Singapore retail rents and inflation moving in tandem may put retailers in a bind

Correlation statistics suggest some businesses will likely face narrower margins if landlords raise rents to support yields, says IREUS study

By Fiona Lam
fiolam@sph.com.sg

SOME retail businesses, including those selling recreational goods and furniture, are likely to be hit harder by rising rents coupled with inflationary pressures in Singapore, an analysis by the Institute of Real Estate and Urban Studies (IREUS) suggests.

On the other hand, retailers of items such as food, toiletries and computers may be better able to weather higher rents.

Historical data shows that core inflation tends to move in tandem with overall rents of private-sector shop spaces in Singapore's Central Region on a quarterly basis.

IREUS highlighted what appears to be a lead-lag relationship between the 2 time series, which possibly explains why the positive correlation between core inflation and the retail index is "relatively weak" at 0.28 over the period spanning the second quarter of 1990 to the first quarter of 2022.

Lee Nai Jia, deputy director of the research institute at the National University of Singapore, said that when inflation is high, landlords usually expect interest rates to go up, so they may raise rents to increase their yields. Rents, however, are contractually locked over a period, except for new tenancies. "Hence, we expect the movements to be lagged," he added.

Some landlords will also adjust rents in view of stronger consumption demand and lower unemployment, though this may not translate immediately to higher prices of goods and services due to the time lag, Dr Lee noted.

"That said, there are other exogenous drivers that impact retail rents, such as new supply of retail spaces," he told *The Business Times*.

As landlords could seek to raise rents to buffer their yields against inflation, the correlation statistics suggest that retailers in some segments may face narrower margins.

Using the retail sales index by industry, IREUS derived the correlation between the quarter-on-quarter change in sales for each segment and Singapore's core inflation for the period from Q2 1993 to Q1 2022.

For retail sales at department stores as well as supermarkets and hypermarkets, the period for deriving the correlation spanned from Q2 2008 to Q1 2022.

A positive correlation indicates that retail sales in the segment are less affected by rental increases arising from inflation, especially if the correlation exceeds that for rents and inflation.

For segments such as food and alcohol, cosmetics, toiletries and medical goods, and computer and telecommunications equipment, the change in sales exhibited a positive correlation with inflation. These shops are thus expected to be able to withstand higher rents.

In contrast, for retailers of recreational goods as well as furniture and household equipment, the change in sales is negatively correlated with inflation. This implies these businesses are likely to suffer a drop in sales volumes while having to cough up higher rents in an inflationary environment.

Dr Lee said: "While correlation is a blunt measure to reflect the relationship between the retail sector and core inflation, it offers some interesting observations."

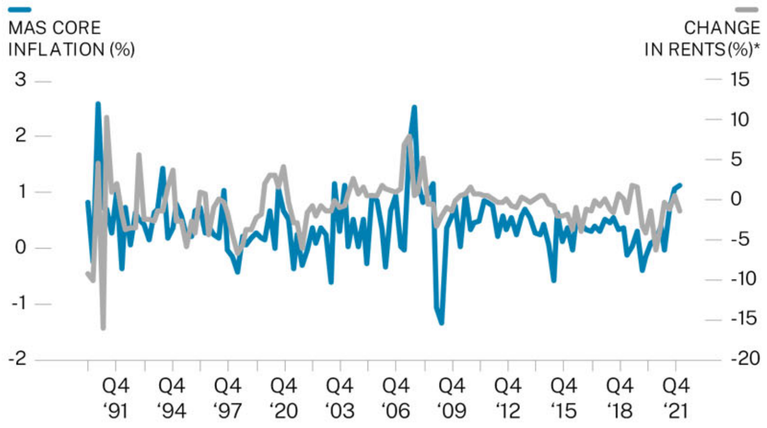
For instance, essentials or goods that provide hedging against inflation are likely to see greater demand, whereas non-essential durable goods such as furniture exhibited negative correlation. "Additionally, rising inflation may trigger consumers to buy more now than later for some goods, which explains the positive correlation," he added.

To be sure, even if sales volumes surge for some retailers, that may not compensate for rising shipping costs and pricier commodities. And if landlords are unwilling to share the burden, retailers will probably need to bear the brunt of higher costs and diminishing profits as consumers become more price-sensitive, Dr Lee pointed out.

"While landlords may be able to support their real returns by demanding higher rents, it is a stop-gap solution. Higher rents could inadvertently push (brick-and-mortar) retailers to e-commerce platforms and hence weaken demand for physical shop space in the future," he said.

Analogous

Core inflation and shop rents in the Central Region generally move in the same direction

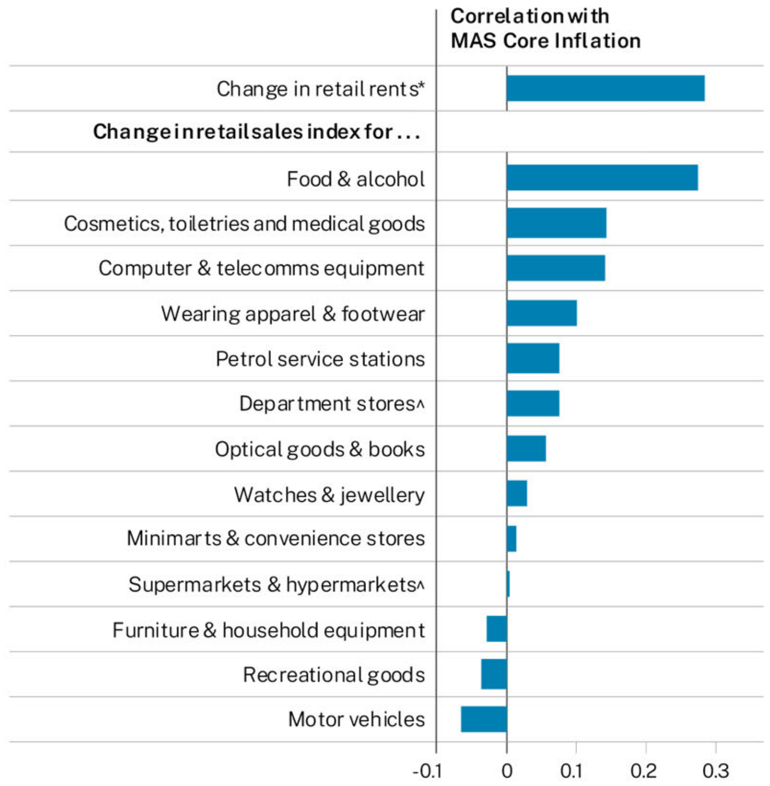


*Quarter-on-quarter change in the rental index of private-sector shop space in Central Region

Sources: URA Realis, MAS, Singstat, IREUS, NUS

Correlation

The change in sales for some segments like food & alcohol is positively correlated with core inflation



*Rental index of private-sector shop space in Central Region
^Correlation is based on the time series spanning Q2 2008 to Q1 2022

Sources: URA Realis, MAS, Singstat, IREUS, NUS