Northern Ireland Quarterly Sectoral Forecasts

Forecast summary

Sluggish economic growth continues in Northern Ireland, with the economy expected to grow by 1.2% this year and 1.0% in 2018. There is clear evidence that high inflation is subduing consumer spending growth. And with businesses wary of investing in a climate of Brexit-related uncertainty, as well as the Government continuing with its programme of fiscal austerity, growth is likely to remain subdued over the next couple of years.

A mixed bag for growth so far in 2017…

Economic growth data in Northern Ireland has been mixed throughout 2017. The Northern Ireland Composite Economic Index data showed that economic activity was estimated to have grown by 0.3% between 2016 Q4 and 2017 Q1, similar to GDP growth in the UK over the same period. Boosted by the relative weakness of sterling, total exports out of Northern Ireland grew by a strong 11.7% over the year to 2017 Q1. Exports to the Republic of Ireland and the US, Northern Ireland's top two export destinations, increased by 12.5% and 16.4% respectively. Looking ahead, we expect economic growth to become more broadly balanced given the improved contribution from net trade and the reduced impetus from the consumer sector. That would serve to make the economy more resilient, were it not for the uncertainties created by Brexit.

In the second quarter of 2017, the Northern Ireland Index of Services decreased over the quarter by 1.0%. Growth over the year was just 0.5%, falling behind growth in the UK of 2.3%. While all broad sectors experienced a decline compared with the previous quarter, all sectors saw growth when averaging over the past four quarters. However, broadly speaking, services output in Northern Ireland remains on an upward trajectory.

A sharper decline was seen in the Index of Production data, with output reported to have fallen by 3.6% in Northern Ireland over the three months to 2017 Q2. A substantial decline in output from the food, beverages and tobacco industry was responsible for a significant proportion of the overall decline.

…dampened by falling consumer confidence.

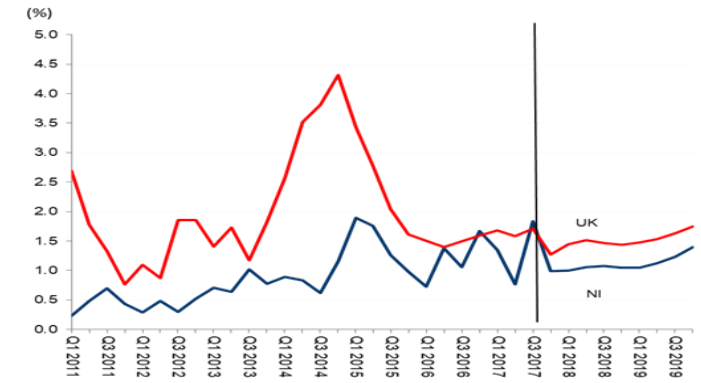
The Danske Bank Northern Ireland Consumer Confidence Index for July 2017 showed a fall in consumer confidence compared with the first quarter of 2017. Rising inflation, Brexit-related uncertainties and the political stalemate in Northern Ireland all contributed to the decline.

We expect inflation to continue to exceed the Bank of England's 2% target, averaging 2.7% in both 2017 and 2018 before falling to around 2.3% in 2019. In light of this, and the recent consumer confidence data, consumer spending growth is expected to slow to 1.7% in 2017 and then fall even further to 0.6% in 2018 – potentially the lowest level of spending growth since 2011.

	Q on Q growth		Y on Y growth		Annual growth	
	NI	UK	NI	UK	NI	UK
Q1 2017	0.3	0.3	1.4	1.8	1.2	1.6
Q2 2017	0.2	0.3	0.8	1.5		
Q3 2017	0.2	0.4	1.8	1.6		
Q4 2017	0.3	0.4	1.0	1.4		
Q1 2018	0.3	0.4	1.0	1.5	1.0	1.5
Q2 2018	0.3	0.4	1.1	1.6		
Q3 2018	0.3	0.4	1.1	1.5		
Q4 2018	0.2	0.4	1.0	1.5		
Q1 2019	0.3	0.4	1.0	1.5	1.2	1.6
Q2 2019	0.3	0.4	1.1	1.5		
Q3 2019	0.4	0.4	1.2	1.6		
Q4 2019	0.4	0.5	1.4	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 continues to squeeze consumers

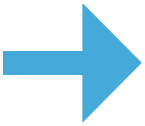
In recent months, inflation has emerged as the key threat to the UK economy with the resulting squeeze on households' spending power shown in the weakness of growth in the first half of 2017. Over the past year, CPI inflation has accelerated from below 1% to almost 3%, due mainly to the pass-through of last year's sterling depreciation. UK inflation in August was 2.9%, up from 2.6% in July, reflecting noise caused by changes in the timing of late-summer discounting by retailers and a rise in motor fuel prices. Consumer spending grew by just 0.2% in 2017 Q2, the weakest performance for two-and-a-half years. The slowdown was exaggerated slightly by the changes to road tax which boosted car sales in Q1 at the expense of Q2. With nominal wage growth remaining subdued, consumers are enduring a severe squeeze on their spending power and this is likely to last for the rest of 2017 and into 2018.

Uncertainty hitting business investment

The corporate sector continues to enjoy a strong financial position, however Brexit-related uncertainty has caused some firms to postpone capital spending until the UK's future trading relationship with the EU becomes clearer. Businesses are likely to remain reticent about investing due to this uncertainty, and as such, we expect only a gradual recovery in UK business investment.

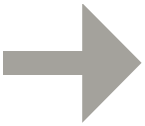
The weaker pound offering a modest boost to net exports

UK business surveys have continued to report strong export orders, suggesting some businesses are enjoying a benefit from the weaker pound. The official data have belatedly begun to improve, though volatility in sales of non-monetary gold has complicated the analysis. We expect net trade to contribute around 0.6 percentage points to UK GDP growth in 2018. This would be a marked turnaround compared with previous years but would not be sufficient to offset drags on growth from elsewhere.



Growth is sluggish, and sectors show mixed results

The August CBI surveys offered a mixed picture of the health of the UK economy. While the manufacturing survey reported robust results for orders and outputs, the retailing equivalent reported a surprise year-on-year decline in sales volumes. The latest PMI data has shown that Northern Ireland's business activity is outpacing the UK, reaching a 17-month high due to strong growth in the private sector. However the retail sector, already suffering from lower consumer confidence, posted the fastest increase in prices throughout the quarter.



An interest rate rise expected by the end of 2018 Q1

The Monetary Policy Committee (MPC) voted by a 7-2 majority to keep Bank Rate at 0.25% at its September meeting. However, the Committee suggested that 'some withdrawal of monetary stimulus is likely to be appropriate over the coming months.' Given further hawkish statements from Bank of England policymakers, we have revised our previous expectation of rates remaining on hold until 2019. We now expect the first interest rate rise to occur before the end of the first quarter of 2018, with a rise in November 2017 a distinct possibility. However, it is important to note that rate rises are likely to be very gradual and so the interest rate environment is likely to remain relatively accommodative for some time yet.

Sectoral outlook

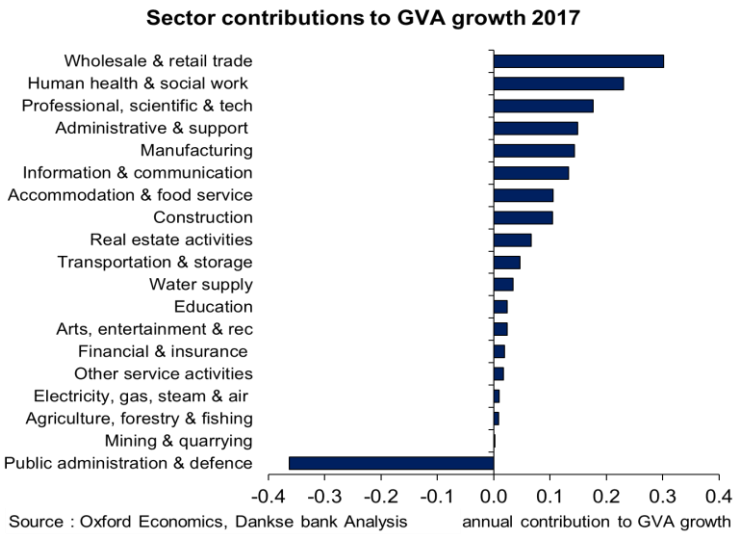
Professional, scientific and technical services and **information & communication** are expected to remain the top two sectors for GVA growth in 2017. The sectors, expected to grow this year at 4.3% and 4.2% respectively, also support growth throughout the UK and are expected to remain strong in the coming years despite Brexit uncertainties.

We have marginally revised our expected growth rate for **wholesale & retail trade** down to 2.1% in 2017 and are projecting growth of around 1.6% in 2018. With inflation forecast to average 2.7% in 2017 and 2018 we expect real wages to continue falling. We have also seen a decline in consumer confidence. The Danske Bank Northern Ireland Consumer Confidence Index showed that households' expectations of how their financial position will change over the next twelve months fell by six points in July compared with 2017 Q1. We also expect growth in other consumer focused sectors, such as **arts** and **accommodation**, to slow next year.

A downward revision in **manufacturing** brings expected growth in the sector to 1.0% in 2017 and 0.9% in 2018. Despite the depreciation of sterling having a positive impact on some exporting businesses, companies that import a significant amount of raw materials are facing increased cost pressures from the weaker exchange rate. The Northern Ireland Index of Production data showed that in 2017 Q1 manufacturing output fell by 0.1%. In the second quarter, output levels in Northern Ireland fell by 4.7% while the UK witnessed a decline of just 0.6%.

We have revised our expectation for growth in the **construction** sector up to 1.7% in 2017. The Northern Ireland Index of Construction data points to a general upward trend in output since late 2014. Despite a decrease in the first quarter of 2017 compared with 2016 Q4 due to sharp falls in infrastructure output, growth was 7.1% higher compared to the same quarter in 2016. The CEF/BDO Half-Year State of Trade Survey showed sustained growth over the first six months of 2017, with 67% of construction companies operating at full or almost full capacity. However, the survey also suggests that the potential impact of Brexit and the lack of a Northern Ireland Executive (alongside rising costs and shortages of skilled labour) are impacting future prospects. We are projecting a slowdown in growth to 0.8% in 2018.

We still expect that **public administration & defence** will be the only sector to exert a significant drag on GVA growth. We have slightly adjusted the expected fall in 2017 down to 3.6%, followed by a further decline of 1.1% in 2018. While the Government may decide to increase spending in the Autumn Budget, we believe that fiscal tightening will continue to squeeze growth in the coming years.



GVA (%)	2017	2018
Professional, scientific & tech	4.3	2.7
Information & communication	4.2	3.2
Administrative & support	4.1	2.9
Accommodation & food service	3.7	1.5
Human health & social work	2.3	0.8
Arts, entertainment & rec	2.2	0.7
Wholesale & retail trade	2.1	1.6
Water supply	1.8	0.9
Construction	1.7	0.8
Transportation & storage	1.3	0.7
Manufacturing	1.0	0.9
Electricity, gas, steam & air	0.9	1.8
Real estate activities	0.9	1.5
Other service activities	0.7	0.4
Agriculture, forestry & fishing	0.7	0.3
Financial & insurance	0.5	0.6
Mining & quarrying	0.4	1.8
Education	0.3	0.7
Public administration & defence	-3.6	-1.1
Total	**1.2**	**1.0**

Source: Oxford Economics, Danske Bank Analysis

Labour market outlook

Labour market growth forecast revised upwards for 2017
We have upgraded our employment growth forecast for 2017 on the back of recent labour market data releases, including new workforce jobs data showing that employment growth bounced back in 2017 Q2 following the decline in total workforce jobs at the start of the year – a decline which was impacted by the fact that the end of 2016 saw the largest quarterly increase in jobs in over three decades. Employee jobs also witnessed a strong second quarter of the year. Over the quarter to 2017 Q2, the seasonally adjusted estimate of employee jobs increased by 0.6%. Over the year, there was an increase of 1.4%.

The seasonally adjusted ILO unemployment rate for Northern Ireland witnessed a 0.1 percentage point decrease over the quarter to 5.3% in May - July 2017. We expect the annual average unemployment rate in Northern Ireland to be around 5.3% in 2017, behind the UK average of 4.4%. We expect to see the Northern Ireland unemployment rate rise slightly to 5.4% in 2018, due to flat employment growth and an increase in the labour force.

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

Information & communication and **professional scientific & technical services** are expected to continue to be key drivers of employment growth, experiencing expansions in 2017 of 2.7% and 2.5% respectively.

Despite an upgrade to our forecast for employment growth in **administrative & support services** to 2.3%, it has been knocked out of the top three sectors by construction. The employment data for the first half of 2017 was strong for the sector, thus we have revised our forecast for **construction** employment growth in 2017 up to 2.5%.

Our forecast for employment growth in the **arts, entertainment & recreation** sector has been significantly upgraded since our last report to 1.1% in 2017. Due to the depreciation of sterling, tourism in Northern Ireland has experienced a boom this year. The latest tourism data from NISRA showed a total visitor spend of £170m in the first quarter of this year, an increase of around 7% from 2016 Q1, and the outlook remains strong for the remainder of the year. However, we expect a decline in employment levels in 2018 of 0.5% given the potential for the pound to recover and the fact that domestic consumer expenditure is expected to remain relatively low.

The March 2017 Budget saw the Chancellor leave fiscal policy largely unchanged. We therefore maintain our view that the **public administration and defence** sector will act as a drag on employment growth. We anticipate an annual contraction of 2.5% in 2017 and 2.9% in 2018.

Employment (%)	2017	2018
Information & communication	2.7	1.2
Professional, scientific & tech	2.5	1.0
Construction	2.5	0.9
Administrative & support	2.3	1.7
Accommodation & food service	1.8	-0.1
Agriculture, forestry & fishing	1.2	0.3
Transportation & storage	1.1	0.8
Arts, entertainment & rec	1.1	-0.5
Other service activities	0.9	-0.1
Wholesale & retail trade	0.5	-0.4
Manufacturing	0.5	-0.1
Human health & social work	0.5	-0.3
Electricity, gas, steam & air	0.5	0.4
Education	0.2	0.2
Water supply	0.1	-0.2
Mining & quarrying	-0.2	-0.4
Financial & insurance	-0.8	-0.8
Real estate activities	-1.8	-0.4
Public administration & defence	-2.5	-2.9
Total	**0.8**	**0.0**

Source: Oxford Economics, Danske Bank Analysis

Risks and uncertainties

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

- **Political uncertainty –** as the Stormont deadlock continues, political uncertainty remains at heightened levels in Northern Ireland. Talks to re-establish the Executive ended in stalemate back in June. Further talks are ongoing in an effort to avoid a return to Direct Rule from Westminster. There are a number of consequences faced by the Northern Ireland economy due to the absence of devolved government. These include the lack of progress on important areas such as finalising and beginning to implement the Industrial Strategy and making decisions locally about how to spend the money allocated to Northern Ireland by the Conservative-DUP deal following the general election. There is also the risk that Northern Ireland is under-represented when it comes to engaging with the UK Government on Brexit and, without the devolved institutions in operation, local policymakers are somewhat restricted in their ability to help shape the future arrangements that will exist at the border with the Republic of Ireland.

- **Brexit –** it appears that some progress was made during the fourth round of Brexit negotiations in September, but there are still significant challenges to overcome. At the European Council meeting in October, the EU's political leaders will determine if sufficient progress has been made on separation issues such that discussions can move onto the terms of the future relationship. From a local perspective, a position paper regarding Northern Ireland's unique position of bordering an EU country was released by the UK Government in August. The paper focused on the need to avoid a hard border with the Republic of Ireland, and proposed an exemption under which small and medium-sized businesses (accounting for a large proportion of cross-border trade on the island) will not have to comply with any potential customs tariffs. However, EU negotiators appear to have dismissed this suggestion on the grounds that it would challenge the integrity of the EU single market. Ultimately, we still believe that a deal on transition and separation is more likely than not, and that a multi-year transitional period from 2019 will eventually give way to the UK and EU cooperating under the terms of a free trade agreement.

- **Fiscal tightening –** the squeeze on national welfare spending, along with other cuts to current spending and tax rises, means that fiscal policy will exert a sizeable drag on growth over the next few years. However, given that 'austerity fatigue' may have been a cause in the Conservative's disappointing general election performance, the Government may decide to loosen the purse strings somewhat in the upcoming Autumn Budget.

And the key global uncertainties include:

- **Policy decisions adversely impacting the US economy –** while recent US economic data has remained broadly upbeat, uncertainty persists around the policy stance of the Trump administration. Detrimental protectionist measures, coupled with a tax reform plan which may not go as far as initially expected, could have a negative impact on the US economy, and have knock-on consequences for global economic growth.

- **Tighter policies in China –** greater action by China's policymakers, including a lowering of growth targets and a more significant reining in of credit growth, could lead to a sharp slowing in the domestic economy and an easing in the pace of global economic growth.

Disclaimer and copyright

Danske Bank Disclaimer

Issued by Northern Bank Limited trading as Danske Bank (the "Bank" or "we").

This report is for information purposes only, is not intended as an offer or solicitation, nor is it the intention of the Bank to create legal relations on the basis of the information contained in it. So far as the law or regulation allow, we disclaim any warranty or representation as to the accuracy or reliability of the information and statements in this report. We will not be liable for any loss or damage suffered from relying on this report. This report does not purport to contain all relevant information. Recipients should not rely on its contents but should make their own assessment and seek professional advice relevant to their circumstances.

Danske Bank is a trading name of Northern Bank Limited which is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Registered in Northern Ireland (registered number R568). Registered Office: Donegall Square West Belfast BT1 6JS. Northern Bank Limited is a member of the Danske Bank Group.

Danske Bank

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

Oxford Economics Disclaimer

Because of the uncertainty of future events and circumstances and because the contents are based on data and information provided by third parties upon which Oxford Economics has relied in producing its reports and forecasts in good faith, Oxford Economics does not warrant that its forecasts, projections, advice, recommendations or the contents of any report, presentation or other document will be accurate or achievable and Oxford Economics will not be liable for the contents of any of the foregoing or for the reliance by the customer on any of the foregoing.

OXFORD ECONOMICS

Copyright

Contact details

Conor Lambe
Economist
Email: conor.lambe@danskebank.co.uk
Twitter: @ConorLambe
LinkedIn: Conor Lambe