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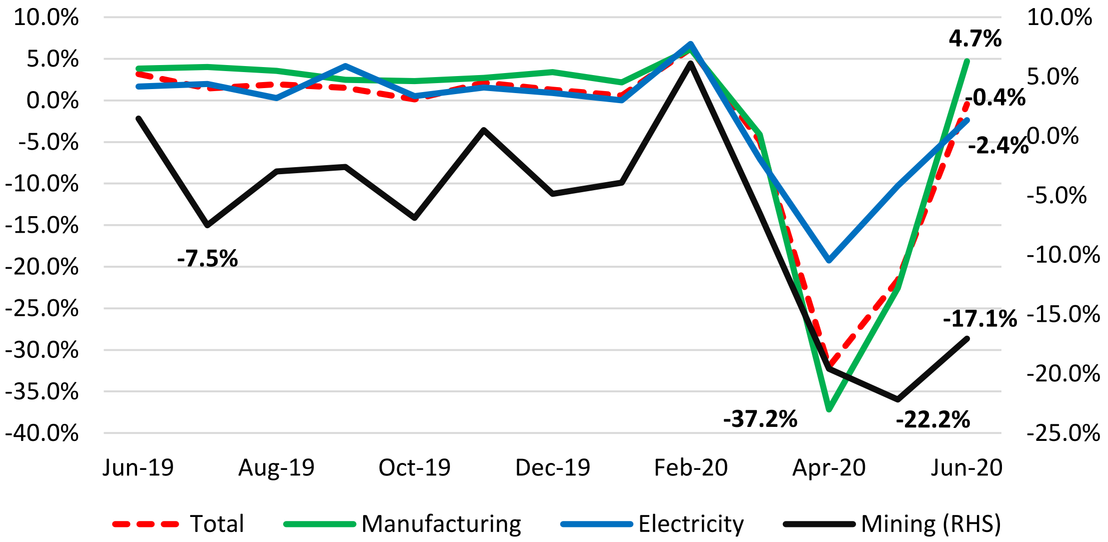
Better than expected IPI in June

Facts

- Malaysia's Industrial Production Index (IPI) contracted modestly by 0.4% year-on-year (y-o-y) in June as compared to 21.6% fall in the previous month (Bank Islam: -14.5%, Consensus: -10.4%). The decline was led by Mining which plummeted by 17.1% in June from -22.2% in the preceding month, though at a softer pace. This was followed by Electricity which remained in the negative territory for the fourth straight month (June: -2.4% vs. May: -10.3%) since March this year. Meanwhile, Manufacturing rebounded by 4.7% in June from -22.6% in May.
- Within Mining industry, Crude Petroleum (June: -21.1% vs. May: -22.2%) and Natural Gas (June: -13.5% vs. May: -22.2%) continued to decrease during June.
- The increase in production of Manufacturing sector was mainly contributed by Electrical & Electronic (E&E) products (June: 13.2% vs. May: -11.2%), Transport Equipment & Other Manufactures (June: 10.7% vs. May: -38.5%), as well as Food, Beverages & Tobacco (June: 10.5% vs. May: -2.5%). Apart from that, Wood, Furniture, Paper Products & Printing (June: 7.1% vs. May: -39.2%) and Petroleum, Chemical, Rubber & Plastic (June: 1.6% vs. May: -21.9%) recorded a positive growth in June.
- On a quarterly basis, total production fell significantly by 17.9% during the 2Q2020 from a marginal growth of 0.4% in the preceding quarter. This was on account of poor performance in all sectors namely Mining (2Q2020: -19.6% vs. 1Q2020: -1.8%), Manufacturing (2Q2020: -18.1% vs. 1Q2020: 1.3%), and Electricity (2Q2020: -10.8% vs. 1Q2020: -0.4%).
- Cumulatively, industrial production declined by -8.8% y-o-y in 1H2020 from a positive growth of 3.2% y-o-y recorded in the same period last year, suggesting weaker demand conditions amid Covid-19 pandemic.

Chart 1: Industrial Production Index (IPI), y-o-y%



Source: CEIC

Table 1: Industrial Production Index (IPI), y-o-y%

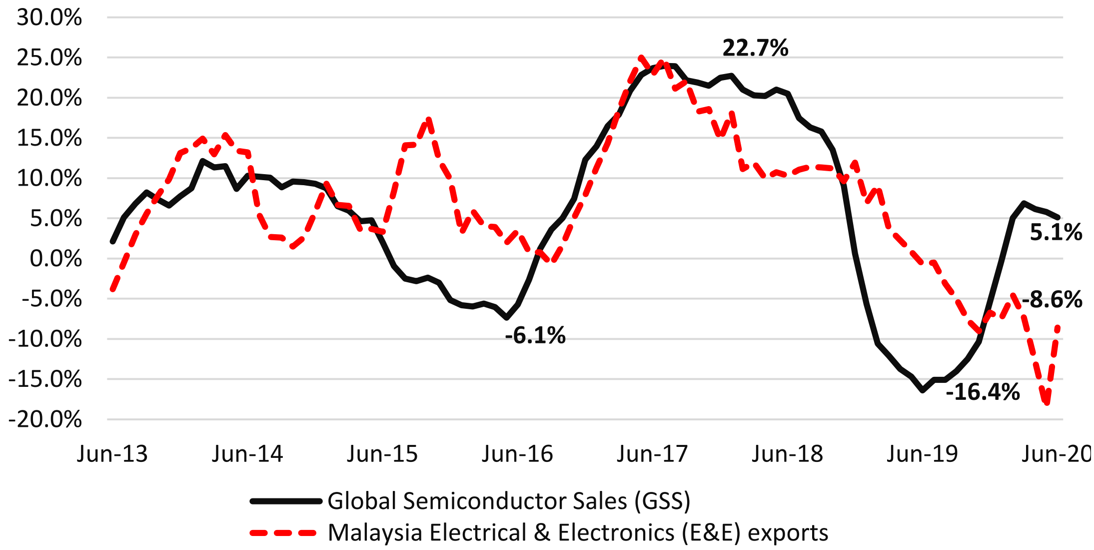
	Weight	Jan-20	Feb-20	Mar-20	Apr-20	May-20	Jun-20	1H2019	1H2020
IPI	**100.0%**	**0.6%**	**6.2%**	**-4.9%**	**-32.0%**	**-21.6%**	**-0.4%**	**3.2%**	**-8.8%**
Mining	**25.1%**	**-3.9%**	**6.1%**	**-6.5%**	**-19.6%**	**-22.2%**	**-17.1%**	**0.0%**	**-10.7%**
-Crude petroleum	12.2%	-5.9%	-0.5%	-7.1%	-20.2%	-22.2%	-21.1%	-5.3%	-12.9%
-Natural gas	12.9%	-2.3%	12.0%	-6.0%	-19.0%	-22.2%	-13.5%	5.0%	-8.8%
Manufacturing	**68.3%**	**2.2%**	**6.2%**	**-4.1%**	**-37.2%**	**-22.6%**	**4.7%**	**4.1%**	**-8.5%**
-Food, Beverages & Tobacco	8.6%	-5.5%	4.4%	-9.8%	-9.0%	-2.5%	10.5%	4.7%	-2.2%
-Textiles, Wearing Apprarel, Leather & Footwear	1.3%	3.2%	6.7%	-1.2%	-73.8%	-45.3%	-9.6%	5.2%	-20.5%
-Wood Products, Furniture, Paper Products, Printing	4.6%	3.0%	6.3%	-6.1%	-68.4%	-39.2%	7.1%	5.4%	-16.0%
-Petroleum, Chemical, Rubber & Plastic Products	20.6%	3.6%	6.5%	3.6%	-21.4%	-21.9%	1.6%	3.2%	-4.6%
-Non-Metalic Mineral, Basic Metal & Fabricated Metal Product	9.1%	3.9%	6.2%	-9.8%	-62.7%	-45.1%	-14.3%	4.2%	-20.7%
-Electrical & Electronic Products	18.2%	3.2%	7.0%	-4.9%	-34.1%	-11.2%	13.2%	3.5%	-4.5%
-Transport Equipment & Other Manufactures	5.9%	1.4%	4.9%	-10.1%	-69.3%	-38.5%	10.7%	6.5%	-16.7%
Electricity	**6.6%**	**0.0%**	**6.8%**	**-7.0%**	**-19.3%**	**-10.3%**	**-2.4%**	**5.1%**	**-5.7%**

Source: CEIC

Our view

The latest indicators reflect that the economy has started to recover as lockdown measures were lifted gradually. The implementation of Recovery Movement Control Order (RMCO) which commenced on 10 June 2020 has allowed almost all sectors to reopen despite with strict Standard Operating Procedures (SOP). Most notably, the production of E&E products (18.2% of total IPI) marked a significant gain in June after shrinking for three consecutive months since March 2020 (-4.9%). On further scrutiny, the Global Semiconductor Sales (GSS) continued to grow positively by 5.1% in June (May: 5.8%) as demand for electronic products surged. As such, Malaysia's E&E is expected to remain resilient in the next few months thanks to the rise in remote working, virtual learning and e-commerce.

Chart 2: Global Semiconductor Sales, y-o-y% vs. Malaysia's E&E Exports (3 Months Moving Average), y-o-y%

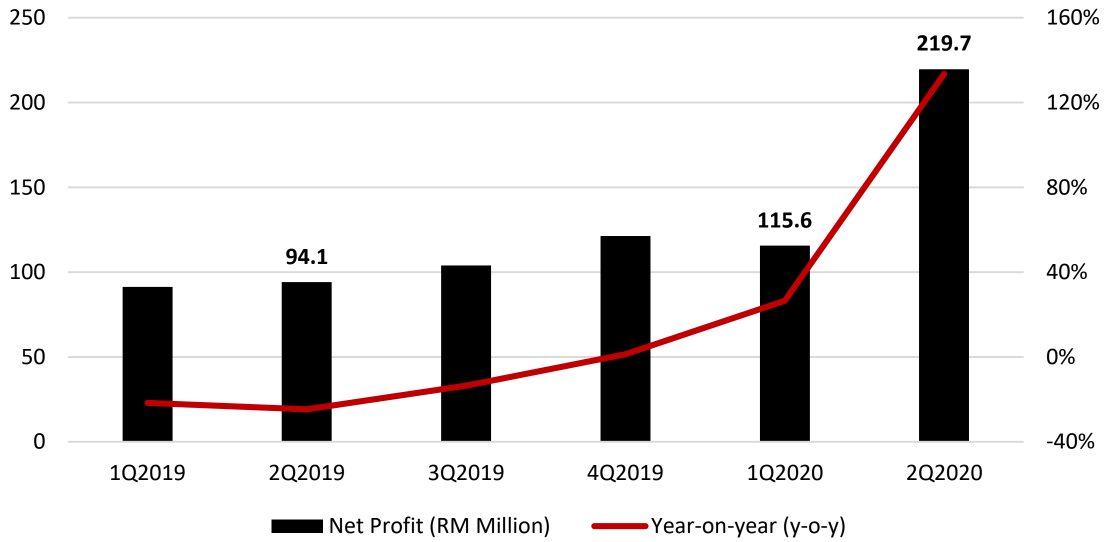


Source: CEIC

The improvement in IPI was aligned with Manufacturing Sales which rebounded by 4.1% y-o-y in June, reversing its negative growth of 20.4% in May. In addition, Malaysia's Manufacturing Purchasing Manager's Index (PMI) showed encouraging signs of recovery after it moved back above 50-threshold to 51.0 points in June and 50.0 points in July. This was largely supported by expansion in output and new orders. Hence, as the initial stage of recovery kicked off, the labour market was lifted up with the Unemployment Rate (UR) declined to 4.9% in June (May: 5.3%).

Aside from that, main players in rubber glove sector are still proceeding to expand their production capacity. For instance, Kossan's Plant 6 and first line of Plant 7 is expected to fully commence by the end of the year. With these new production lines, Kossan's capacity will increase from current 37 billion pieces per annum (pcs pa) to 42 billion pcs pa by 2022. Beyond this, the Kossan's next phase of capacity expansion plan will be the next generation integrated glove complex 2.0 (NGC 2.0) in Banting, Selangor. This entails seven production plants, comprising of 82 production lines with an installed capacity of 32 billion pcs pa. The first plant of NGC 2.0 is expected to commence in 2023. Likewise, Hartalega has seen 8 lines commissioned under its Plant 6 with 4 remaining lines to be commissioned. Meanwhile, Plant 7 is expected to be commissioned by 4Q2020. Upon completion of the two plants, the company's annual production capacity will be boosted to 43.7b pieces per year by 2022, up 18.0% from the 37 billion gloves currently. With the vaccine still yet to be found for Covid-19 we expect such expansion plans to continue ensuring profitability of these glove makers. Recall that Hartalega registered a record high quarterly net profit in 2Q2020, jumping 133.6% y-o-y to RM219.7 million due to higher sales volume, lower raw material and energy cost coupled with the cost control initiative to reduce operating costs.

Chart 3: Hartalega Quarterly Net Profit (RM Million)



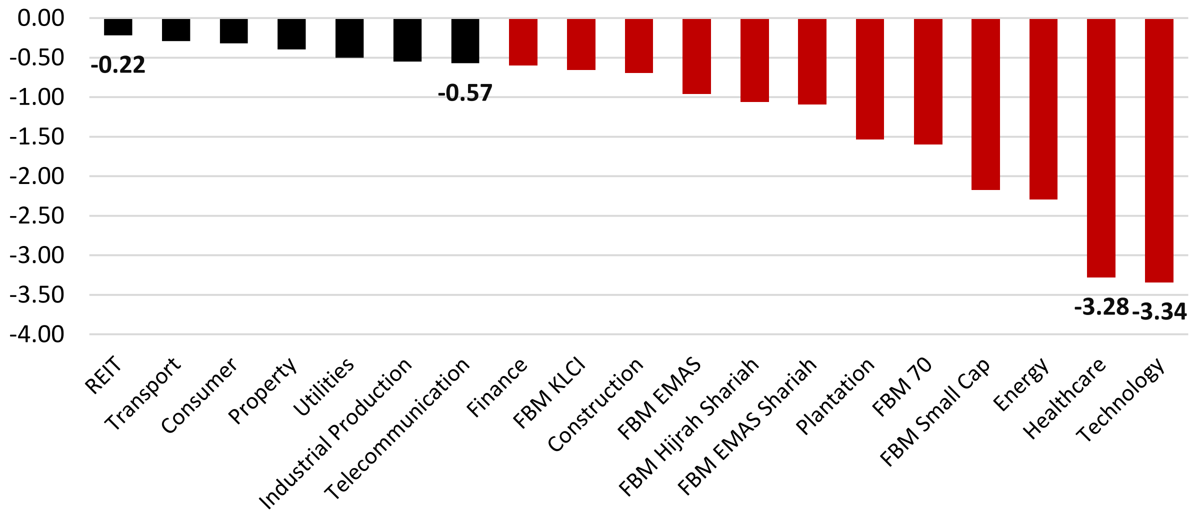
Source: Hartalega

In relation to the equity market, trading was relatively flat as the FBM KLCI only closed at 1,578.14 points on 7 August 2020, a decline of less than -1.0%. Amongst the 30 constituents of the FBM KLCI index, Hartalega's share price declined the most by -3.3% as investors cashed-in gains. As such, Bursa Malaysia's Healthcare Index was the second worst performer on Friday with a -3.3% drop after Bursa Malaysia Technology Index. Notwithstanding this, both indexes remain as the biggest gainers for the week and we opine that the profit taking activity to be temporary as fears of another wave of the Covid-19 pandemic would continue to increase demand for rubber gloves and technology related services in the advent of remote working and the need for cloud computing services. In the near term, we still expect the local bourse to be trading in the range of 1,550 to 1,600 points unless there are some positive catalyst such as a major breakthrough in the development of the Covid-19 vaccine.

Another important takeaway from the latest IPI print is the 2Q2020 GDP. **It could come in at -4.5% if we strictly based the model estimation from the IPI**. After tweaking for the severity from the demand and supply shocks following the MCO, **we are more inclined to put our 2Q2020 GDP estimates at -7.0% (1Q2020: 0.7%).** The 2Q2020 GDP will be announced on 14 August with most economists are likely to peg the June quarter GDP to fall more than 10%.

Be that as it may, **the IPI is projected to fall by 7.5% this year from positive growth of 2.4% in 2019.** A recovery path in the industrial activities would be more evident in 2H2020. However, there are a lot of risk factors that could dampen the recovery or even put it completely on hold as Covid-19 induced economic uncertainty persists. In tandem with this, **we are maintaining our 2020 GDP at -1.5% pending for the 2Q2020 GDP announcement.**

Chart 4: Performance of FBM KLCI Constituents on 7 August 2020



Source: Bloomberg