2017 Quarter 4

Northern Ireland Quarterly Sectoral Forecasts

Forecast summary

Northern Ireland experienced sluggish growth in 2017, with the economy estimated to have grown by just 1.1%. The lack of an Executive and Brexit-related uncertainty has created a climate that is holding back investment and lowering consumer confidence. While inflation is expected to gradually decline in 2018, it is likely to remain above the 2% target throughout the year ahead. We expect the Northern Ireland economy to grow by 1.0% in 2018 and by 1.2% in 2019.

Economic growth was subdued throughout 2017…

The Northern Ireland Composite Economic Index data implied that the level of economic output decreased by 0.1% over the quarter to 2017 Q3, following a contraction of 0.9% in 2017 Q2. However, year-on-year growth was 1.2% in the third quarter of the year.

The Index of Production data for 2017 Q3 showed that production output fell by 3.6% in Northern Ireland compared with the second quarter of the year and by 6.5% compared with 2016 Q3.

But the Northern Ireland Index of Services data suggested that services output increased by 1.0% in 2017 Q3 following a decline in 2017 Q2. Output is now at its highest level since 2008 Q3. All industry groups enjoyed an increase in output over the quarter.

There was some more positive news on the export front. The value of goods exports grew by 13.3% in the year ending in 2017 Q3, supported by the weaker pound. Growth was reported in all five of Northern Ireland’s top export partners, with exports to the Republic of Ireland increasing by 16.3% over the year to the third quarter of 2017.

The weak pound also drew tourists to Northern Ireland. In the 12 months between July 2016 and June 2017, total trips to Northern Ireland rose by 8% and expenditure on these trips increased by 17% compared to the previous year.

…as falling confidence and high inflation took their toll.

The Danske Bank Northern Ireland Consumer Confidence Index fell in both the second and third quarters of 2017 as political uncertainty and the lack of an Executive continues to take its toll on the outlook of local people.

Inflation increased sharply throughout 2017 with the December figure of 3.0% just below the five-and-a-half year high of 3.1% in November 2017.

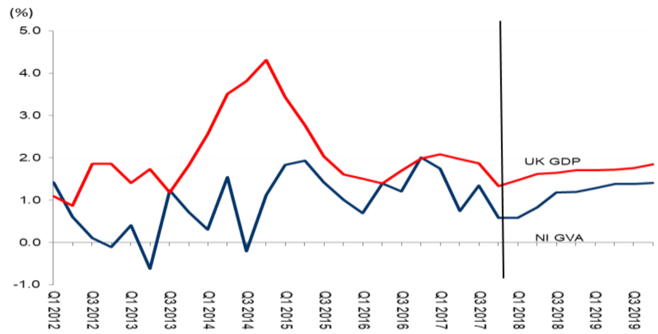
Given the quarterly contractions in the Composite Economic Index, and the falls in consumer confidence, we have revised our forecast for economic growth in Northern Ireland in 2017 down slightly from 1.2% in our last report to 1.1%. However we continue to expect the local economy to grow by 1.0% in 2018.

We expect the UK economy to grow by 1.5% in 2018, down from an estimated 1.8% in 2017. We also think that inflation in the UK will fall gradually over the year ahead, but still average 2.6% in 2018.

Forecast summary (%)		
	2017	2018
UK GDP growth	1.8	1.5
NI GVA growth	1.1	1.0
NI consumer spending growth	0.5	0.7
NI employee jobs growth	1.4	0.3
NI unemployment rate	4.7	4.1
UK CPI inflation rate	2.7	2.6

Source: Oxford Economics, Danske Bank Analysis

Economic growth (Y-on-Y, %)



Source: Oxford Economics, Danske Bank Analysis

Key factors in the outlook

Squeeze on household spending power easing, but only gradually
CPI inflation in the UK accelerated from below 1% in mid-2016 to a high of 3.1% in November 2017, due mainly to the pass-through of the post-referendum depreciation of sterling. With nominal wage growth remaining subdued, consumers have endured a severe squeeze on their spending power. We expect inflation to fall gradually over the year ahead on the back of some fading of the sterling effect, but it is likely to remain above the Bank of England's 2% target and average 2.6% over 2018. We think that household spending power will remain under pressure as increases in the rate of nominal wage growth are unlikely to be enough to push real wage growth well into positive territory. The savings ratio is also very low and we see little scope for households to lean against this pressure by borrowing more. As such, we expect consumer spending growth in Northern Ireland to remain relatively low at around 0.7% in 2018.

Brexit uncertainty weighs on business investment
Having recovered strongly after the global financial crisis, business investment has been broadly flat since the start of 2015. Though corporate profitability remains firm, with Brexit-related uncertainty likely to persist, we continue to expect some firms to postpone capital spending until the UK's future trading relationship with the EU becomes clearer. We are forecasting relatively subdued growth in business investment, with capital spending in the UK rising by 1.6% in 2018. Overall investment is projected to be a touch firmer than business investment, growing by 1.8%.

Boost to net exports from a weaker pound could fade
The combination of a weaker pound and a pick-up in global growth has strengthened export demand, though the boost to net trade has been limited by the persistent strength of imports. We expect net trade to lift UK GDP growth by 0.4 percentage points in 2017 but only by 0.1 percentage points in 2018, with the support gradually fading if sterling strengthens and erodes some of the recent gains in competitiveness.

Manufacturing in the UK sees a strong end to 2017
Despite weak manufacturing output in Northern Ireland, the UK sector enjoyed a strong performance in the second half of 2017. While December's manufacturing PMI of 56.3 represented a dip from November's 51-month high, the average over the final quarter of 2017 was the highest since 2014 Q2. An easing in inflationary pressures and benefits of the weaker pound are apparent, however the UK's reliance on the services sectors (which make up close to 80% of total output) limits the good news for the economy as a whole.

UK interest rates to rise only gradually
Having increased interest rates in November 2017, the MPC voted 9-0 in favour of keeping policy unchanged at its December meeting. Given statements made by the Monetary Policy Committee, the relatively modest growth of the UK economy, and the considerable uncertainty that still surrounds the UK's future relationship with the EU, we expect the pace of future interest rate rises to be very gradual. We expect the next interest rate increase to occur in the second half of 2018.

Sectoral outlook

We estimate that **the professional, scientific & technical services** and **information & communication** sectors accounted for the highest growth in Northern Ireland in 2017, at 4.1% and 4.0% respectively. These sectors also support growth throughout the UK and are expected to remain strong in the coming years despite Brexit-related uncertainties.

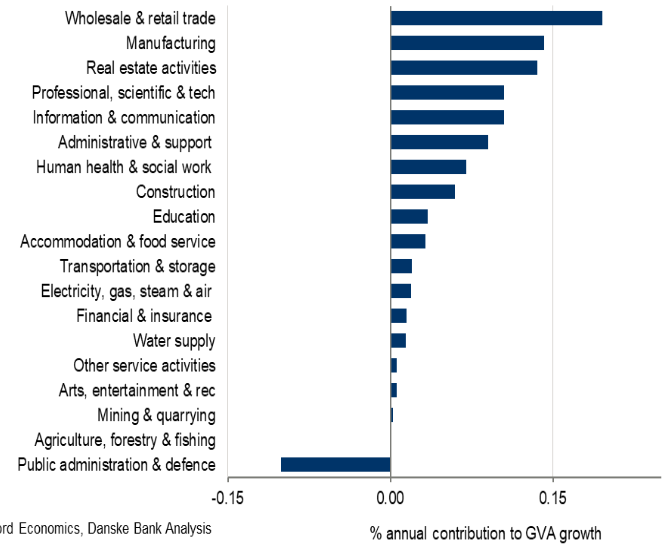
We have revised our expected growth rate for **wholesale & retail trade** down to 1.7% in 2017 and are projecting growth of around 1.5% in 2018. Declines in real wages and squeezed household spending are impacting growth in this sector. The Danske Bank Northern Ireland Consumer Confidence Index showed that confidence around consumers' future financial positions, job security and spending expectations all deteriorated in 2017 Q3. We expect consumer spending growth to continue to be weak over the forecast period, remaining below 1%. Linked to this, we also expect growth to slow in 2018 in the other consumer-focused sectors, namely **accommodation & food services** and **arts, entertainment & recreation**.

The expected growth rate for the **manufacturing** sector has been revised down marginally to 0.9% in 2017, with growth expected to be similar in 2018. The Northern Ireland Index of Production data suggests that in 2017 Q3, manufacturing output fell by 4.4% compared with the previous quarter. A sharp fall in food, beverages and tobacco manufacturing output was largely responsible for Northern Ireland's production decline during this quarter; while the UK as a whole saw production output rise.

We have revised our expectation for growth in the **construction** sector up to 1.9% in 2017. The Northern Ireland Quarterly Construction Bulletin reported a 1.2% increase in the total volume of construction output in 2017 Q3 compared with the previous quarter, and an increase of 11.3% compared to 2016 Q3. The volume of output is at its highest level throughout the past five years. However, we expect growth to moderate over the next twelve months and are projecting an expansion of 0.9% in the construction sector in 2018.

Our projection is that **public administration & defence** will remain the only sector to experience negative GVA growth. We continue to expect a fall in output in 2017 of 3.6%, followed by a further decline of 1.2% in 2018. While the UK Government did reduce the level of austerity in November a little, it is expected that fiscal tightening will remain a drag on growth.

Sector contributions to GVA growth 2018



Source: Oxford Economics, Danske Bank Analysis

GVA (%)	2017	2018
Professional, scientific & tech	4.1	2.6
Information & communication	4.0	3.0
Administrative & support	3.9	2.6
Accommodation & food service	3.3	1.2
Human health & social work	2.1	0.7
Construction	1.9	0.9
Arts, entertainment & rec	1.8	0.6
Wholesale & retail trade	1.7	1.5
Water supply	1.6	0.8
Electricity, gas, steam & air	1.2	1.4
Transportation & storage	1.1	0.5
Manufacturing	0.9	0.9
Real estate activities	0.7	1.3
Other service activities	0.5	0.3
Agriculture, forestry & fishing	0.5	0.0
Financial & insurance	0.3	0.4
Mining & quarrying	0.2	0.7
Education	0.1	0.5
Public administration & defence	-3.6	-1.2
Total	**1.1**	**1.0**

Source: Oxford Economics, Danske Bank Analysis

Labour market outlook

Labour market forecasts updated, employee jobs growth to slow in 2018
We have made an adjustment to the data used to generate our employment growth forecasts. From this release onwards, we will base our forecasts on the employee jobs series, which is consistent with the data in the Quarterly Employment Survey published by NISRA. This quarter's employment forecasts will not be comparable with previous editions and should be viewed in isolation.

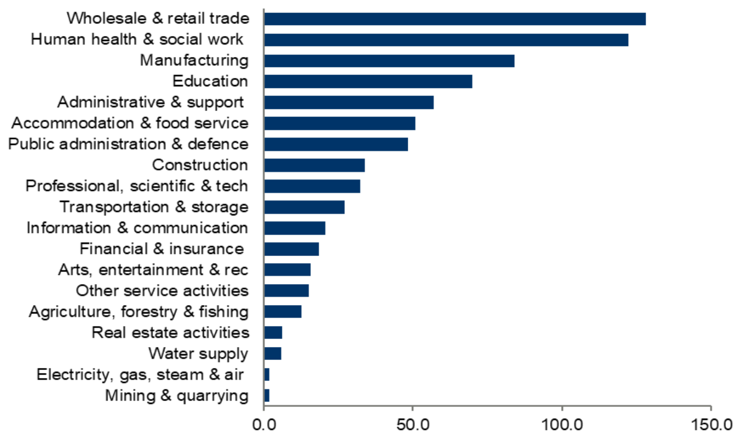
The number of employee jobs in 2017 is estimated to have grown by 1.4%, equivalent to an increase of around 10,600 jobs compared to the average employment figure for 2016. However, we expect to see a slight slowdown in job creation in 2017 Q4 compared to the previous two quarters. This slowdown in jobs growth is forecast to continue into 2018, ultimately leading to a decline in employment in the final quarter of the year, and averaging just 0.3% throughout the whole year.

Construction is expected to be a key driver of employment growth in 2017. The latest data is positive for the construction sector with the volume of housing output, infrastructure output and other work all estimated to have increased in 2017 Q3. A 7.4% expansion in the number of jobs is expected in 2017. This higher level of employment is expected to be maintained in 2018, although growth is forecast to slow to 2.2%.

Wholesale & retail trade, the sector recording the highest number of employee jobs in Northern Ireland, is expected to experience a 1.8% decline in the number of jobs in 2017. A squeeze on consumer spending, due to falling real wages and subdued consumer confidence, has contributed to a reduction in the number of employees working in this sector. While consumer spending is expected to recover slightly in 2018, the sector is likely to remain under pressure and so we are forecasting a decrease of 0.1% in the number of employee jobs throughout the year.

The seasonally adjusted ILO unemployment rate for Northern Ireland witnessed a decline between August and October 2017, falling to 3.9% compared with 5.3% in the previous three-month period. However, the fall in unemployment is partially due to an increase in economic inactivity, which rose by 1.2 percentage points over the same time period to 29.0%. We expect the Northern Ireland unemployment rate to decrease from an average of 4.7% in 2017 to 4.1% in 2018. However, the high inactivity rate means that this development is not as positive as it might, at first, appear.

Employee jobs per sector 2018 (000s)



Source: Oxford Economics, Danske Bank Analysis

Employee jobs (%)	2017	2018
Construction	7.4	2.2
Information & communication	5.8	2.0
Professional, scientific & tech	5.2	1.8
Water supply	4.8	-0.2
Arts, entertainment & rec	4.8	0.2
Accommodation & food service	4.4	0.3
Transportation & storage	4.4	1.0
Administrative & support	1.9	2.4
Human health & social work	1.7	-0.3
Manufacturing	1.5	0.5
Financial & insurance	0.8	-0.8
Education	0.4	0.2
Agriculture, forestry & fishing	0.1	-0.1
Other service activities	-0.7	-0.3
Mining & quarrying	-1.0	-1.0
Public administration & defence	-1.3	-1.8
Real estate activities	-1.4	-0.5
Wholesale & retail trade	-1.8	-0.1
Electricity, gas, steam & air	-8.8	-0.4
Total	**1.4**	**0.3**

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** – Northern Ireland has been without an Executive since January 2017, as political disagreements led to the collapse of the government at Stormont. Talks to re-establish the Executive throughout the past year have been unsuccessful, with several issues remaining unresolved. Continued warnings regarding direct UK Government intervention were realised in November when a Budget for Northern Ireland for the 2017/2018 period passed through Westminster. The budget briefing paper for 2018-2020 highlights the potential need for spending cuts, and emphasises some of the difficult decisions that need to be made with regards to Northern Ireland's public finances. The current lack of devolved government means 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** – The end of 2017 brought the close of the first phase of the Brexit talks. EU leaders agreed in December that talks could move to the next stage following sufficient progress regarding the Northern Ireland border, citizens' rights and the 'divorce bill'. There remains more work to be done regarding the border and the deal agreed at the end of last year included a commitment to have a "distinct strand" of talks related to issues pertaining to Northern Ireland and Ireland as part of the next stage of the negotiations. The months and years ahead will bring a new set of challenges, including securing a future trade deal, managing the UK's borders, devising a new approach to migration and replacing the plethora of other economic and non-economic arrangements that currently exist between the UK and the EU. However, focusing on the shorter-term, we are hopeful that a multi-year transition period will be agreed in the first half of 2018.

- **Fiscal tightening** – the squeeze on national welfare spending, along with other cuts to current spending and tax rises, means that fiscal policy is expected to exert a sizeable drag on growth over the next few years. The Government did reduce the scale of austerity a little in November's Budget, but forecasts from the Office for Budget Responsibility imply that fiscal tightening will exert a drag on GDP growth in each year between 2018/19 and 2022/23, with the peak impact of 0.4 percentage points a year falling in 2018/19 and 2019/20.

And the key global uncertainties include:

- **Tension on the Korean peninsula** – Elevated tension between North Korea and the US continues to pose a risk to the global economy. While we believe it to be unlikely, any outbreak of conflict is expected to heighten tension between the US and China and increase uncertainty, with negative consequences for investment in the region.

- **Narrow majority in the US chamber** – Following the loss of a seat in the Alabama Senatorial race, the Republican Party's majority in the chamber is now even slimmer. While there was little market reaction to the initial result, the addition of a Democrat in the Senate may slow the Republican's legislative agenda going forward. However, the narrow majority did not prevent the tax reform legislation being passed by Congress in December 2017, which notably lowers corporation tax and limits individual tax rates in the US.

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