GI / 07 / 2024

March 12, 2024

To: CEO/ Directors/ Managing Directors/
Finance/ Business Development/Sales Managers

FMM Business Conditions Survey 2H2023

The Federation of Malaysian Manufacturers (FMM) is pleased to publish the findings of the 24th biannual survey of business conditions in the manufacturing sector for the second half of 2023 (2H2023). The findings were successfully released to the media via a press conference on March 11, 2024. We are pleased to enclose a copy of the survey findings for your reference and record.

The survey revealed that business conditions in the Malaysian manufacturing sector improved in 2H2023 amid challenges in the global and domestic economic landscapes. While several indicators within the sector showed improvement, the overall situation remained below the optimism threshold, signalling a slow recovery as the sector continued to grapple with persistent economic headwinds:

- ***Manufacturing activity picked up in 2H2023,*** *as shown by the general business conditions index which, at 89, gained 23 points from 1H2023. Its continued stay below the 100-point optimism threshold is an indication that while sentiments had improved, respondents had remained cautious as well. 26% of the 613 respondents noted an increase in business activity in 2H2023, up from 20% in 1H2023. A smaller proportion of 36% responded negatively this time around, compared to the previous survey's 54%.*
- ***Domestic and export sales improved in 2H2023*** *from 1H2023 where the indexes for local sales and export sales rose to 86 and 80, respectively, up from 71 and 66 in 1H2023. With both indices still hovering below the threshold level of optimism, it suggests that the increase in local and export sales had remained below expectations. Higher local and export sales were reported by 21% and 22% of the respondents in 2H2023, up from 18% and 17% in 1H2023, respectively. Most, however, reported no change in their sales locally and abroad, as indicated by 44% and 36% of the respondents, respectively, while weak local and export sales were experienced by 35% and 42% of the respondents, respectively.*
- ***Production volume and capacity utilisation shifted higher as new orders and sales picked up pace in 2H2023*** *with both the current production and capacity utilisation indices higher at 91 each in 2H2023, up from 69 and 68, in 1H2023, respectively. Like sales, their readings below the optimism threshold level suggest much room for improvement. 27% of the respondents produced more in 2H2023, while 23% expanded their capacities during this period.*
- ***Manufacturing costs eased slightly but remained high*** *as depicted by the index for the 2H2023 cost of production which, at 154, is the lowest reading in three years. 61% of the respondents had to put up with higher production costs in 2H2023, the smallest proportion tabulated in three years.*
- ***The index for current capital investment (CAPEX) gained 8 points to 103*** *after dipping below the optimism threshold level in 1H2023, rising above the threshold once again in 2H2023. 22% injected additional CAPEX lately, little changed from 21% in 1H2023. 58% were impartial on this, while 7% reduced their investments, down from 10% previously.*
- *Employment opportunities in the manufacturing sector were generally less prospective in 2023 than they were a year ago.* ***The current employment index fell again below the threshold in 2H2023***

to 98. *After staying above the optimism threshold for the whole of 2022 and 1H2023, 15% of the respondents hired more employees in 2H2023, the lowest proportion received since 1H2021. 17% reduced their manpower, while 68% had retained their current headcount.*

Going into 2024, with economic conditions expected to improve, including the easing of global interest rates as inflation continues its descent, manufacturing activity could likely gain some momentum, albeit slowly, with an expected pick-up in sales, production, capital investment and hiring going forward. Across-the-board improvements were charted for all the forward-looking indicators covered in the survey. Notwithstanding the improvements, some indicators still remained below the optimism threshold, an inference that respondents are cautiously forward looking in 1H2024, in particular, local and export sales, production volume and capacity utilisation.

- ***The latest index for expected business activity rose six points to 92 from the prior survey,*** *an inference that business conditions are expected to improve in the coming months. 23% of the respondents are anticipating a pick-up in business conditions soon, while 31% are expecting a slowdown and 46% opined that the status quo will remain.*
- ***Local and export sales are expected to increase in tandem with higher demand. The 1H2024 index for local sales climbed eleven points to 92, while the index for export sales rose slightly to 89, signalling a faster pace of domestic sales to export sales in 1H2024.*** *20% of the domestic-oriented respondents projected an increase in sales, up from 16% previously. Of those who export, 24% expected higher sales in the coming months, while 36% revised their forecast lower.*
- ***Concomitant to the higher sales forecast, the index for expected production volume picked up thirteen points to 97.*** *28% of the respondents planned to beef up their production volume in 1H2024, up from 23% previously, while most preferred to maintain their current volumes. Capacity utilisation is also expected to trend higher, as indicated by the expected capacity utilisation index which gained twelve points to 99, with 26% of the respondents responding positively.*
- ***Production costs in the coming months are also expected to shore up, with a higher index of 159.*** *A bigger majority of 65% than previously (54%) will likely have to deal with higher production costs in 1H2024, while 28% do not foresee any change in their costs anytime soon.*
- ***The latest index for expected capital investment, at 110, was up ten points from the previous period, implying that an increase in CAPEX is likely in the coming months.*** *30% planned to increase their CAPEX soon, while 51% will maintain their current budgets in early 2024 as well.*
- ***The latest index for expected employment stood at 105, higher than the prior period's 101, suggesting that more headcounts will likely be added in the sector in the months ahead.*** *20% of the respondents planned to increase their manpower soon, while 64% will maintain their existing workforce for now.*

Topical issues covered in the survey revealed the following key findings:

- *3 biggest challenges to business operations and growth in 2024: rising input costs, weak demand and ringgit depreciation.*
- *Revenue & profit growth 2024: higher revenue and profit by 1-10% expected in 2024 vis-à-vis 2023.*
- *Manufacturing operations preparedness and resilience: 45% of respondents are somewhat prepared and 44% are adequately prepared to withstand disruptions to operations.*
- *Assistance needed for export market expansion: expand double tax deduction incentive and introduce new incentives to increase the visibility of Malaysian brands regionally and internationally.*
- *Top Markets Identified for Free Trade Agreement Negotiations: Tanzania, USA, UAE, Saudi Arabia, Qatar, South Africa and Brazil.*
- *Industry 4.0 and digitalisation: 55% of respondents have not invested in IR4.0/smart manufacturing yet. Most (53% respondents) cited the lack of in-house expertise to lead their adoption of IR4.0, while 45% do not have a budget for it.*
- *Areas Equipped With Industry 4.0 Technologies: The set-up of IR4.0 technologies at most factories is mostly low (20-40%) to moderate (>40-60%). 30-40% of respondents were moderately equipped with IR4.0 technologies in production, quality control systems, packaging management systems, inventory management systems, maintenance, store/warehouse and logistics.*

- *Government support required to commence IR4.0 (Pilot POC) and to scale up current IR4.0 (expand Pilot scope)*
- *Financial support from government for IR4.0 adoption: incentives, matching grants and double tax deduction*
- *Technical support from government for IR4.0 adoption: training, consultancy, and research and development*
- *Access and Speed 5G Internet: Most (46%) rated coverage as Average, 24% as Poor and 17% as Very Poor.*
- *Top 3 IR 4.0 technologies and tools used in factory operations: cloud computing, cybersecurity and industrial Internet of Things (IoT)*
- *Cost is biggest challenge to manufacturing sector in adopting or transitioning towards Environmental Social and Governance (ESG) practices*
- *New service tax on logistics expected to increase the product prices of 78% of respondents*
- *54% of respondents not sure about volunteering their participation in the PWM. Main concern is lack of clarity on the implementation mechanism and requirements*
- *83% of respondents opined that the new tax measures, as announced in Budget 2024, will likely impact their businesses, with minimal or moderate impact expected. Increase and expansion of the scope of the service tax and e-invoicing are expected to impact most respondents.*

FMM would like to thank all members who took the time to respond and give their valuable feedback. The next survey would be in June 2024. FMM members' support and continued participation would ensure that the Business Conditions Index (BCI) is representative and an accurate monitor of business condition trends in the manufacturing sector.

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