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Malaysia Manufacturing PMI

Slow March PMI recovery as cost concerns weighs

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OVERVIEW

- **March PMI just slightly higher.** The Nikkei Malaysia Manufacturing Purchasing Managers' Index (PMI) increased a notch to 49.5 in March (February: 49.4), still slightly below the 50.0 point threshold. March reading was its highest since May 2015, though this was its second consecutive year of sub-50 reading since April 2015.
- **Output continues to improve.** Output improved for the second month in a row since its reversal in February. However, this was somewhat dampened by a slightly faster contraction in new orders.
- **Cost pressures a drag.** Average input costs rose at the second fastest rate in the survey's history, behind February 2016. Respondents largely attributed higher unfavourable exchange rates weighing against import costs. This was likewise reflected in the sharp increase of output charges.
- **Stalling recovery despite improved production?** Despite higher headline figures from improved output, higher production were largely translated into inventories in light of a faster contraction in new orders and amidst rising costs and the resulting bump in output price. However, notwithstanding stalled recovery, we believe that recovery in Malaysia's manufacturing sector remains largely intact.

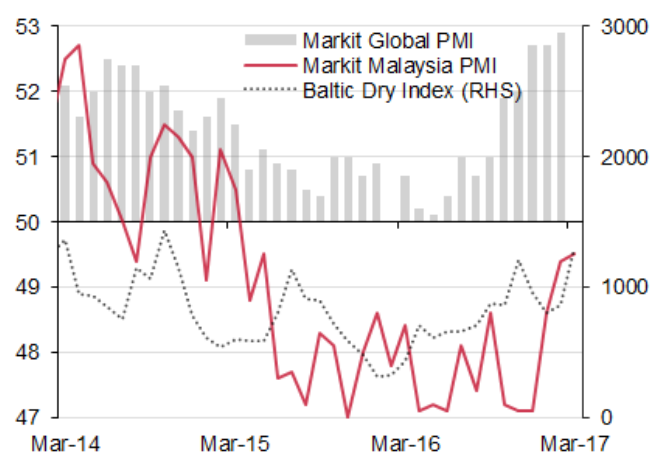
Up slightly in March. Malaysia's manufacturing PMI declined slightly in March with a headline reading of 49.5 compared to February's 49.4, but still the highest since May 2015. However, March's figures extend the sub-50 reading for the 24th consecutive month since April 2015.

Higher output lifts inventories. The output sub-index continued to rise for the second consecutive month though much of these output were largely accumulated as inventories. This came as new orders fell at a faster rate – new export orders likewise fell marginally during March. Higher output levels saw finished goods inventory rising for a third consecutive month.

Weak new orders disappoint. Higher production output and a corresponding increase in inventory were contrasted by falling new orders, both domestically and abroad. This meant that new orders extended its deterioration for the 25th month running with a slightly elevated decline compared to February.

Flat employment despite labour shortages. Some panellists reported some labour shortages which were subsequently reflected in the continued increase in backlog of work. However, despite reported labour shortages, employment remained somewhat flat, defying expectations for a slight increase. This may suggest concerns on future sales and business activity given continued weakness in sales trend.

Graph 1: Global & Malaysia Manufacturing PMI



Source: Dept. of Statistics, Bloomberg, Kenanga Research

Cost considerations prevail. Average input costs continued to rise moving into March, a factor some panellists attribute to unfavourable exchange rates. This resulted in an increase in output price as manufacturers opted to pass on the costs downstream despite continued weakness in new orders. This is consistent with higher inflation levels observed, likely from supply-factors (Feb CPI and PPI: 4.5% and 10.8% YoY respectively).

Malaysia's PMI lowest in region. Regionally, the PMI was largely upbeat among the seven ASEAN countries covered by Markit (the ASEAN-4, Vietnam, Singapore and Myanmar) with Malaysian ranking the lowest in the region and indeed, the only country reporting sub-50 PMI. Vietnam (54.6), Philippines (53.8) and Myanmar (53.1) top. Indonesia (50.5), Singapore (50.4) and Thailand (50.2) meanwhile hovered around the threshold 50.0 point. As a whole, the region reported a PMI of 50.9 points (Feb: 50.3) from expansion in output and new orders.

Global PMI sustained expansionary trend. Elsewhere, the global PMI was sustained at 53.0, unchanged from February's 69-month high. The US manufacturing sector continued to expand, although slightly slower, at 54.2 points (Feb: 53.3), decelerating for the second consecutive month on slower expansion of output and new orders. Euro Area, meanwhile, saw improved momentum, with PMI reading of 56.2 (Feb: 55.4), rising at a 71 month high. In Asia, China and Japan sustained high PMI at 51.2 and 52.4 respectively though lower than the previous month (Feb: 51.7 and 53.3 respectively).

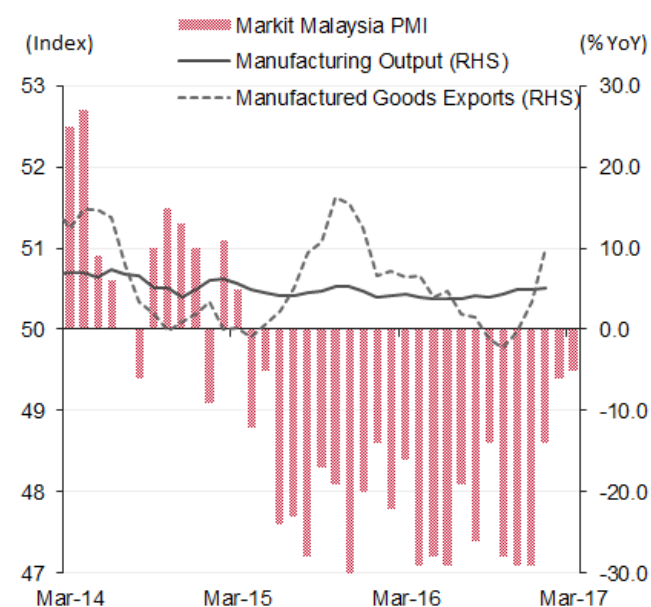
OUTLOOK

Recovery stalls. The marginal improvement in the PMI suggests that there are pockets of confidence among manufacturers for recovery, as evidenced by improvements in the output sub-index and inventory accumulation. However, flat employment sub-index amidst higher order backlog suggests a lack of conviction among manufacturers for a strong recovery momentum. Furthermore, with weak demand and production largely flowing into inventories, there are looming threats that Malaysia's recovery momentum may hit a snag before picking up pace.

...but likely sustained. Despite speed bumps to recovery, we believe that it is too early to write off Malaysia's recovery. We continue to expect a manufacturing sector upturn in 2Q17 which would lend support to the sector's GDP contribution in 1H17 (1H17^F: 4.9%). With Malaysia's regional neighbours seeing improving business condition, we believe that it will only be a matter of time when Malaysia sees similar improvements in new orders, and by extension, prompting an improvement in the employment sub-index.

Heightened inflation expectations. With manufacturers opting to pass on higher input costs towards output price despite lower new orders, inflation expectations appear to be heightened among manufacturers given persistent weaknesses in the ringgit. However, we believe that cost pressures from exchange rate translations will likely be capped as the ringgit approaches a turning point and is expected to strengthen somewhat moving into 2Q17.

Graph 2: PMI & Manufacturing Output



Note: Manufacturing Output and Exports reflect 3-month moving average
Source: Dept. of Statistics, Kenanga Research

Table 1: Malaysia Industrial Production Trend

	2015	2016	Mar-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17
Markit Malaysia PMI	48.6	47.6	47.8	47.2	47.1	47.1	48.6	49.4	49.5
New Orders*			Down	Down	Down	Down	Down	Down	Down
Output*			Down	Down	Down	Down	Down	Up	Up
Employment*			Up	Up	Up	Up	Up	Down	Down
Stocks of Purchases*			Down	Down	Down	Down	Down	Up	Up
Markit Global PMI	51.0	51.0	50.0	51.9	52.0	52.7	52.7	53.0	53.0
Baltic Dry Index	704	693	429	857	1204	961	800	859	1,297
DoS Leading Index	117.9	116.6	116.8	116.4	116.1	117.0	117.8	-	-

Source: Markit Economics, Bloomberg, CEIC, Dept. of Statistics, Kenanga Research

*The "Up/Down" movements for sub-indicators are based on Markit's own reports. Detailed and historical data is available on a subscription basis only.

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