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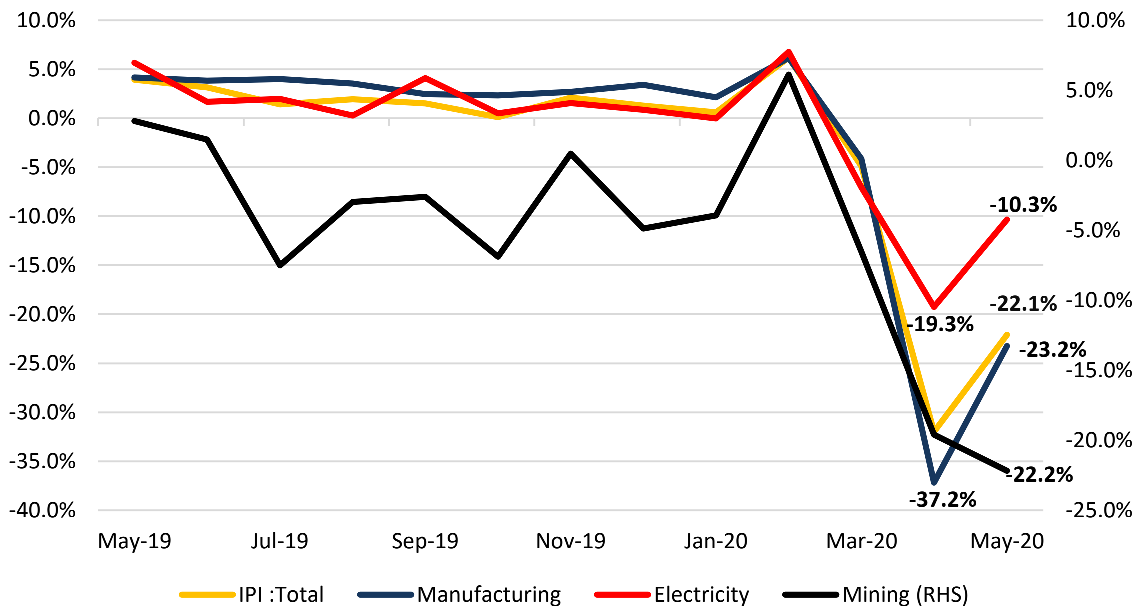
IPI plunged by 22.1% in May albeit improving from 32.0% fall previously

Facts

- Malaysia's Industrial Production Index (IPI) contracted by 22.1% year-on-year (y-o-y) in May albeit at a slower pace as compared to -32.0% in April (Bank Islam: -27.0%, Consensus: -29.0%). It was a broad-based downturn led by Manufacturing which has plummeted by 23.2% in May (April: -37.2%). Similarly, Mining and Electricity remained in the negative territory at 22.2% (April: -19.6%) and 10.3% (April: -19.3%) in May.
- Within manufacturing sector, production of Textiles, Wearing Apparel, Leather & Footwear (May: -45.3% vs. April: -73.8%), Non-Metallic Mineral Products, Basic Mineral & Fabricated Metal Products (May: -45.1% vs. April: -62.7%), Wood, Furniture, Paper Products & Printing (May: -39.2% vs. April: -68.4%) and Transport Equipment & Other Manufactures (May: -38.5% vs. April: -69.3%) have posted slower decline during May. Meanwhile, Petroleum, Chemical, Rubber & Plastic dropped by 24.3% in May, extending 21.4% fall in the preceding month.
- On a similar note, Mining activity was weighed by production of Crude Petroleum (May: -22.2% vs. April: -20.2%) and Natural Gas (May: -22.2% vs. April: -19.0%) which have decreased at a same rate in May.
- Cumulatively, industrial production declined by 10.6% in 5M2020 from positive growth of 3.2% recorded in the same period last year.

Chart 1: Industrial Production Index 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	5M2019	5M2020
IPI	**100.0%**	**0.6%**	**6.2%**	**-4.9%**	**-32.0%**	**-22.1%**	**3.2%**	**-10.6%**
Mining	**25.1%**	**-3.9%**	**6.1%**	**-6.5%**	**-19.6%**	**-22.2%**	**-0.3%**	**-9.5%**
Crude Petroleum	12.2%	-5.9%	-0.5%	-7.1%	-20.2%	-22.2%	-5.1%	-11.3%
Natural Gas	12.9%	-2.3%	12.0%	-6.0%	-19.0%	-22.2%	4.2%	-7.9%
Manufacturing	**68.3%**	**2.2%**	**6.2%**	**-4.1%**	**-37.2%**	**-23.2%**	**4.1%**	**-11.4%**
Food, Beverages & Tobacco	8.6%	-5.5%	4.4%	-9.8%	-9.0%	-2.5%	4.8%	-4.7%
Textiles, Wearing Apparel, Leather & Footwear	1.3%	3.2%	6.7%	-1.2%	-73.8%	-45.3%	5.1%	-22.7%
Wood, Furniture, Paper Products & Printing	4.6%	3.0%	6.3%	-6.1%	-68.4%	-39.2%	5.6%	-20.6%
Petroleum, Chemical, Rubber & Plastic	20.6%	3.6%	6.5%	3.6%	-21.4%	-24.3%	3.2%	-6.3%
Non-Metallic Mineral Products, Basic Mineral & Fabricated Metal Products	9.1%	3.9%	6.2%	-9.8%	-62.7%	-45.1%	4.0%	-22.0%
Electrical & Electronics Products	18.2%	3.2%	7.0%	-4.9%	-34.1%	-11.2%	3.5%	-8.5%
Transport Equipment & Other Manufactures	5.9%	1.4%	4.9%	-10.1%	-69.3%	-38.5%	6.7%	-21.9%
Electricity	**6.6%**	**0.0%**	**6.8%**	**-7.0%**	**-19.3%**	**-10.3%**	**5.8%**	**-6.3%**

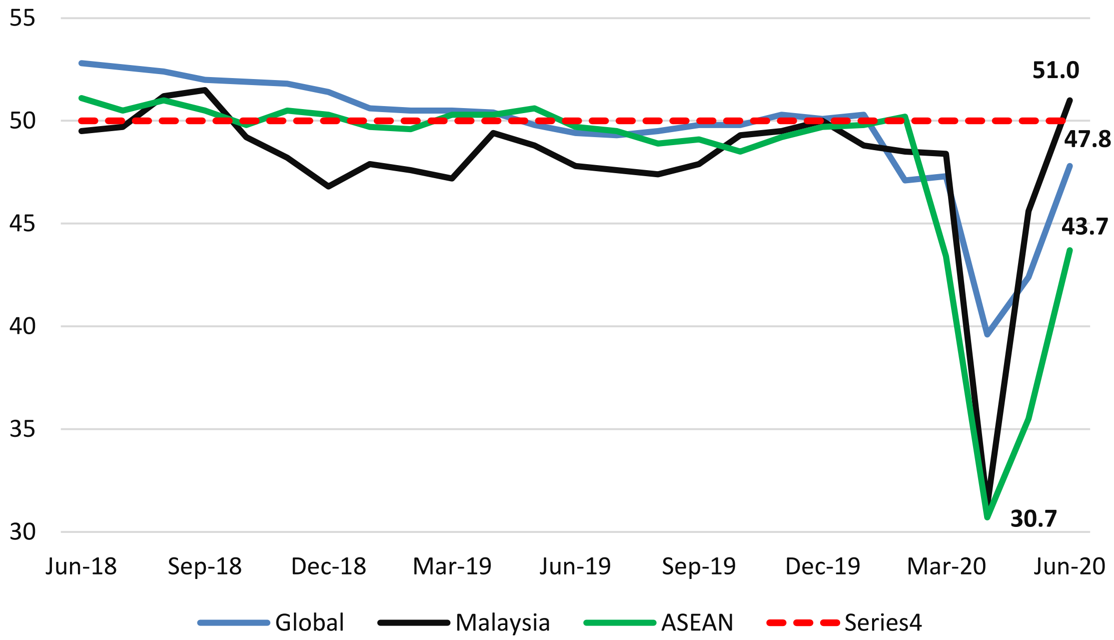
Source: CEIC

Our view

Malaysia's industrial activities have been experiencing the third straight month of contraction following sluggish demand conditions brought by the Covid-19 pandemic which have girdled the globe since end of last year. Other jurisdictions have also faced similar trend. For instance, the US industrial production has shrunk for the ninth consecutive month since September last year (May: -15.3% vs. April: -16.2%) while India's factory output plummeted by 55.5% y-o-y in April, extending 18.2% fall in the previous month. Similarly, Singapore's manufacturing production plunged by 7.4% y-o-y in May from 13.6% expansion in the preceding month. This was predominantly driven by the slump in all clusters led by Chemicals (May: -13.5% vs. April: -6.8%), Precision Engineering (May: -5.3% vs. April: 10.0%), as well as Electronics (May: -1.0% vs. April: 1.3%). These accounted for about 66.1% of total production.

Be that as it may, there is light despite all the darkness as business sentiments has started to regain its momentum. This was reflected by the Malaysia's IHS Markit Manufacturing Purchasing Manager's Index (PMI) which rebounded to 51.0 points in June (May: 45.6 points) after enduring a sharp contraction during March (31.3 points). This suggests an encouraging sign of recovery as resumption of business operations have supported the private sector economic activities. According to the survey, output rose drastically as large number of firms have increased factory operating capacity after Covid-19 related disruptions. However, weak external demand is still expected following strict restrictions across borders.

Chart 2: Malaysia's Manufacturing PMI, points

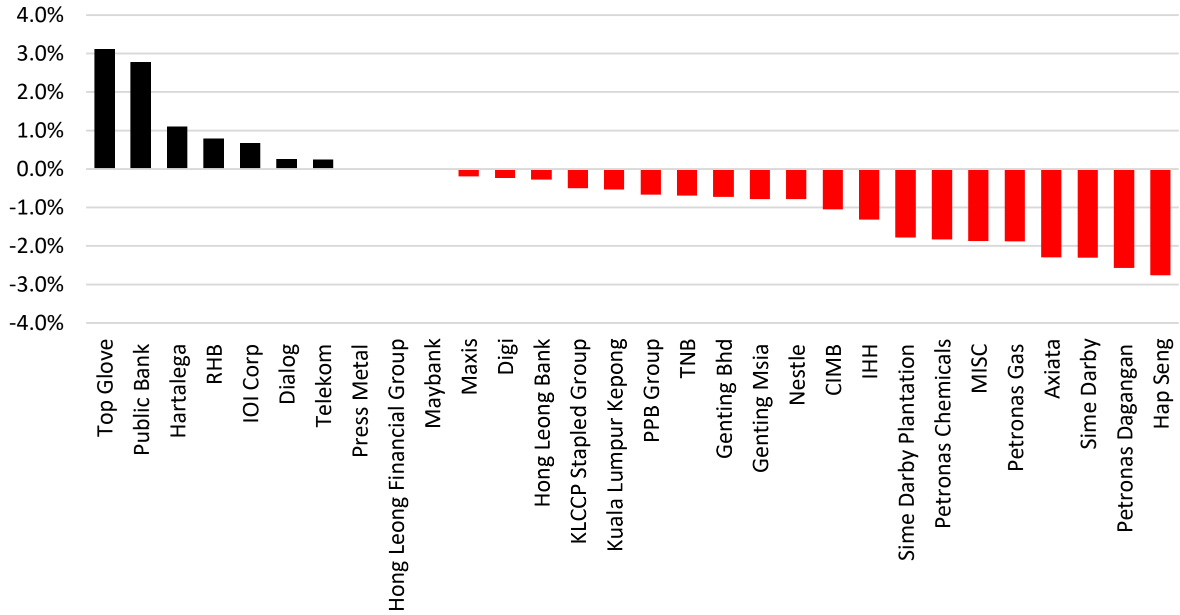


Source: Bloomberg

While the economic outlook has been increasingly challenging, we can see the main players in rubber glove industry have been considering to expand their production capacity. Top Glove will continue to expand its capacity and is expected to grow between 12% and 15% per annum on the back of strong demand for medical and non-medical sectors. Apart from that, Hartalega will continue with its next generation integrated glove manufacturing complex (NGC) project for Plant 6 and 7, which annual installed capacity is expected to increase from current 38.1 billion to 43.7 billion pieces by FY2022. As such, it's a selective market with different opportunities evolved.

In relation to the equity market, trading was relatively flat as the FBM KLCI only closed at 1,583.25 points on 9 July 2020, 0.25 points lower or a decline of less than -0.5%. Major gainers were the glove makers namely Top Glove and Hartalega which rose 1.1% and 3.1% respectively on the same day. Fears of the second wave of the pandemic lingering will further reinforce the capacity expansion plans of the glove makers mentioned above and will push the IPI index in the remainder of the year. As such, there is still room for the earnings of glove makers to grow, translating to a higher valuation of the FBM KLCI. Recall that both glove makers (categorised under the healthcare sector) make up approximately 8.0% of the FBM KLCI's total market capitalization weightage. Henceforth, the FBM KLCI which is currently trading at a price-earnings ratio of around 19.0x based on 2020 consensus earnings could see loftier valuations moving forward supported by the glove makers.

Chart 3: Performance of FBM KLCI Constituents on 9 July 2020



Source: Bloomberg

Despite all the gloom and doom, the month-on-month rebounded forcefully by 18.2% in May (April: -30.5%). This was primarily driven by the strong sequential gain in the Manufacturing sector which shot up to 25.9% (April: -35.8%). Similarly, the Electricity sub index bumped up to 13.7% after 13.3% decline while Mining grew a tad higher by 0.4% (April: -19.1%). **All in all, we expect IPI to decline by 7.5% in 2020 (2019: 2.4%) from the previous forecast of -5.9% to -11.2%.** We envisage that the IPI figure will improve gradually in the next few months particularly in the 2H2020 as we believe that more business sectors will gradually reopen as the Covid-19 pandemic infections have slowed down. This would also mean Overnight Policy Rate (OPR) cut may not be a compelling option should the reopening of the economy continues to take hold. **Expect the OPR to be maintained at 1.75% for the remainder period of 2020.**