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

FMM Business Conditions Survey 1H2026 - RESULTS

The Federation of Malaysian Manufacturing (FMM) is pleased to publish the findings of the 29th biannual survey of business conditions in the manufacturing sector for the first half of 2026 (1H2026). The findings were successfully released to the media via a press conference on September 3, 2026. We are pleased to enclose a copy of the survey findings for your reference and record.

The survey revealed that manufacturing conditions weakened in the first half of 2026 following the stabilisation recorded in 2H2025. Softer domestic and export demand weighed on business activity, production and capacity utilisation, while significantly higher production costs added to operating pressures. Despite the more challenging environment, capital investment remained relatively resilient and employment broadly stable, suggesting that manufacturers continued to take a cautious approach while navigating weaker demand, geopolitical uncertainty and rising costs:

- ***General business activity:*** *The index declined from 103 in 2H2025 to 90 in 1H2026, falling below the neutral threshold of 100. About 23% of respondents reported higher activity, while 43% recorded stable conditions and 33% experienced declines, indicating a more challenging operating environment than previously anticipated.*
- ***Local sales:*** *The index fell from 94 to 82, reflecting a further weakening in domestic demand. Only 16% reported higher sales, while 35% experienced declines, suggesting that the anticipated recovery in local demand did not materialise.*
- ***Exports:*** *The export sales index declined from 93 to 85, reflecting weaker external demand amid heightened global uncertainty. Around 19% of respondents reported higher exports, while 34% recorded declines, with geopolitical tensions, logistics disruptions and evolving trade conditions weighing on performance.*
- ***Production volume:*** *The index declined from 102 to 94 as manufacturers adjusted production to softer sales and more uncertain operating conditions. About 25% reported higher output, while 31% recorded declines, indicating a moderation in production activity.*
- ***Capacity utilisation:*** *The index fell from 102 to 94, consistent with weaker production and demand. While 50% of respondents maintained existing utilisation levels, 28% reported lower utilisation, indicating greater spare capacity across parts of the sector.*
- ***Production costs:*** *The index rose sharply from 146 to 163, indicating a significant intensification of cost pressures. About 69% of respondents reported higher costs, reflecting the impact of higher freight and logistics costs, raw material pressures, and increased energy and fuel costs.*
- ***Capital investment:*** *The index increased to 106, indicating that investment remained relatively resilient despite weaker business conditions. About 24% reported higher investment, while 58% maintained existing levels, suggesting that manufacturers continued to undertake selected investments to support productivity, efficiency and longer-term competitiveness.*
- ***Employment:*** *The index improved to 100, indicating broadly stable employment conditions. Around 68% of respondents maintained their existing workforce, while equal shares of 16% reported increases and reductions, suggesting that manufacturers generally sought to preserve employment despite weaker operating conditions.*

Looking ahead, manufacturers have become more cautious about the outlook for the second half of 2026. Expectations for business activity, domestic and export sales, production and capacity utilisation have all been revised lower, while production cost pressures are expected to remain intense. Capital investment and employment are expected to remain relatively resilient, although expectations have also moderated. Overall, respondents anticipate a more subdued operating environment in 2H2026, with weaker demand and continued cost pressures constraining the pace of recovery:

- ***General business activity:*** *The expected index declined to 93 for 2H2026, from the previous expectation of 104 for 1H2026, remaining below the neutral threshold. This suggests that manufacturers have become more cautious about the strength and pace of the recovery.*
- ***Local sales:*** *The expected index declined to 88 from 95 previously, indicating that domestic demand is expected to remain weak and continue to constrain manufacturing performance.*
- ***Export sales:*** *The expected index fell to 92 from 100 previously, suggesting a more cautious outlook for external demand amid continued geopolitical and global trade uncertainty.*
- ***Production:*** *The expected production volume index declined to 99 from 106 previously, pointing to broadly subdued production conditions rather than the stronger expansion earlier anticipated.*
- ***Capacity utilisation:*** *The expected index moderated to 98 from 106, suggesting that manufacturers expect capacity utilisation to remain relatively soft alongside weaker production and demand conditions.*
- ***Costs:*** *The expected production cost index increased to 156 from 150 previously, indicating that manufacturers anticipate cost pressures to remain elevated and potentially intensify further, continuing to weigh on margins and business performance.*
- ***Capital investment:*** *The expected index moderated to 107 from 110 previously but remains above the neutral threshold, suggesting that manufacturers intend to maintain investment despite greater caution over the operating outlook.*
- ***Employment:*** *The expected index declined slightly to 104 from 106, indicating that hiring sentiment remains positive but more cautious, with firms expected to adopt a measured approach towards workforce expansion.*

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

- *The revenue outlook for 2H2026 remains cautiously positive, with 45% of respondents expecting higher revenues, 28% anticipating no change and 27% projecting declines. However, growth expectations remain modest and uneven, with most firms anticipating increases of 10% or less.*
- *The profit outlook is more subdued, with 38% expecting profits to increase, 24% anticipating no change and 38% expecting declines. Persistent operating costs and limited ability to pass higher costs on to customers continue to constrain margins, suggesting that modest revenue improvements may not translate proportionately into stronger earnings.*
- *Business confidence reveals a clear gap between manufacturers' confidence in their own businesses and the broader economy. While 32% expect conditions within their own companies to improve, sentiment towards the manufacturing industry, Malaysian economy and global economy is more cautious. Technology deployment remains a relative bright spot, with 35% expecting improvement.*
- *The top five challenges to business operations and growth in 2H2026 are higher raw material and intermediate input costs (53%), the West Asia conflict, Red Sea disruptions and higher war-risk costs (45%), weak domestic and/or export demand (33%), increasing competition (31%), and difficulty passing higher costs on to customers and resulting margin compression (29%).*
- *The top five opportunities for business operations and growth in 2H2026 are strengthening cost control and operational efficiency (46%), expanding product or service portfolios (29%), expanding sales to existing customers and market segments (28%), enhancing product quality, innovation and value-added capabilities (28%), and developing specialised or higher-value niche products (26%).*
- *Industry 4.0 adoption remains uneven, with 36% of manufacturers reporting implementation, slightly lower than 38% previously. Among adopters, system integration (60%), artificial intelligence (49%), IoT (48%) and cloud computing (46%) are the leading technologies. At the same time, AI usage in general business operations is considerably more widespread, with 62% of respondents using AI software or productivity tools, led by ChatGPT, Gemini and Copilot.*
- *Geopolitical disruptions continue to significantly affect manufacturers, with 96% reporting some impact. The main effects are raw material shortages or higher costs (74%), increased freight, logistics and shipping costs (72%), and higher energy and fuel costs (44%). While 40% report that pressures have partially eased, 32% say conditions remain at the same elevated level and 11% report further deterioration.*

- *Manufacturers are responding to geopolitical risks by strengthening supply-chain resilience, including increasing stocks of critical raw materials, switching to alternative suppliers or sourcing countries, restructuring logistics arrangements and diversifying export markets. The main government support sought includes duty and tax exemptions on alternative-origin raw materials, industrial fuel rebates, tariff reductions or accelerated trade agreements, and double tax deductions for crisis-related freight and war-risk costs.*
- *The current SST system continues to create significant cost, compliance and competitiveness concerns, with 60% reporting higher production costs from embedded taxes in the supply chain and 59% citing unrecoverable taxes on business inputs. Compliance burdens, uncertainty over scope and exemptions, higher export costs and reduced pricing competitiveness are also key concerns.*
- *A majority of manufacturers (61%) support the reintroduction of GST to replace SST, primarily because of the ability to claim input tax credits and the greater transparency of GST. A 3% GST rate is the most preferred option. Manufacturers emphasised that timely refunds, clear input tax credit rules, simple compliance requirements and a well-managed transition would be critical to any reintroduction.*
- *Renewable energy adoption remains gradual, with Net Energy Metering (NEM) recording the highest adoption at 20%, followed by Solar ATAP at 17%. High upfront investment costs and long payback periods remain the main barriers, while manufacturers identify financial incentives and grants, simpler application and approval processes, clearer policy direction and affordable financing as the most important measures to accelerate adoption.*
- *The revised HRD Corp training grant conditions introduced from June 15, 2026 are creating planning and administrative challenges, with 44% of respondents reporting that the changes have hindered their ability to plan and conduct training. The 14-day advance approval requirement is the most widely cited challenge, while manufacturers also highlighted difficulties arranging urgent or regulatory training, reduced flexibility to alter training arrangements and higher administrative workload.*
- *Manufacturers' Pre-Budget 2027 priorities are strongly centred on reducing business costs and strengthening competitiveness. The leading measures sought are tax or duty relief for essential raw materials, machinery and production inputs (46%), lower corporate income tax particularly for SMEs and mid-tier companies (43%), and electricity, natural gas or energy-cost relief (30%). Faster tax refunds, support for freight and logistics costs, and accelerated capital allowances for automation, digitalisation and energy-efficiency investments are also key priorities.*

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 2026/January 2027. FMM members' support and continued participation would ensure that the Business Conditions Index (BCI) is representative and accurate monitor of business condition trends in the manufacturing sector.

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