Northern Ireland Quarterly Sectoral Forecasts

Forecast summary

The UK economy grew by 0.1% in the fourth quarter of 2022 and in Northern Ireland, the economy is also estimated to have expanded in the final quarter of last year. Looking forward, the economic outlook remains challenging as high inflation and changes to the economic policy environment are continuing to impact economic performance. However, the economy has proved more resilient than previously anticipated and the labour market remains in a relatively robust position. The economic outlook remains highly uncertain and, while we still expect annual economic output to decline this year, we have revised our forecasts upwards. We are now forecasting that the Northern Ireland economy will contract by around 0.3% in 2023 but grow by about 0.9% in 2024.

Challenges around high inflation and tighter policy are persisting with economic performance still under pressure

After contracting by 0.1% in the third quarter of 2022, the UK economy avoided falling into a technical recession – defined as two successive quarters of negative economic growth – after GDP increased by 0.1% in 2022 Q4. In Northern Ireland, the economy is also estimated to have grown at the end of last year. The Northern Ireland Composite Economic Index posted a 1.4% expansion with services and construction output rising over the quarter but production activity declining.

Looking forward, the UK and Northern Ireland economies are continuing to face challenges as we move through 2023. High inflation is still squeezing household purchasing power, consumer confidence remains low and the monetary policy environment is considerably tighter. However, the economy has proved more resilient than previously expected and the labour market remains in a relatively robust position. We still expect annual economic output to fall this year in Northern Ireland and the wider UK but we have revised our forecasts upwards relative to our previous report.

The economic outlook remains highly uncertain but we are now forecasting that the Northern Ireland economy will contract by around 0.3% in 2023, an upward revision from the 1.0% fall in activity we previously projected. We expect annual output to return to growth in 2024 with the local economy projected to expand by about 0.9% next year.

The labour market remains robust with the expected weakening likely to be modest

Northern Ireland's labour market is continuing to perform relatively strongly despite the challenging economic environment. The latest data from the Quarterly Employment Survey showed a 0.6% quarterly rise in the number of employee jobs in 2022 Q4, following growth of 0.7% in quarter three. The total number of employee jobs in quarter four was at a new series high.

The more timely HMRC Pay As You Earn data showed that the number of payrolled employees increased by 0.4% over the month in February 2023. The rise marked the fourth monthly increase in the last five months. The unemployment rate fell by 0.4 percentage points over the November 2022 – January 2023 period, down to 2.4%. In addition, the number of people on the claimant count decreased by 0.1% in February, following a decrease of 1.7% in January.

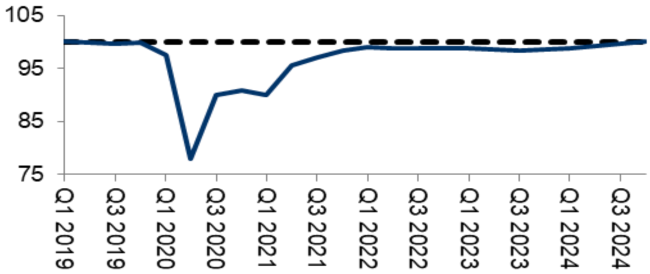
Although the labour market is still relatively robust, it tends to lag wider economic performance and so given the challenging environment, we expect the labour market to soften over the coming quarters. We are projecting that the annual average number of employee jobs in Northern Ireland will increase by around 0.2% in 2023, down from 3.6% last year. We are also forecasting that the unemployment rate in Northern Ireland will rise to an annual average of around 3.2% this year and 3.5% in 2024.

Forecast summary (%)

	2022	2023	2024
UK GDP growth	4.1	-0.2	1.0
NI GVA growth	3.7	-0.3	0.9
NI employee jobs growth	3.6	0.2	0.3
NI unemployment rate	2.7	3.2	3.5
UK unemployment rate	3.7	4.2	4.5
UK CPI inflation rate	9.1	6.3	1.8

Sources: ONS, NISRA, Oxford Economics, Danske Bank Analysis

NI Gross Value Added (Index: 2019 Q4 = 100)



Sources: Oxford Economics, Danske Bank Analysis

Key factors in the outlook

Inflation expected to fall but remain above target throughout 2023

UK inflation reached a multi-decade high of 11.1% in October 2022 but has fallen back from that peak in recent months, despite the unexpected rise to 10.4% in February 2023. Looking beneath the headline number, the annual inflation rate is above the 2% target for each of the main categories of goods and services that households spend their money on, emphasising the broad-based nature of the price pressures being observed across the economy. In February, the annual rate of price rises for housing, water, electricity, gas and other fuels was 26.6% and for food and non-alcoholic drinks it was 18%. Core inflation – which excludes energy, food, alcohol and tobacco – was 6.2%, more than 3 times the target rate. Looking forward, the combination of strong base effects and an expected fall in energy prices mean inflation is projected to drop relatively sharply during 2023 but some elevated prices are likely to prove stickier. We are forecasting that CPI inflation will average around 6.3% in 2023 then average about 1.8% in 2024.

Tighter monetary policy

The Bank of England's Monetary Policy Committee (MPC) increased Bank Rate by 25 basis points to 4.25% at its March policy meeting, which was the eleventh consecutive rise in Bank Rate. Despite inflation being expected to fall this year, there are a number of factors which highlight the risk that it could prove more persistent including the increase in rate of price rises observed in February, the stronger than expected economic data and the continued strength of the labour market. At this point, we think that Bank Rate is now at or close to its peak but if the economic data over the next few months continues to be stronger than expected then the MPC may decide to tighten policy further and increase Bank Rate to 4.5%.

Developments in fiscal policy

Fiscal policy in the UK is currently providing some support to households to manage higher energy costs. In the March Budget, the Chancellor loosened fiscal policy and announced short-term measures to further support household finances as well as policies aimed at boosting investment and labour market participation over the medium-term. However, there are other ways in which fiscal policy is also likely to prove restrictive including the increase in the rate of Corporation Tax and the continued freeze in income tax thresholds.

Real incomes and consumer spending power likely to remain under pressure this year

The combination of above target inflation and higher interest rates mean that real household income and consumer spending power is expected to remain under pressure during 2023. Consumer confidence in Northern Ireland and the wider UK also remains low despite some modest improvements recently. The expected decline in inflation means the outlook for consumer spending is somewhat brighter for 2024 but we expect annual household expenditure to contract this year.

Resilient labour market providing some support to consumer spending

While high inflation is putting household finances under pressure, the robustness of the labour market may give some support to spending. For some time now, the unemployment rate has been low in both Northern Ireland and in the wider UK. While we expect unemployment to gradually edge upwards, its peak is still expected to be relatively modest when considered against the challenging economic backdrop. In addition, the tightness of the labour market is putting upward pressure on wages. While the strong labour market is unlikely to fully offset the squeeze on spending power, it should give household expenditure some support.

The outlook for the UK economy

After contracting in the third quarter of 2022, the UK economy returned to modest growth in quarter four and therefore avoided falling into a technical recession. Within **private consumption**, real household spending rose by 0.2%, with the positive outturn likely influenced by the comparison with quarter three, when there was an extra public holiday. **Government expenditure** also grew, by 0.5%, as energy support schemes added to public spending. **Total investment** increased by 0.3% but business investment declined by 0.2% and remains 2.2% below its pre-pandemic level. **Exports** fell by 1.4% over the quarter while **imports** declined by 0.2%.

The monthly GDP data showed that output levels in the UK economy rose by 0.3% in January. After a sizeable drop of 0.8% in December, the recovery in **services** output in January was relatively modest at 0.5%, reflecting the ongoing squeeze on household spending power. Output in the wholesale and retail trade sector grew by 0.3% over the month but had fallen by 0.4% in December and by 0.1% in November. Accommodation and food services activity also expanded by 0.3% but that followed a decline of 0.8% in the previous month. Elsewhere, January saw renewed declines in **production** and **construction** output, which fell by 0.3% and 1.7% respectively.

Looking to 2023 as a whole, we expect the UK economy to contract by around 0.2%. However, this is an upward revision of 0.7 percentage points relative to our previous forecast reflecting the stronger momentum that the economy came into this year with, the resilience evident in the economic data at the start of 2023, the strength of the labour market, the fall in global energy prices and the short-term fiscal loosening in the Budget. In 2024, we are projecting that UK GDP will grow by about 1.0%. We expect aggregate **private consumption** to fall by around 0.8% this year amid the pressure on consumer spending power from high inflation, before growing by about 1.0% next year. The combination of higher interest rates and the uncertain outlook makes for a challenging backdrop for **investment**, which we expect to contract by about 2.6% in 2023 then grow by around 0.4% in 2024. **Government consumption** is projected to grow by around 2.8% in 2023, somewhat cushioning GDP from the expected declines in private consumption and investment, with growth then expected to slow to about 1.5% next year.

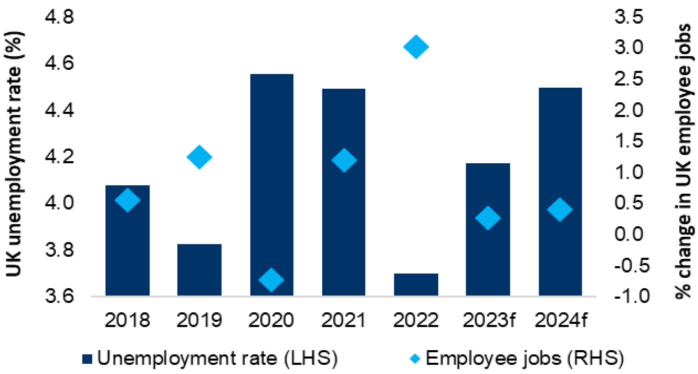
The UK labour market remains resilient but there are some signs that unemployment may soon start to rise modestly. A rise in the employment rate was accompanied by a fall in the inactivity rate in the November 2022 – January 2023 period, leaving the **unemployment rate** unchanged at 3.7%. However, job vacancies have continued their downward trend, falling to 1.1 million in the three months to February, suggesting demand for workers is waning. After rising by 3.0% in 2022, we are forecasting that the average number of **employee jobs** in the UK will increase by around 0.3% in 2023 followed by growth of about 0.4% in 2024. The **unemployment rate** is expected to increase modestly and average around 4.2% in 2023 and 4.5% next year.

UK CPI **inflation** unexpectedly increased from 10.1% in January to 10.4% in February, but it is still expected to decline during 2023. Following the short-term extension to the current terms of the Energy Price Guarantee in the Budget and the fall in wholesale energy prices, we've revised our forecast for CPI **inflation** in 2023 downwards to 6.3%, from 7.5% in our previous report. Looking to next year, we expect inflation to average about 1.8% over 2024.

UK GDP forecasts (%)

	2022	2023	2024
UK GDP growth	4.1	-0.2	1.0
Private Consumption	5.6	-0.8	1.0
Investment	8.6	-2.6	0.4
Government Consumption	1.8	2.8	1.5
Exports of Goods and Services	9.9	-2.8	1.9
Imports of Goods and Services	13.3	-2.8	2.5

Sources: ONS, Oxford Economics, Danske Bank Analysis



Sources: ONS, Oxford Economics, Danske Bank Analysis

Northern Ireland sectoral outlook

2023 forecast revised upwards but annual economic output still likely to fall this year

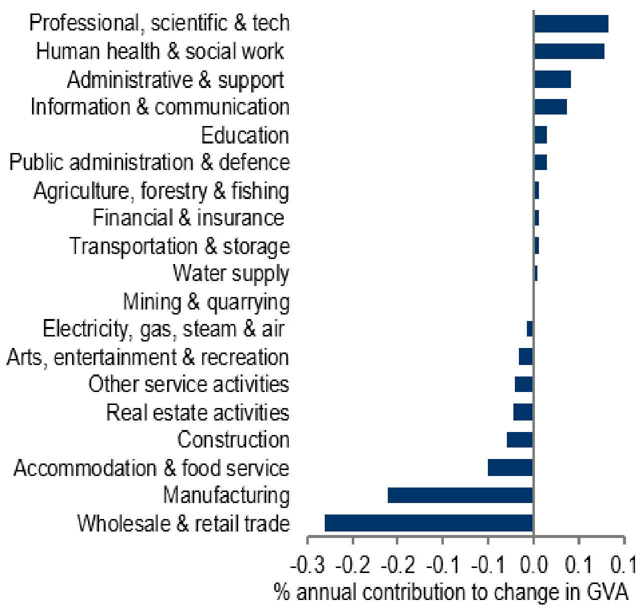
The Northern Ireland economy is estimated to have grown in the final quarter of 2022 but the outlook for 2023 remains a challenging one. High inflation is putting pressure on consumer spending and monetary policy has tightened significantly. However, the labour market remains relatively strong and the economy has proved more resilient than initially anticipated. For example, in the *2023 Q1 Quarterly Economic Survey* published by the *Northern Ireland Chamber of Commerce and Industry* and *BDO*, it was reported that business confidence was higher than in the final quarter of last year. The outlook remains uncertain and we still expect annual output to contract this year but we have revised our forecast upwards and now expect a fall in economic activity in Northern Ireland in 2023 of around 0.3%, compared with a 1.0% decline in our previous report. With regards to 2024, we expect the local economy to grow by about 0.9%.

High inflation is exerting a squeeze on household spending power and, despite the small rise observed in consumer confidence shown by the Danske Bank Northern Ireland Consumer Confidence Index in 2022 Q4, sentiment remains relatively low. As such, we expect the consumer-focused parts of the economy to experience the largest falls in annual output this year. We are projecting that the **wholesale & retail trade** sector will experience the deepest contraction in activity of around 1.9% in 2023 but return to growth of about 1.0% in 2024. Given the sector is the largest in the local economy, it is expected to make the largest contribution to the overall decline in output this year. Other consumer-focused sectors including **accommodation & food services** and **arts, entertainment, & recreation** are also projected to see falls in output in 2023 of approximately 1.7%.

Output in the **manufacturing** sector is projected to decline by around 1.0% this year followed by growth of about 0.6% in 2024. Weaker household spending also negatively impacts the demand for manufactured consumer goods, adding to other pressures facing the sector including the softer outlook for investment, high energy prices and skills shortages. Inflation is likely to be having adverse impacts on demand and supply in the **construction** sector. Output in the sector is forecast to decline by about 0.4% in 2023. Activity is also projected to fall in the **real estate activities** and **mining & quarrying** sectors in 2023.

Although we are forecasting that total GVA will decline this year, some service sectors are projected to see increases in activity including **professional, scientific & technical services**, **administrative & support services** and **information & communication**. These sectors are traditionally strong performers in Northern Ireland and are less exposed to the squeeze on consumer spending. As such, we are expecting output in these industries to grow by 1.9%, 1.2% and 1.0% respectively in 2023 but this would still represent a significant slowdown from their estimated growth rates in 2022.

Sector contributions to GVA growth in 2023



Sources: Oxford Economics, Danske Bank Analysis

GVA (%)	2023	2024
Professional, scientific & tech	1.9	1.6
Administrative & support	1.2	1.2
Information & communication	1.0	1.6
Human health & social work	0.8	0.9
Agriculture, forestry & fishing	0.3	0.6
Water supply	0.3	0.2
Education	0.3	0.6
Public administration & defence	0.2	0.8
Financial & insurance	0.2	0.3
Transportation & storage	0.2	1.2
Real estate activities	-0.2	0.1
Construction	-0.4	1.2
Electricity, gas, steam & air	-0.4	1.3
Mining & quarrying	-0.4	0.9
Manufacturing	-1.0	0.6
Other service activities	-1.5	1.5
Arts, entertainment & recreation	-1.7	1.4
Accommodation & food service	-1.7	1.3
Wholesale & retail trade	-1.9	1.0
Total	**-0.3**	**0.9**

Sources: Oxford Economics, Danske Bank Analysis

Northern Ireland labour market outlook

Annual jobs growth projected to slow sharply this year but rise in unemployment expected to be modest

Despite the challenging economic backdrop, the labour market in Northern Ireland has remained relatively robust. In 2022, the average number of employee jobs increased by 3.6% but we expect the rate of jobs growth to slow sharply this year. We are projecting that the annual average number of employee jobs will increase by around 0.2% during 2023, an upward revision of 1.2 percentage points compared with our previous report. It is important to note that the stronger projected numbers for annual jobs growth this year, including at a sector level, are influenced by the jobs growth observed in the latter part of 2022. Despite the positive annual figure, we do expect the number of jobs to fall in some quarters of this year as the wider economic environment takes its toll on the labour market, but we expect these impacts to be relatively modest. In 2024, we are projecting that the annual average number of employee jobs will rise by about 0.3%.

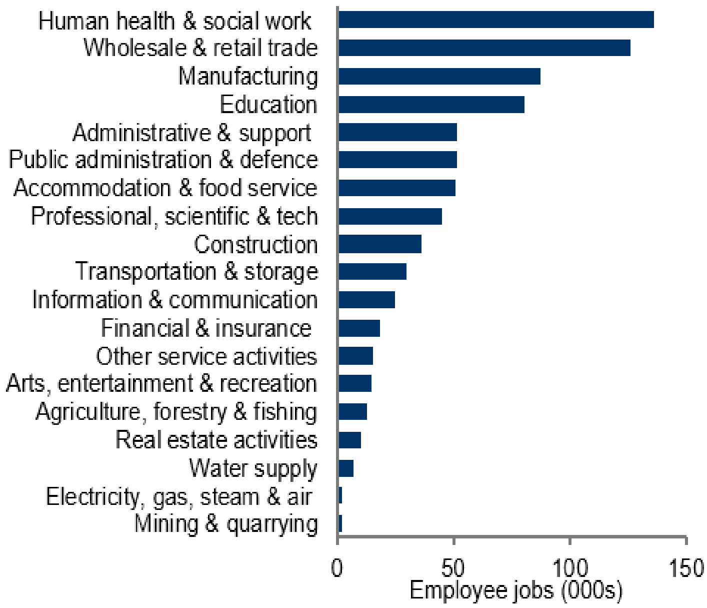
The largest declines in output in 2023 are expected to occur in the consumer-focused parts of the economy and, as such, we expect these sectors to also experience declines in the number of employee jobs. Employment in the **wholesale & retail trade** sector is projected to decline by around 2.2% in 2023. For the **arts, entertainment, & recreation** sector, the number of employee jobs is projected to contract by about 1.5%. The number of jobs in the **accommodation & food services** sector is also expected to decline in 2023, by around 1.4%. Employment growth is expected to return to these sectors in 2024 with projected increases in the number of employee jobs of about 1.3%, 0.7% and 0.8% respectively.

The **manufacturing** sector, which is experiencing cost challenges from high energy and raw material prices, is forecast to experience a decline in the number of jobs of around 1.2% in 2023. In addition, the **administrative & support services** sector is also expected to experience a contraction in employment of about 1.4% though it is worth highlighting that this sector includes recruitment agencies that employ staff which work in other industries.

With less reliance on consumer spending, two sectors expected to experience relatively high rates of jobs growth this year are the **professional, scientific & technical services** and **information & communication** sectors. Annual employment in these sectors is projected to rise by around 8.3% and 2.2% respectively in 2023, followed by expected growth of about 1.6% and 2.3% in 2024.

Northern Ireland's unemployment rate in the November 2022 – January 2023 period was 2.4%, 0.4 percentage points lower than in the August – October period, and below both its long-term average and the UK rate of 3.7%. We are forecasting that the unemployment rate in Northern Ireland will rise albeit to a relatively low level when considered against the challenging economic backdrop and average around 3.2% in 2023, before increasing to an annual average of about 3.5% in 2024.

Employee jobs per sector in 2023



Sources: Oxford Economics, Danske Bank Analysis

Employee jobs (%)	2023	2024
Professional, scientific & tech	8.3	1.6
Transportation & storage	2.7	1.3
Information & communication	2.2	2.3
Human health & social work	1.3	0.6
Water supply	1.1	-1.2
Construction	0.8	0.9
Education	0.7	-0.9
Real estate activities	0.6	-0.2
Other service activities	0.3	0.0
Public administration & defence	0.0	-1.5
Agriculture, forestry & fishing	-0.2	-0.7
Financial & insurance	-0.9	-1.4
Manufacturing	-1.2	-1.2
Accommodation & food service	-1.4	0.8
Administrative & support	-1.4	1.1
Arts, entertainment & recreation	-1.5	0.7
Wholesale & retail trade	-2.2	1.3
Electricity, gas, steam & air	-2.5	-0.2
Mining & quarrying	-3.4	-1.2
Total	**0.2**	**0.3**

Sources: Oxford Economics, Danske Bank Analysis

Risks and uncertainties

While there is always uncertainty associated with economic forecasts, the extent of the risks and uncertainties around these projections is considered to be particularly elevated. The main sources of uncertainty include:

- **Persistent inflation** – Inflation in the UK remains near its multi-decade high and while we think it has likely peaked, the rate of price rises is still expected to remain above its 2% target throughout this year. If inflation remains higher than forecast and declines more slowly than anticipated, it has the potential to constrain economic activity even further. Factors which could see this come about include businesses having to raise prices in response to higher costs, rising wages feeding into increased prices or if commodity prices rise again. More prolonged inflation could also mean that the Bank of England's Monetary Policy Committee may need to increase Bank Rate even higher to contain the rate of price rises and that could further dampen economic output.

- **Prolonged political uncertainty** – Northern Ireland has not had a fully functioning Executive since early last year and government ministers are no longer in post, with issues around the implementation of the Northern Ireland Protocol the main factor preventing the re-establishment of the political institutions. The recently agreed Windsor Framework – a new UK-EU agreement relating to the operation of the Protocol – should address some of the challenges that local businesses are facing. However, it is not yet clear whether it will eventually lead to the restoration of the political institutions. The lack of an Executive has created uncertainty and challenges around policymaking in Northern Ireland and if this persists there is a risk that addressing key economic challenges will not progress as quickly as needed.

- **Skills shortages and recruitment challenges** – Across the economy, many businesses are still struggling to fill job vacancies with the skills that they need. In the *2023 Q1 Quarterly Economic Survey* published by the *Northern Ireland Chamber of Commerce and Industry* and *BDO* it was reported that 92% of the manufacturing businesses and 82% of the services firms that responded to the survey were facing difficulties when it came to recruiting employees. While we expect unemployment to rise, this competition for workers is one of the reasons that we think the extent of the increase may be lower than what might typically be assumed given the challenging economic environment. Skills shortages and recruitment challenges could weigh on economic output levels and taking steps to address this challenge, alongside other labour market issues such as low productivity and high levels of economic inactivity, should be policy priorities in Northern Ireland in an attempt to raise the economy's growth potential over the longer term.

In addition, a key global uncertainty relates to:

- **The war in Ukraine** – The economic consequences of the war in Ukraine on the UK and Northern Ireland economies have included higher commodity prices, in particular for oil and gas, and disruption to supplies of inputs from Russia and Ukraine. The war has also likely weighed on business and consumer confidence and the timing of an end to the war remains highly uncertain. However, if the war and the associated geopolitical tensions were to be particularly prolonged or to escalate further, in addition to the tragic human consequences that could ensue, the performance of the economy could also be negatively affected.

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The information in this document has been prepared in conjunction with Oxford Economics.

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