Northern Ireland Quarterly Sectoral Forecasts

Forecast summary

Following the announcement of very strong growth in the Northern Ireland Composite Economic Index and workforce jobs data for 2016 Q4, compounded by reasonably robust early data releases for 2017 Q1, we have revised our forecast for growth in 2017 up to 1.2%. We do, however, anticipate a slight slowdown in 2018 to growth of 1.0% as inflation remains above the 2.0% target and squeezes consumers' spending power.

A strong finish to 2016...

There were a number of positive data releases for Northern Ireland which pointed to a very strong end to last year. The ONS workforce jobs data suggested that Northern Ireland recorded an increase of 18,000 jobs in the final quarter of 2016. This rate of growth equates to an increase on 2016 Q3 of 2.1% which compares favourably to the UK over the same period (0.2%).

The Northern Ireland Composite Economic Index release for the final quarter of 2016, showed year-on-year growth of 2.9%, faster than at any time in the last ten years. The production sector performed relatively well, bolstered by the weakness of the pound. Indeed data from HM Revenue & Customs suggests that the value of goods exports from Northern Ireland in 2016 was 11.7% higher than in 2015. This export data will no doubt also have been supported by the recent strength of the Republic of Ireland economy, Northern Ireland's largest trading partner. Given the historical volatility of the Composite Economic Index, we have been cautious with its incorporation in our historical and forecast data. But we have taken it as an indication that growth in Northern Ireland surpassed that in the UK in 2016 Q4.

Whilst we believe positive growth appears to have continued into the first quarter of 2017, the pace of growth is forecast to be somewhat more muted than in 2016 Q4. The Northern Ireland Index of Services saw growth of 0.5% over the quarter but the Index of Production contracted by 0.2%. The workforce jobs release also suggests a slight contraction of 0.2% in the first 3 months of the year, significantly behind the 0.7% growth seen in the UK over the same period. However, this quarterly fall was relative to a fairly high jobs figure for 2016 Q4.

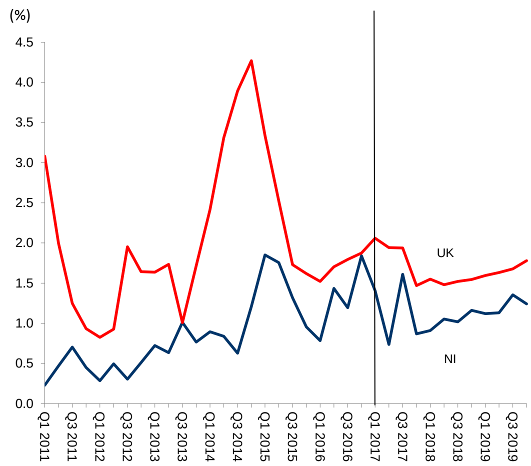
...although inflation is set to weigh heavily on consumers' spending power.

Despite the bounce back observed in the Danske Bank Northern Ireland Consumer Confidence Index for 2017 Q1, consumers' spending power is coming under pressure as a result of rising inflation. We expect the average rate of CPI inflation in the UK to be around 2.8% in 2017 and 2.7% in 2018. Therefore, we are projecting that consumer spending growth in Northern Ireland will slow to 1.2% in 2017 and just 0.6% in 2018.

	Q on Q growth		Y on Y growth		Annual growth	
	NI	UK	NI	UK	NI	UK
Q1 2017	0.1	0.2	1.4	2.0	1.2	1.7
Q2 2017	0.2	0.4	0.7	1.8		
Q3 2017	0.2	0.3	1.6	1.7		
Q4 2017	0.4	0.3	0.9	1.3		
Q1 2018	0.2	0.3	0.9	1.5	1.0	1.4
Q2 2018	0.3	0.4	1.1	1.4		
Q3 2018	0.2	0.4	1.0	1.4		
Q4 2018	0.5	0.4	1.2	1.5		
Q1 2019	0.2	0.4	1.1	1.5	1.2	1.6
Q2 2019	0.3	0.4	1.1	1.6		
Q3 2019	0.4	0.4	1.4	1.6		
Q4 2019	0.4	0.5	1.2	1.7		

Source: Oxford Economics, Danske Bank Analysis

GVA growth (%)



Source: Oxford Economics, Danske Bank Analysis
Note: excludes North Sea Oil

Key factors in the outlook

Higher inflation squeezing consumers
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 accelerated and could rise a little higher moving through 2017 as the impact of the sharp depreciation of sterling over the past couple of years continues to feed along the supply chain. We expect to see CPI inflation rise from its current rate of 2.9% to just over 3% later in 2017, and this high rate of inflation will squeeze consumers' purchasing power. Household spending power will also come under pressure from the Government's welfare reforms, while softening activity is likely to mean that the labour market offers little additional support. And with the savings ratio already very low, we see little scope for households to lean against these pressures by borrowing more. We expect consumer spending growth in Northern Ireland to slow from 2.8% last year to 1.2% in 2017 and just 0.6% in 2018.

Uncertainty hitting business investment
Nationally, business investment faltered last year - it fell by 1.5% in 2016 after growing by 5.1% in 2015. Although 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 UK business investment, with capital spending growth accelerating from 0.4% this year to 1.3% in 2018. Overall investment in the UK — which also includes government investment and investment in private dwellings — is set to be weaker this year, rising just 0.1%, but stronger in 2018 when it is forecast to grow by 1.8%.

The weaker pound offering a modest boost to net exports
UK business surveys have increasingly reported stronger results for export orders, suggesting some benefit from the weaker pound, and the official data have belatedly begun to improve. We expect some improvement in the net trade position in 2017 and 2018 but the pickup will not be sufficient to offset the drags on growth from elsewhere. The boost from this stronger trade performance could be constrained if sterling gradually appreciates moving towards the end of 2018, and if a sizeable proportion of firms prioritise improving profitability over using the weaker pound to gain market share.

Tight fiscal stance
The March 2017 Budget saw the Chancellor leave fiscal policy largely unchanged. But the squeeze on welfare spending, plus previously-announced tax rises and cuts to current spending, mean that fiscal policy is expected to exert a drag on growth over the next few years. Analysis of the Office for Budget Responsibility forecasts implies that fiscal tightening could exert a drag of about 0.6 percentage points a year on UK GDP growth between 2017-18 and 2019-20.

Monetary policy likely to remain on hold until 2019
With aggregate demand slowing markedly in 2017 Q1, the Monetary Policy Committee (MPC) voted by a 5-3 majority to keep Bank Rate at 0.25% at their June meeting. We continue to expect the prospect of slower growth, the absence of underlying inflationary pressures and the high degree of uncertainty around Brexit to mean that the MPC will wait until the second half of 2019 before raising interest rates.

Sectoral outlook

Inflation squeezing buoyant consumers, as business investment slowly recovers
Despite the high level of inflation in 2017, GVA growth will remain largely dependent upon the consumer this year. Though next year will see a slight shift in this pattern due to slower consumer spending growth, as a result of continued high levels of inflation, and stronger business investment growth, as more details around the UK's future relationship with the EU begin to emerge.

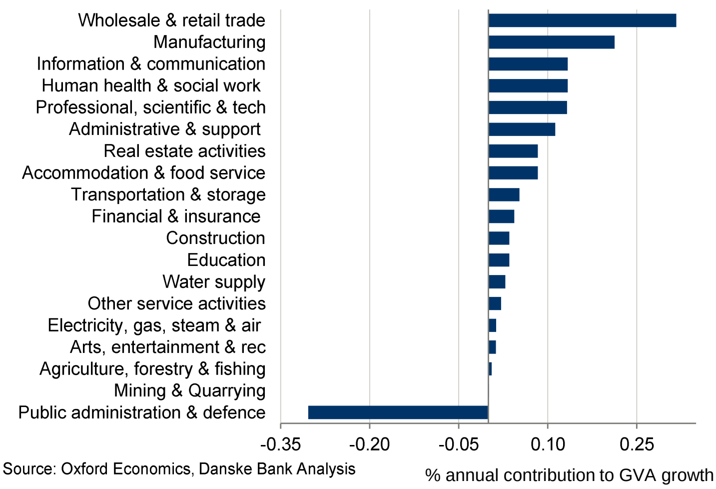
After performing well in 2016, the fastest growing sector in Northern Ireland in 2017 is expected to be **information & communication**. This sector is forecast to grow strongly across the whole of the UK in the coming years and we expect to see 4.0% growth in Northern Ireland in 2017. The **professional, scientific & technical** sector follows closely behind, we expect to see growth of around 3.2% in this sector in 2017.

As we approach the date at which the UK will formally leave the EU, it is our current view that the most likely outcome will be an initial transitional arrangement followed by a permanent free trade agreement. Although the outlook for the investment related sectors remains relatively challenging, we have raised our growth expectations in light of the emerging clarity around Brexit and the knock-on impact of this on corporate confidence and business investment levels. We are now forecasting GVA growth of 1.4% in the **manufacturing** sector and 0.6% growth in the **construction** sector in 2017. The manufacturing sector has also been bolstered in recent months by the depreciation of sterling and the strong performance of the Republic of Ireland economy, Northern Ireland's largest trading partner.

The **accommodation & food and wholesale & retail trade** sectors are set to experience strong growth of 2.9% and 2.2% respectively in 2017, with the latest Danske Bank Index showing consumer confidence is at its highest level since the third quarter of 2015. However, we expect to see a slowdown in growth in 2018 in these sectors as sustained high inflation eats into households' spending power.

Given the March Budget saw the Government leave its fiscal stance broadly unchanged, 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 successive contractions of 3.1% and 1.0%.

Sector contributions to GVA growth in 2017



Source: Oxford Economics, Danske Bank Analysis

GVA (%)	2017	2018
Information & communication	4.0	3.1
Professional, scientific & tech	3.2	2.7
Administrative & support	3.0	2.5
Accommodation & food service	2.9	1.3
Wholesale & retail trade	2.2	1.6
Water supply	1.5	1.0
Manufacturing	1.4	1.1
Transportation & storage	1.4	0.8
Human health & social work	1.3	0.8
Electricity, gas, steam & air	1.2	1.8
Arts, entertainment & rec	1.2	0.3
Financial & insurance	1.1	1.0
Real estate activities	1.0	1.3
Other service activities	0.9	0.4
Construction	0.6	0.8
Education	0.5	0.3
Agriculture, forestry & fishing	0.4	0.3
Mining & Quarrying	0.2	0.8
Public administration & defence	-3.1	-1.0
Total	**1.2**	**1.0**

Source: Oxford Economics, Danske Bank Analysis

Labour market outlook

Labour market contraction ahead

On the back of the recent labour market data releases, we have upgraded our 2017 employment forecast for Northern Ireland and now expect to see modest growth of around 1,300 jobs. Our 2018 forecast remains negative though and we expect to see around 2,100 job losses. The forecasts of employment levels in the table below are based on the workforce jobs data series, rather than employment as included in the Labour Force Survey data.

The seasonally adjusted ILO unemployment rate for Northern Ireland witnessed a 0.3 percentage point fall over the quarter to 5.4% in February – April 2017. We expect the annual average unemployment rate in 2017 to be around 5.7%, slightly lower than the 5.8% observed last year. Although with the anticipated fall back in employment levels in 2018, we expect to see the unemployment rate rise marginally to 5.8%.

Sectorally, the employment performance will be underpinned by the following:

Information & communication, professional scientific & technical services and **administration & support** are expected to continue to be key drivers of employment growth, experiencing expansions in 2017 of 2.5%, 2.0% and 1.6% respectively. No other sectors are projected to experience growth above 1.0%. The **transport & storage** and **other services** sectors are forecast to be the next fastest growers, at 0.9% and 0.7%. Although the information & communication sector is expected to be the fastest growing in 2017, the administration & support sector should create the most jobs. We expect to see around 900 additional jobs in the sector by the end of 2017.

Our **construction** sector forecast has been significantly upgraded since our last report. The latest Northern Ireland Composite Economic Index figures showed a significant spike in construction activity in the final quarter of 2016 and we expect the sector to have taken some of this momentum into 2017. We are forecasting 0.5% employment growth in 2017.

In light of the depreciation of sterling and the fact that we now have a little bit more clarity around the Brexit process, we have marginally upgraded our **manufacturing** employment outlook. The employment outlook in the manufacturing sector is expected to be impacted by two main events. A constrained recovery in business investment, upon which it is heavily dependent, and a shift towards less labour intensive production methods. Employment is expected to contract in 2017 by 0.3% and by 0.9% in 2018.

As mentioned above, the March 2017 Budget saw the Chancellor leave fiscal policy largely unchanged. We therefore maintain our view that the **public administration & defence** sector will act as a drag on employment growth in 2017. We anticipate an annual contraction of 3.3% in 2017.

Employment (%)	2017	2018
Information & communication	2.5	1.1
Professional, scientific & tech	2.0	0.7
Administrative & support	1.6	1.2
Transportation & storage	0.9	0.3
Other service activities	0.7	0.0
Human health & social work	0.6	-0.1
Arts, entertainment & rec	0.5	0.2
Electricity, gas, steam & air	0.5	-1.1
Real estate activities	0.5	0.2
Construction	0.5	0.3
Agriculture, forestry & fishing	0.3	0.0
Accommodation & food service	0.0	-0.2
Education	-0.2	-0.7
Water supply	-0.3	-1.0
Wholesale & retail trade	-0.3	-0.5
Manufacturing	-0.3	-0.9
Financial & insurance	-0.8	-0.7
Mining & quarrying	-3.0	-2.4
Public administration & defence	-3.3	-2.8
Total	**0.1**	**-0.2**

Source: Oxford Economics, Danske Bank Analysis

Risks and uncertainties

There are a number of risks and uncertainties which could impact upon the Northern Ireland forecasts presented above. These include:

- **Political uncertainty –** following the outcome of the UK general election, which resulted in a hung Parliament, political uncertainty is now at a more elevated level. It remains to be seen whether the new Government can bring about an increase in political stability, and indeed, what policy agenda it will pursue over the coming years. In Northern Ireland, the next key political milestone will be the 29th June - the deadline for the local parties to reach a deal to re-establish the Executive. Having a fully functioning Executive and Assembly, and the political stability that they can bring, are important factors that contribute to the performance of the Northern Ireland economy.

- **Brexit –** this represents a significant risk to our forecasts over both the short and long-term. In the short-term, if sufficient progress is not made during the early stages of the Brexit process, there is a risk that there could be a negative impact on confidence which would cause activity to falter. Looking further out, our forecast assumes that the Government is successful in negotiating a free trade agreement with the EU. However, there is still a risk that negotiations break down and that the UK is forced to trade with the EU according to WTO rules, which would be the most economically-damaging outcome. Conversely, if the UK Government is able to quickly agree an extremely comprehensive free trade agreement with the EU, and pursues more liberal policies in areas such as immigration, then the outlook for GDP growth over the longer-term could be somewhat stronger.

- **Productivity –** the UK's productivity performance since the global financial crisis has been weak. Recently, the pace of productivity growth has gradually picked up and our forecast assumes that this continues, although we do not expect it to return to its 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.

- **Fiscal tightening –** the Government has consistently fallen short of its fiscal targets in recent years. 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:

- **Bond market sell-off –** in this scenario, the Federal Reserve hikes US interest rates more aggressively, leading to a spike in global bond yields and declines in equity prices. Under these circumstances, the UK could see lower GDP growth.

- **US growth surges –** 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, putting some upward pressure on growth. However, the associated tighter monetary policy that this would result in would subsequently restrain the UK upturn.

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