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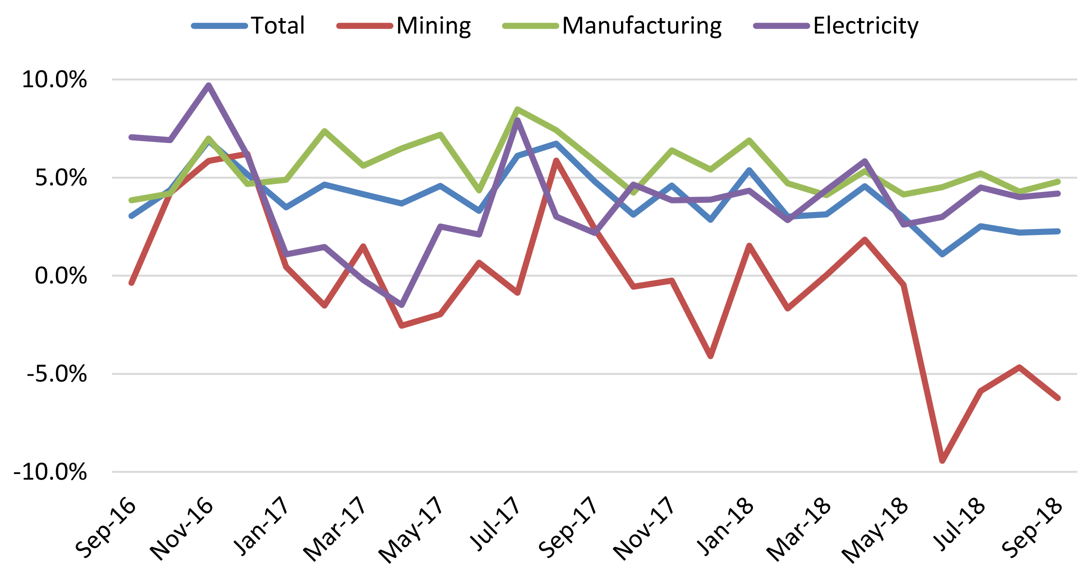
IPI growth: fairly modest in September

Facts

- The Industrial Production Index (IPI) rose 2.3% y-o-y in September, a slight increase from 2.2% gain in the preceding month (Bloomberg consensus: 2.3%, Bank Islam: 2.3%). Such performance was largely underpinned by Manufacturing and Electricity index which grew by 4.8% (August: 4.2%) and 4.2% (August: 4.0%) respectively.
- The expansion in the manufacturing sector was mainly driven by the Electrical and Electronics products (E&E) and Petroleum, Chemicals, Rubber & Plastics products. Both sub-indices rose 5.5% (August: 4.6%) and 3.8% (August: 3.5%) during September. At the same time, Food, Tobacco and Beverages posted commendable growth of 6.9% in September (August: 2.1%).
- Meanwhile, Mining sector remained weak with growth deteriorated further to -6.2% in September (August: -4.7%), owing to decline in crude petroleum (September: -6.3% vs. August: -0.6%). Natural gas output growth, however, recorded smaller contraction from -8.0% in August to -6.2% in September. However, it still a drag to the overall IPI.
- As for the 3Q2018, IPI grew modestly to 2.3% from 2.8% in the previous quarter largely due to further contraction in Mining (-5.6% in 3Q2018 vs. -2.8% in 2Q2018). However, Manufacturing growth sustained at 4.7% for two consecutive quarters while some of the sub-indices have demonstrated favourable performance.
- These includes E&E (6.0% in 3Q2018 vs. 5.8% in 2Q2018), Wood Products, Furniture, Paper Products & Printing (6.2% in 3Q2018 vs. 3.7% in 2Q2018) and Petroleum, Chemical, Rubber & Plastic Products (3.8% in 3Q2018 vs. 3.7% in 2Q2018). This could really explain the rise in Electricity index from 3.8% in 2Q2018 to 4.2% in 3Q2018.
- For the first nine months of 2018, IPI growth moderated to 3.0% as compared to the same period last year at 4.6%, suggesting slower momentum in the production activities. Mining related industries remain the key driver for slower growth with total output produced fell 2.8% (9M2017: 0.5%) while Manufacturing posted slower growth of 4.9% from 6.4% previously. Electricity index appears to defy the overall trend with further expansion in the output growth from 2.1% to 4.0% between January and September this year.

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



Source: CEIC

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

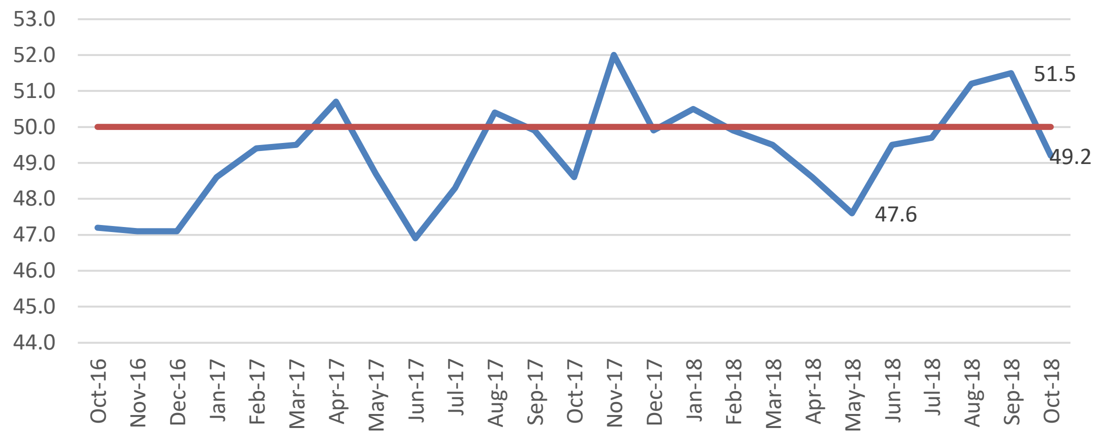
	Weight	Jun-18	Jul-18	Aug-18	Sep-18	9M 2017	9M 2018
IPI	**100.0%**	**1.1%**	**2.6%**	**2.2%**	**2.3%**	**4.6%**	**3.0%**
Mining	**25.1%**	**-9.4%**	**-5.9%**	**-4.7%**	**-6.2%**	0.5%	-2.8%
-Crude petroleum	12.2%	-2.2%	4.4%	-0.6%	-6.3%	-4.2%	0.9%
-Natural gas	12.9%	-15.7%	-15.2%	-7.9%	-6.2%	4.9%	-5.9%
Manufacturing	**68.3%**	**4.6%**	**5.2%**	**4.2%**	**4.8%**	**6.4%**	**4.9%**
-Food, Beverages & Tobacco	8.6%	3.4%	-2.8%	2.1%	6.9%	11.2%	4.7%
-Textiles, Wearing Apprarel, Leather & Footwear	1.3%	6.2%	3.7%	2.9%	2.2%	7.8%	4.6%
-Wood Products, Furniture, Paper Products, Printing	4.6%	5.4%	6.0%	6.3%	6.4%	6.0%	4.6%
-Petroleum, Chemical, Rubber & Plastic Products	20.6%	3.4%	4.1%	3.5%	3.8%	3.8%	4.1%
-Non-Metalic Mineral, Basic Metal &FabricatedMetal Prod	9.1%	5.2%	5.6%	4.9%	4.6%	5.0%	5.1%
-Electrical & Electronic Products	18.2%	5.5%	8.0%	4.6%	5.5%	8.0%	5.8%
-Transport Equipment & Other Manufactures	5.9%	4.7%	13.5%	7.4%	2.3%	6.3%	5.3%
Electricity	**6.6%**	**3.0%**	**4.5%**	**4.0%**	**4.2%**	**2.1%**	**4.0%**

Source: CEIC

Our view

The latest IPI series in September suggests that manufacturers have become increasingly cautious on final demand outlook. This was reflected in the employment growth which has been stagnating at a rate of 1.9% y-o-y for two consecutive months. Such trend is very much in tandem with the Nikkei Malaysia Manufacturing Purchasing Managers Index (PMI) which has fallen below 50-point demarcation line to 49.2 points in October (September: 51.5). According to the PMI survey, the deterioration in operating conditions was largely driven by a marked reduction in total new sales. Demand from domestic markets were also less encouraging following the implementation of Sales and Services Tax (SST) in September. However, new business from overseas increased at the sharpest pace in nine months. The US and other countries in South East Asia were mentioned as destinations for new export orders. In that sense, export-oriented industries have been the saviour, thanks to the competitive exchange rates. The MYR Nominal Effective Exchange Rate (NEER) is currently hovering at 86.3 points, implying 13.7 points undervaluation against a basket of currencies (see Chart 3).

Chart 2: Nikkei Malaysia Manufacturing Purchasing Managers Index (PMI)



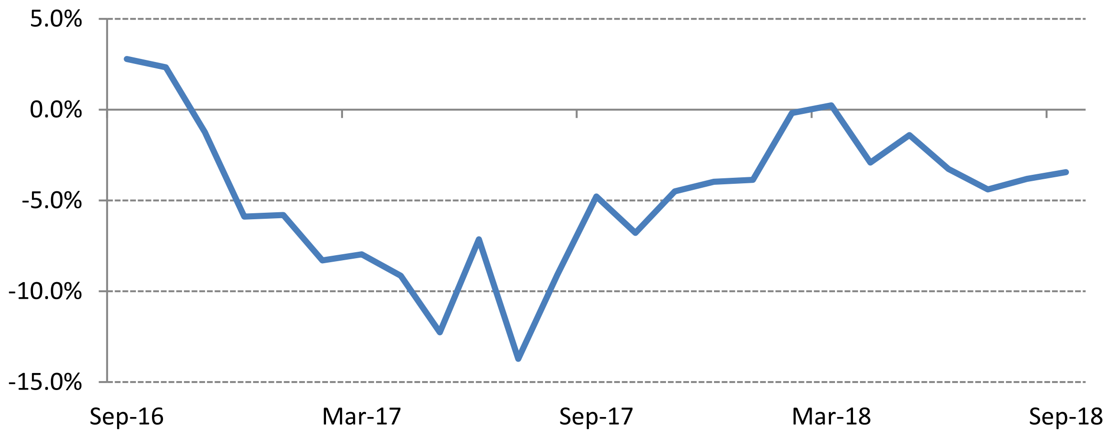
Sources: Markit Economics & Bloomberg

Chart 3: MYR Nominal Effective Exchange Rate (NEER)

Source: Bank Islam

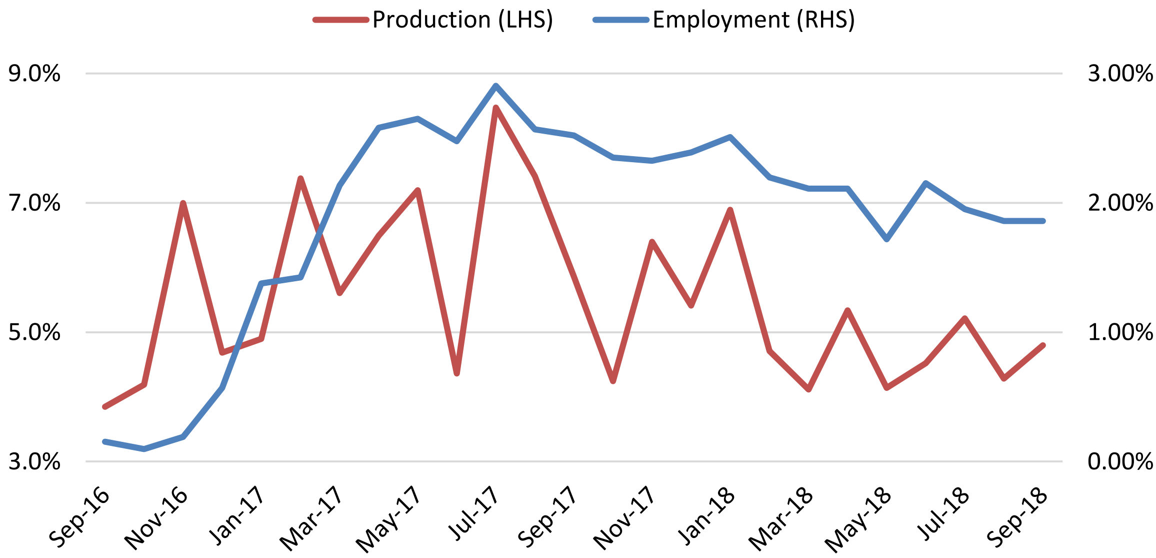
Thus far, inventory level in the manufacturing sector is not alarming as sales growth continue to exceed production growth (see chart 4). Therefore, the existing labour force in the sector should remain stable and production activities especially companies in the export-oriented industries is expected to perform favourably. Against such backdrop, **we are projecting the 3Q2018 GDP growth to be estimated at 4.7% (2Q2018: 4.5%)** owing to improved consumer sentiments, ongoing investment by the private sector as well as supportive external sector. The 3Q2018 will be announced on 16 November.

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



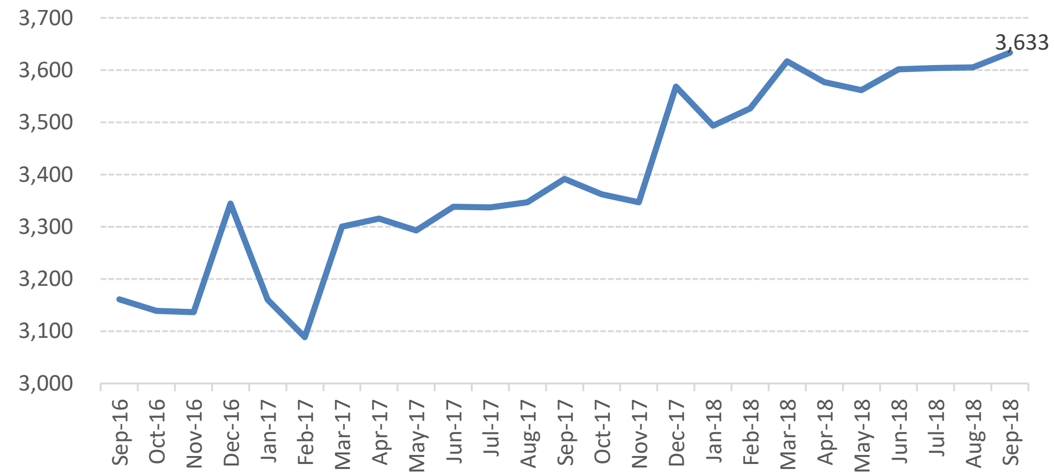
Sources: CEIC & Bank Islam

Chart 5: Total production and employment growth in manufacturing sector y-o-y%



Source: CEIC

Chart 6: Average monthly salaries in the manfacturing sector (RM)



Source: CEIC