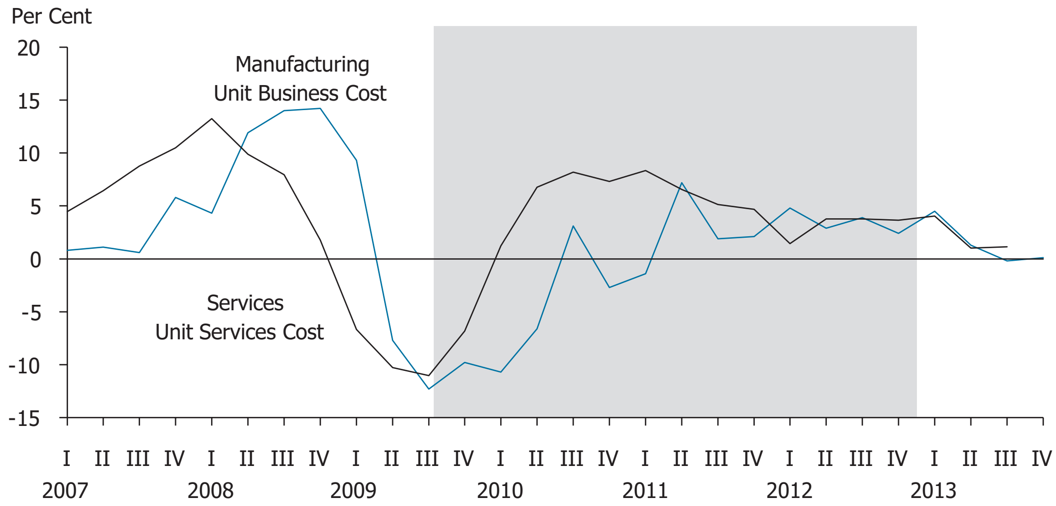
Box 3.1: Business Costs of Singapore's Manufacturing and Services Sectors

Business costs in the manufacturing and services sectors have increased after a period of decline during the global financial crisis (Exhibit 1).[1] Between the third quarter of 2009 and the first quarter of 2013, the unit business cost (UBC) index for the manufacturing sector rose by 19 per cent cumulatively, while the unit services cost (USC) index for the services sector rose by a higher 25 per cent. However, the pace of increase in business costs has moderated in recent quarters. For the whole of 2013, the UBC index rose by 1.5 per cent, slower than the 3.5 per cent increase in the previous year. Similarly, the increase in the USC index eased from 3.1 per cent in 2012 to 2.1 per cent[2] in 2013.

Exhibit 1: Manufacturing UBC Index and Services USC Index



Source: Singapore Department of Statistics, Monetary Authority of Singapore

Labour, utilities and trade & transport costs make up the bulk of business costs in the manufacturing sector

In the manufacturing sector, labour cost takes up the largest share of total business costs, followed by utilities and trade & transport costs (Annex A, Exhibit A1). Collectively, these three cost components account for 78 per cent and 85 per cent of the total business costs of small-and-medium enterprises (SMEs) and large enterprises in the sector respectively.[3] Other services cost components, including rentals, and government rates & fees account for only a small proportion of business costs for both SMEs and large enterprises in the sector. (See details of the cost structures of SMEs and large enterprises at the overall level, as well as in the various manufacturing clusters in Annex A.)

[1] Only operating and recurrent costs are included as part of business costs. This follows the definition adopted by the Singapore Department of Statistics (DOS) in its computation of the Unit Business Cost for Manufacturing. See DOS' Information Paper, "Unit Business Cost Index of the Manufacturing Sector: Rebasing to Year 2005", September 2010.

[2] Based on the first three quarters of 2013.

[3] Based on SPRING's definition, SMEs refer to firms with annual sales turnover of not more than S$100 million or employment size of not more than 200 workers.

Similarly, labour cost is a major cost component for most services industries

The diverse nature of services activities means that business cost structures vary considerably across services industries. Nonetheless, labour is still a major cost component in most of the services industries, especially in the labour-intensive retail trade and accommodation & food services industries where it accounts for more than 30 per cent of total business costs (Annex A, Exhibit A2). The SMEs in the retail trade, accommodation & food services and information & communications industries, in particular, have some of the highest labour cost shares.

Rentals are a key cost component for selected services industries, notably the retail trade and accommodation & food services industries. The SMEs in these two industries face rental shares of 32 per cent and 20 per cent respectively.

Labour, utilities and rentals were the key drivers of recent increases in business costs

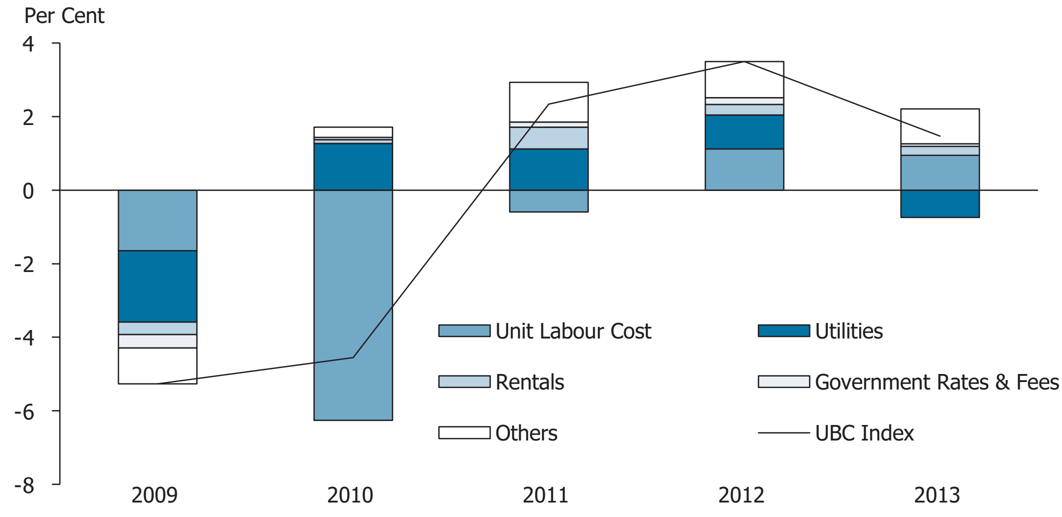
As labour and utilities costs constitute a large part of total manufacturing business costs, it is not surprising that they were also the key drivers of manufacturing UBC changes in the last five years (Exhibit 2). On an annual basis, utilities cost contributed significantly to UBC increases in 2010 and 2011. However, its contribution moderated in 2012 and turned negative in 2013 in tandem with easing global oil prices and an increase in new generation capacity which led to greater competition in the wholesale and retail electricity markets.

By contrast, the contribution of manufacturing unit labour cost (ULC) – or total labour cost per unit of output – was negative in 2010 and 2011, largely due to strong productivity growth in those years as the economy recovered from the financial crisis.[4] In 2012 and 2013, however, manufacturing ULC increases became the largest contributor to UBC increases, as labour cost rose and productivity growth remained lacklustre alongside tepid economic growth.

Apart from labour and utilities costs, rental cost was also one of the larger contributors to UBC increases, notwithstanding its relatively small share in total business costs. Between 2010 and 2012, industrial rentals rose sharply as demand for industrial space started to recover following the financial crisis. Since then, however, industrial rental growth has started to ease. In line with this, rental's contribution to UBC increases has declined.

[4] The change in ULC can be decomposed as the difference of the change in total labour costs per worker and the change in labour productivity. Hence, an increase in labour costs will raise ULC, while an improvement in labour productivity will lead to a fall in ULC. Source: Singapore Department of Statistics (2009), "Average Monthly Earnings, Compensation of Employees and Unit Labour Cost: Key Concepts and Data Sources", Statistics Singapore Newsletter.

Exhibit 2: Percentage Contribution to Annual UBC Growth by Key Cost Components



Source: Singapore Department of Statistics

Note: "Others" consists of the rest of the UBC cost components. Each individual cost component in "Others" accounted for not more than 0.87 percentage points of annual UBC growth.

Meanwhile, the increase in business costs for firms in the services industries in recent years was similarly on account of higher labour costs, as well as rentals in the case of selected services industries. We describe in greater detail the recent trends in labour, rental and utilities costs for both the manufacturing and services sectors, as well as the outlook for these cost components below.

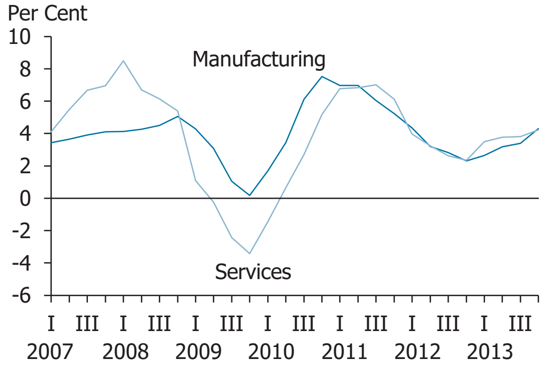
Higher wage growth is expected in the near term due to a tight labour market

The tight labour market, arising from the introduction of more stringent foreign manpower policies in late 2012 and early 2013, has caused wage growth to edge up in recent periods, thus contributing to higher labour costs (Exhibit 3). Apart from stronger wage growth, weak productivity growth in tandem with weak economic growth also contributed to ULC increases in 2012 and 2013.

Looking ahead, wage growth is likely to remain strong. Hiring expectations have strengthened in the services sector and remain stable in the manufacturing sector (Exhibit 4). Furthermore, the labour market is likely to remain tight due to foreign worker tightening measures and low resident unemployment rates.

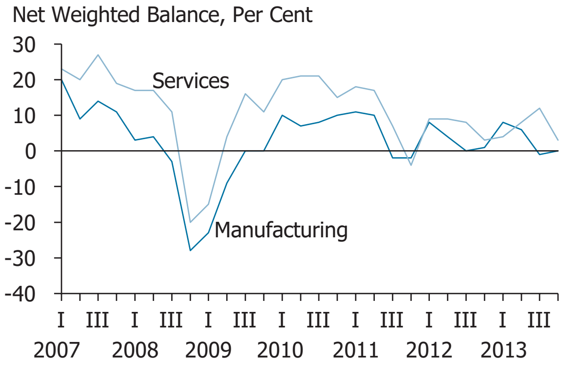
With wage growth expected to remain strong, the ULC will likely continue to increase in the near term. However, as on-going productivity initiatives gain traction and productivity growth improves over the longer term, the upward pressure on ULC is likely to ease.

Exhibit 3: Changes in Average Monthly Earnings (4-Quarter Moving Average)



Source: Derived based on data from CPF Board

Exhibit 4: Hiring Expectations



Source: Singapore Department of Statistics

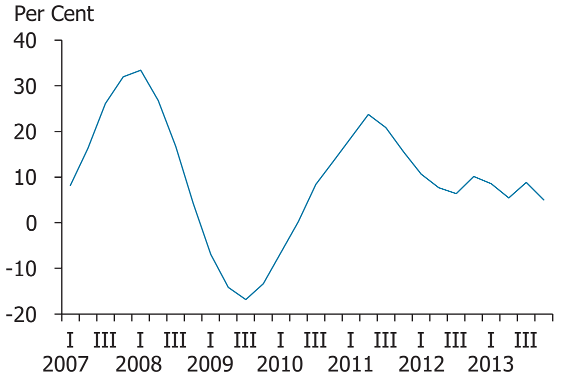
Pressure on industrial and commercial rental growth could ease due to the strong supply coming on-stream

Although the rentals of industrial space have risen steadily since bottoming out in the third quarter of 2009, the pace of increase has moderated in recent quarters (Exhibit 5). In the fourth quarter of 2013, rental growth was 5.0 per cent year-on-year, down from the recent high of 24 per cent in the second quarter of 2011. For 2013 as a whole, average industrial rentals increased by 6.9 per cent, slower than the 8.7 per cent increase in the previous year. The easing in rental growth came on the back of a fall in occupancy rate, which was in turn due to an increase in the supply of industrial space, and a moderation in demand for space arising from economic uncertainty and the relocation of some lower value-added manufacturing firms (Exhibit 6).[5]

For 2014, the strong supply of industrial space coming on-stream could dampen pressure on industrial rental growth. At 3.2 million gross square metres, the total supply of industrial space that is expected to be completed in 2014 is significantly higher than the 2.3 million gross square metres of industrial space that were completed in 2013 (Annex B, Exhibit B1).

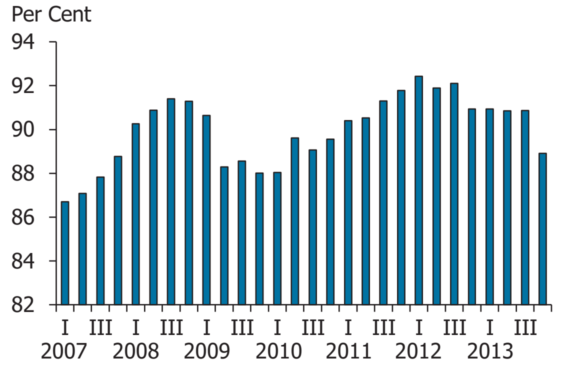
[5] CBRE Global Research and Consulting, "Singapore Market View", 3Q 2013

Exhibit 5: Industrial Rental Index



Source: Urban Redevelopment Authority, JTC Corporation
Note: The industrial rental index covers multiple-user factories and multiple-user warehouses only.

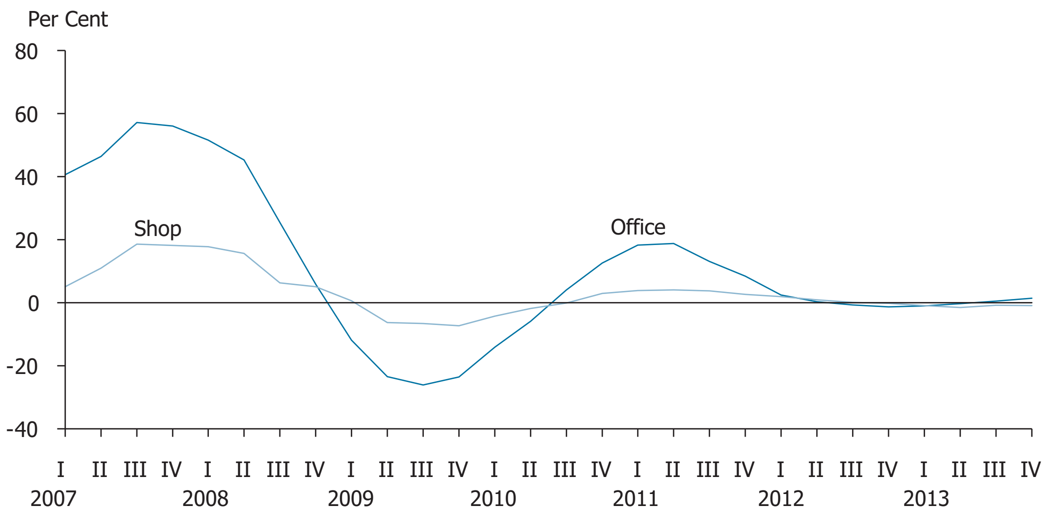
Exhibit 6: Industrial Occupancy Rate



Source: Urban Redevelopment Authority and JTC Corporation
Note: The industrial occupancy rate covers multiple-user factories and multiple-user warehouses only.

In terms of commercial space, rental growth for both shop and office space has largely been flat since 2011 (Exhibit 7). Industry feedback suggests that office rentals could increase modestly, as business sentiments improve alongside improvements in macroeconomic conditions. In particular, the demand for office space from firms in industries such as professional services and IT services is likely to remain resilient, while the demand from firms in the finance & insurance industry could begin to pick up. However, the significant supply of commercial space coming on-stream in 2014 could help to dampen pressure on rental growth (Annex B, Exhibit B2).

Exhibit 7: Office and Shop Rental Indices



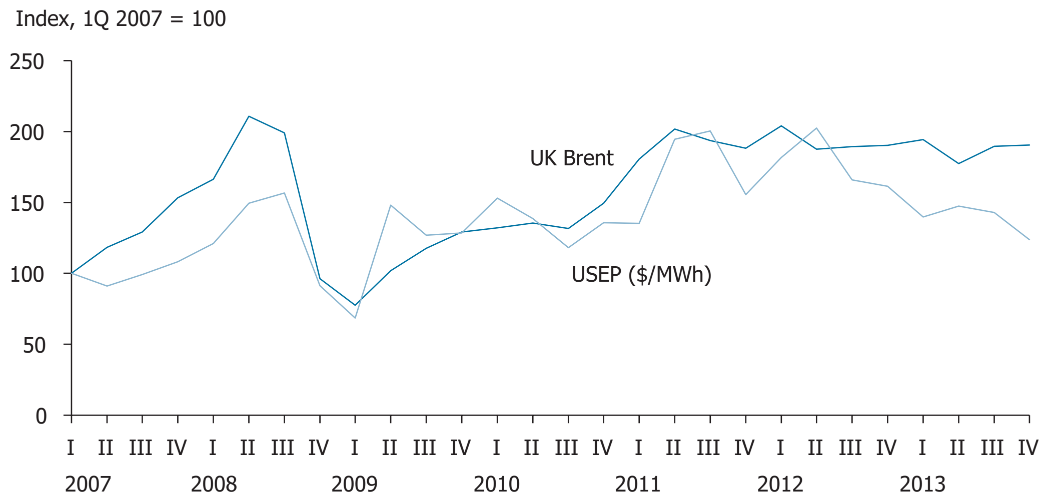
Source: Urban Redevelopment Authority

Moderating global oil prices could ease pressures on utilities cost

Utilities cost for manufacturers is closely linked to electricity tariffs[6], which are in turn influenced by movements in global oil prices.[7] Oil prices also contribute to business cost indirectly through transportation costs. After a period of sustained increases following the global financial crisis, global oil prices started to level off in 2012 and actually declined in 2013 (Exhibit 8). Specifically, the UK Brent averaged US$109 per barrel in 2013, 2.7 per cent lower than the average price of US$112 per barrel in 2012. Coupled with the increase in new generation capacity which led to increased competition in the wholesale and retail electricity markets, the average wholesale electricity price fell by over 20 per cent in 2013.[8]

With the Organisation of Petroleum Exporting Countries' (OPEC) decision in December 2013 to maintain its crude oil production target and projected higher crude oil supply from non-OPEC countries, the US Energy Information Administration (EIA) expects oil prices to average US$105 per barrel in 2014.[9] A moderation in oil prices could reduce fuel costs for utilities in 2014 and translate into lower electricity prices for businesses.

Exhibit 8: Global Oil Prices and Uniform Singapore Energy Prices



Source: International Monetary Fund, Energy Market Company

[6] Electricity cost accounts for 75 per cent of the weight of utilities cost in the manufacturing UBC index.
[7] About 90 per cent of our electricity is generated from natural gas, the price of which is indexed to oil prices. This is the common market practice in Asia. As fuel cost is a key cost component accounting for around half of the electricity tariff, our electricity tariffs move in tandem with oil prices.
[8] The Uniform Singapore Energy Price (USEP) is the average wholesale energy price in the National Electricity Market of Singapore (NEMS).
[9] EIA Short-Term Energy Outlook Report, 7 January 2014

Conclusion

The pace of increase in business costs has moderated in recent quarters, on the back of slower rental growth and a decline in utilities cost. Looking ahead, continued tight labour market conditions amidst on-going economic restructuring efforts are likely to lead to strong wage (and hence labour cost) growth in the coming quarters. However, given the strong supply pipeline of industrial and commercial space and moderating global oil prices, pressures on rental and utilities costs could ease.

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ANNEX A: BUSINESS COST STRUCTURE OF LARGE ENTERPRISES AND SMES IN THE MANUFACTURING AND SERVICES SECTORS

Exhibit A1: Business Cost Structure of the Manufacturing Sector by Type of Firm, 2011

Per Cent

	Total		Electronics		Chemicals		Biomedical Services		Precision Engineering		Transport Engineering		General Manufacturing	
	Large Enterprises	SMEs	Large Enterprises	SMEs	Large Enterprises	SMEs	Large Enterprises	SMEs	Large Enterprises	SMEs	Large Enterprises	SMEs	Large Enterprises	SMEs
Labour Cost	**40.7**	**52.5**	**52.4**	**53.6**	**12.9**	**28.1**	**49.1**	**50.1**	**60.7**	**59.2**	**66.8**	**65.4**	**49.3**	**55.6**
Services Cost	**58.6**	**46.1**	**46.9**	**45.9**	**86.5**	**70.7**	**50.0**	**48.6**	**38.5**	**38.6**	**32.4**	**33.2**	**50.1**	**43.4**
Utilities	30.1	12.4	19.3	6.6	59.8	36.5	14.0	11.5	5.9	6.3	5.8	3.1	12.7	7.7
Trade & Transport	14.5	12.8	14.4	18.0	16.3	13.3	12.8	14.4	14.7	12.3	12.4	12.0	11.6	12.5
Financial Services	2.7	4.3	3.7	5.4	2.3	5.1	1.5	4.0	2.1	4.7	2.1	3.9	3.3	3.3
Communications	1.2	1.5	1.7	1.9	0.6	1.5	1.4	2.5	2.0	1.5	1.6	1.2	1.1	1.3
Warehousing	0.9	0.9	1.1	1.6	0.7	2.3	0.8	0.4	1.9	0.2	0.4	0.2	0.7	0.9
Real estate, include rental	2.4	5.5	2.0	4.7	1.3	3.2	2.8	4.5	2.8	5.6	4.5	6.3	5.1	7.1
Business & other services	6.7	8.7	4.8	7.6	5.4	8.7	16.7	11.4	9.0	8.1	5.6	6.5	15.5	10.6
Government Rates & Fees	**0.7**	**1.4**	**0.6**	**0.5**	**0.7**	**1.1**	**0.9**	**1.3**	**0.8**	**2.2**	**0.8**	**1.4**	**0.5**	**0.9**

Source: Economic Development Board

Exhibit A2: Business Cost Structure of the Services Sector by Type of Firm, 2011

Per Cent

	Wholesale Trade		Retail Trade		Accommodation & Food Services		Transportation & Storage		Finance & Insurance		Information & Communications		Business Services	
	Large Enterprises	SMEs	Large Enterprises	SMEs	Large Enterprises	SMEs	Large Enterprises	SMEs	Large Enterprises	SMEs	Large Enterprises	SMEs	Large Enterprises	SMEs
Labour Cost	**24.2**	**25.8**	**33.9**	**36.1**	**37.7**	**42.0**	**11.5**	**10.3**	**16.0**	**12.9**	**17.7**	**34.3**	**22.9**	**27.8**
Services Cost	**73.2**	**71.5**	**60.1**	**59.0**	**53.1**	**49.8**	**79.5**	**84.3**	**82.5**	**86.1**	**76.4**	**60.3**	**71.4**	**65.3**
Utilities	0.4	0.6	5.2	2.3	7.9	6.8	0.9	0.3	0.2	0.1	0.8	1.1	0.5	1.9
Freight & Transport	17.7	22.7	0.6	1.4	0.7	0.2	34.4	47.6	–	0.2	–	0.3	–	1.6
Financial Services	0.8	2.1	2.3	2.2	1.3	1.6	0.6	0.8	3.8	4.1	0.1	0.4	0.2	0.8
Communications	0.9	1.2	0.5	0.8	0.5	0.6	0.3	0.4	0.4	0.3	4.3	14.7	0.5	0.6
Renting of Premises	5.5	5.2	31.8	32.0	15.9	20.9	0.7	2.1	1.2	1.3	1.6	3.3	1.1	3.4
Professional Services	4.1	4.6	1.0	1.3	0.7	1.1	0.6	0.5	3.1	2.1	5.4	6.1	6.9	7.3
Other Services	43.7	35.1	18.7	19.1	26.1	18.7	41.9	32.6	73.7	78.0	64.2	34.4	62.2	49.6
Contract labour & work given out	5.7	3.8	1.1	2.0	2.1	2.4	1.1	2.6	0.4	0.3	4.3	6.0	32.9	21.2
Commission & agency fees	7.0	5.6	0.3	3.0	1.2	1.0	3.9	2.4	3.0	5.9	13.0	2.5	0.5	2.5
Government Rates & Fees	**0.5**	**0.5**	**0.6**	**0.6**	**1.4**	**1.1**	**0.6**	**0.5**	**0.1**	**0.2**	**0.6**	**0.4**	**1.4**	**2.0**

Source: Singapore Department Of Statistics and Monetary Authority of Singapore

Notes:

1. SMEs refer to enterprises with operating receipts of not more than $100 million and employment of not more than 200 workers. Large enterprises refer to enterprises with operating receipts of more than $100 million and employment of more than 200 workers.
2. The cost components do not sum to 100% as depreciation cost is excluded.
3. "-" refers to nil or negligible.

ANNEX B: SUPPLY OF INDUSTRIAL AND COMMERCIAL SPACE

Exhibit B1: Supply of Industrial Space

	Total	2014	2015	2016	2017	2018	>2018
Factory Space ('000 sqm gross)							
Total	**4,479**	**2,177**	**1,802**	**422**	**13**	**10**	**55**
Under Construction	3,264	2,158	946	158	2	–	–
Planned	1,215	19	856	264	11	10	55
Warehouse Space ('000 sqm gross)							
Total	**1,574**	**1,043**	**395**	**136**	**–**	**–**	**–**
Under Construction	1,169	1,043	126	–	–	–	–
Planned	405	–	269	136	–	–	–
Total Industrial Space	**6,053**	**3,220**	**2,197**	**558**	**13**	**10**	**55**

Source: JTC Corporation

Exhibit B2: Supply of Commercial Space

	Total	2014	2015	2016	2017	2018	>2018
Office Space ('000 sqm gross)							
Total	**1,123**	**306**	**41**	**496**	**119**	**161**	**–**
Under Construction	800	306	35	451	8	–	–
Planned	323	–	6	45	111	161	–
Shop Space ('000 sqm gross)							
Total	**702**	**221**	**115**	**100**	**98**	**168**	**–**
Under Construction	428	221	113	66	24	4	–
Planned	274	–	2	34	74	164	–
Total Commercial Space	**1,825**	**527**	**156**	**596**	**217**	**329**	**–**

Source: Urban Redevelopment Authority