2017 Quarter 1

Northern Ireland Quarterly Sectoral Forecasts

Forecast summary

The Northern Ireland economy enjoyed a solid performance in 2016 with overall growth of 1.5%, the strongest rate of growth since 2007. However, we expect activity to slow through this year and into 2018 as higher inflation squeezes household spending power. We do expect economic output to continue rising and, as such, are forecasting GVA growth of 0.8% this year and 1.0% in 2018. We do not anticipate any major changes to monetary or fiscal policy in the near future.

Post referendum picture begins to emerge...

The post-referendum picture is still emerging and will continue to do so over the coming quarters. The release of the Quarterly Employment Survey for September 2016 was the first release of post referendum employment data for Northern Ireland. The seasonally adjusted results reported virtually no change in employee jobs between the second and third quarter of 2016 (-100 jobs). This slight slowdown in jobs growth represents a continuation of a trend that has been evident since June 2015.

The ONS WorkForce jobs data also suggested a weakening of the labour market in Q3 2016. Whilst the UK managed growth of 58,000 jobs, six of the twelve UK regions suffered a contraction in total employment, including Northern Ireland. According to the data (which includes self-employment, Government-supported trainees and the armed forces) Northern Ireland lost 6,000 jobs in Q3 2016. The losses came from quite a broad base, and there was no notable shock in any one sector. Furthermore, the Northern Ireland Composite Economic Index reported a fall of 0.9% in real terms between Q2 2016 and Q3 2016. Against this backdrop we estimate a slowdown in output growth and a slight deterioration in the labour market in 2017.

...with consumer power weakening, growth will slow.

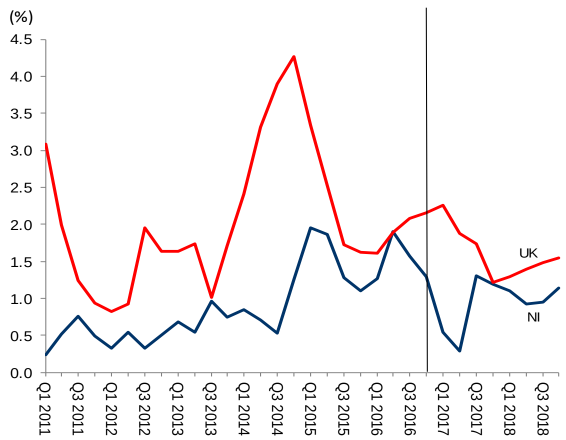
The consumer has been key to driving economic growth over recent years. However, household spending power will increasingly come under pressure from higher inflation, thus consumer activity is expected to slow. Indeed the latest Danske Bank Northern Ireland Consumer Confidence Index revealed a decline between the third and fourth quarter of 2016 and also reported a marked decline in expectations for future finances. This slowdown in consumer spending will be offset through the year with a stronger performance from external-facing sectors. But with the consumer accounting for such a large share of the economy, GVA growth is expected to slow from 1.5% in 2016 to 0.8% this year. In 2018, growth will likely come from a much broader base, as the depreciation of sterling continues to feed through to the consumer and reduces their spending power.

A weaker outlook for demand points to a slight deterioration in the jobs market over the next year or two. Employment growth is expected to reverse, with the loss of around 400 jobs throughout 2017.

	Q on Q growth		Y on Y growth		Annual growth	
	NI	UK	NI	UK	NI	UK
Q1 2016	0.9	0.2	1.3	1.6	1.5	1.8
Q2 2016	0.7	0.6	1.9	1.7		
Q3 2016	-0.9	0.6	1.6	2.0		
Q4 2016	0.5	0.7	1.3	2.0		
Q1 2017	0.2	0.3	0.5	2.1	0.8	1.6
Q2 2017	0.4	0.3	0.3	1.7		
Q3 2017	0.1	0.3	1.3	1.4		
Q4 2017	0.4	0.3	1.2	1.1		
Q1 2018	0.1	0.3	1.1	1.2	1.0	1.3
Q2 2018	0.2	0.4	0.9	1.3		
Q3 2018	0.2	0.4	1.0	1.4		
Q4 2018	0.6	0.4	1.1	1.5		

Source: Oxford Economics

GVA growth (%)



Source: Oxford Economics Note: excludes North Sea Oil

Key factors in the outlook

Uncertainty hitting business investment
Nationally, business investment had slowed prior to the referendum as uncertainty weighed on corporate confidence; capital spending is estimated to have fallen by 1.5% in 2016, after rising by slightly more than 5% in 2015. Though the corporate sector continues to enjoy a strong financial position, Brexit-related uncertainty is likely to persist with some firms set to postpone capital spending until the UK's future trading relationship with the EU becomes clearer. As such, we expect only a very gradual recovery in business investment within the UK to around 1.1% this year and 2.4% in 2018.

Higher inflation sqeezing consumer spending
Over the past couple of years, consumer spending has been boosted by low inflation, falling oil prices and a strong labour market. But inflation has already started to accelerate and this is likely to continue through 2017 as the impact of the depreciation of sterling – by some 28% against the dollar between the mid-2014 peak and end-2016 – feeds along the supply chain. We expect to see CPI inflation rise from its current rate of 1.8% to around 2.5-3% in the second half of 2017. With softening activity likely to mean that the labour market offers little support and household spending power also under pressure from the Government's welfare reforms, we see consumer spending growth in Northern Ireland slowing from 2.2% last year to 1.2% in 2017 and just 0.4% in 2018.

The weaker pound offering a modest boost to net exports
UK business surveys have increasingly reported stronger results for export order books, but the official data is yet to show any material improvement. The disparity appears to be because firms have made minimal cuts to their foreign currency prices, prioritising profitability over using the weaker pound to gain market share. Thus, while sales have been strong in cash terms, in the national accounts this has shown up as a sharp rise in export prices and only a modest improvement in export volumes. We expect this behaviour to continue so, while the weaker pound should improve the net trade position, the contribution of net exports to GDP growth is likely to be fairly modest.

Tight fiscal stance
The Autumn Statement saw the Chancellor adopt less-stretching fiscal rules and announce a modest increase in infrastructure investment. But the squeeze on welfare spending noted above, plus previously announced tax rises and cuts to current spending, mean that fiscal policy will still drag on growth over the next few years. The Office for Budget Responsibility estimates that fiscal tightening will exert a drag of about 0.8% a year on GDP growth until 2019-20.

Monetary policy to remain on hold until 2019
The probability of an interest rate increase at some point during 2017 jumped up during January and was sitting close to 50% prior to the Monetary Policy Committee's February meeting. But the Committee's relatively balanced tone shocked markets to the extent that the implied probability of a 2017 rate increase is now just 24%. We see little reason for such an increase, and still expect the Bank Rate to remain at 0.25% until around the second half of 2019. And with growth set to slow and little risk of the weaker pound causing secondround effects in the form of higher wages and continually increasing inflation expectations, we still expect the MPC to take a very cautious approach to tightening policy.

Sectoral outlook

GVA growth continues to be underpinned by the domestic economy
Growth over the short run in Northern Ireland is expected to be driven predominantly by consumer spending, accompanied by a slight pick-up in investment spending from 2017. Net trade is also expected to positively contribute to growth. Private services are forecast to remain as the primary contributors to growth in 2017, with the wholesale & retail trade sector forecast to make the biggest contribution to GVA growth in 2017. Growth in 2018 will need to come from a broader base, as the depreciation of sterling feeds through to the consumer and reduces their spending power.

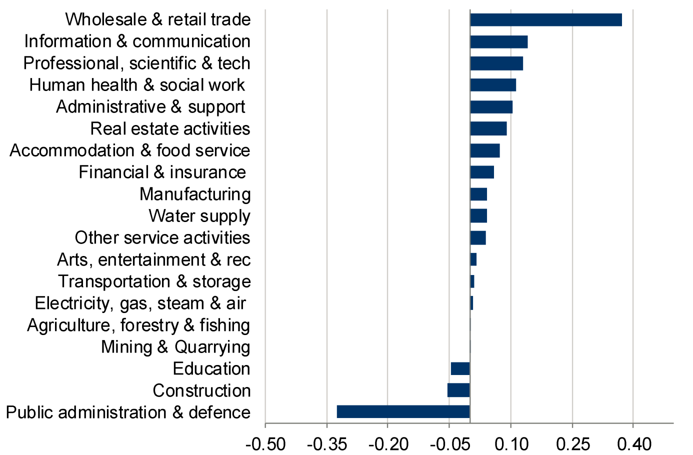
Sectorally, growth in 2017 will be led by the **information and communication** sector (4.4%). The **professional, scientific & technical** sector and the **administration & support** sector are also expected to perform relatively strongly. The consumer focused sectors are forecast to continue their 2016 momentum into 2017, with 2.6% growth expected in **wholesale & retail trade** and 2.8% in **accommodation & food**. This momentum, however, will be short-lived. We expect higher inflation to squeeze consumers with activity in these sectors to slow. In 2018, we expect growth to slow to 1.8% within **wholesale & retail trade** and 1.3% in **accommodation & food**.

The outlook for investment orientated sectors remains relatively weak. Although Theresa May's January speech helped to clarify the Government's plan for Brexit there remains significant uncertainty over the trade arrangements that will ultimately be agreed and indeed there is still a risk that it proves impossible to agree a deal and the UK will be forced to revert to trading with the EU according to WTO rules. This uncertainty and corresponding reduced corporate confidence has already, and will continue to cause businesses to postpone capital spending, disproportionally damaging the **manufacturing** and **construction** sectors.

Output in the **agriculture** sector is expected to remain relatively flat over the short run, with modest growth of 0.3% and 0.2% forecast in 2017 and 2018 respectively. The recent fall in the value of sterling should provide some benefits to the sector over the short run. Over the longer run, agriculture will be particularly sensitive to the terms and conditions of the Brexit deal.

Although the Autumn Statement saw the Government adopt a less-stretching fiscal stance, we maintain our view that the **public administration & defence** sector will continue to be a drag on GVA growth in 2017 and 2018. We expect a 3.3% and 1.4% contraction respectively, a slower rate of decline than that experienced in both 2015 and 2016.

Sector contributions to GVA growth in 2017



Source: Oxford Economics

% annual contribution to GVA growth

GVA (%)	2017	2018
Information & communication	4.4	3.3
Professional, scientific & tech	3.3	2.8
Administrative & support	2.8	2.5
Accommodation & food service	2.8	1.3
Wholesale & retail trade	2.6	1.8
Water supply	2.0	1.0
Other service activities	1.6	0.6
Financial & insurance	1.5	1.0
Arts, entertainment & rec	1.4	0.7
Real estate activities	1.1	2.1
Human health & social work	1.1	0.8
Electricity, gas, steam & air	0.8	2.0
Transportation & storage	0.3	0.7
Manufacturing	0.3	0.6
Agriculture, forestry & fishing	0.3	0.2
Mining & Quarrying	0.2	0.5
Education	-0.6	0.3
Construction	-1.0	0.9
Public administration & defence	-3.3	-1.4
Total	**0.8**	**1.0**

Source: Oxford Economics

Labour market outlook

A weakening labour market
A weaker outlook for demand suggests that there will be a slight deterioration in the jobs market over the short-run. Employment levels are expected to fall by around 400 jobs in 2017, equivalent to a contraction of 0.1%. Modest job losses are expected to continue in 2018 with the further loss of around 1,000 jobs, given the uncertain economic conditions.

The employment performance will be underpinned by:

Information & communication, professional scientific & technical services and administration & support are expected to enjoy robust growth in 2017 rising by 2.7%, 1.5% and 1.3% respectively. Collectively these sectors are expected to generate 1,800 new jobs, which will be quite evenly spread across the three sectors.

The uncertainty that remains around Brexit and the resulting impact on investment levels will hit the investment dependent **manufacturing** and **construction** sectors heavily in 2017. We anticipate 800 job losses in construction and 700 in manufacturing by the end of the year. 2018 will bring mixed fortunes for these sectors, with manufacturing losses set to increase to 1,100 whilst the construction sector is forecast to return to positive growth. It is our view that rising manufacturing activity will be achieved through the adoption of new technologies and increased productivity rather than through higher employment, a feature that will be important to maintain competitiveness in international markets. **Agriculture** employment is expected to increase modestly in both 2017 and 2018, generating 100 new jobs as the fall in the exchange rate makes local produce more competitive.

Public sector job losses are also expected to continue be a net drag on employment growth over the short and medium-term as continued austerity measures impact on departmental funding. We forecast 1,700 job losses in the public administration & defence sector in 2017 and a further 1,400 losses in 2018.

Employment (%)	2017	2018
Information & communication	2.7	1.7
Professional, scientific & tech	1.5	1.1
Administrative & support	1.3	1.4
Real estate activities	0.7	1.4
Human health & social work	0.7	0.0
Transportation & storage	0.5	0.5
Arts, entertainment & rec	0.5	0.2
Other service activities	0.3	0.0
Agriculture, forestry & fishing	0.3	0.1
Accommodation & food service	0.1	0.0
Water supply	0.0	-0.8
Wholesale & retail trade	-0.2	0.0
Education	-0.3	-0.5
Financial & insurance	-0.5	-0.6
Manufacturing	-0.8	-1.3
Construction	-1.4	0.5
Mining & quarrying	-1.8	-1.9
Electricity, gas, steam & air	-2.5	-1.0
Public administration & defence	-3.1	-2.8
Total	**-0.1**	**-0.1**

Source: Oxford Economics

Risks and uncertainties

There are a number of risks which could impact upon the Northern Ireland economy. These include:

- **Political instability** – The collapse of the Stormont executive in the wake of the RHI revelations poses a threat to the local economy. A stable political environment is essential for robust economic growth and the perception of instability risks discouraging potential foreign investors.

- **Brexit** - this represents a significant risk to our forecast over both the short and long-term. In the short-term, there is a risk that the negative impact on confidence is larger than that assumed in our baseline forecast, causing activity to falter. Further out, our forecast assumes that the Government is successful in its aim of negotiating a free trade agreement with the EU. But there remains a risk that negotiations break down and that the UK is forced to trade with the EU according to WTO rules – this would be the most economically damaging outcome. Conversely, if the UK rows back from its decision to leave the single market, or pursues more liberal policies in areas such as immigration, then it could achieve a stronger outcome for GDP growth over the longer-term.

- **Productivity** – the UK's productivity performance since the global financial crisis has been weak. Recently, the pace of productivity growth has picked up gradually and our forecast assumes this continues, although we do not expect it to return to pre-crisis norms. But there is a risk that productivity regresses once more, particularly if Brexit results in less openness and lower inflows of FDI.

- **Further austerity** – the Government has consistently fallen short of its fiscal targets since the global financial crisis. The latest iteration of the fiscal rules provides some extra margin for error, but if tax revenues disappoint then the Government may opt for further austerity measures to commence around the turn of the decade.

And the key global uncertainties include:

- **Downturn in Europe** – in this scenario the UK suffers a greater fallout from the Brexit vote than expected, while problems in the Italian banking sector increase the degree of financial stress and result in a general movement out of European assets. Under these circumstances, the UK could see GDP growth slow to just 0.6% a year in 2017 and 2018.

- **Strong pickup in US growth** – congressional negotiations may result in a significantly more expansionary US fiscal package than assumed in the baseline. This would boost US growth and the UK's strong trading links with the US would ensure that it too benefits initially, though tighter monetary policy would subsequently restrain the UK upturn.

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