BUSINESS CONDITIONS IN 2H2016 RESILIENT OUTLOOK FOR 1H2017 CAUTIOUS

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Indicators	FMM – MIER Business Conditions Index Values							
	Current (Compared to 6 months ago)				Looking Forward (Next 6 months)			
	1H2015	2H2015	1H2016	2H2016	2H2015	1H2016	2H2016	1H2017
Business conditions	86	83	90	102	95	94	107	100
Local sales	77	72	80	87	87	84	99	87
Export sales	102	95	99	109	107	106	112	111
Production volume	95	88	93	106	104	104	114	106
Capacity utilisation	93	90	94	107	107	100	111	106
Capital investment	108	104	110	110	111	107	108	116
Number of employees	104	91	106	104	103	106	111	110
Cost of production	162	154	154	167	156	157	150	165

The Malaysian manufacturing sector has shown resilience in the face of global and domestic economic uncertainties and challenges as 2016 came to a close. In the latest FMM-MIER Business Conditions Survey, improvements were observed for current local and export sales, production volume and capacity utilisation, albeit with higher cost of production. Manufacturers are adjusting expectations lower as they remain cautious about economic and business prospects in the first half of 2017.

KEY POSITIVE FINDINGS

- ☑ 2H2016 business conditions index breached the 100-point threshold at 102 after 6 consecutive period of low activity.
- ☑ 33% noted increase in business activity in 2H2016 (1H2016: 28%)
- ☑ Export index in 2H2016 rose to 109 - 37% reported higher exports
- ☑ Production volume and capacity utilisation higher - 37% and 35% respectively expanding in 2H2016
- ☑ Capital investment steady in 1H2016 - 30% injected additional investment and 33% expected to expand investment in 1H2017
- ☑ 34% respondents automated at the 31-50% level; 20% at 51-100%.
- ☑ 41% respondents are somewhat aware of Industry 4.0

BUSINESS ACTIVITY IN 2H2016 PICKS UP

After six consecutive bi-annual periods of low activity, the current general business conditions index finally turned a corner to breach the 100-point threshold level of confidence in 2H2016. At 102, this suggests that manufacturersô confidence in the domestic economy has improved recently.

33% of respondents believed that business conditions in 2H2016 have improved, up from 28% and 23% in 1H2016 and 2H2015, respectively. A majority of 36% saw no change, while 31% responded unfavourably.

Local and Export Sales Improve Further

The current local sales index picked up seven points from 1H2016 to 87 in 2H2016. Despite the index continuing to stay below the 100-point demarcation level, the higher reading indicates that local sales have gained momentum.

A quarter of respondents noted higher local sales in 2H2016, up from 22% in 1H2016 and 18% in 2H2015. Those who sold less domestically totaled 38% this time around, down from 42% six months ago and 46% last year.

Exports at year-end were also encouraging. Following two consecutive bi-annual periods of registering less than 100 points, the index for current export sales rose to 109 in 2H2016, indicating that export sales have increased in recent months. Those who exported more registered a higher majority of 37%, up from 34% in 1H2016 and 30% in 2H2015.

Production Volume and Capacity Utilisation Expand

Production volume and capacity utilisation rose in tandem with the pick-up in local and export sales. This is reflected in the indexes for current production volume and capacity utilisation which surpassed 100 points for the first time since 2H2014 to reach 106 and 107 in 2H2016, respectively. Most respondents had expanded production volume (37%) and capacity utilisation rates (35%).

Cost of Production Increase, Capital Investment Steady

The index for current cost of production gained 13 points from the prior survey to 167 in 2H2016, indicating production costs have escalated. Almost three-quarters of respondents claimed to have experienced higher costs of production in 2H2016, up from 62% in 1H2016 and 64% in 2H2015.

Capital investment was steady in 2H2016, with the index for current capital investment remaining unchanged from 1H2016, at 110. Half of the respondents maintained capital investment in 2H2016, while 30% and 20% increased and reduced theirs, respectively.

Employment Slows Down

Hiring at year-end in the manufacturing sector was less ambitious, with most putting hiring on hold. The current employment index remained positive at 104 albeit falling two points from 1H2016.

23% of respondents increased their headcount, a notch down from 1H2016ôs 24%.

The majority (58%) maintained workforce in 2H2016, while 19% downsized.

SUBDUED EXPECTATIONS FOR 1H2017

Business conditions for the manufacturing sector are expected to remain subdued going forward. This is mainly due to a poorer view of domestic sales while exports are expected to perform better. The index for expected business conditions for the first six months of 2017 fell seven points to 100. 26% of respondents anticipate business conditions to improve while most (48%) believe the situation will remain the same and 26% foresee a downtrend.

Exports are expected to remain steady and perform better than local sales in 1H2017. The expected export sales index, at 111, is little changed from the previous period. 35% and 41% of respondents are projecting higher and stable sales, respectively. The index for expected local sales plummeted 12 points to 87 inferring that domestic sales will likely wane in the coming months.

The index for expected production volume fell eight points to 106 for the first six months of 2017, suggesting that production will also moderate. 32% of respondents are planning to increase production in the months ahead, down from 36% in the prior survey. While there is not much change in the proportion of those who responded neutrally, those considering lowering production volume have grown to 26%.

The expected capacity utilisation index lost five points to 106 indicating caution and pragmatism as 2017 gets underway. 29% of respondents are likely to expand capacity utilisation in the near term, down from the prior surveyôs 33%.

Manufacturers are bracing for costlier production in the coming months. The expected cost of production index soared to 165 up from 150 in the previous survey. 7-in-10 respondents expect higher production costs in 1H2017.

Capital investment is set for further expansion in the early months of 2017. The index for expected capital investment jumped eight points to 116. 33% of respondents are preparing to inject more funds for capital investment, compared to the previous two surveys.

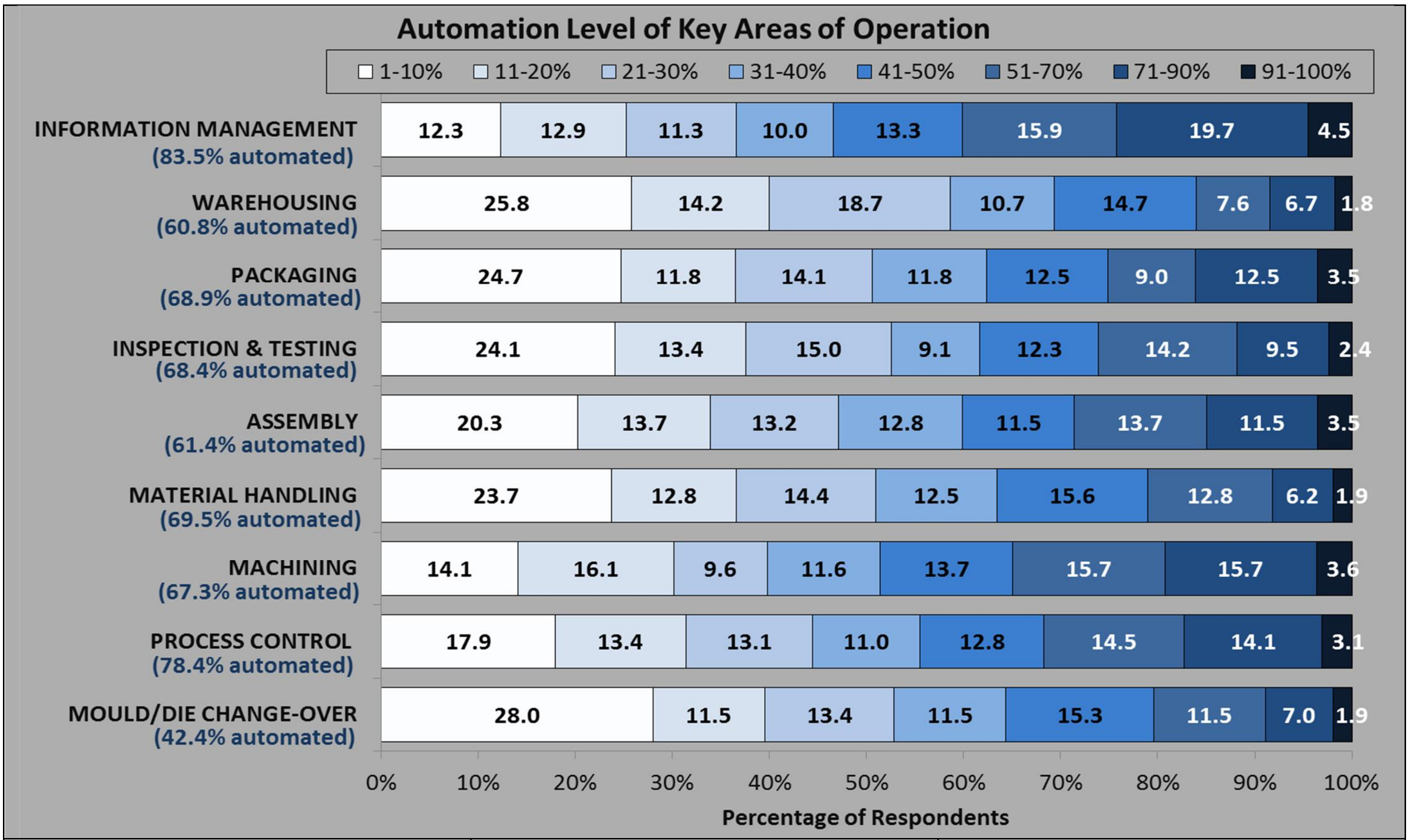
The expected employment index is held somewhat steady at 110 compared to 111 in the previous survey. 6-in-10 respondents plan to keep hiring and retrenchment on hold for now.

INDUSTRY 4.0

Industry 4.0 is the current trend of automation and data exchange in manufacturing technologies that includes cyber-physical systems, the Internet of Things and cloud computing. Most respondents were generally unfamiliar. Almost 41% were somewhat aware, 28% needed more information (via seminars, literature, etc), 19% not aware at all, and only 12% ñvery awareò.

AUTOMATION

Further to the 1H2016 FMM-MIER Survey where 37% of the respondents indicated interest in stepping up automation, FMM members were asked to indicate their current level of automation in the latest survey. The findings show that most (about 34%) respondents are automated at the 31-50% level, while 20% were at 51-100% and almost 30% at 1-20%. About 13% are 21-30% automated and 3% not automated at all.



Respondents were further asked the extent of automation in nine key areas of operations:

- Mould/die change-over
- Process control
- Machining
- Material handling
- Assembly
- Inspection & Testing
- Packaging
- Warehousing, and
- Information management.

The findings show that mould/die change-over is the least automated, while information management is highly automated.

42.4% of respondents have automated mould/die change-over with the majority achieving automation at the 1-10% level.

78.4% indicated some level of automation in process control; of which 17.9% and 14.5% automated at the 1-10% and 51-70% levels, respectively.

Machining is automated by 67.3% of respondents; of which 16.1% automated at 11-20%.

69.5% automated material handling and 61.4% assembly. Of those who did, 23.7% (material handling) and 20.3% (assembly) automated at 1-10%. 13.7% each in assembly automated at the 11-20% and 51-70% levels. 15.6% in material handling also automated at the 41-50% level.

Inspection & testing, packaging and warehousing were automated by 68.4%, 68.9% and 60.8% of respondents respectively. Of those who did, majority automated at the 1-10% level followed by the 21-30% level for all the three operations.

Information management was the highest automated operation with 83.5% respondents. The majority that automated rated automation at 71-90% followed by 51-70% and 41-50%.

Of those who have not or have automated to a small extent, most (71%) cited high cost as the main factor hampering their automation efforts.

Other factors include:

- Lack of technical support (31% responses)
- Limited labour savings (29%)
- Difficult to obtain government incentives (21%)
- Technology being too dynamic (16%), and
- Difficult to obtain loan (10%).

High mix / low volume and nature of process / operations / product (customised) were other factors included by some respondents as well.

FOREIGN WORKERS (FW)

The Government intends to implement the annual FOMEMA FW Medical Examination to reduce the risk of transmission of communicable diseases and the Employer Mandatory Commitment (EMC) which include employers bearing the levy burden, paying minimum wage and insurance for FW, ensuring decent accommodation, paying the immigration deposit to reduce dependency on FW and ensuring their FW's well-being.

Almost 6-in-10 of respondents agreed to the annual FOMEMA Medical Examination, despite 55% cautioning that this will add to their cost of doing business. 44% believed that the objectives will be achieved, while 35% felt that illegal foreign workers and weak enforcement are the main problems. 22% do not think the desired objectives would be met.

33% suggested that the medical examination be carried out only on the return of the FW from his/her home country and 26% opined that, as a multiplier effect, locals will demand more benefits. Discrimination against local workers is the concern of 26% of respondents.

Unlike the FOMEMA issue, most respondents (72%) voted against the EMC. Almost 45% said levy is currently borne by the FW, while 17% pay for their FW and another 17% share the burden with their FW.

Like FOMEMA, 74% agree that the EMC will increase the cost of doing business. 48% doubted that the desired objectives will be met. Only 11% felt that the EMC will achieve its objectives.

43% felt that the issues are more of illegal FW and weak enforcement.

40% believed that this would cause locals to demand more benefits. 39% were concerned over discrimination of locals.

Almost 3-in-10 opined that the EMC should be implemented in phases with a scheduled notification.

2017 BUDGET INCENTIVES

Respondents were asked if their companies will benefit from the Budget 2017 incentives.

A majority of 48% said that the reduced tax rate of 1% and 4% for significant increase in taxable income for YA 2017 and 2018 will benefit them, while 42% do not think they will benefit.

Export promotion programmes and insurance credit facilities for SMEs, as well as double deduction incentive on expenses incurred to provide structured internship programme for TVET were noted by 18% and 17% of respondents, respectively.

11% feel they can benefit from the guarantees and 2% rebate on interest rates charged to SME borrowers under the *Skim Jaminan Pembiayaan Perniagaan*.

Only 4% said they can benefit from the Working Capital Guarantee Scheme Fund for start-ups.

LATEST BNM FOREIGN EXCHANGE RULES

Under the latest BNM foreign exchange rules, exporters can retain up to 25% of export proceeds in foreign currency, with the balance 75% to be converted into Ringgit.

57% opined that BNM should revert back to the original rule of 100% retention of foreign currency.

15% suggested that the natural offset in the month before conversion of net proceeds be allowed, while 13% are agreeable to the latest ruling, given the flexibilities by BNM.

Another 13.2% felt that 50% retention of foreign currency should be allowed.

FINDINGS OF CONCERN

- ☑ Cost of production escalated in 2H2016; similar expected in 1H2017
- ☑ 19% downsized their workforce in 2H2016
- ☑ Local sales to wane in 1H2017 with index falling 12-points to 87
- ☑ Production volume and capacity utilisation to moderate in 1H2017
- ☑ Employment to be held steady by 60% in 1H2017

HIGHLIGHTS OF SPECIAL TOPICS

- ☑ 84% automated information management; 78% process control
- ☑ More scope for automation of the various factory operations
- ☑ 60% agree to annual FOMEMA medical examination; 55% cautioned that it will add to cost of doing business
- ☑ 72% against Employer Mandatory Commitment – higher cost, desired objectives would not be met, illegal FW & weak enforcement key issue
- ☑ 2017 Budget - 48% likely to benefit from reduced income tax rates; export promotion programme (18%); double tax deduction for TVET internship (17%); guarantees and interest rate rebate under SJPP (11%)
- ☑ BNM to revert back to original rule of 100% retention of export proceeds – 57%

The FMM-MIER Business Conditions Index (FMM-MIER BCI) is a collaborative effort between FMM and the Malaysian Institute of Economic Research (MIER).

Business conditions can be defined as the general state of an economy as it affects the viability of individual businesses. 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 2H2016 received 370 responses.

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