following: address the current labour shortage issues, especially in expediting the processing and approvals for foreign workers; control inflation, especially for raw materials; and provide tax incentives and grants, in particular to support SMEs, export activities, automation, Industry 4.0 and digitalisation.

Reduction in corporate tax rate

Reduction in personal tax rate

Moderation in energy cost (electricity and natural gas)

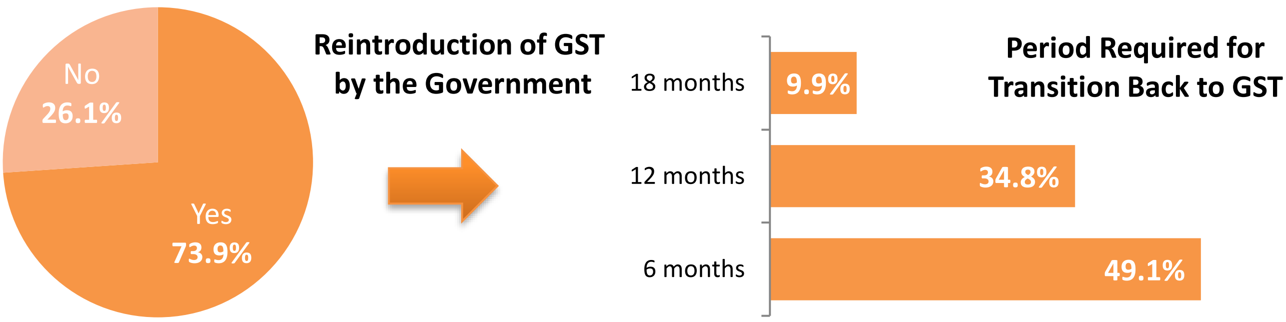
Reintroduction of GST (with a lower rate)

Strengthening of the Ringgit

GOODS AND SERVICES TAX (GST)

The Government is currently studying the possibility of re-introducing the GST. FMM is of the view that GST is a more transparent and effective tax regime compared to the Sales and Services Tax (SST) but it must come with improvements to make it more consumer-and-business friendly, including reducing the GST rate. When asked if the Government should re-introduce the GST, close to three quarters (74%) of the respondents are in favour of the GST. Among them, most (49%) opined that they will need a period of six months for the transition back to GST, while 35% believe they will need twelve months and 10% will require 18 months.

For the 26% of respondents who do not support the re-introduction of the GST, most of them cited reasons of it having a cost impact on consumers, and the burdensome paperwork, documentation and claims process that the tax entails.



The FMM-MIER Business Conditions Index (FMM-MIER BCI) is a collaborative effort between FMM and the Malaysian Institute of Economic Research (MIER). Business condition is the general state of an economy affecting business viability. The FMM-MIER 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 – MIER Business Conditions Survey 1H2022 was conducted from July 9 to August 12, 2022 and received 794 responses, of which 66.1% were SMEs (based on full-time employees), with 227, 115 & 114 responses from Klang Valley, Johor & Perak respectively. The top three industries for responses were: Food, Beverage & Tobacco (17.5% of respondents); Chemicals & Chemical Products (12.6%); and Electrical & Electronics (11.7%).

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