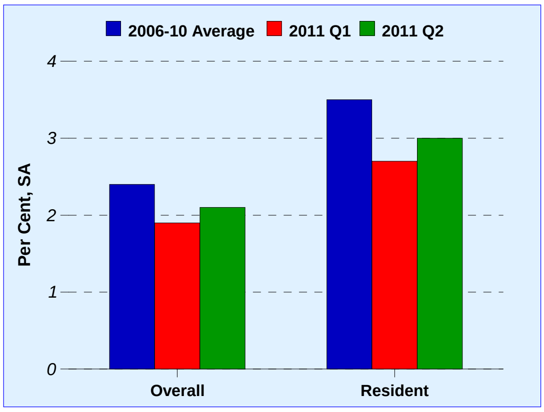
2.1 Labour Market Conditions

Employment Growth Moderated

Job creation slowed but the labour market remained tight.

Singapore's employment growth moderated in H1 2011. While seasonally weaker demand for hospitality workers was largely responsible for the slowdown in job creation in Q1, the trade-related and sentiment-sensitive industries were the main drags on employment growth in Q2. Despite this, the labour market remained tight, with vacancy rates at recent record levels and unemployment rates below their recent historical averages. (Chart 2.1) Firms responded to the labour shortage by increasing average working hours and raising wages.

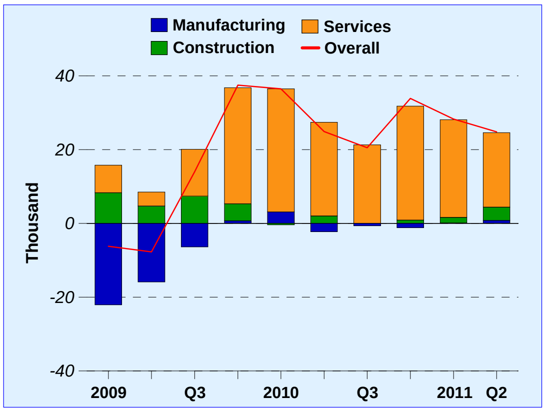
Chart 2.1
Unemployment Rates



The services sector saw a sharp slowdown in hiring.

Overall employment gains moderated from a seasonal high of 33,900 in Q4 2010 to 28,300 in Q1 2011 and 24,800 in Q2. (Chart 2.2) The services sector witnessed a sharp slowdown in job creation in the first half of the year, as hotels & restaurants hired only modestly after the year-end festivities. At the same time, the employment boost from the Integrated Resorts dissipated as most of their hiring needs were met in 2010.

Chart 2.2
Employment Changes by Sector



Wholesale trade and financial services were also more restrained in their headcount expansion given the greater economic uncertainty. Within the business services sector, professional services added 3,000 fewer workers in Q2 compared to the preceding quarter. In manufacturing, the electronics industry started to cut employment in Q1, with job losses accelerating in Q2 as global demand for IT products slowed.

Nevertheless, hiring in a number of industries stayed firm. The transport & storage and retail trade industries increased employment on account of higher tourist inflows, while the healthcare industry added strongly to headcount to meet the expansion of hospital facilities. Ancillary services such as information & communications and administrative support were also relatively resilient to the economic slowdown and continued to hire.

Concomitantly, even in manufacturing, there was considerable demand for workers in the machinery & equipment and transport equipment segments, which had a high volume of maintenance and repair work from commercial airlines and rig orders from previous quarters. Construction also stepped up hiring throughout H1 2011, supported by a steady stream of public sector infrastructure projects.

Overall, labour supply remained constrained …

Notwithstanding the overall slower pace of employment growth, the labour market remained tight. The headline unemployment rate stayed below its recent five-year average of 2.4% even as it inched up from 1.9% in Q1 2011 to 2.1% in Q2. (Chart 2.1) Similarly, although the resident unemployment rate rose to 3.0% in Q2 2011, it was still lower than the 3.5% average over the last five years.

As a result, firms still found it difficult to hire workers and many positions remained unfilled. Reflecting this, the seasonally adjusted overall vacancy rate rose to 3.0% in H1 2011, the highest since 1997. (Chart 2.3) This was despite the resident labour force participation rate reaching a record high of 66.2% in 2010.

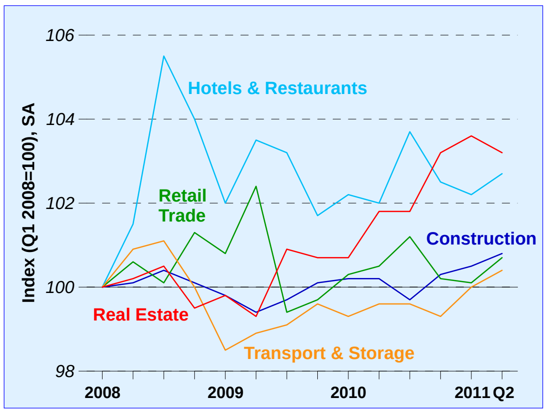
… causing firms in some sectors to increase hours of work.

Firms in sectors where labour constraints were more binding raised their average working hours to meet output requirements. This was most evident in hotels & restaurants, construction, retail trade, and transport & storage where overtime work is more widely adopted. These sectors were also likely to have been adversely affected by the tighter foreign worker policy, given their large proportion of low-skilled workers.[1] (Chart 2.4a)

Chart 2.3
Job Vacancy Rate

Source: EPG, MAS estimates

Chart 2.4a
Average Hours Worked by Sector



Source: EPG, MAS estimates

[1] The phasing out of unskilled construction work permit holders began in July 2011. At the same time, a further increase in foreign worker levies came into effect. In February 2011, MOM also announced that there would be larger increases in levies for the construction and services sectors compared to those for manufacturing. These would take effect from January 2012 with the levies increasing every six months until July 2013.

Conversely, there was evidence of increased slack in some of the external-oriented sectors, such as electronics manufacturing, financial services and wholesale trade. Notably, there was a marked decline in average hours worked in electronics manufacturing in Q2 as firms cut back on overtime hours. (Chart 2.4b)

Wage growth was generally stronger in sectors with higher vacancies.

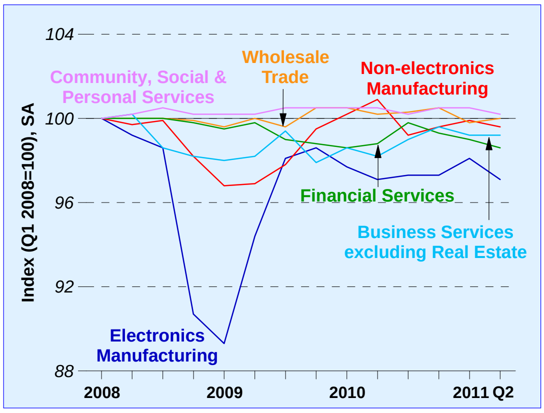
In addition to increasing average hours worked, firms responded to the tight labour supply by raising wages. Resident nominal wages rose by an average of 7.3% y-o-y in H1 2011, or more than twice the average increase in the last five years. The average seasonally adjusted nominal wage is currently about 6.3% above its previous peak in Q1 2008.

Nominal wage growth was strongest in sectors where labour shortages were more acute, as indicated by their vacancy rates. (Chart 2.5) The exceptions were wage gains in hotels & restaurants, and administrative & support services. The heavy reliance on foreign labour in hotels & restaurants, and the large share of low-skilled workers in administrative & support services[2], likely accounted for the weaker wage growth in these sectors despite their high vacancy rates.

Unit labour costs rose sharply in Q2.

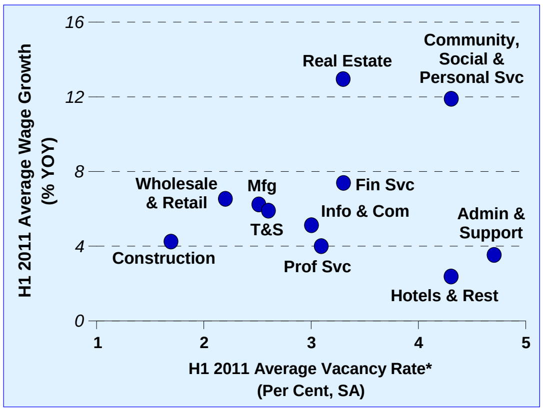
Alongside continuing employment growth, lower output led to a fall in labour productivity in Q2 2011. (Chart 2.6) Together with the strong growth in wages, this resulted in a further pickup in unit labour costs (ULCs), which rose close to its previous peak in Q1 2009.

Chart 2.4b
Average Hours Worked by Sector



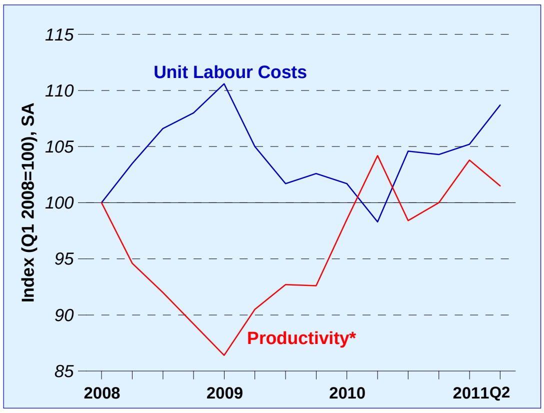
Source: EPG, MAS estimates

Chart 2.5
Wage Growth and Vacancy Rates by Sector



* EPG, MAS estimates.

Chart 2.6
Unit Labour Costs and Labour Productivity



* EPG, MAS estimates.

[2] Security, cleaning and landscape care companies make up a large proportion of employment in administrative & support services.

2.2 Consumer Price Developments

Consumer Price Inflation Was Underpinned by Domestic Factors

Domestic cost pressures were strong ...

Domestic price and cost pressures were relatively strong, amidst a high level of resource utilisation. As a result, wage growth stayed strong despite moderating employment growth. Coupled with weaker labour productivity, unit labour costs rose sharply in Q2 2011.

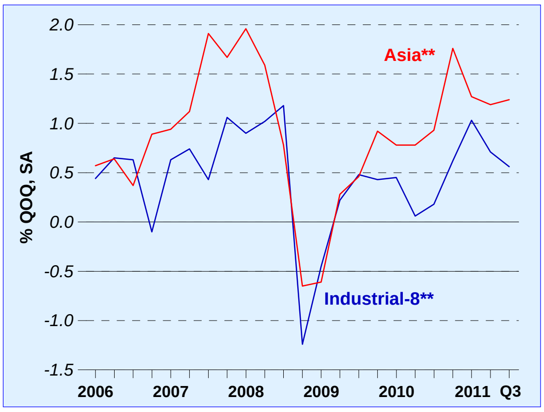
... while external sources of inflation receded.

Singapore's main import source countries witnessed slower sequential price increases in line with weaker economic growth. (Chart 2.7) However, inflation on a year-ago basis remained elevated in these countries, especially in the regional economies that faced cost pressures in H1 this year.

Following sharp increases in Q4 2010 and Q1 2011, Singapore's Import Price Index has edged down since April, largely due to the recent correction in global oil prices. (Chart 2.8) The 4% appreciation of the trade-weighted S$NEER[3] also had a dampening effect on Singapore's import prices. Nevertheless, import prices in Jul–Aug were on average still 4% higher than a year ago.

The previous rounds of policy tightening by MAS since April 2010 have kept imported inflation in check, notwithstanding the strong price pressures emanating from the external front since late last year. Recent econometric work by EPG reaffirmed the relevance of the fairly strong exchange rate pass-through effect for the most recent period and also established the structural stability of this relationship.[4]

Chart 2.7
Foreign CPI Inflation*

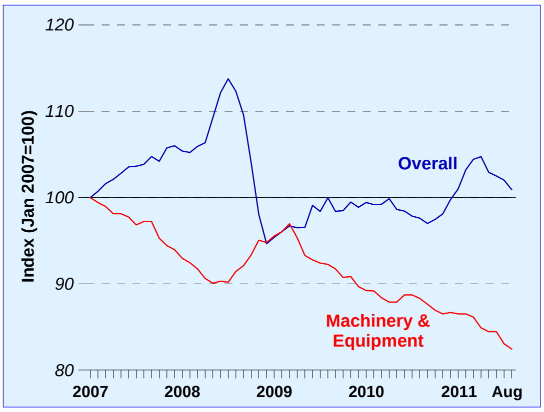


* Weighted by 2010 nominal GDP.

** Asia refers to China, Hong Kong, Indonesia, Korea, Malaysia, Taiwan, Thailand, and the Philippines while Industrial-8 consists of Australia, France, Germany, Italy, Japan, Netherlands, UK and US.

Source: EPG, MAS estimates

Chart 2.8
Import Price Indices



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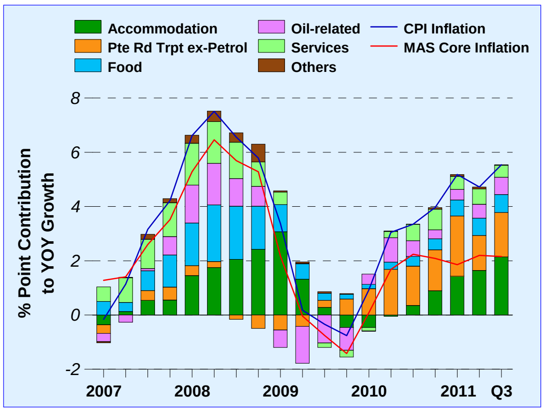
3 Based on the daily average rate in Jan-Sep 2011 compared to the whole of 2010.

4 Chew, J, Ouliaris, S and Tan, S M (2009), "An Empirical Analysis of Exchange Rate Pass-Through in Singapore", *MAS Staff Paper* No. 50. EPG adapted the methodology used in this staff paper and combined the first and second stages of the pass-through approach, allowing for a direct analysis of the effects of the exchange rate on Singapore's CPI inflation until Q2 2011. The structural stability of the relationship between inflation and its major sources was also assessed by recursive estimations.

CPI inflation rose sharply in Q3 2011 after easing in Q2.

Given domestic and external cost pressures, both headline CPI inflation and MAS Core Inflation remained elevated. While CPI Inflation, measured on a year-ago basis, moderated from 5.2% in Q1 2011 to 4.7% in Q2, this was entirely due to high base effects associated with car prices in Q2 last year. (Chart 2.9) With car prices recently rising rapidly again, CPI inflation picked up to 5.5% in Q3. MAS Core Inflation, which excludes accommodation and private road transport costs, was lower but also edged up from 1.9% in Q1 to 2.2% in both Q2 and Q3.

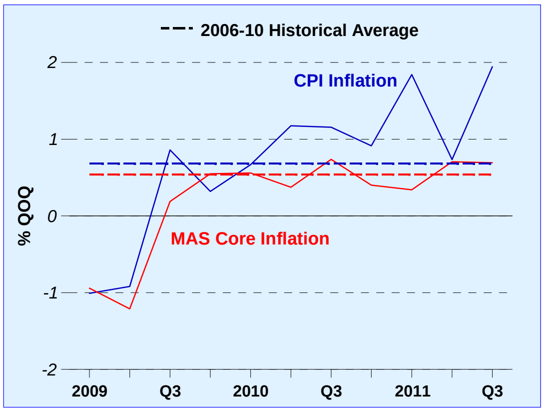
Chart 2.9
CPI Inflation and MAS Core Inflation and Contributions to CPI Inflation



Prices also saw rapid sequential increases …

CPI rose sharply on a sequential basis, as compared to the 2006–10 average due to a rapid increase in accommodation costs and car prices. Together, these items accounted for more than two-thirds of the average 1.5% q-o-q rise in the CPI thus far in 2011. MAS Core Inflation has also been higher than in previous years, due in part to the rise in the prices of commodity-related items in the CPI. (Chart 2.10)

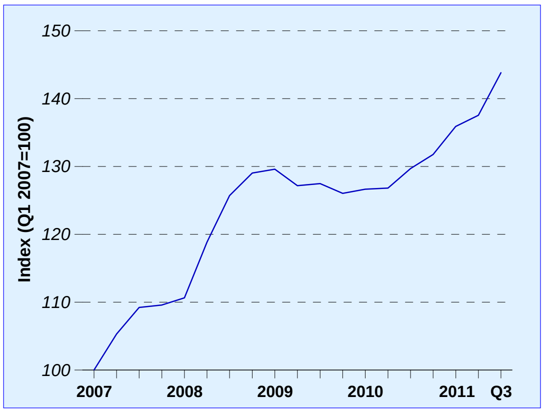
Chart 2.10
Sequential CPI and MAS Core Inflation



… due largely to higher rental values amidst a tight housing market …

Accommodation cost has been on an upward trajectory due to rising rental values of new tenancy contracts.[5] (Chart 2.11) This partly reflected the low vacancy rate for private residential property despite a sizeable increase in the number of new units available.[6] HDB rentals rose even faster, suggesting that supply constraints in this segment were even more binding. Overall, accommodation costs accounted for 2.1% points or around two-fifths of CPI inflation in Q3 2011, up from 1.4% points in Q1 this year.

Chart 2.11
CPI Accommodation Cost Inflation



[5] The average rental value of the entire stock of leased properties is used to compute the cost of rented accommodation as well as the imputed costs of owner-occupied housing in the CPI basket.

[6] In H1 2011, the net addition to the stock of private residential units was 36% higher than the average for the last five years.

… and sharp increases in COE premiums.

After stabilising at around $50,000 in Jan–May this year, average COE premiums for cars surged to $63,000 in July, before the 3% cut in the COE quota in August. (Chart 2.12) The supply of COEs is now at its lowest since 1999. Given that the vehicle population has risen by nearly 40% since then, the current market is arguably the tightest ever. Thus, COE premiums continued to rise, even as demand for cars weakened, as reflected in the lower number of bids. (Chart 2.13) As a result, the costs of private road transport, excluding petrol, added 1.6% points or around a third to CPI inflation in Q3 this year, compared to 1.3% points in Q2 and 2.2% points in Q1.

Lower global oil prices have had little impact on domestic oil-related prices so far.

Global oil prices, as measured by the West Texas Intermediate (WTI) benchmark, reached US$110 a barrel in April this year, the highest since August 2008, when civil strife broke out in several oil-producing countries. (Chart 2.14) Since then, oil prices have retreated to about US$85 a barrel due to rising concerns about global economic growth prospects, the release of 60 million barrels of emergency stockpiles by the International Energy Agency (IEA) and diminishing geopolitical risks in Libya.

While receding global oil prices led to petrol pump operators lowering prices, the cost of other energy-related items in the CPI have barely adjusted. In particular, electricity tariffs, which respond to global oil prices with a lag of one quarter, rose by 6.6% q-o-q in Q3. On the whole, oil-related items added 0.6% point to CPI inflation in Q3 2011, slightly more than the 0.5% point in H1 2011.

Chart 2.12
COE Premiums and Car Quotas

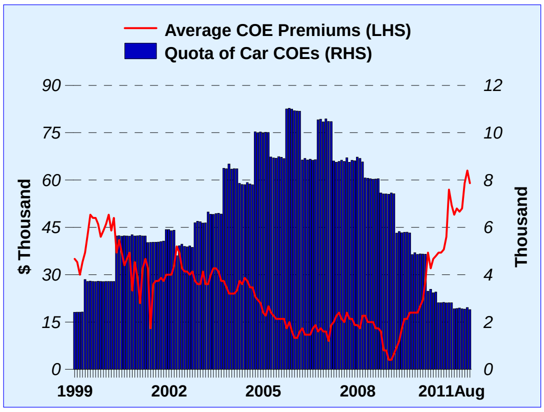


Chart 2.13
Number of Bids Received for Car COEs

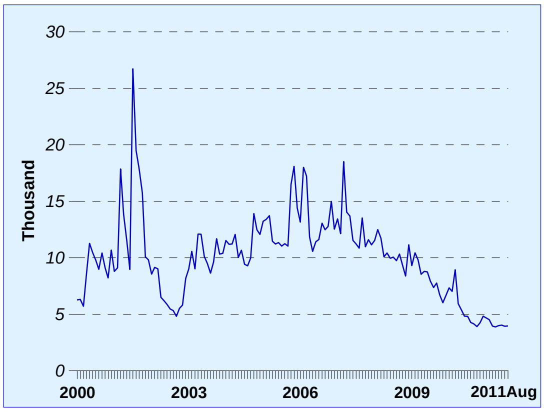
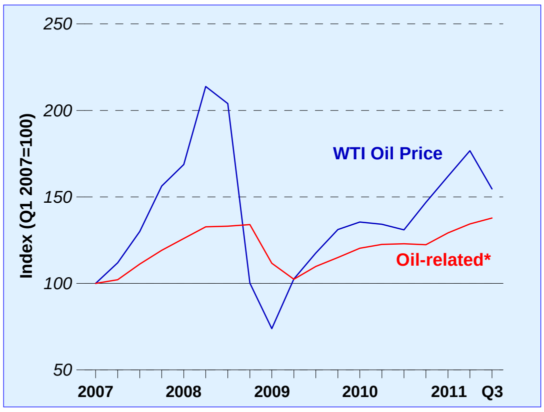


Chart 2.14
Global Oil Prices and Domestic Prices of Oil-related Items



*EPG, MAS estimates.

Domestic food price increases were muted as global food commodity prices corrected.

After surging by around 40% between June 2010 and February 2011, global food prices have edged down slightly in recent months as weather conditions improved and crop production increased in response to higher prices. The heightened risk aversion amongst commodity traders also dampened speculative activities and hence food commodity prices. Correspondingly, domestic food price increases were relatively muted. (Chart 2.15)

On a year-ago basis, food price inflation in Singapore continued to edge up modestly, from 2.7% in Q1 to 3.0% in Q3. Only a small fraction of food items, such as mutton and certain seafood products, saw significant price increases of 10% or more this time around, compared to the commodity price surge in 2007–08.[7] (Chart 2.16) There was also a considerable number of items, such as bread and some vegetables, which registered price declines from a year ago. In addition, items with substantial weight in the CPI basket, such as rice and infant milk powder, saw far more moderate price increases compared to 2007–08.

Some services firms held back on fee increases recently.

As noted in Section 2.1, wages grew strongly in H1 this year. Correspondingly, cost pressures for the services sector, which had not been able to raise productivity substantially, were the strongest in recent years. (Chart 2.17)

As a result, services cost inflation picked up from 1.5% y-o-y in Q1 to 1.8% in Q2, but subsequently eased to 1.4% in Q3 as some service providers held back from passing on cost increases further, possibly due to the uncertain economic outlook. Reflecting this, sequential price increases for a number of services were more subdued in Q3 2011 compared to the same period last year. (Chart 2.18)

Chart 2.15
Food Price Indices

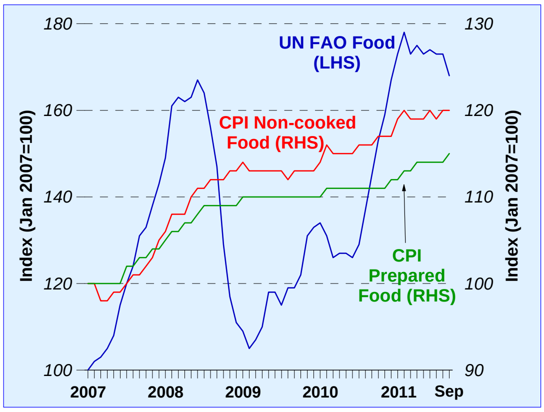


Chart 2.16
Distribution of Price Changes for Selected Retail Food Items

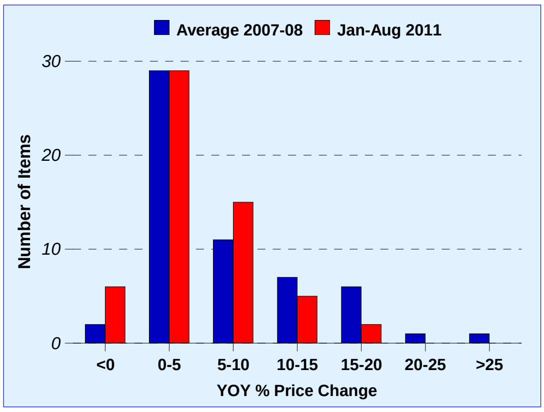
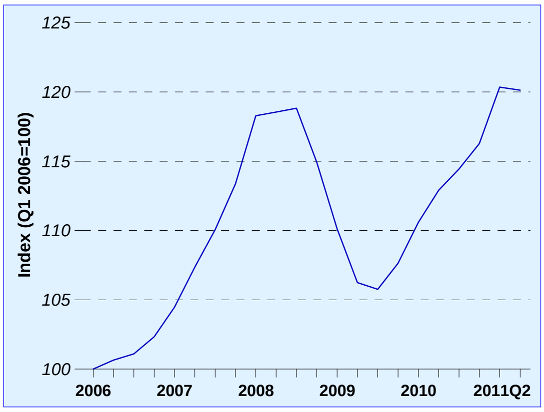


Chart 2.17
Unit Services Cost Index

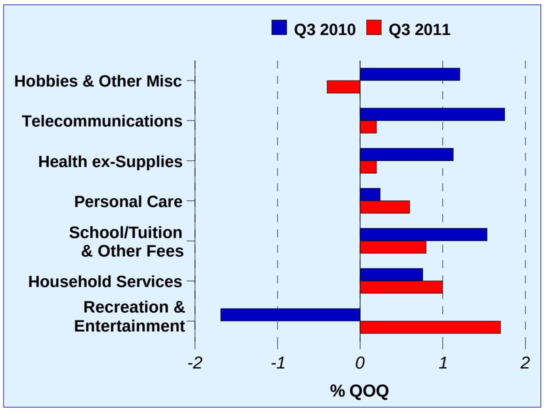


Source: EPG, MAS estimates

[7] This is based on the list of retail prices found in *DOS' Monthly Digest of Statistics*.

On the whole, despite strong labour cost pressures, services cost inflation has been relatively modest so far. There are a number of reasons for this. First, the removal of the TV and radio license fees lowered services cost inflation by 1% point y-o-y this year. Second, the earthquake and subsequent nuclear crisis that hit Japan dampened demand for overseas travel and resulted in cheaper holiday packages. Finally, competitive pressures in the telecommunications sector have constrained price increases.[8]

Chart 2.18
Sequential Services Cost Inflation



[8] The launch of the Next Generation Nationwide Broadband Network (NGNBN) in September 2010, which offers ultra-high speed broadband access, has put a lid on traditional cable broadband providers' ability to raise prices. Furthermore, competition within the industry has intensified as seven retail service providers now offer NGNBN services, compared to four cable broadband providers previously.