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

FMM Business Conditions Survey 1H2023

The Federation of Malaysian Manufacturers (FMM) is pleased to publish the findings of the 23rd biannual survey of business conditions in the manufacturing sector for the first half of 2023 (1H2023). The findings were successfully released to the media via a press conference on September 11, 2023. We are pleased to enclose a copy of the survey findings for your reference and record.

The survey revealed that business activity of the manufacturing sector had slowed down in 1H2023 where 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:

- ***Manufacturing activity was lacklustre in 1H2023****, as shown by the current business activity index which from a reading of 107 in 2H2022, 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.*
- ***Sales were weak in 1H2023, both at home and abroad****. The indexes for local sales and export sales 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 shifted lower due to the weak new orders and sales, among others in 1H2023.*** *The indexes for production volume and capacity utilisation, 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, 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.*
- ***Manufacturing costs eased further in 1H2023****, as denoted by the decline in the 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 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 waned further*** *as shown by the current capital investment index which fell below the optimism threshold in 1H2023. Only 21% increased their CAPEX in 1H2023. 53% had retained their CAPEX, down from 57% in the prior survey, while 26% reduced their expenditure, up from 2H2022's 20%.*

- ***Recruitment in the manufacturing sector was generally less active in 1H2023.*** *The employment index, at 101, had lost 11 points from the previous survey. 20% of the respondents increased their hirings while 62% had maintained their existing workforce. 19% reduced their headcount recently up from14% in 2H2022.*
- ***Employment was the only current index that registered an increase in 2H2022.*** *At 112, the 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 while 61% put hiring and retrenchment on hold.*

Going forward, 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.

- ***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 and capacity utilisation 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 while another 37% will reduce theirs soon. The latest expected capacity utilisation index fell to 87 from 94 previously. 23% and 36% planned to increase and reduce their capacities in the coming months, respectively.*
- ***With production volume set to shrink soon, the cost of production is also expected to reduce further in 2H2023****. Declining for the third time since 1H2022, the expected cost of production index settled at 148. While costs are expected to increase for 54% of the respondents in 2H2023 (73% previously), 40% anticipated their costs to remain the same for now. Unit production cost however remains high.*
- ***The expected index for capital investment, at 100, is at the optimism threshold, but had lost twelve points from the prior survey, implying that CAPEX is expected to hold its own in 2H2023, albeit at a slower pace.*** *25% of 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,*** *with the index for expected employment falling 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.*

Topical issues covered in the survey revealed the following:

- *Business growth for 2H2023: 41% of respondents to maintain their current position for now, 27% to streamline their production lines. 18% plan to engage in high-growth projects.*
- *Cost profile: In 1H2023, costs of water, maintenance of machinery, logistics and energy ranged up to 5% of total operating costs for 56-70% of respondents. Labour costs incurred by most (36%) at >10-20% of their total operating costs. Raw material cost was more widespread. 29% estimated cost of raw materials at >40-60% of their total operating costs; 24% at >60-80% and 13% at >80-100%.*
- *Cost movement in 1H2023: In 1H2023, most costs increase by up to 20%, with labour, maintenance of machinery and raw materials comprising the top three cost increases.*
- *Operating cost by year and as percentage of revenue: As percentage of total revenue up to 1H2023, more respondents report higher operating costs of >50% during Covid and post-Covid periods than pre-Covid period. Overall costs increases were higher during the pre-Covid years of*

2018-19 than the Covid and post-Covid years from 2020-2023. Those experiencing >10% cost increases more than doubled during the post-Covid period from 2022-2023 vs the pre-Covid period from 2018-19

- *Business confidence in 2H2023 vis-à-vis 1H2023: For 2H2023, cautious optimism for company and industry conditions while there were unfavourable expectations for global and domestic economic conditions.*
- *Economic outlook 2024: For 2024, the economic outlook is cautiously optimistic with 35% saying that the economy will improve in 2023 while 39% were neutral and 25% pessimistic.*
- *International trade currency: Renminbi (RMB) was the top choice of most respondents as alternative currency to the USD, followed by European Euro and Japanese Yen.*
- *European Green Deal Policy – Carbon Border Adjustment Mechanism (CBAM) and EU Deforestation Regulation (EUDR): 63% of respondents not aware of mandatory regulation on CBAM and EUDR. Majority (55%) believe they would need more awareness sessions on CBAM and EUDR while 50% would require funding and grants to meet the new directives/standards. 43% suggested double tax deduction to cover their sustainable initiatives including consultancy fee / expenditure for those requiring external expertise.*
- *Introduction of legislation on setting credit term limits for SMEs: 33% were in favour and felt that 30-45 days was acceptable. 35% were not in favour with majority (82%) of the view that credit terms are best left to be determined by the individual business operator and buyer.*
- *BNM's fifth OPR hike in May 2023 increased operating costs of most (41%) respondents by 1-3%, and another 19% by 4-6%. The OPR hike also impacted cash flow and business operations of 67% of respondents. 37% willing to accept longer repayment period, 30% not willing to if the increase in OPR was too costly to finance. Should OPR be increased further by 25 basis points by end 2023, the impact on most business revenues and profits is expected to be less than 30%.*

FMM would like to thank all members who took the time to respond and give their valuable feedback. The next survey would be in December 2023. 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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