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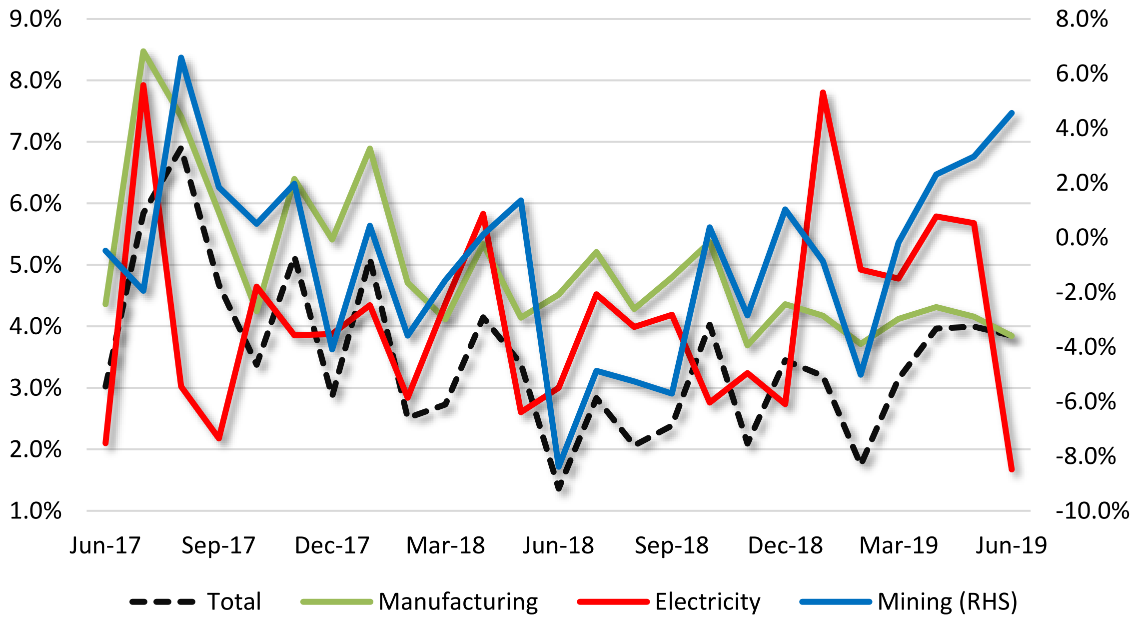
IPI growth fairly stable at 3.9% in June

Facts

- The Industrial Production Index (IPI) came in at 3.9% year-on-year (y-o-y) in June, a tad lower compared to 4.0% growth in the preceding month (Consensus: 3.8%, Bank Islam: 3.9%). This was largely contributed by the expansion in Mining sector, which accelerated to 4.6% in June from 3.0% previously. Conversely, Manufacturing and Electricity grew moderately from 4.2% and 5.7% in May to 3.8% and 1.7% respectively in June.
- The strong output growth in the mining sector was mainly due to the Natural Gas sub-sector, surging by 13.0% in June from 7.6% growth in the previous month while Crude Oil output fell further to 3.7% from 2.0% contraction. Higher Natural Gas output suggests that the sector has recovered from the supply shocks experienced in early last year.
- Manufacturing sector appears to be shifting into lower gear. The Electrical & Electronics (E&E) industries, which forms sizeable share in total IPI (18.2% of total IPI), posted a modest growth of 3.5% in June (May: 3.7%). Additionally, softer growth was also seen in the production of Food, Beverages & Tobacco (June: 3.9% vs. May: 4.4%), Textiles, Wearing Apparel, Leather & Footwear (June: 5.5% vs. May: 5.8%), Wood Products, Furniture, Paper Products, Printing (June: 4.7% vs. May: 6.5%), Petroleum, Chemical, Rubber & Plastic Products (June: 3.0% vs. May: 3.2%), as well as Transport Equipment & Other Manufacturers (June: 5.6% vs. May: 6.9%).
- For the 2Q2019, IPI expanded to 3.9% y-o-y from 2.7% in the preceding quarter. Cumulatively, IPI grew by an average of 3.3% in 1H2019. This is slightly higher compared to 3.2% in 1H2018, suggesting production activities are growing at a marginal pace.

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



Source: CEIC

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

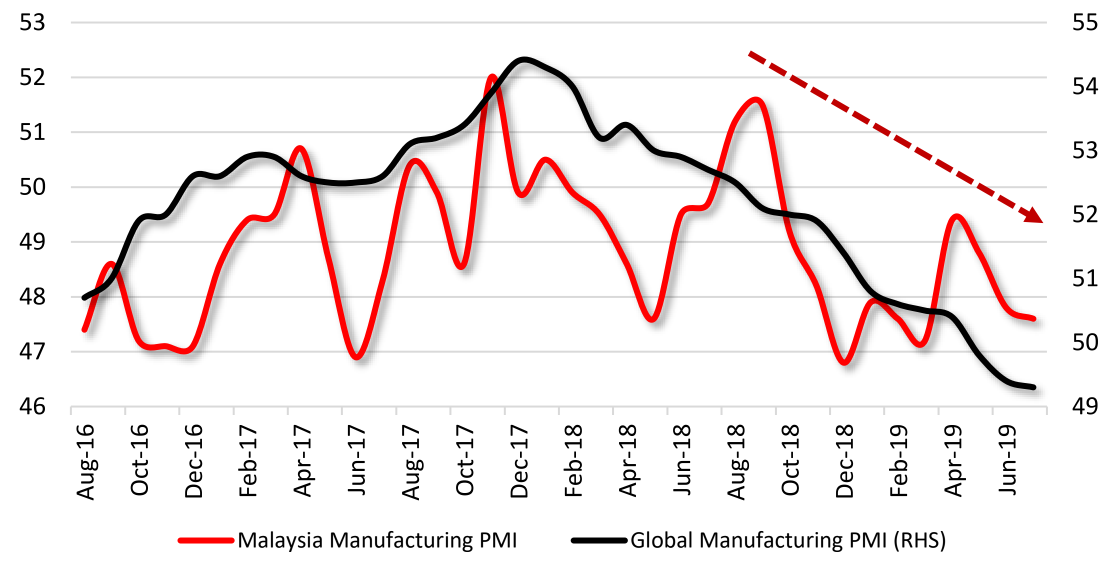
	Weight	Mar-19	Apr-19	May-19	Jun-19	1H2018	1H2019
IPI	**100.0%**	**3.1%**	**4.0%**	**4.0%**	**3.9%**	**3.2%**	**3.3%**
Mining	**25.1%**	**-0.2%**	**2.3%**	**3.0%**	**4.6%**	**-2.0%**	**0.6%**
-Crude petroleum	12.2%	-2.0%	-1.9%	-2.0%	-3.7%	-1.7%	-2.7%
-Natural gas	12.9%	1.4%	6.1%	7.6%	13.0%	-2.2%	3.6%
Manufacturing	**68.3%**	**4.1%**	**4.3%**	**4.2%**	**3.8%**	**4.9%**	**4.1%**
-Food, Beverages and Tobacco	8.6%	6.8%	4.2%	4.4%	3.9%	5.9%	4.7%
-Textiles, Wearing Apparel, Leather and Footwear	1.3%	4.9%	5.7%	5.8%	5.5%	5.3%	5.2%
-Wood Products, Furniture, Paper Products, Printing	4.6%	5.0%	5.2%	6.5%	4.7%	3.9%	5.4%
-Petroleum, Chemical, Rubber and Plastic Products	20.6%	3.7%	3.6%	3.2%	3.0%	4.3%	3.2%
-Non-Metalic Mineral, Basic Metal and Fabricated Metal Product	9.1%	3.5%	4.0%	3.8%	4.8%	5.2%	4.2%
-Electric and Electronic Products	18.2%	2.7%	4.1%	3.7%	3.5%	5.7%	3.5%
-Transport Equipment and Other Manufactures	5.9%	6.1%	7.2%	6.9%	5.6%	4.0%	6.5%
Electricity	**6.6%**	**4.8%**	**5.8%**	**5.7%**	**1.7%**	**3.8%**	**5.1%**

Source: CEIC

Our view

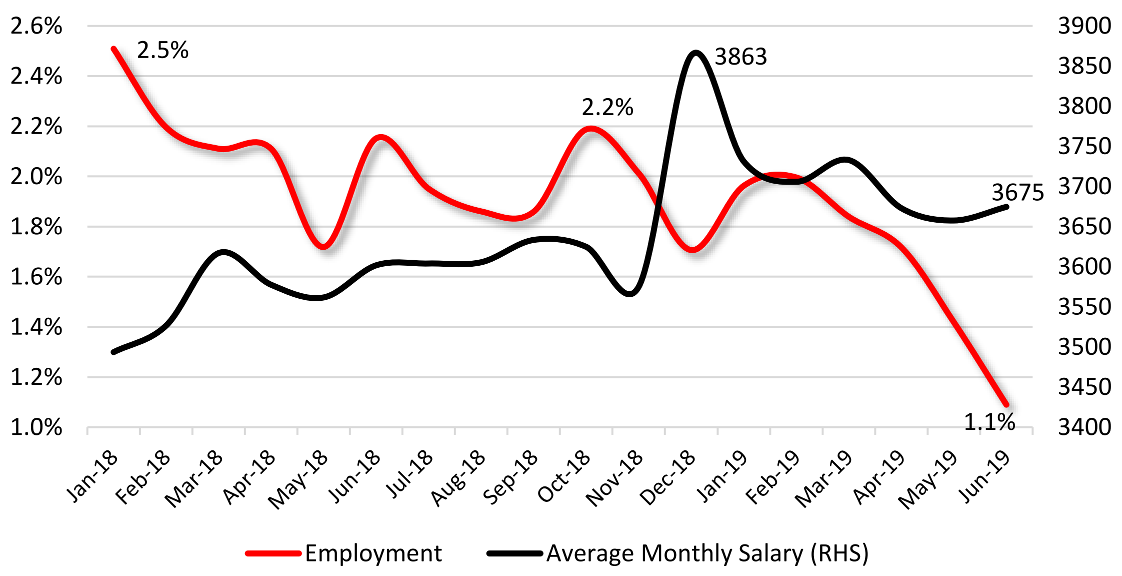
The industrial production activities have been quite timid although the sharp rise in Natural Gas output provided some cushion to the overall performance. Slower global demand for electronic products has affected Malaysia's E&E exports, which fell by 6.0% in June. Such trend was very much in line with the Global Semiconductor Sales (GSS), which has been in the negative territory for 6 straight months (June: -16.8% vs. May: -14.8%). Business sentiments were not forthcoming too. The J.P Morgan Global Manufacturing Purchasing Manager Index (PMI) dropped to 49.3 points in July from 49.4 points in the preceding month. Moreover, things are looking gloomier in Europe with Euro Zone Manufacturing PMI plummeted further to 46.5 points during July (June: 47.6 points), recording 6 consecutive months of reading below 50-point demarcation line since February 2019. This was predominantly driven by the fall in production and new orders. The bloc's biggest economy, Germany registered the worst performance at 43.2 points during the month (June: 45.0 points). All in all, we foresee the bloc's PMI will remain weak due to worsening demand conditions, particularly from the automotive industry.

Chart 2: Global & Malaysia Manufacturing PMI (points)



Source: IHS Markit, Bloomberg

Chart 3: Manufacturing Sector Average Monthly Salary (RM) vs. Employment (%)



Source: DOSM, CEIC

The trade conflict between the US and China has yet to be resolved and it will continue to remain fluid and highly uncertain. The latest announcement by the President Trump on 10.0% tariff levied against imports from China totaling USD300 billion is expected to be implemented on 1 September. This would target a wide range of goods, from smart-phones and E&E related products to clothing and toys. The additional tariff could adversely impact the manufacturers and consumers moving forward as cost of doing business is getting higher. Retaliation from Chinese government is also quite severe, targeting at the agricultural products. Non-tariff measures also seems to be a compelling option to China with Yuan surpassing the 7.0 mark per unit of US dollar (USDCNY 7.0577).

Against such backdrop, manufacturers are taking a very cautious view with regards to their production activities. Already, hiring activities in the manufacturing sector has been quite lukewarm with average monthly pay stagnating at RM3,675 in June. Similarly, total employment growth in the manufacturing industries moderated from 1.4% y-o-y in May to 1.1% in June. In light of this**, the 2Q2019 Gross Domestic Product (GDP), which will be announced on 16 August, could come in at 4.5% (1Q2019: 4.5%).** We expect consumer spending will continue to be the main pillars for growth as business investment, public expenditure as well as net exports would take a back seat.