Economic Research, Strategic Management

Saturday, September 8 2018 / 27 Zulhijjah 1439H

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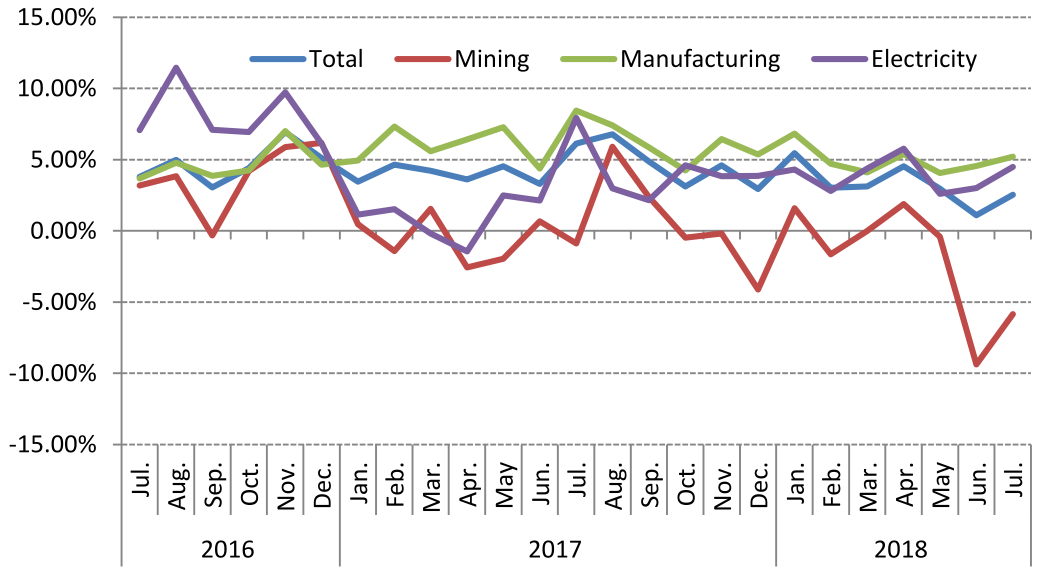
IPI grew 2.6% in July, momentum slowing

Facts

- The Industrial Production Index (IPI) recorded 2.6% y-o-y (Jun: 1.1%) gain in July. This was higher compared to consensus estimates of 1.4% based on Bloomberg survey. The increase in IPI was supported by the increase in the Manufacturing index by 5.2% (Jun: 4.5%) and Electricity index by 4.5% (Jun: 3.0%).
- Manufacturing sector was obviously the main driver, growing by 5.2% in July from 4.5% in the previous month. This was largely due to strong growth in Electrical and Electronic Products (E&E) which contributed of 18.2% of total IPI and Petroleum, Chemical, Rubber and Plastics Products (20.6% of total IPI). Both industries recorded 8.0% (June: 5.5%) and 4.1% (June: 3.4%) growth respectively. Transport Equipment and Other manufactures (5.9% of total IPI) also recorded stellar performance, expanding by 13.5% in July from 4.7% in the preceding month.
- Meanwhile, the Mining sector remained weak despite its improving growth of -5.9% in July from -9.4% in June. The improvement mainly was contributed by the increase in Crude Petroleum (4.4% in July vs. -2.2% in June). It is pertinent to note that the 2.6% IPI growth in July is still remains below the 2Q2018 average IPI of 2.9%, suggesting that production activities appears to be moderating going into the 3Q2018.

Chart 1: Industrial Production Index y-o-y%



Source: CEIC

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

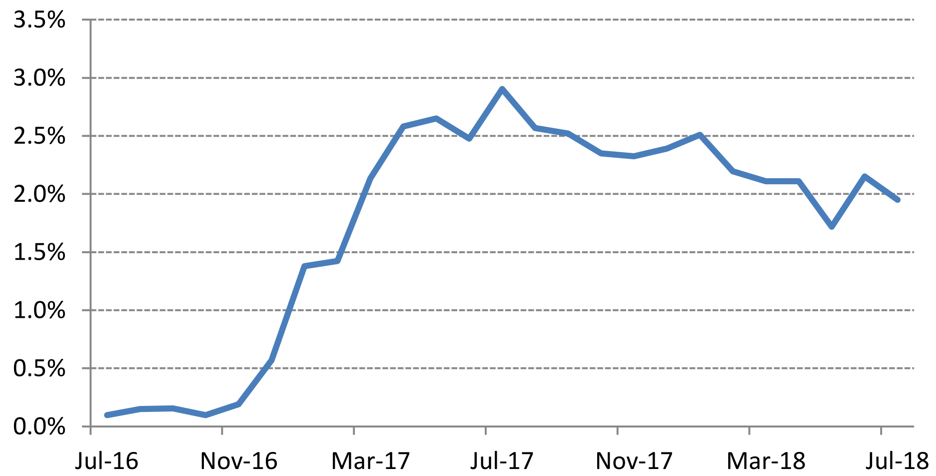
	Weight	Apr-18	May-18	Jun-18	Jul-18	7M 2017	7M 2018
IPI	**100.0%**	**4.5%**	**3.0%**	**1.1%**	**2.6%**	**4.3%**	**1.2%**
Mining	**25.1%**	**1.9%**	**-0.4%**	**-9.4%**	**-5.9%**	**-0.1%**	**-1.5%**
-Crude petroleum	12.2%	4.4%	4.8%	-2.2%	4.4%	-5.0%	2.1%
-Natural gas	12.9%	-0.4%	-4.8%	-15.7%	-15.2%	3.6%	-5.6%
Manufacturing	**68.3%**	**5.4%**	**4.1%**	**4.5%**	**5.2%**	**6.3%**	**5.0%**
-Food, Beverages & Tobacco	8.6%	4.7%	3.3%	3.4%	-2.8%	11.8%	4.5%
-Textiles, Wearing Apprarel, Leather & Footwear	1.3%	3.9%	2.2%	6.2%	3.7%	7.6%	5.1%
-Wood Products, Furniture, Paper Products, Printing	4.6%	3.0%	2.6%	5.4%	6.0%	6.9%	4.2%
-Petroleum, Chemical, Rubber & Plastic Products	20.6%	4.1%	3.7%	3.4%	4.1%	3.3%	4.2%
-Non-Metalic Mineral, Basic Metal &FabricatedMetal Prod	9.1%	5.1%	5.0%	5.2%	5.6%	4.6%	5.2%
-Electrical & Electronic Products	18.2%	7.1%	4.8%	5.5%	8.0%	8.2%	6.0%
-Transport Equipment & Other Manufactures	5.9%	7.8%	5.0%	4.7%	13.5%	5.5%	5.3%
Electricity	**6.6%**	**5.8%**	**2.6%**	**3.0%**	**4.5%**	**1.9%**	**3.9%**

Source: CEIC

Our view

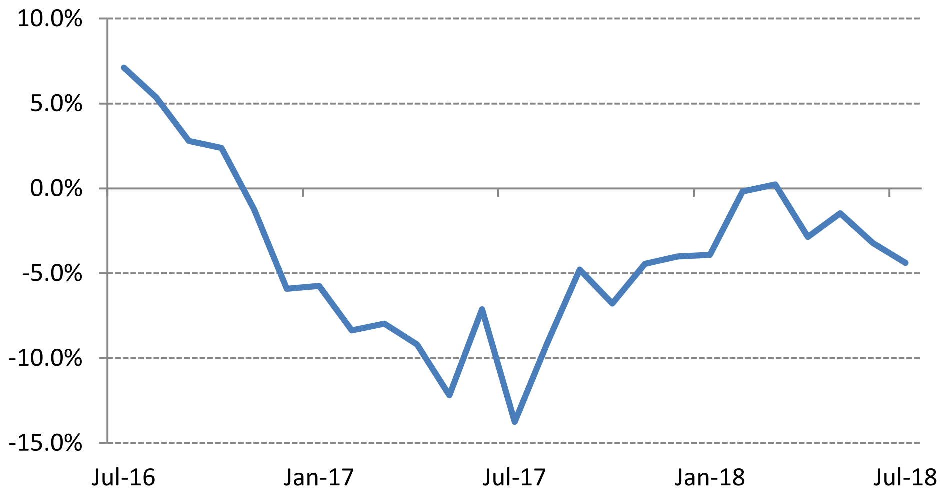
Despite higher-than-expected IPI growth, demand for input factor namely labour has been quite flattish in the recent months. The total employment growth in the manufacturing sector was going at a rate of 2.0% y-o-y in July to 1.075 million from 2.2% in the previous month. Subsequently, the average monthly average salaries earned by the manufacturing workers has been climbing at a benign pace from RM3,602 per month in June (May: RM3,562) to RM3,604 per month in July. There seems to be a build-up in the inventory level in March and it has been dissipating thereafter. Perhaps, manufacturers have been very mindful with the production lines especially in the context of the ongoing trade war championed by the US government. It could be a matter of time before the new tariff rate will be announced for the USD200 billion worth of US imports from China.

Chart 3: Total employment growth in manufacturing sector y-o-y%



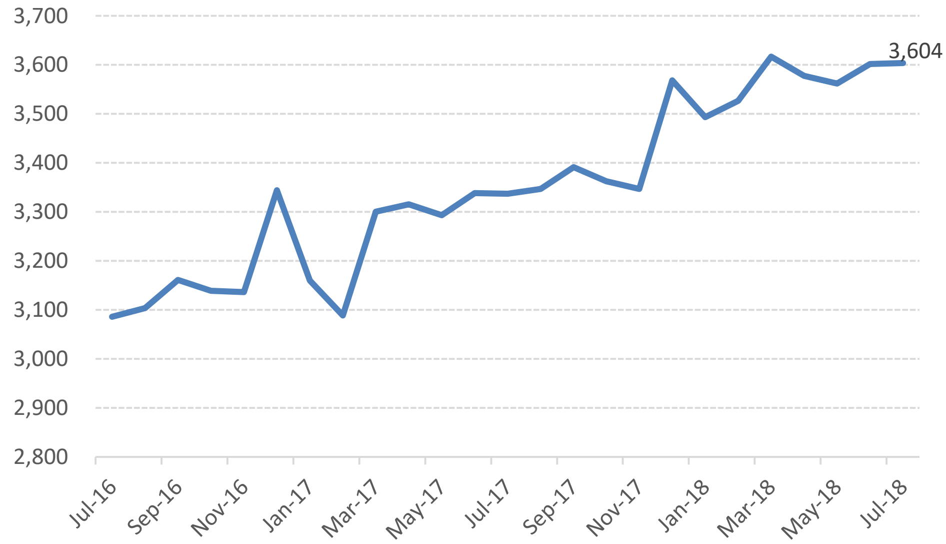
Source: CEIC

Chart 4: Inventory level in manufacturing (production less sales)



Source: CEIC

Chart 5: Average monthly salaries in the manfacturing sector



Source: CEIC

Be that as it may, export-oriented industries have been actively expanding their production capacities in view of healthy demand from abroad. Expansion could be in the form of larger floor space of manufacturing plant and increase automation as well as mechanisation in their production lines. Also, some of the players have been considering to pursue mergers and acquisition (M&A) in order to gain their foothold on industries that will complement their existing capabilities. For instance, Malaysian Pacific Industries Berhad (MPI), one of the main semiconductor players is aiming to increase revenue contribution from the automotive industries to 50% from the current 25%, which is embedded in their five-year plan. At the moment, smartphones accounted for 40% of MPI's revenue and it is the largest revenue contributor for the group.

Meanwhile, rubber glove main player, Hartalega Holdings Berhad is focusing on leveraging the Internet of Things (IoT) in order to boost up productivity, reducing human error and dependency on foreign labour at their Next Generation Integrated Glove Manufacturing Complex (NGC) Plant 5 which has commenced production in August. As such, Malaysia's manufacturers are well-positioned to cater for large order from clients as companies have gained their economies of scale. Be that as it may, final demand outlook remain highly uncertain now. At the current juncture, there appears to be noises coming from the external front and it remain to be seen how the turbulent would recede in the months to come. **Against such backdrop, we are projecting IPI to grow by 2.9% in 2018 after expanding 4.3% in 2017.**

Table 2: Capacity expansion plans

Companies	Industries	Remarks
Top Glove Corp. Bhd	Rubber Gloves	In the process of constructing two new manufacturing facilities, namely Factory 31 (operational by July 2018) and Factory 32 (operational by early 2019), which upon completion will boost the group's total number of production lines by an additional 74 lines and production capacity by 7.4 billion gloves per annum to 64.9 billion (+11%).
Hartalega Holdings Berhad	Rubber Gloves	Accelerating the adoption of Internet of Things (IoT), starting with the new Next Generation Integrated Glove Manufacturing Complex (NGC) Plant 5. IoT was not only aimed at improving productivity but also to reduce human error and the dependency on foreign labour, as well as enabling digital monitoring of production lines
Malaysia Pacific Industries Berhad (MPI)	Semiconductor	Eyeing for merger and acquisitions (M&A) opportunities in new technologies, particularly in the automotive space. This comes in line with the group's five-year plan of achieving 50% of its revenue derived from the automotive segment. Currently, the automotive segment represents 25% of total group revenue, while the largest segment at 40% comes from smartphones.

Source: Media