The recovery in the Malaysian manufacturing sector continued in July. After rising at a joint-record pace in June, output continued to expand in the latest survey period, with trends in new orders much improved since the nadir of the coronavirus disease 2019 (COVID-19) downturn in April. That said, the ongoing effects of the pandemic meant that firms continued to operate below capacity and therefore expressed further caution around hiring, particularly in the face of rising input costs. Output prices also increased at the start of the third quarter.

The headline IHS Markit Malaysia Manufacturing Purchasing Managers’ Index™ (PMI®) – a composite single-figure indicator of manufacturing performance – posted 50.0 in July, down marginally from 51.0 in June but still well above the readings seen during the worst of the COVID-19 downturn and above the survey’s long-run average of 49.0.

Encouragingly, manufacturing production rose for the second month running in July, building on the joint-record expansion registered in the previous month. Respondents linked higher output to signs of an improving trend in new orders following an easing of the movement control order.

The New Orders Index was unchanged on the level seen during the previous month in July, but that represents a much improved picture on the situation in April and May. Some respondents indicated that demand remained fragile, however, as the pandemic continued to impact the sector. This was particularly the case with regards to new export orders, which softened to a greater extent than in June.

A number of firms expect market demand to strengthen over the coming year, supporting overall confidence in the 12-month outlook for production. Sentiment was down only slightly from that seen in June.

Commenting on the latest survey results, Chris Williamson, Chief Business Economist at IHS Markit, said:

“July saw the manufacturing sector expand for a second consecutive month, albeit with the rebound in factory output losing some of its momentum due to some settling down of production after returns to work in May and June. New order growth has meanwhile recovered to its long-run average in the past two months, though remained somewhat subdued, thanks mainly to a further deterioration of demand in export markets. It will be important for demand to rise further in coming months to encourage more hiring and boost confidence. July saw job numbers fall at a slightly increased rate as firms grew slightly less optimistic about the year ahead, underscoring how producers are likely to remain cost-conscious and err towards risk aversion until the outlook for demand beyond the initial rebound from COVID-19 lockdowns becomes clearer.”
Although seeing a relative improvement compared to the nadir of the recent downturn, new order volumes were insufficient to place pressure on operating capacity. In fact, a number of firms indicated that they had been able to complete all backlogs of work during the month.

A lack of pressure on capacity, and efforts to limit input costs, led to further caution among manufacturers when making hiring decisions. Employment was consequently scaled back for the fourth month running.

Meanwhile, input costs increased sharply during July, rising for the second month running and at the fastest pace since October 2018. Respondents generally attributed higher input prices to supply shortages for raw materials. In response to rising input costs, firms increased their selling prices. Although modest, the rate of inflation was the most marked for 20 months.

Recent signs of improvement in demand and production requirements encouraged manufacturers to expand their purchasing activity. Input buying ticked up, thereby ending a 21-month sequence of decline.

COVID-19 continued to impact the ability of firms to receive purchased inputs in a timely manner, however, with transportation issues widely mentioned. Suppliers' delivery times lengthened for an eighth consecutive month, albeit to the least degree since January.

Finally, inventories of both purchases and finished goods were scaled back, but in both cases at slower rates than in June.

Using PMI to nowcast Malaysian GDP

PMI data are available faster than official GDP and at higher frequency, providing an accurate advance guide to economic growth

Simple rules allow easy interpretation of PMI data for economic growth

A common question we receive is how to use the PMI to predict economic growth, or GDP. Nowcasting models are typically complex, with many variables, of which the PMI can certainly be included. But in many countries, nowcast models do not offer significantly greater accuracy than a simple model that uses just the PMI.

In the case of Malaysia, comparing the headline PMI with annual GDP growth rates shows a reasonably high correlation of 60%, with the PMI acting as a coincident indicator of economic growth. Using the average of PMI Output Index for each calendar quarter lifts this correlation to 74%.

With this correlation as the basis of PMI-implied GDP growth rates, we can build a simple OLS regression model where the annual rate of change in GDP is explained by a single variable: the headline Malaysia manufacturing PMI. The model therefore allows us to estimate GDP using the following formula:

\[
\text{Annual % change in GDP} = (\text{PMI} \times 0.287) - 8.99
\]

Using this formula, a headline PMI reading of 31.4 is comparable to a zero annual growth rate of GDP. Each index point above (below) is roughly the same as 0.3 percentage points of GDP growth (decline) such that:

\[
\begin{align*}
30 & = -0.4 \\
40 & = 2.5 \\
50 & = 5.3 \\
60 & = 8.2
\end{align*}
\]
The IHS Markit Malaysia Manufacturing PMI® is compiled by IHS Markit from responses to questionnaires sent to purchasing managers in a panel of around 400 manufacturers. The panel is stratified by detailed sector and company workforce size, based on contributions to GDP. Survey responses are collected in the second half of each month and indicate the direction of change compared to the previous month. A diffusion index is calculated for each survey variable. The index is the sum of the percentage of 'higher' responses and half the percentage of 'unchanged' responses. The indices vary between 0 and 100, with a reading above 50 indicating an overall increase compared to the previous month, and below 50 an overall decrease. The indices are then seasonally adjusted. The headline figure is the Purchasing Managers' Index® (PMI). The PMI is a weighted average of the following five indices: New Orders (30%), Output (25%), Employment (20%), Suppliers' Delivery Times (15%) and Stocks of Purchases (10%). For the PMI calculation the Suppliers' Delivery Times Index is inverted so that it moves in a comparable direction to the other indices.

Underlying survey data are not revised after publication, but seasonal adjustment factors may be revised from time to time as appropriate which will affect the seasonally adjusted data series. For further information on the PMI survey methodology, please contact economics@ihsmarkit.com.

Survey dates and history
July data were collected 13-27 July 2020. Survey data were first collected July 2012.

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