Economics

SG: Downgraded

DBS Group Research 23 July 2014

- **Manufacturing has disappointed and the outlook remains tepid**
- **Services continues to slide with restructuring compounding the woes**
- **We have downgraded our full year GDP growth forecast to 3% from 4% previously**

Weak GDP growth in the second quarter surprised many [1]. Based on initial estimates, the economy contracted by 0.8% QoQ, saar (DBSf: -0.7%; consensus: 2.4%) (Table 1). This translates into a year-on-year expansion of 2.1% YoY (DBSf: 2.3%; consensus: 3.1%).

Table 1: GDP growth by sectors

	2Q13	3Q13	4Q13	2013	1Q14	2Q14 (a)
Percentage change year-on-year						
Overall GDP	4.0	5.0	4.9	3.9	4.7	2.1
Manufacturing	0.8	5.3	7.0	1.7	9.9	0.2
Construction	6.1	5.6	7.3	6.1	6.4	5.0
Services producing	5.7	5.8	5.5	5.3	3.9	2.8
Quarter-on-quarter annualised growth rate, seasonally adjusted						
Overall GDP	10.2	0.7	6.9	3.9	1.6	-0.8
Manufacturing	17.6	0.0	10.4	1.7	12.2	-19.4
Construction	9.8	6.7	10.6	6.1	-0.5	2.6
Services producing	10.0	0.6	7.1	5.3	-1.4	5.2

A tepid performance in the manufacturing sector and a persistent deceleration in the services are the key reasons. The slowdown was broad-based with all key sectors posting slower growth. Based on this and the current outlook, we have downgraded our full year growth forecast to 3.0% from 4.0% previously.

From key driver to the weakest link

The manufacturing sector, which was the key driver of growth in the previous quarter, became the weakest link in 2Q14. Growth slipped to a mere 0.2% YoY, from 9.9% previously. To begin with, the strong showing by the manufacturing sector in the first quarter was never sustainable in our opinion. The surge in pharmaceutical output and a spike-up in offshore marine engineering production were never meant to persist (Chart 1). As these impetuses dissipated, manufacturing growth naturally ebbed.

The key electronics cluster is still in the doldrums. Electronics exports have been declining for the last 23 months. A recent statement by the EDB on "firm specific" disruption to semiconductor output implies there won't be a light at the end of the tunnel for some time. Whether this is a case of "hollowing-out" in

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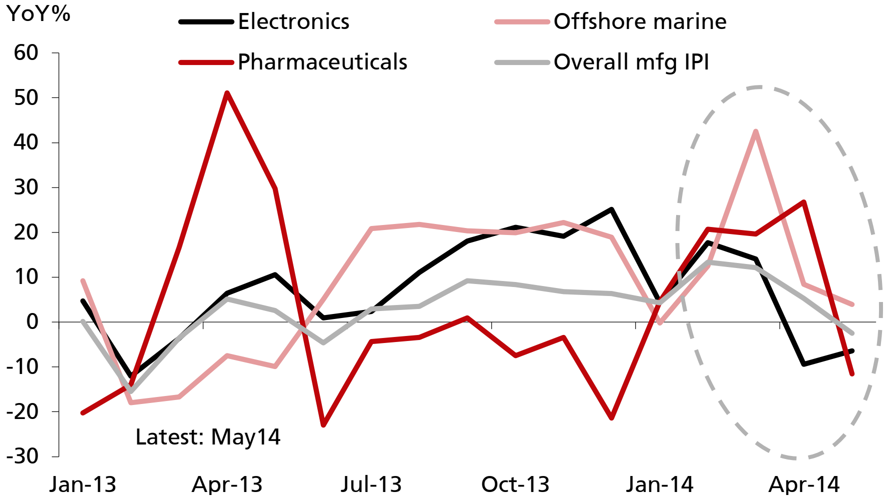
Chart 1: Tepid manufacturing performance



the semiconductor segment or merely a temporary firm specific "overhaul" of production capacity remains to be seen. Either way, the manufacturing sector is struggling.

A dampened outlook for manufacturing

Moreover, the manufacturing sector is being weighed down by the restructuring and weak export competitiveness [2]. Non-oil domestic exports (NODX) could possibly see the second consecutive year of decline after a harsh 6% contraction last year. The labour crunch remains a problem with higher costs affecting exporters' ability to compete. The hope is for productivity growth to pick up but that will take time. Plainly, the near-term outlook of the manufacturing sector has been dampened by restructuring.

The biggest risk

The services sector, traditionally the most stable engine of growth, is becoming the biggest risk to the economy. Growth here slowed to 2.8% YoY in 2Q14, from 3.9% previously. And this is down from 5.5% and 5.8%, in 4Q13 and 3Q13 respectively (Chart 2). This downward trend warrants close attention.

While a base effect is at work, sequential growth in the sector has been tepid too. The existing labour crunch due to curbs in foreign manpower has been

Chart 2: Services growth tapering off

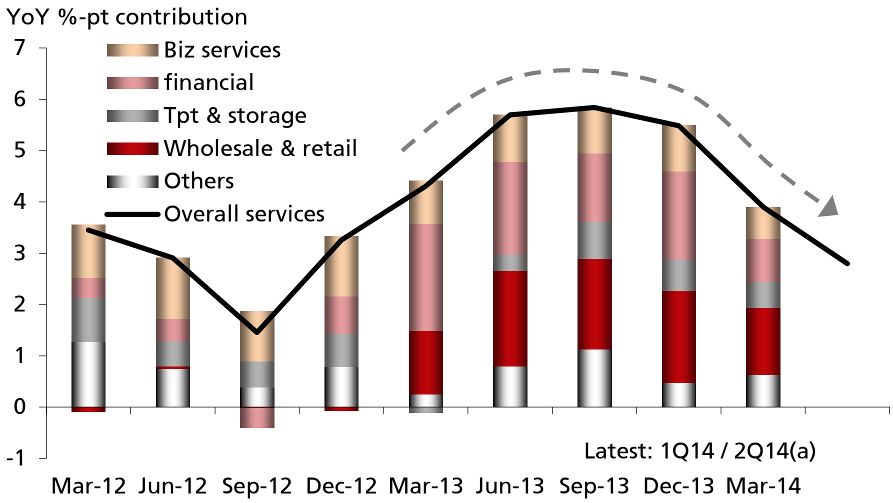
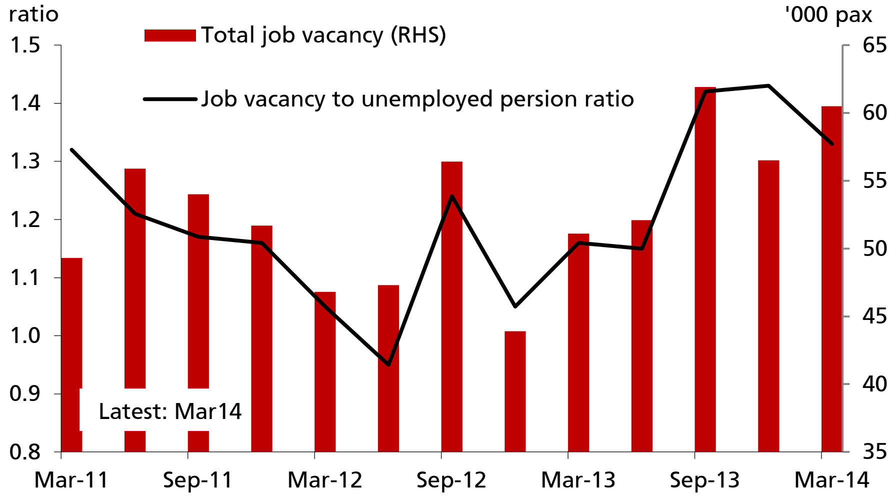


Chart 3: Labour crunch



taking a toll on this relatively more labour intensive sector. The total number of job vacancies in the economy registered 60,500 in 1Q14, a rise of 18.4% from the same period last year (Chart 3). The ratio of job vacancy to unemployed person ratio has also spiked up to 1.33 in the first quarter, the highest since 4Q07. The labour market is extremely tight at present.

GDP forecast for 2014 lowered to 3.0%

There is a risk that the services sector continues to slow in the coming quarters owing to the labour crunch. This would pose a threat to the medium-term prospects for the economy given its relatively large share in GDP and employment. The sector accounts for about 70% of GDP and total employment share in 2013. The continued slide in services sector growth is the biggest risk at the moment.

Lastly, construction sector growth has also moderated, to 5.0% YoY, from 6.4% in 1Q14. Both demand and supply side issues are at play. The tightening in foreign labour policy associated with the restructuring is having an effect here. The slowdown in the property market due to earlier cooling measures has also dampened prospects for this sector.

Growth forecast lowered

The external outlook remains a question. While expectation of a gradual recovery remains in place, recent data have been mixed. Demand from Asia and the West remains sluggish. Growth expectation for the US has been lowered [3]. This is juxtaposed against a weak Eurozone and a slowdown in China. None of this bodes well for Singapore.

The economy continues to be weighed down by the domestic restructuring and external uncertainties. Manufacturing is in doldrums but the services sector is the biggest risk. We have downgraded our full year GDP growth forecast for 2014 to 3%. A marginal improvement to 3.6% is expected in 2015.

Notes:

[1] Advance GDP estimates are largely computed from data in the first two months of the quarter. They are intended as an early indication of the GDP growth in the quarter, and are subject to revision when more comprehensive data become available.

[2] “SG: Competitiveness matters”, 23 Apr14; “SG: The cost of restructuring”, 9 Feb12; “SG: Recession and competitiveness”, 2 Oct12; “SG: Stagflation”, 1 Aug12

[3] Full year GDP growth forecast for the US has been lowered to 1.6%, from 2.1% previously. See DBS Daily Breakfast Spread, 26 Jun14

Sources:

All data are sourced from CEIC and forecasts are DBS Group Research.

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