SME BANK GROUP

INDUSTRY FOCUS:

SECTORAL SCAN

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1 **Macro Developments & Thematic Research**

2 Sectoral Scan & Outlook of Key Sub-sectors

Macro Developments: Impact Analysis (1/2)

China economy reopening

\+ Travel and related industries – **transportation, accommodation, food & beverages** and **retail** are expected to be a top beneficiary.

\+ In 2019, China ranked 3rd in tourist arrival (±12% share; 2022: ±2%) after Singapore (39%; 2022: 52%) and Indonesia (14%; 2022: 15%).

\+ **China has higher per capita spending (RM5,000)** compared to Singapore (RM2,000) and Indonesia (RM3,600) in 2019. Key expenditure of China's tourists are mainly in accommodation, shopping and F&B.

\+ Recovery in China's economic activities should improve demand for goods. This will support Malaysia's exports performance as **China is our 2nd largest export partner** consisting of **E&E (39%), chemicals (9%), LNG (9%), metal (6%), palm oil (5%)**.

– The reopening may **slow the deflationary trajectory** globally hence prices could remain high longer and limit purchasing power. However, inflation in China has been relatively low since the reopening due to uneven economic recovery.

Lower commodity prices

\+ Lower crude oil price (Brent) is a potential positive for the **transportation, consumers (both staple and discretionary)**, and **manufacturing** sector due to lower freight and fuel costs.

\+ **Downstream for the CPO and oil & gas sectors could be beneficiaries** as value added products (refined products) are sold at a premium – low input prices will result in higher profit margins if the benefits are not passed to consumers.

\+ Lower CPO prices should bode well for **manufacturing of food** and **hotel, restaurant and café (HoReCa)**.

\+ **Automotive** – may encourage consumers to buy larger and expensive vehicles over fuel-efficient models

– However, govt may use this chance to remove the fuel subsidy – may pose adverse affect on consumers and businesses at current price.

– **Upstream** segment of the O&G, palm oil and its related industries **could be hit hardest** as selling price is determined by global market.

Ringgit appreciation

\+ Ringgit is expected to **gradually appreciate against USD throughout the year** amid less hawkish stance from the Fed and dwindling fears of a widespread banking crisis in the US and Europe.

\+ YTD (until 2nd May), Ringgit has appreciated against several advanced countries (e.g. South Korea, Japan).

\+ Stronger ringgit would be a **relief for imported-dependent companies** where their input, raw material and operational costs are **denominated in foreign currencies** (Straits Times: ±80% of Malaysia's trade in 2022 is denominated in USD)

\+ **Net importers** will benefit (e.g. **coal, automotive, power generating machinery, metal** and **food** such as cereals, fruits & vegetables, meat).

– Stronger ringgit could **adversely affect export-oriented companies** from a pricing competitiveness angle – top net export sectors: **E&E, CPO, LNG, telco & recording equipment, chemicals, refined petroleum, furniture.**

– May **dampen inbound tourists that are cost conscious** vis-à-vis ASEAN peers.

Sources: EMIS, CEIC, DOSM, Bloomberg, The Straits Times and SME Bank Economic Research

Revision in minimum wages and labour shortages

+ Higher wages could push businesses to adopt more **automation** and value-added processing as a form of cost-minimization in the long run – **increase demand for ICT and digitalisation services.**

+ **Retail sector may benefit** from the rising individual income as people have **higher disposal income** and spends more (higher sales/revenue).

– Nonetheless, it could also affect companies' operating costs as they need to pay their employees higher wages **to retain talent** amid staff shortages.

– Other sectors that are likely to be affected by the higher minimum wage are **agriculture** (plantation), **construction, labour-intensive manufacturing and services** (F&B, accommodation, administrative & support services).

– Foreign labour demand is critical in key sectors: **construction, agriculture, services** and **manufacturing**.

– The construction sector lacks about 300k workers, agriculture (230k), manufacturing (100k to 200k), whereas service sector (100k). While these sectors may be **operating below their potential capacity**, the recent **Foreign Worker Employment Relaxation Plan** (Jan 17 – March 31) may **provide some respite** as it speeds up approvals of foreign worker quota applications from 15 source countries.

Rising cost of doing business (high inflation & electricity tariff hike)

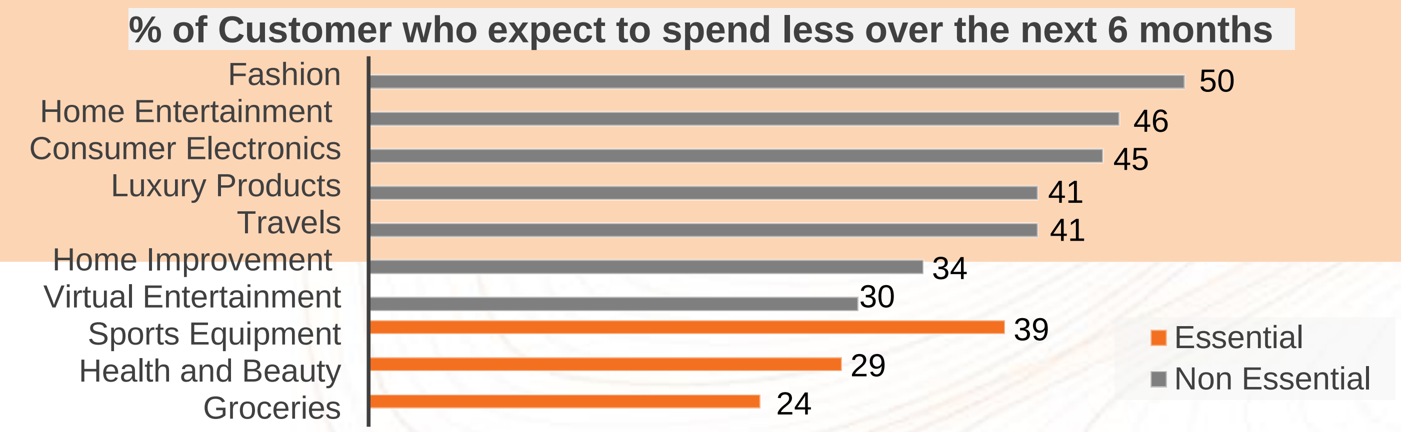
+ The increase in electricity tariff is **excluded for domestic consumers, SMEs,** as well as **producers in the agriculture and food industries.**

+ The tariff hike could encourage the **shift towards renewable energy (e.g. solar panels, biomass)** which can be costlier (hence more doable by large companies) in the short run but has more advantages in the long run.

– Nonetheless, at this juncture, industries that **consume high electricity (e.g. manufacturing of chemicals, metals, cement, paper, machinery and service providers such as F&B, hotels & theme parks)** will be **affected** the most.

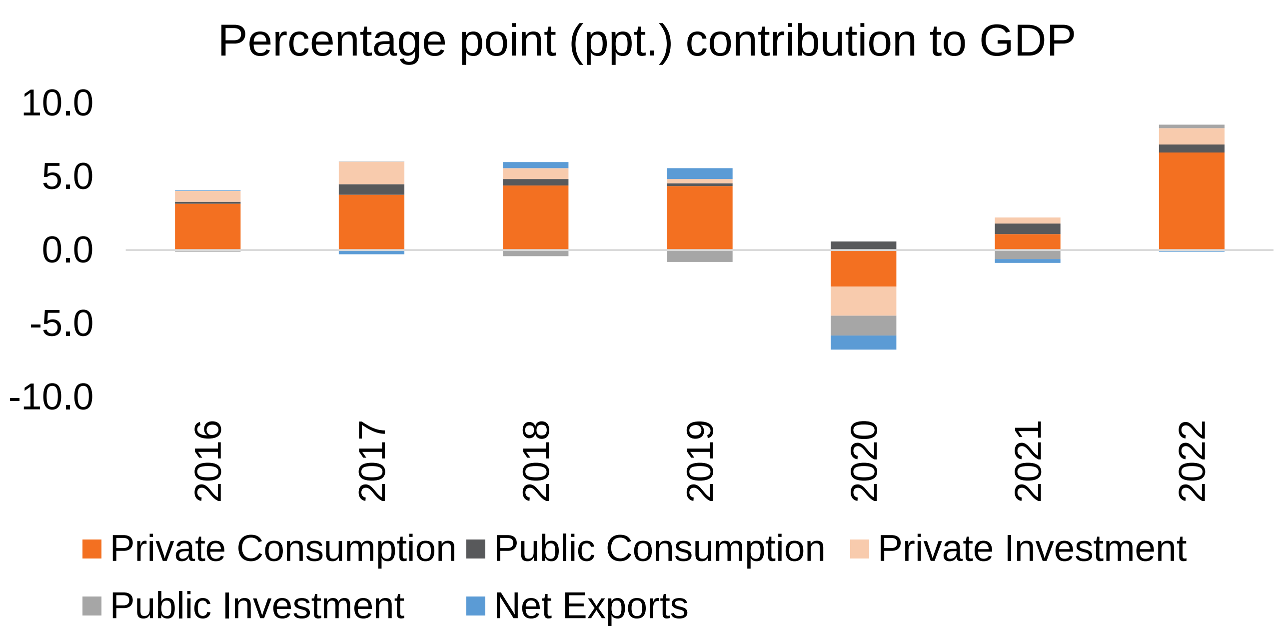
– High inflationary pressure remain broad based, affecting **almost all industries** especially when competition is stiff, and companies are unable to pass it on to consumers.

– Malaysians are expected to **cutback on non-essential spending more sharply** during leaner times (tighten belt) – according to PWC, 50% of consumers are expected to spend less on Fashion.

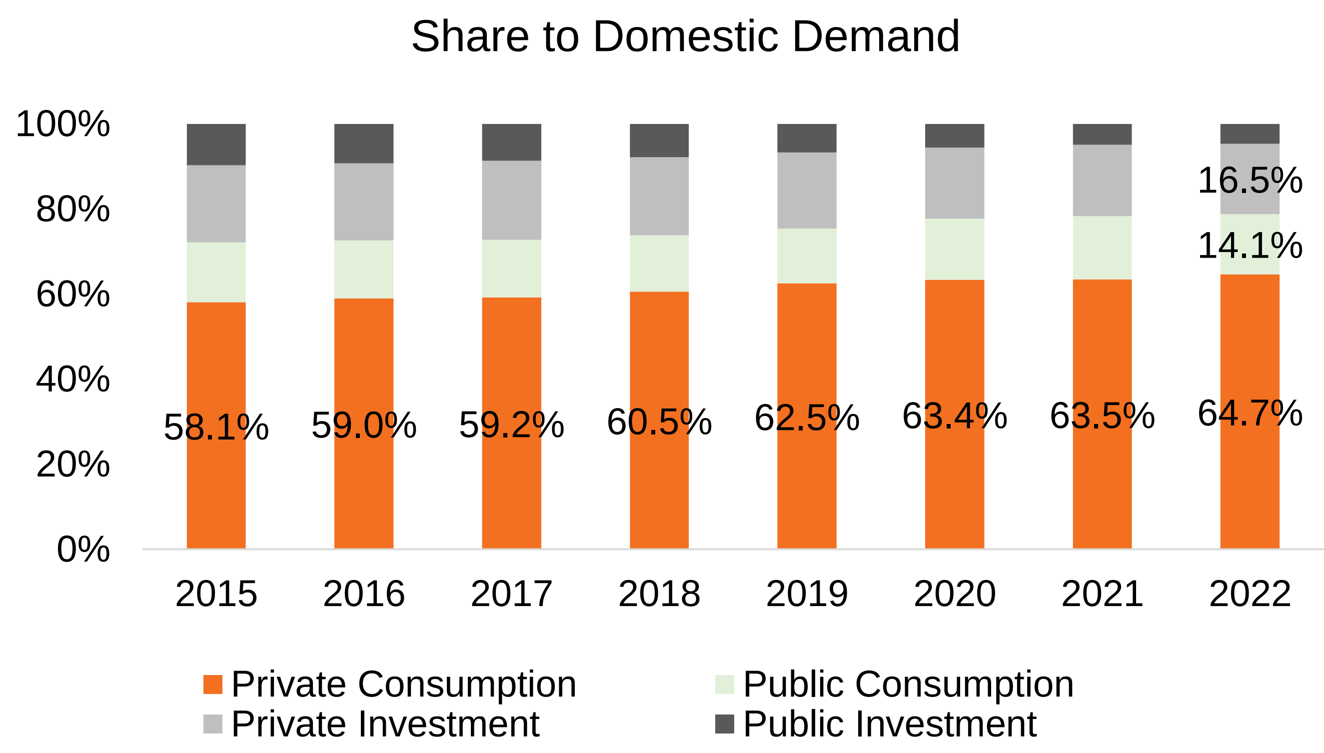


Sources: Association of Employment Agencies (Papa), PWC Global Consumer Insights Pulse's Survey, CEIC and SME Bank Economic Research

1 **Domestic demand made up 93% of GDP in 2022 and contributed 8.5 ppt to the growth (2022's GDP: 8.7%)**



2 **Private consumption is the key component of domestic demand**



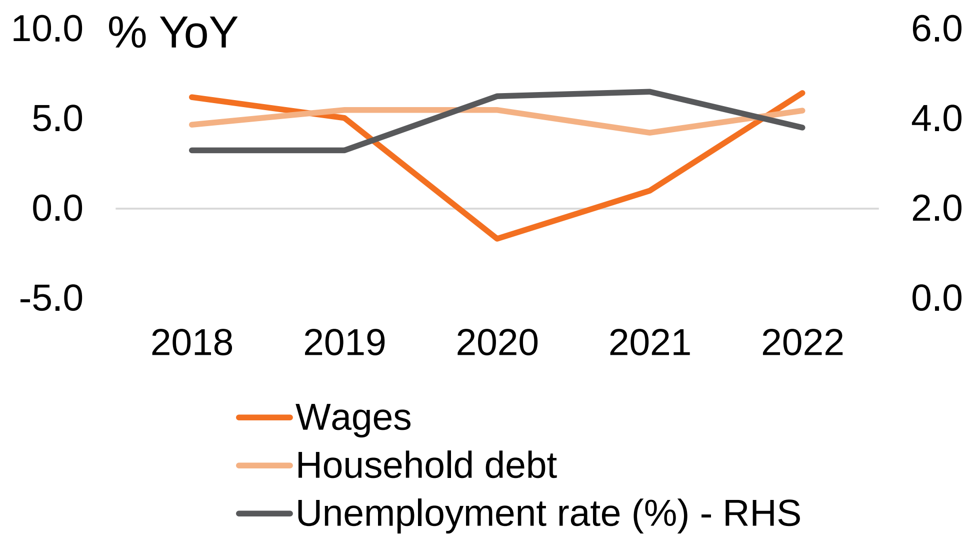
- Domestic demand **has always been the largest contributor to GDP vs external demand.**
- **Domestic demand share** stood at **93.1% of GDP in 2022** (2021: 92.7%: 2019: 93.9%), amounting to RM1.4 tri, lesser than pre-pandemic level amid growing external trade contribution **(export's 2019: 63.8% vs 2022: 71.7%).**
- However, external demand (exports) is expected to slow this year (BNM's 2023f: 2.7% YoY; 2022: 12.8%) amid high inflation and interest rates, elevated debt levels (which may limit fiscal assistances) and geopolitical uncertainties.
- Thus, domestic demand (BNM's 2023f: 5.4% YoY; 2022: 9.2%) is expected to support the overall GDP growth in 2023 albeit at a slower pace.

- Domestic demand is **largely driven by the private sector**. **Share of private consumption and private investment to domestic demand** stood at 64.7% and 16.5% respectively, followed by public consumption (14.1%) and public investment (4.7%).
- Private investment share has been trending downward for the past years (share to GDP in 2022: 15.4% vs 2019: 16.8%), which could dampen the long term growth prospective.
- BNM foresee **private consumption to moderate** at **6.1% YoY in 2023** (2022: 11.3%), below historical growth rate (average 2016-2019: 7.1%).
- Meanwhile, **private investment** is expected to grow by 5.8% YoY in 2023 (2022: 7.2%; average 2016-2019: 4.8%).

Sources: BNM, CEIC, DOSM and SME Bank Economic Research

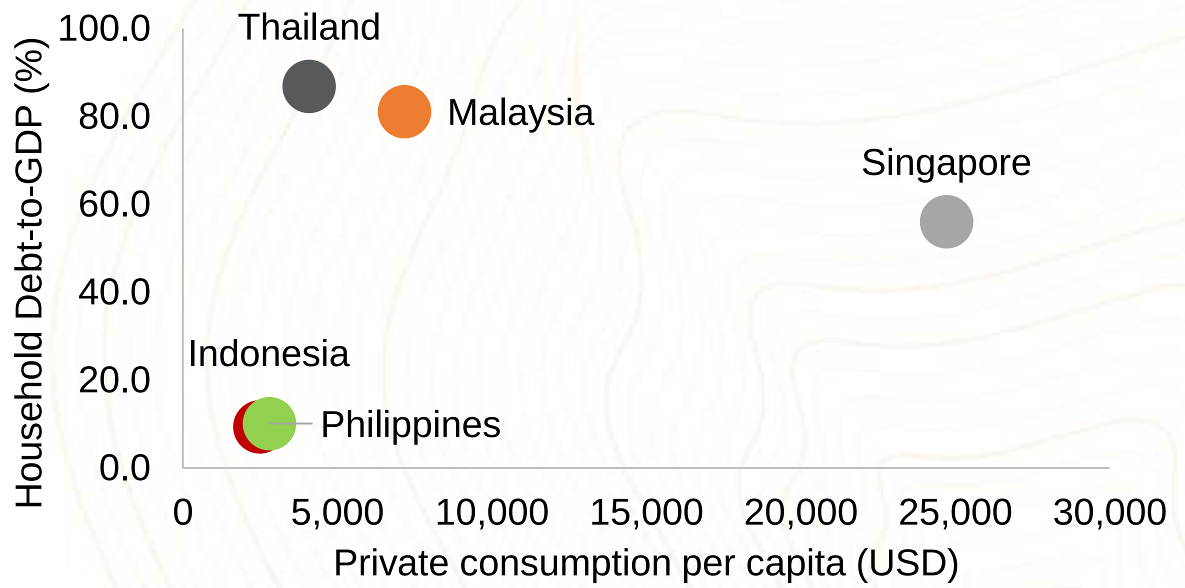
Private consumption supported by wages, debt and savings…

1 Growth in wages exceeded household debt in 2022 as labour market improved

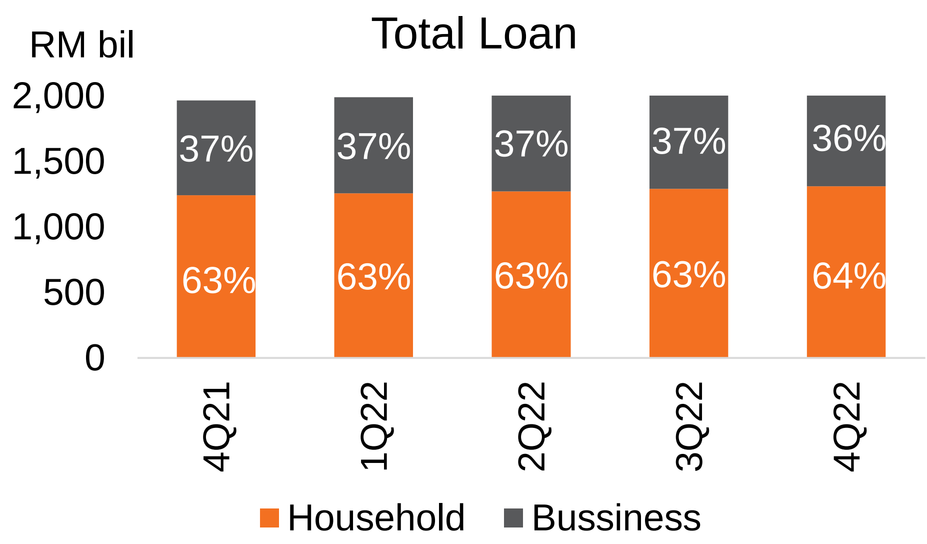


Note: Wages derived from services and manufacturing sectors (sum of both sectors)

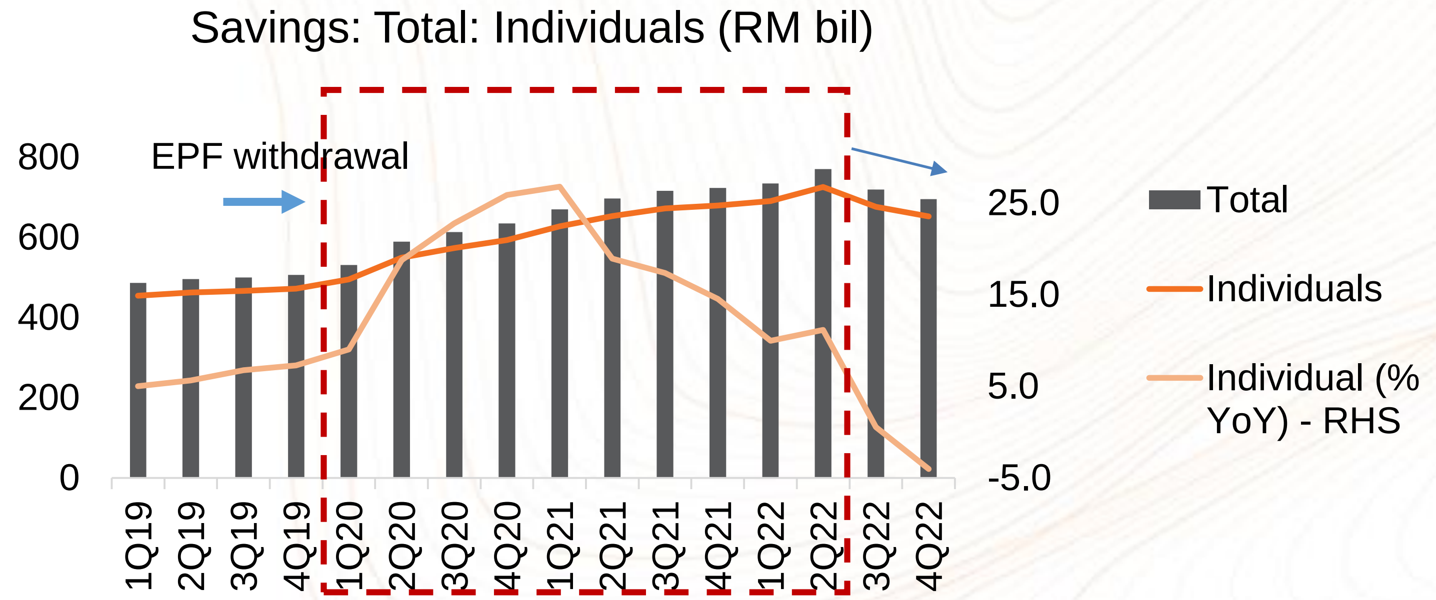
2 Malaysia is the 2nd highest among ASEAN members for debt driven consumption



3 >60% of total domestic banking debts are households related consumption (residential property, passenger cars, personal uses, credit cars, etc)



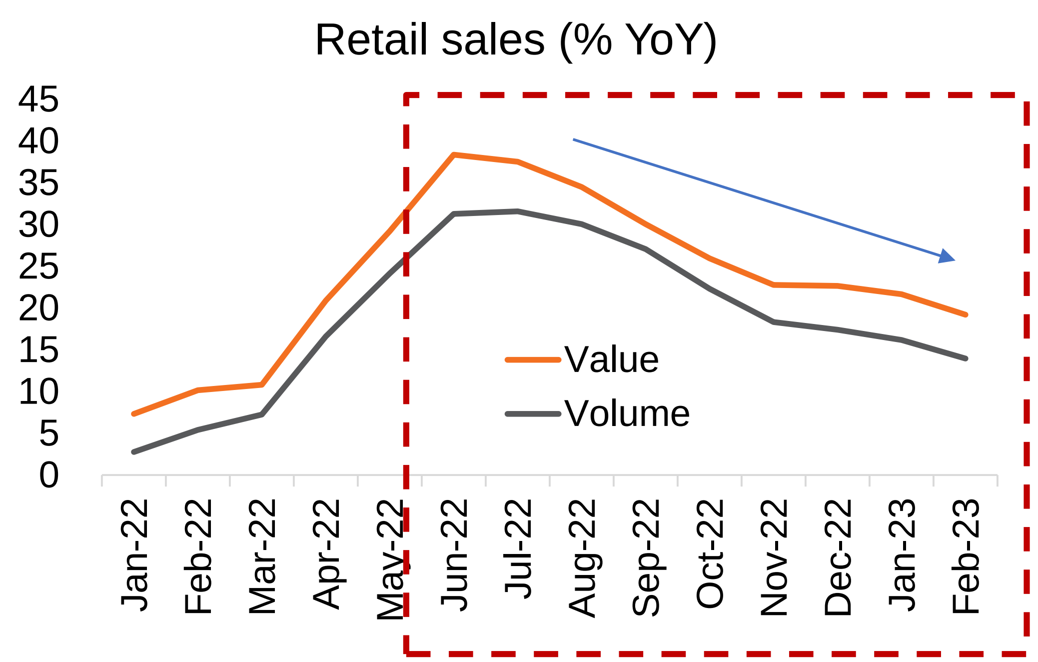
4 Excess saving is still above pre-pandemic levels but has been shrinking, reflecting pressures from higher cost of living



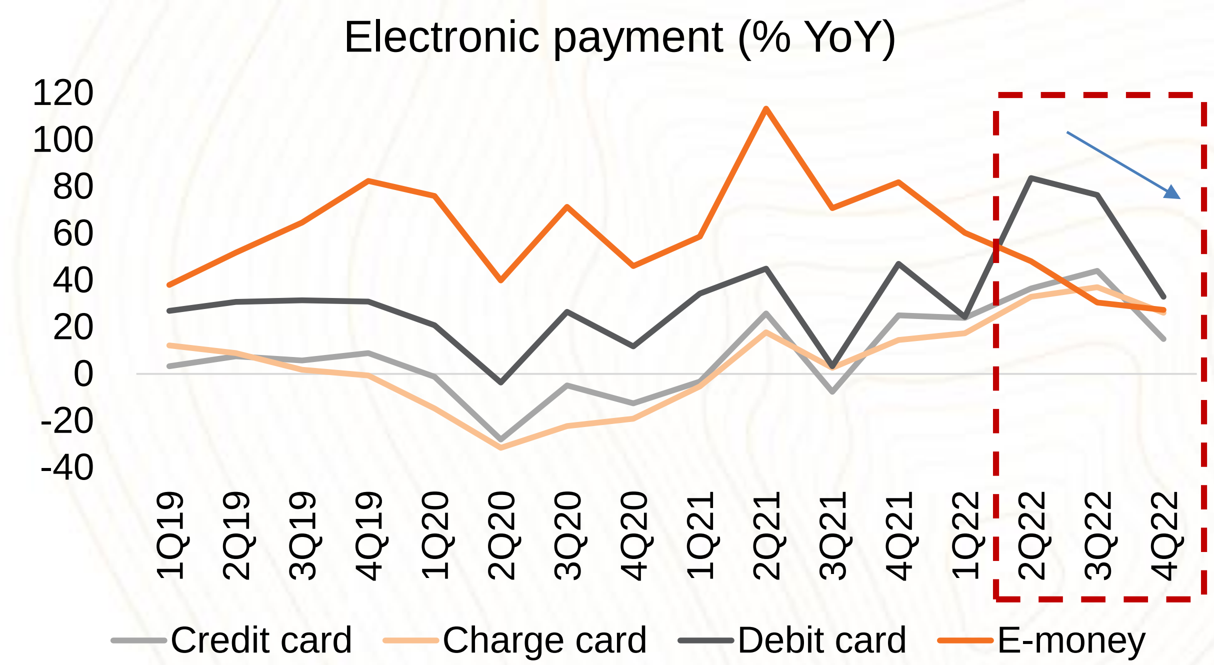
Sources: BNM, CEIC, Country's specific DOSM, World Bank and SME Bank Economic Research

…however, indicators of private consumption have started to moderate

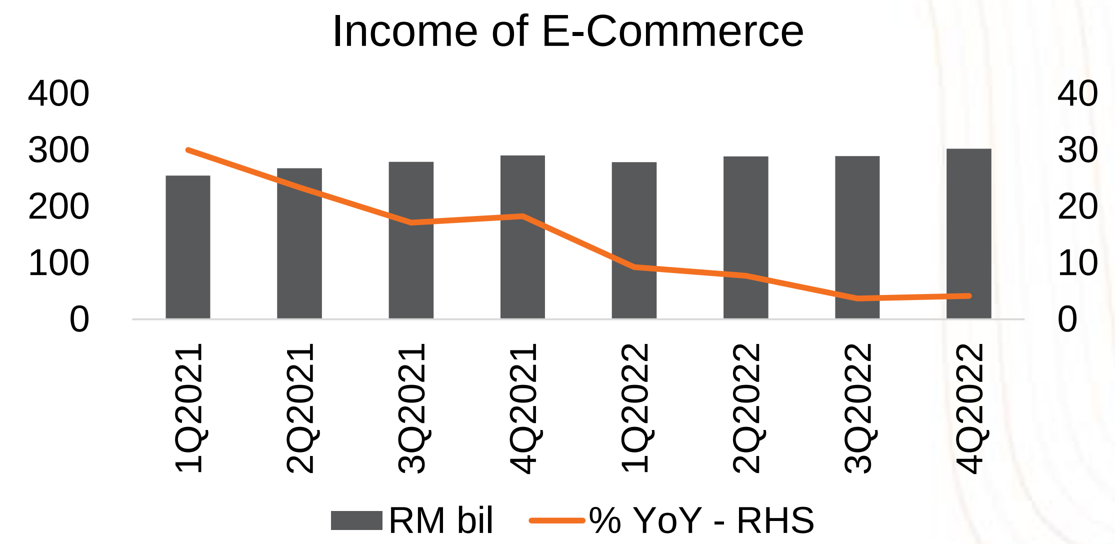
1 **Retail sales growth have been easing due to high base effect and other factors (e.g. higher interest rate and waning pent up demand)**



2 **Easing consumption are reflected in the moderation of electronic payment in recent quarters**



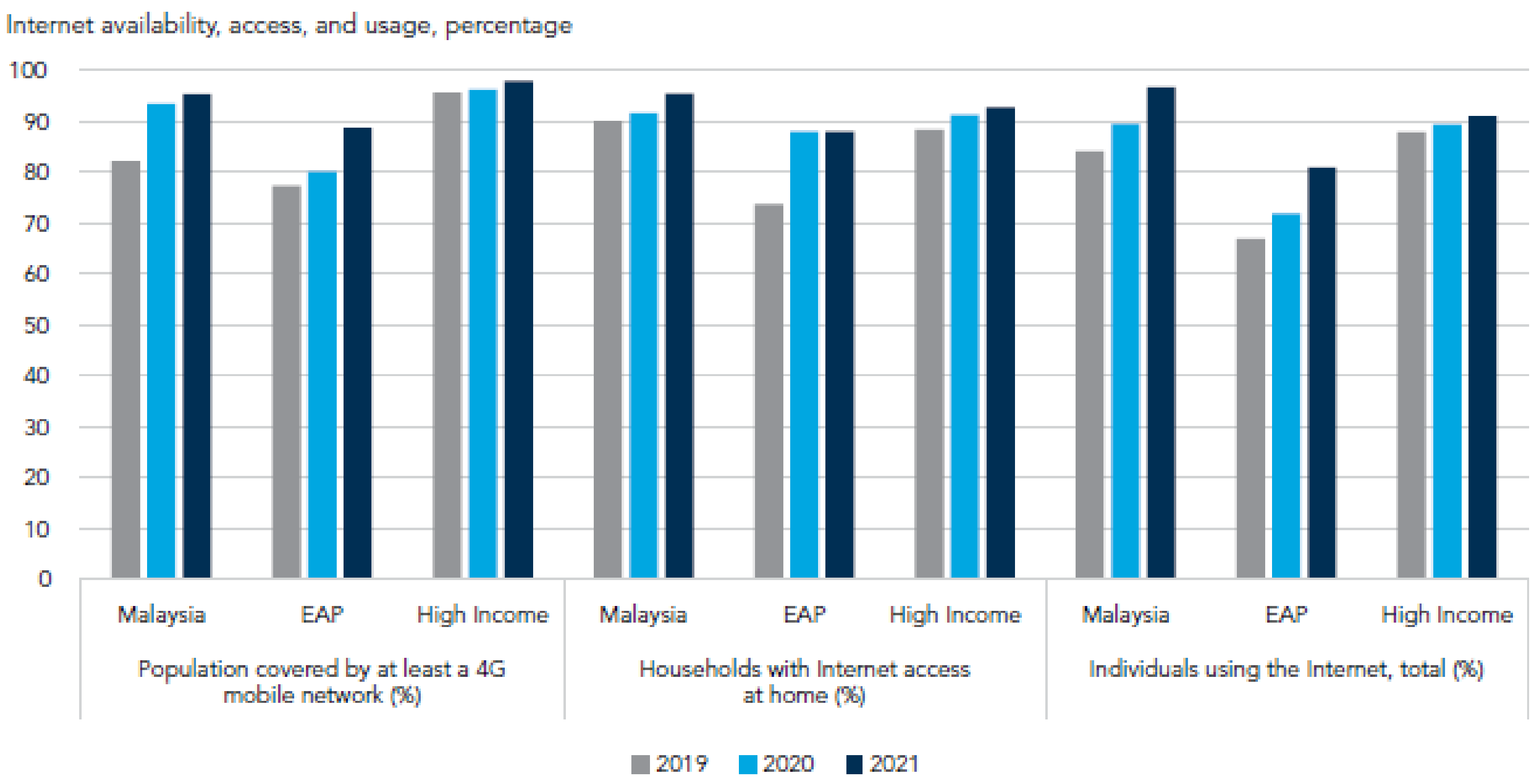
3 **In line, e-commerce continued to grow, but at a slower pace**



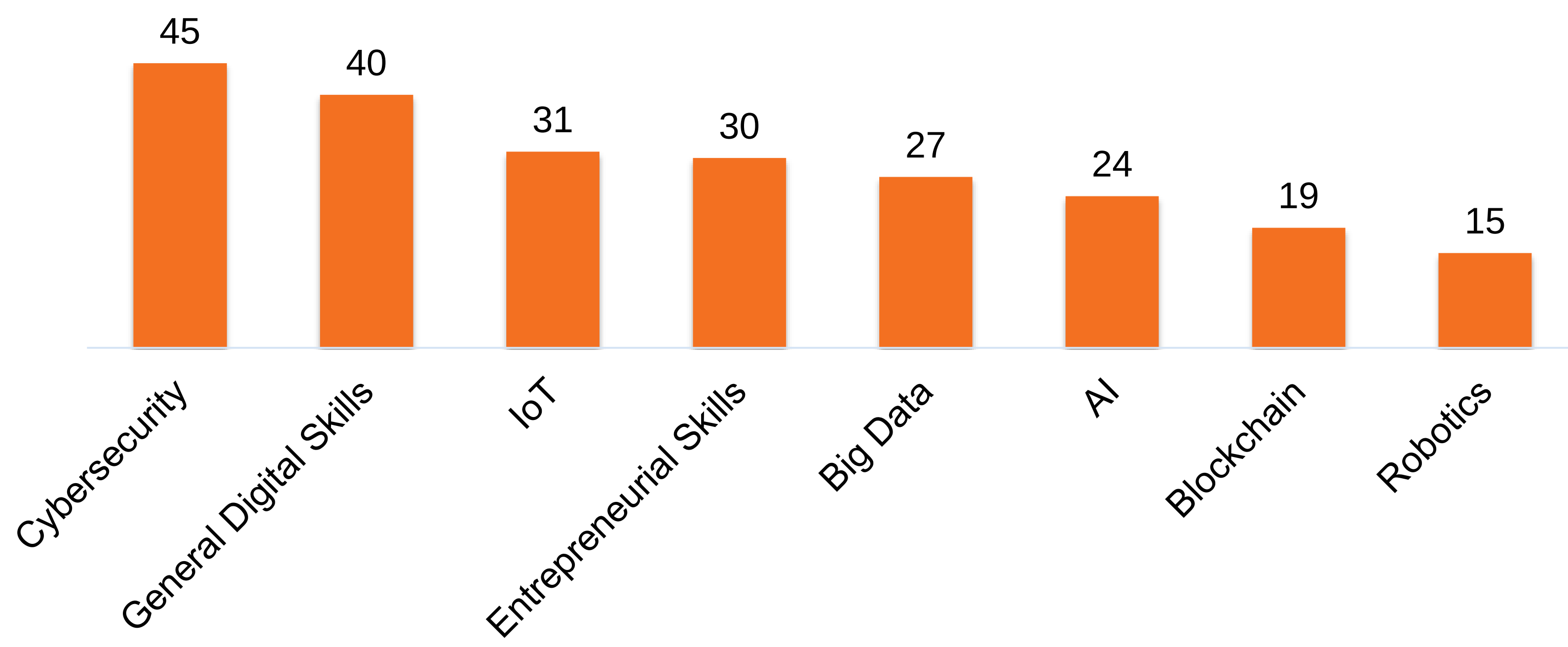
Sources: BNM, CEIC, DOSM and SME Bank Economic Research

Thematic Research: Domestic demand to drive GDP growth (4/5)

World Bank: The pandemic accelerated digitalisation in Malaysia



Firms outsourcing types of digital skills (share of firms, %)

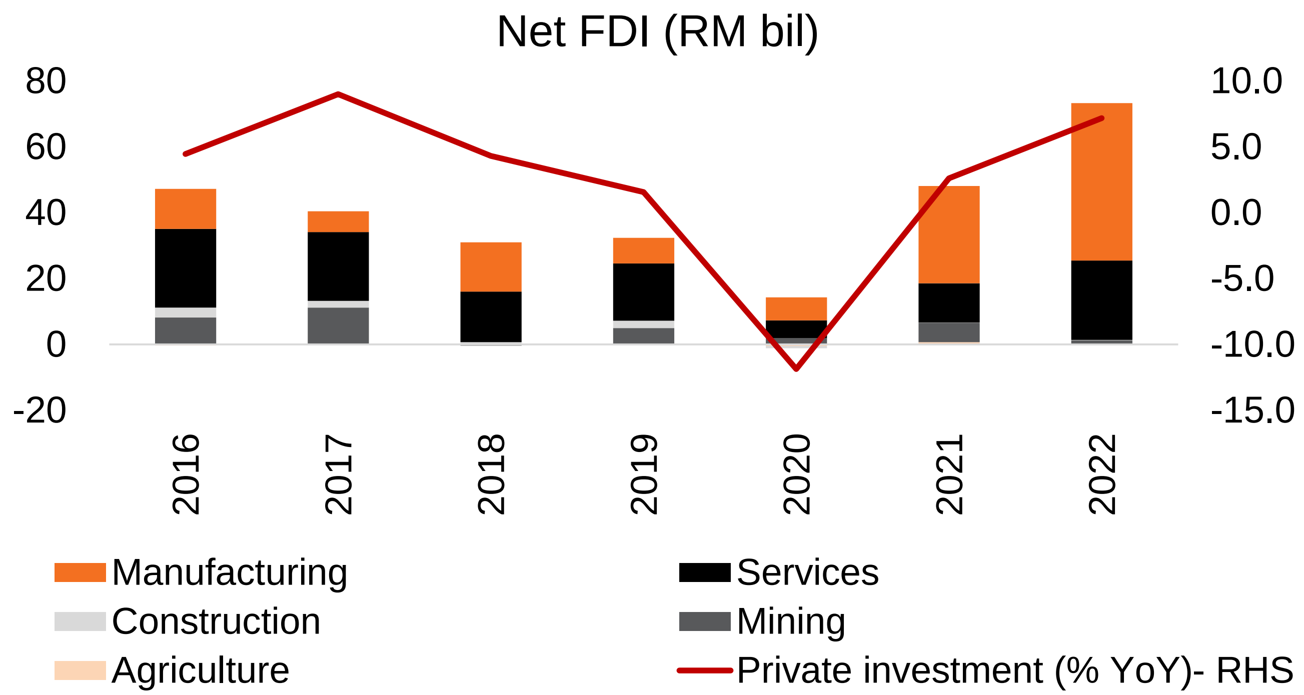


- A rapid expansion in access and usage of internet have led to:
  i. **an increase in Malaysians using digital payments** in 2021 to 79% (2017: 70%; 2014: 63%).
  ii. An acceleration in the pace of digitalisation among firms. **Half of total SMEs have increased the use of digital platforms.**
  iii. 70%-90% of government services are already in end-to-end (E2E) online services/ fully digitalised in 2021.
- Despite the acceleration, **inadequate financial resources** is the most cited reason (~40%) among SMEs which constraints the adoption of new digital technologies.
- **Large firms are more likely to invest in digital solutions than smaller ones.** Share of firms investing in digital solutions (Small: 54%, Medium: 81%; Large: 83%).
- **Current digital adoption is considered permanent** as only a tiny fraction (2%-5% of business) would revert to pre-pandemic manual systems.
- Nonetheless, as the nation reaches the full adoption rate, the **rapid expansion cycle may gradually normalize in the future.**
- In term of outsourcing the digital skills, cybersecurity has the highest tendency (45% of firms surveyed) probably due to cost efficiency – leverage on the industry experts.
- In contrast, robotis has low % in term of outsourcing related digital skills as it is more production related – need to have readily available in-house experts to monitor production to avoid any hiccups.

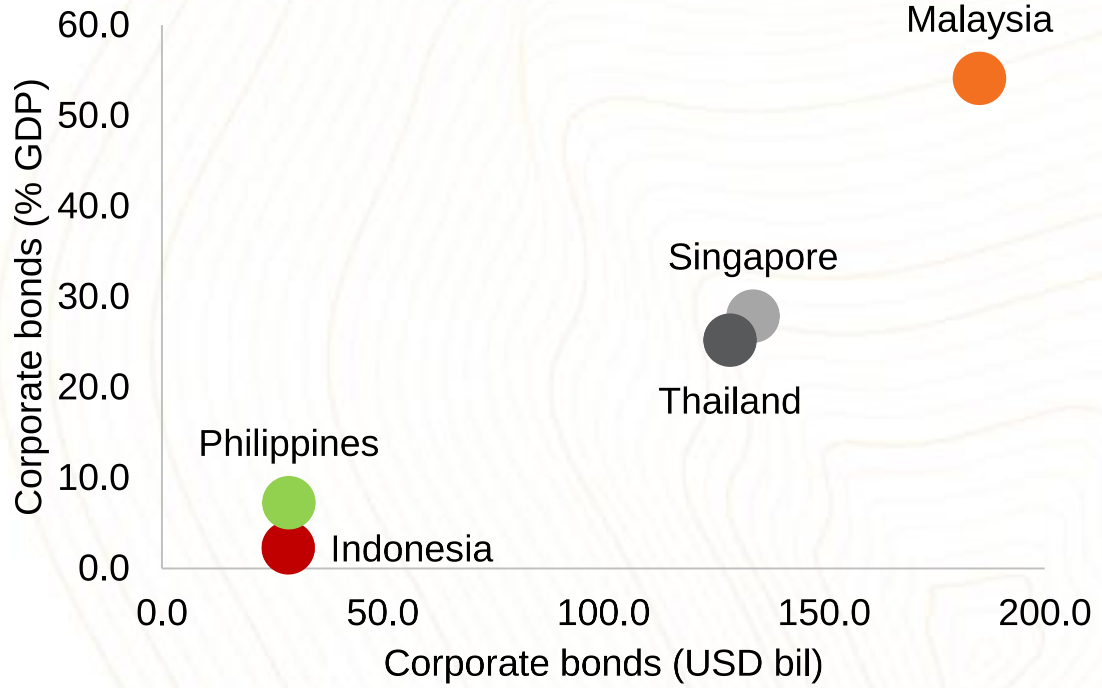
Sources: World Bank and SME Bank Economic Research

Resilient investment supported by domestic and external factors

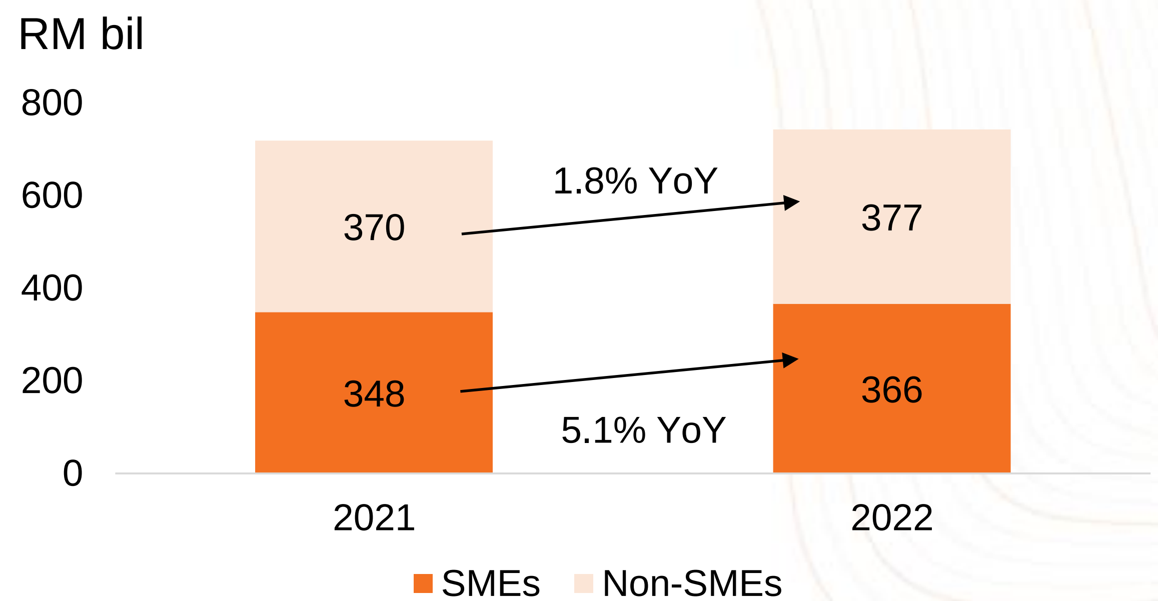
1 FDI inflows diverts from services to manufacturing in recent years



2 Malaysia has the most developed corporate bond market in ASEAN-5 to support fund raising & long-term investments.



3 Faster financing growth for SMEs compared to Non-SMEs



Sources: asianbondsonline, BNM, CEIC, DOSM and SME Bank Economic Research

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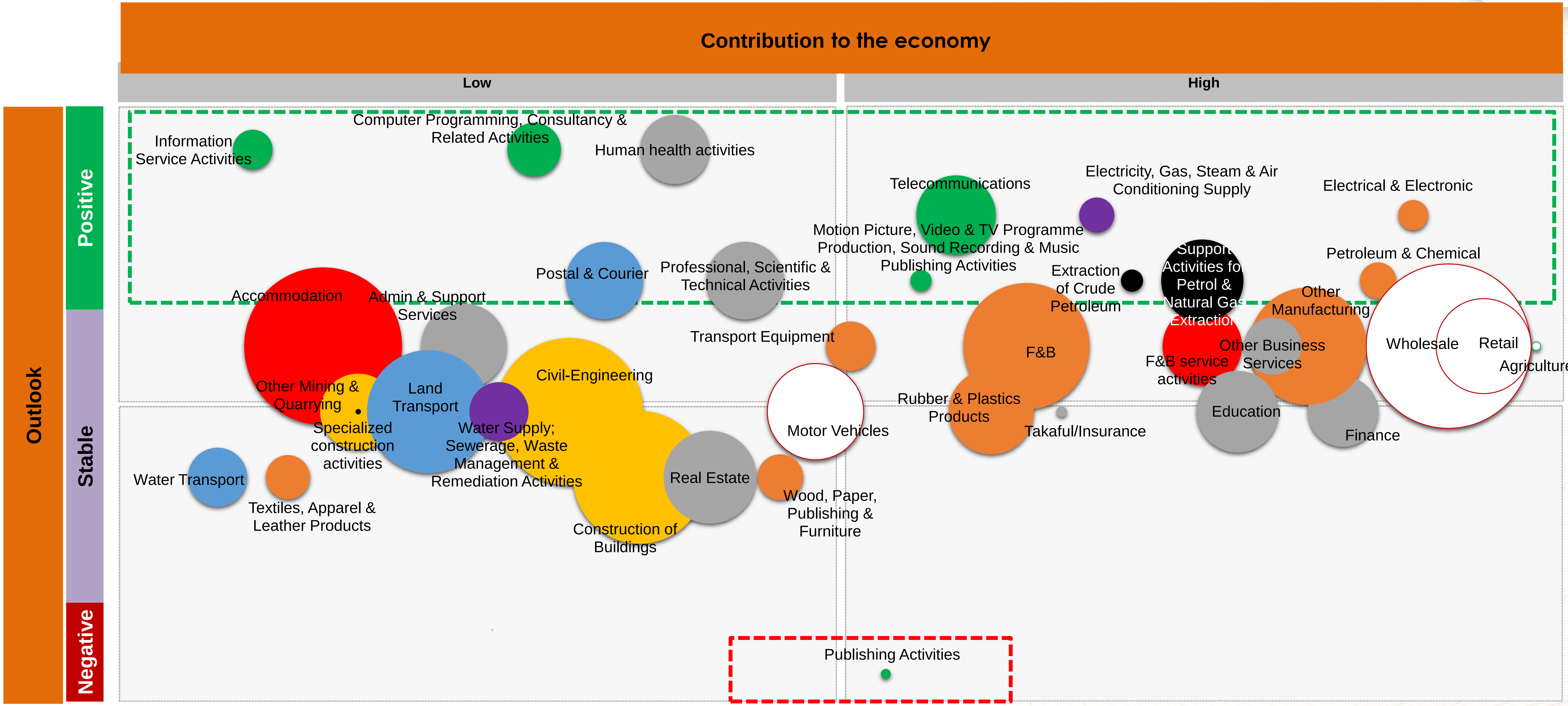

Legends

Accommodation & F&B Services	Real Estate, Business Services & Other Services
Mining & Quarrying	Utilities
Construction	Manufacturing
Agriculture	Information & Communication
Transportation	Wholesale, Retail & Motor Vehicles

 Sources: EMIS, CEIC, DOSM and SME Bank Economic Research

Sectoral Scan: Outlook of Key Sub-sectors (2/5)

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ELECTRICITY, GAS & AIR CONDITIONING

Positive Outlook

PROS

- **Supportive govt** policies & initiatives on renewable energy (RE). Supply of RE is currently at 25% (targets 31% by 2025; 40% by 2035).
- **High commitment by Sarawak govt.** to lead in RE. 1st in the region to generate power from **wind using AI Tech.**
- **Solar industry** – high demand and lower cost of installation
- **Increase in EVs** and **charging points** (govt plans to set up 10k charging station by 2025)

CONS

- Require **large capital investment**
- **Regulated by govt** and **high competition** to win tender projects (e.g. Large Scale Solar Project)
- Hydropower Mega Dams projects can give **rise to a range of ESG concerns** (Landslide serves as a threat to river ecosystem).
- **High possibility of hacking and unauthorized electricity theft** (EV Charging Station) – may require investment to enhance security measures

TELECOMMUNICATION

Positive Outlook

PROS

- The **ramp-up of 5G's infrastructure** (Mar 2023: 55% completion; targets 75% by year end
- Increase in 5G for **commercial uses** (real-time tracking) esp. in mfg and warehouse facilities
- Increase in **data usage** with 5G mobile phones and smart appliances – internet bandwidth peaked at 1.9tbps in 2022 (2020: 588gbps)
- Spillover effects from **rising data centres** and demand for cloud services

CONS

- No new major catalyst after 5G – **6G will only be ready by 2030**
- **Highly saturated telco towers** – 47k telco towers in 2021 (2018: 22.7k) – hence small room for further growth
- **Fierce pricing competition** and **govt intervention** hence prices remain low –ripple effect to sub-contractors (less new projects from providers to minimize cost)

MOTION PICTURE, VIDEO & TV PROG.

Positive Outlook

PROS

- **Global visual effect and 3D animation market** to grow at a CAGR of 10.4% (2023 - 2028) and 11.7% (2021 - 2028), respectively
- Increase in services (e.g. **visual effect, sound**) to international clients. Many local talents/ studios work for global studio/film (Life of Pi, X-Men)
- Up and rising **local animations** gaining attraction in the ASEAN and global market (e.g. Boboiboy, Upinlpin, Mechamato)

CONS

- Small local industry hence **high dependency on foreign contracts** – causing labour migration as well
- **Loose IP law** – unauthorised usages/counterfeit- (e.g. logo/picture on products)
- **High cost** – involves high tech apps & high-skilled labour

Sources: EMIS, CEIC, Statista, The Edge, Malaysia Internet Exchange (MYIX), Expert Market Research (EMR), Grand View Research and SME Bank Economic Research

Sectoral Scan: Outlook of Key Sub-sectors (5/5)

ELECTRICAL & ELECTRONIC

Positive Outlook

PROS

- **China-US chip tension** may benefit Malaysia – **trade diversion**
- The **global transition towards 5G and digitalisation** is continuing – massive investment in the E&E sector, particularly in Penang (e.g. Intel, AMD, and Micron Technology)
- **Increasing Electric Vehicle (EV)** production in Malaysia – **govt incentives** (financing extension with 60% guarantee, import duty and excise duty exemption on EVs, tax incentives for manufacturer of EV charging equipment
- **Growth in smart technology** – e.g. Global Smart toys (CAGR of 16.5% for 2023-2032) – opening of first smart digital hotel and Augmented reality park in Malaysia.

CONS

- **Semiconductor downcycle** – WSTS **forecast global semiconductor market to decline by 4.1% YoY** this year (2022e: +4.4%, 2021: +26.2%).
- **Decreasing demand** for tablets, smartphones, and PCs, as consumers hold onto their devices longer due to the **absence of new technology**
- **Some devices** (e.g. radio) is becoming a **sunset industry** – but **paves the way for other segment** - smartphones incorporating music (e.g. Joox, Spotify), WiFi air conditioner – may require more chips/ advance ones
- **Talent shortage** in semiconductor industry – MSIA: industry struggles to attract new talent and have high employee turnover >10%

RUBBER & PLASTIC PRODUCTS

Stable Outlook

PROS

- **Post pandemic hygiene concerns** support usage of gloves in other sectors (F&B, manufacturing)
- **Ageing population** – rising share of >60 years old to total population (2021: 11% vs 2010: 8%) – require more healthcare services hence higher demand for gloves
- R&D in rubber tech. – to diversify rubber products (e.g. tyres)
- High demand for **durable/hard plastics** – used in E&E, automotive industry, etc
- **No easy substitute** to hard plastics due to **low cost, versatility**
- May benefit from **Comprehensive & Progressive Agreement for Trans-Pacific Partnership** – export market opportunities to net importer of plastic products (Canada, Mexico & Peru)

CONS

- **Oversupply** of gloves as Covid-19 subsides
- Not so attractive average selling price (ASP) (ytd 2023: ±USD20; avg peak in 2Q2021:USD78) – insufficient to fully pass on the cost increase
- Increase cost from revision in minimum wage and **electricity tariff hike**
- Labour shortages as it is a labour intensive industry
- High barrier of entry as **conquered by giant companies** (e.g. Top Glove, Hartalega, Kossan)
- **ESG concerns** for plastic products

 Sources: EMIS, CEIC, World Semiconductor Trade Statistics (WSTS), MSIA 2022 E&E Survey, JP Morgan and SME Bank Economic Research

Sectoral Scan: Outlook of Key Sub-sectors (5/5)

ACOMMODATION

Stable Outlook

PROS

- **Continuous recovery** in tourism industry, sustained by domestic tourism – hotel occupancy rate at 47% in 3Q22 (2Q: 44%)
- Resumption of **China outbound travelling**
- More **local attractions** ranging from islands, mountains to heritage buildings and skyscrapers
- Opportunities in **new demand area** e.g. low-carbon vacations, ecotourism (glamping), sustainable travel, destination wedding
- **Improved connectivity** via new highways & trains as well as road/ congestion improvement in hot spots
- Active **promotional/marketing activities** – 1) Govt's sales mission & roadshow in foreign countries (e.g. China, India); 2) social media influencers free/paid reviews on their experiences

CONS

- **Still high inflation** e.g. airline ticket prices, food
- **Appreciation in Ringgit** – encourage Malaysians to travel abroad and could dampen inbound tourists
- **Competition with neighboring countries** (e.g. Thailand, Indonesia, Singapore) in attracting tourists
- **Cloudy economic outlook** – less income/ opt to save for rainy days
- **Proposed luxury goods tax** – set to be implemented this year but no specific date yet
- Maintenance and refurbishment of hotel/resort can be costly
- Understaff

EDUCATION

Stable Outlook

PROS

- More **working parents** increases demand for early education (~2 years old)
- Continuous **govt support** (e.g. income tax exemption for kindergarten fees, early school aid)
- Parent's **brand awareness** – preference towards **holistic education**, arts & skills (e.g. music, dance, martial arts, drawing)
- **High fragmentation in private schools** (mostly only has 1-2 branches) – provide **opportunities for SMEs** to enter and reach smaller target markets
- **Increasing demand in TVET** – supported by various govt incentives
- Prospect of **international students** returning – 130k to 170k foreign students enrolment in 2022 (2025 goal: 250k students).

CONS

- **High competition** at **kindergarten** levels (heavy franchising)
- The use of Youtube and Google as **substitute to tuition centres**
- Revision to minimum wage – increase labour costs
- Demotivating factor to further tertiary studies 1) **Course mismatch** between what's being offered in the university vs what's needed by the industry – industries source talent overseas; 2) **availability of gig jogs** – didn't require high qualification

Sources: EMIS, CEIC, International Consultants for Education and Fairs (ICEF) Monitor and SME Bank Economic Research

Sectoral Scan: Outlook of Key Sub-sectors (5/5)

CONSTRUCTION & BUILDING

Stable Outlook

PROS

- **Thriving industrial property** amid rising e-commerce, data centres, and F&B (e.g. warehouse & storage, industrial parks)
- **Surged in FDI** last year will translate into construction of infrastructure such as factories and related facilities (FDI in 2022: +32% YoY to RM278 bil, above 2017-2019 average of RM151 bil)
- **New projects under Budget 2023** such as schools, hospitals, and sport facilities.
- **Doubling Singapore's non-resident property taxes to 60%** could lift property sales in nearby states such as Johor.
- **Stamp duty exemption** for first time home buyers and transfer of property (the first RM1 mil)

CONS

- **High building material prices** (cement & steel), higher borrowing costs (increasing OPR) as well as acute labour shortages
- **Oversupply in high-end residential** (47.2% of total residential overhang in 2022). Highest overhang recorded in Johor (5.3k unit), followed by Selangor (3.7k) and Pulau Pinang (3.6k).
- **Declining office occupancy rate** (2022: 78.5% vs 2019: 80.6%) and expected to be even **more challenging** with **influx of upcoming supply** e.g. TRX, PNB 118
- **Future oversupply risk** of industrial properties due to current rapid building.

WHOLESALE & RETAIL

Stable Outlook

PROS

- To benefit from **continuous economic recovery** & increasing tourism activities via both **brick & mortar** and **online platforms**
- Relatively good demand for **niche products** (e.g. Korean specific, on-the-go hot food, designer brand offers ready-to-wear clothing)
- **Wholesalers ventures into retail market space** to penetrate neighborhoods
- Govt initiatives (Payung Rahmah) may attract customers – more **volume-driven sales**
- **Digitalisation and automation** facilitates business operations – minimize costs in long term
- Pharmacies to remain resilient with **strong demand for healthcare** – Revenue CAGR (2019 – 2025F): 9.3%

CONS

- **Inflationary pressure** may limit consumers' purchasing power – **cutback on discretionary items**
- High competition both locally and externally – **rising chain stores** (has economies of scale) – such as F&B and pharmacies
- **Direct online store** sellers may eliminate retailers
- Wholesalers venturing into retail market **threatens retailers** (e.g. Mini Giant, Mydin Mart)
- **Menu Rahmah** could be **negative to SMEs.** Big industry players could cross subsidies to attract customers

Sources: EMIS, CEIC, National Property Information Centre (NAPIC), Ken Research and SME Bank Economic Research

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