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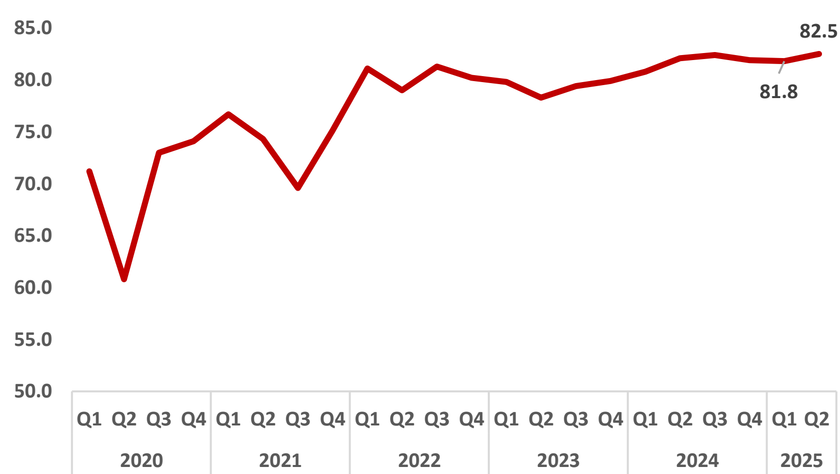
MANUFACTURING CAPACITY STRENGTHENS AMID MODERATE OUTPUT AND TRADE GROWTH

- **Manufacturing capacity strengthens amid moderate output and trade growth**
- **Capacity utilisation rose to 82.5% in 2Q 2025**
- **Capacity utilisation among export-oriented industries edged higher**
- **Domestic-oriented industries maintained a stronger utilisation rate**
- **Frontloading ahead of U.S. tariffs lifts manufacturing capacity utilisation in 1H 2025**
- **Regional capacity utilisation trends: Divergent impact of tariffs and shifting supply chains**
- **Malaysia manufacturing capacity utilisation: Sustained in 3Q 2025 but set to drift lower amid tariff uncertainty**
- **Conclusion: Measured optimism amid shifting trade dynamics**

- Capacity utilisation, which gauges how efficiently the manufacturing sector operates relative to its maximum potential output, strengthened in the second quarter of 2025, reflecting improved production momentum and steady industrial demand. The utilisation rate rose to 82.5%, up 0.4 percentage points year-on-year (2Q 2024: 82.1%) and 0.7 percentage points higher than the previous quarter (1Q 2025: 81.8%). Monthly trends suggest a gradual pick-up in activity, with utilisation climbing from 81.1% in April to 82.9% in May and 83.6% in June, indicating a consistent expansion in output as business conditions improved. The broad-based nature of this recovery is notable, as all manufacturing sub-sectors recorded rates above 80%, signalling sustained resilience in production capacity despite ongoing cost pressures and external uncertainties. This uptrend suggests that manufacturers are operating closer to optimal levels, supported by stable domestic demand and a gradual recovery in export-oriented industries.

Chart 1: Manufacturing Capacity Utilisation



Sources: Department of Statistics Malaysia (DOSM), Bank Islam

- At the state level, eight states recorded capacity utilisation rates exceeding the national average of 82.5% in 2Q25, reflecting robust manufacturing activity across key industrial hubs. The highest rate was observed in WP Labuan (92.7%), driven largely by strong performance in the petroleum and chemical-related industries, followed by Terengganu (90.1%), Melaka (87.7%), and Negeri Sembilan (85.9%). Other states that also outperformed the national level included Johor (85.1%), Pahang (84.6%), Selangor (84.0%), and Kedah (82.9%), underscoring the broad based nature of manufacturing resilience across both the central and southern regions. In contrast, Perlis registered the lowest capacity utilisation rate at 58.5%, marking a significant divergence from the national trend and suggesting continued structural challenges in its smaller-scale manufacturing base compared to the same period last year.

Capacity Utilisation in Export-Oriented and Domestic-Oriented Industries

- In the second quarter of 2025, capacity utilisation among export-oriented industries edged higher by 0.3 percentage points year-on-year to 81.6% (2Q 2024: 81.3%), reflecting a modest recovery in external demand amid stabilising global trade conditions. The improvement was particularly evident in the manufacture of machinery and equipment n.e.c. and furniture sub-sectors, which recorded the highest utilisation rates within this category. On a quarterly basis, export-oriented industries rebounded by 1.0 percentage point from 80.6% in 1Q 2025, indicating firmer production activity as new orders improved and supply chain conditions normalised.

- Meanwhile, domestic-oriented industries maintained a stronger utilisation rate of 84.4%, up 0.7 percentage points from the same period last year, supported by steady household spending and continued public infrastructure activity. However, compared to the preceding quarter, the rate eased slightly by 0.1 percentage point (1Q 2025: 84.5%), suggesting a mild moderation in domestic production momentum after earlier gains.

- Across the manufacturing sector, low demand, insufficient supply of raw materials, and machinery repair and maintenance activities remained the primary factors contributing to under-utilisation. These challenges indicate that while overall operating conditions have improved, lingering supply constraints and uneven demand recovery continue to cap the sector's ability to reach full productive capacity.

Table 1: Manufacturing Industry Capacity Utilisation by Export-Oriented and Domestic-Oriented Industry

	1Q25	2Q25
Manufacturing Capacity Utilisation	**81.8**	**82.5**
Export-Oriented Industry	**80.6**	**81.6**
Manufacture of vegetable and animal oils and fats	**72.8**	**80.1**
Manufacture of textiles	**83.6**	**80.0**
Manufacture of wearing apparel	**80.7**	**80.5**
Manufacture of wood and products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials	**75.4**	**75.0**
Manufacture of coke and refined petroleum products	**82.4**	**80.5**
Manufacture of chemicals and chemical products	**81.4**	**82.5**
Manufacture of rubber products	**83.5**	**80.7**

Manufacture of plastics products	**80.2**	**80.9**
Manufacture of computer, electronics and optical products	**79.2**	**81.4**
Manufacture of electrical equipment	**83.6**	**84.7**
Manufacture of machinery and equipment n.e.c.	**85.9**	**88.8**
Manufacture of furniture	**88.4**	**87.1**
Domestic-Oriented Industry	**84.5**	**84.4**
Manufacture of food processing products	**85.3**	**86.1**
Manufacture of beverages	**83.0**	**83.9**
Manufacture of tobacco products	**96.7**	**85.3**
Manufacture of leather and related products	**87.9**	**88.6**
Manufacture of paper and paper products	**77.9**	**75.9**
Printing and reproduction of recorded media	**85.2**	**85.6**
Manufacture of basic pharmaceuticals, medicinal chemical and botanical products	**86.9**	**87.5**
Manufacture of other non-metallic mineral products	**87.3**	**83.8**
Manufacture of basic metals	**80.3**	**80.9**
Manufacture of fabricated metal products, except machinery and equipment	**86.6**	**85.0**
Manufacture of motor vehicles, trailers and semi-trailers	**82.9**	**88.2**
Manufacture of other transport equipment	**83.1**	**81.3**
Other manufacturing	**84.9**	**82.2**
Repair and installation of machinery and equipment	**87.3**	**87.1**

Sources: CEIC, Bank Islam

Frontloading Ahead of U.S. Tariffs Lifts Manufacturing Capacity Utilisation in 1H 2025

- Malaysia's manufacturing capacity utilisation rose steadily in 2Q 2025, in line with modest gains in industrial output and external trade. The Industrial Production Index (IPI) grew 2.0% year-on-year (1Q 2025: +2.3%), led by a 3.9% expansion in manufacturing, while mining output contracted and electricity output improved slightly. The rise in utilization, from 81.1% in April to 83.6% in June, mirrored stronger late-quarter production as firms ramped up operations to meet orders and replenish inventories.

- External trade expanded 6.1% YoY, supported by exports (+3.4%) and imports (+9.0%), though the trade surplus narrowed by 55.3% to RM14.5 billion. The mid-year improvement in exports, particularly the rebound observed in July, implies stronger utilisation of capacity in re-export and high-value processing activities, even as domestic export performance remained subdued. This suggests that part of the higher utilisation was linked to transshipment and processing trade, rather than a broad-based recovery in domestic manufacturing output. The pattern of higher mid-year trade and rising utilisation points to frontloading, as global buyers pulled forward orders to avoid higher import costs. This temporary boost helped sustain factory run rates in May and June, particularly in electronics, machinery, and furniture segments tied to U.S. demand.

- Meanwhile, the Manufacturing PMI, though still below the neutral threshold of 50, trended upward through the quarter, signaling a slower pace of contraction and nascent recovery in new orders and production volumes. The stabilisation in order flows, coupled with lean inventories and contained backlogs, indicates that firms were cautiously increasing production runs without overextending capacity.

- Overall, the rise in capacity utilisation in the first half of 2025 reflects frontloaded production ahead of impending U.S. tariff deadlines and steady domestic-oriented output, indicating near-term manufacturing strength. However, this momentum is expected to moderate in subsequent quarters as the effects of tariffs and order normalisation set in. Taken together, the data point to a measured recovery in manufacturing activity, with higher utilisation supported by selective improvements in external demand and firm domestic resilience, even as the sector continues to navigate weak global trade conditions and lingering supply-side constraints.

Regional Capacity Utilisation Trends: Divergent Impact of Tariffs and Shifting Supply Chains

- Across key manufacturing economies, capacity utilisation remained uneven in 2Q 2025, reflecting the differentiated impact of U.S. tariffs and varying stages of global demand recovery. China's rate held steady at 74.0% (1Q: 74.1%), indicating stable but cautious output as manufacturers frontloaded production ahead of tariff deadlines while moderating new orders amid uncertainty over U.S. trade measures. In contrast, Southeast Asian peers such as Indonesia (73.6%) and the Philippines (76.8%) saw slight gains, supported by production diversification and trade diversion from China, particularly in electronics, automotive parts, and consumer goods. These economies benefited from supply-chain reconfiguration, as multinational producers sought to mitigate U.S. tariff exposure by expanding operations in non-China locations.

- Meanwhile, South Korea's utilisation fell to 72.5% (1Q: 73.8%), as weak semiconductor exports and elevated inventories weighed on industrial activity. Thailand recorded a deeper contraction to 59.1% (1Q: 60.9%), underscoring persistent challenges in its automotive and electronics sectors amid soft global demand and limited substitution benefits from tariff realignment. The United States maintained a stable utilisation rate of 76.8% (1Q: 76.9%), reflecting resilient domestic demand but early signs of strain in export-oriented manufacturing as reciprocal tariffs began to take effect from mid-year.

- Looking ahead, regional capacity utilisation is likely to soften modestly over the next few quarters as frontloading dissipates and the full effects of tariffs feed through global supply chains. While China and South Korea may see further moderation due to export headwinds and high-tech sector exposure, ASEAN economies such as Malaysia, Indonesia, and the Philippines could remain comparatively resilient, underpinned by diversion of orders, domestic policy support, and strengthening intra-ASEAN trade. Nonetheless, the overall regional trend points to a mild deceleration in manufacturing activity, pending clarity on the direction of U.S.–China trade negotiations.

- For Malaysia, capacity utilisation is expected to hold steady through 3Q 2025 before easing slightly towards year-end, in line with broader regional patterns. The sustained strength in E&E exports and frontloaded production ahead of U.S. tariff deadlines has supported factory activity, while domestic-oriented output remains resilient amid stable household demand and fiscal support measures. However, similar to peers like China and South Korea, Malaysia's exposure to global semiconductor cycles and potential spillover effects from renewed U.S.–China trade frictions pose downside risks. As frontloading fades and uncertainty over product-specific tariffs persists, utilisation may drift lower in 4Q 2025, though continued trade diversion and supply-chain shifts into ASEAN could cushion the slowdown and help Malaysia sustain above-regional-average factory.

Table 2: Capacity Utilisation of Selected Countries

	2Q24	3Q24	4Q24	1Q25	2Q25
China	74.9	75.1	76.2	74.1	74.0
Indonesia	73.7	73.1	72.9	73.3	73.6
Malaysia	82.1	82.4	81.9	81.8	82.5
Philippines	74.9	75.6	76.2	76.1	76.8
Thailand	58.3	58.8	57.7	60.9	59.1
South Korea	73.4	72.5	72.5	73.8	72.5
United States	77.1	76.7	76.2	76.9	76.8

Sources: CEIC, Bank Islam

Malaysia Manufacturing Capacity Utilisation: Sustained in 3Q 2025 but Set to Drift Lower Amid Tariff Uncertainty

- **3Q 2025 Performance: Frontloading and Strong Trade Support Capacity Utilisation.** Malaysia's manufacturing capacity utilisation likely remained relatively firm in 3Q 2025, supported by stronger-than-expected industrial output, resilient domestic demand, and continued frontloading of export orders ahead of U.S. tariff deadlines. The Industrial Production Index (IPI) rose 4.9% YoY in August (July: +4.2%), marking the fastest expansion since mid-2024. While manufacturing output growth eased to 2.8%, both export-oriented industries (+2.3%) and domestic-oriented industries (+3.8%) maintained positive momentum. Manufacturing sales also grew 2.7% YoY to RM168.3bn, reflecting stable domestic orders and firm production activity.

- External trade data reinforce this trend. Gross exports surged 12.2% YoY in September, driven by record-high shipments of electrical and electronics (E&E) products and a 12.5% increase in manufactured goods exports. For the quarter, exports expanded 6.7% YoY, outpacing import growth (+0.4%), widening the trade surplus to RM50.3bn. The rebound in exports to the United States following the implementation of the 19% reciprocal tariff in August suggests that Malaysian manufacturers have adapted quickly by frontloading shipments and re-routing goods, particularly in tariff-exempt semiconductor segments.

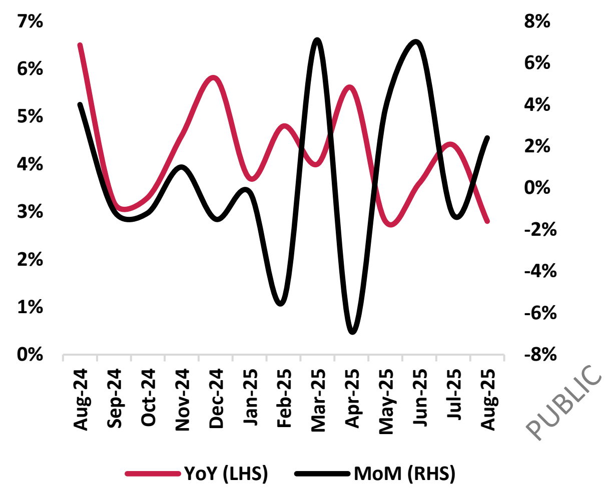
- The Manufacturing PMI averaged 49.8 in 3Q 2025 (2Q 2025: 48.9), signaling stabilisation in production conditions as new orders held steady and business sentiment improved to its highest level since early 2024. This combination of stronger trade, firm domestic orders, and lean inventory management suggests that capacity utilisation remained elevated through 3Q 2025, likely holding close to 2Q's 82.5% level.

- Nevertheless, lingering uncertainty surrounding U.S.–China trade relations continues to cloud the outlook. The renewed cycle of tariffs and countermeasures, coupled with the potential extension of U.S. duties to semiconductor and high-tech components, could disrupt regional supply chains, and soften external demand in the coming months.

- **4Q 2025 Capacity Utilisation to Ease Modestly but Remain Resilient.** Moving into the final quarter of 2025, Malaysia's manufacturing capacity utilisation is expected to drift slightly lower, averaging around 81.5%–82.0%, as earlier frontloading effects fade and global demand normalises. Export momentum may taper as firms adjust to new tariff structures and slower order flows, particularly in price-sensitive and low-margin segments. However, domestic-oriented industries are expected to provide a buffer, supported by strong household incomes, wage adjustments for civil servants, and ongoing infrastructure spending.

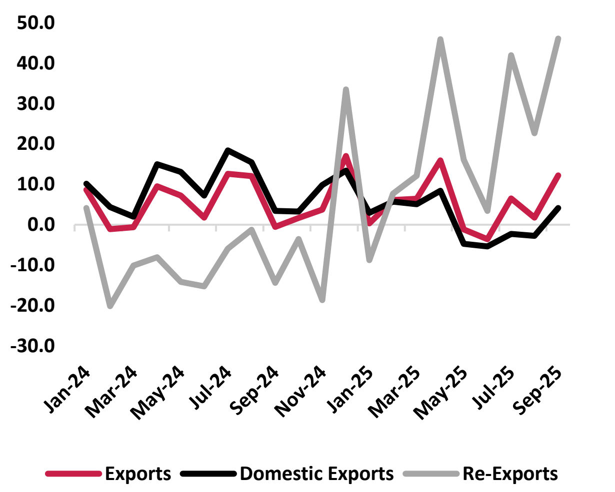
- While the manufacturing sector may experience a mild cooling in production activity, capacity utilisation should remain above pre-2024 averages, indicating continued resilience in Malaysia's industrial base. Overall, the sector appears well-positioned to weather near-term global trade volatility, aided by diversification efforts, adaptive supply chain strategies, and solid domestic fundamentals.

Chart 2: Malaysia IPI: Manufacturing Sector (Aug 2024 – Aug 2025)



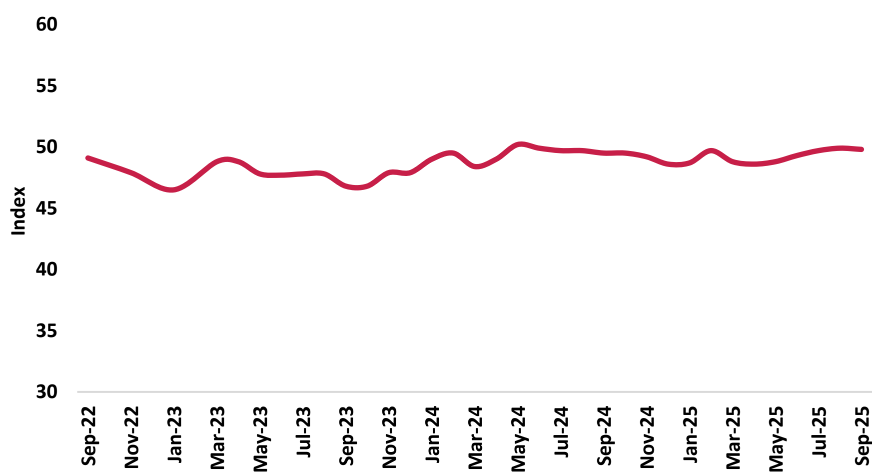
Sources: DOSM, Bank Islam

Chart 3: Exports by Type (YoY, %)



Sources: CEIC, Bank Islam

Chart 4: Malaysia Manufacturing PMI (September 2022 – September 2025)



Sources: Markit, Bank Islam

Measured Optimism Amid Shifting Trade Dynamics

- Overall, Malaysia's manufacturing capacity utilisation is likely to remain resilient through 3Q 2025, supported by steady domestic demand, ongoing trade diversion within ASEAN, and residual effects of earlier frontloading ahead of U.S. tariff deadlines. However, the sustainability of this strength is uncertain, as renewed U.S.–China trade frictions and potential product-specific tariff expansions could weigh on external demand and disrupt supply chain flows in the coming quarters. While the strong performance in E&E exports and improving PMI readings suggest that the manufacturing sector has adapted well to the evolving trade environment, moderation in utilisation rates is expected into late 2025, reflecting the transition from frontloaded momentum to more normalized production cycles. In this context, Malaysia's manufacturing outlook remains cautiously optimistic, with resilience in domestic-oriented industries providing a critical buffer against external headwinds.