Northern Ireland Quarterly Sectoral Forecasts

Forecast summary

For the Northern Ireland economy, the first part of 2018 has brought continued political uncertainty. The ongoing stalemate in Stormont, in addition to uncertainty regarding the border with the Republic of Ireland after Brexit, is contributing to growth remaining under its full potential. However on a positive note, the global economy is performing strongly and domestic inflation is expected to decline gradually over this year. We are forecasting economic growth in Northern Ireland of 1.0% in 2018 and 1.2% in 2019.

Economic growth in 2017 was relatively stable

Growth in Northern Ireland in 2017 was underpinned by the services sector with output rising by 1.2% over the year to 2017 Q4, according to the Index of Services data. Production, on the other hand, witnessed a 5.9% decline over the same period, with a significant fall in output in the food, beverages and tobacco subsector.

Tourism in Northern Ireland remained a bright spot last year, with overall expenditure in the 12 months up to September 2017 rising by 18% compared to the 12 months up to September 2016. However in the fourth quarter of last year, consumer confidence in Northern Ireland fell to its lowest level since 2013 as local political uncertainty and high inflation weighed down on people's confidence levels.

2018 is set to be a year of modest GVA growth...

GVA in Northern Ireland is forecast to grow by 1.0% in 2018, lower than the 1.6% growth in real GDP expected in the UK. Local consumer spending growth is projected to pick up slightly as the squeeze on spending power gradually eases, but the expected 0.7% increase in 2018 is still relatively modest. Brexit-related uncertainty is likely to continue to weigh on business investment. But the strength of the global economy should provide some support to exporting businesses.

...and the rate of jobs grow is also expected to slow

Total employee jobs growth is expected to slow over the next two years, falling from 1.6% in 2017 to 0.4% in 2018 and 0.2% in 2019.

Employment growth is projected to be fastest in the information & communication, construction and administrative & support services sectors in 2018. The largest contraction is projected to be in the public administration & defence sector.

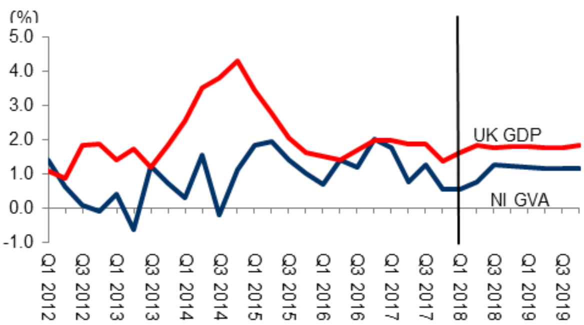
The unemployment rate in Northern Ireland fell to 3.2% in the period November 2017 – January 2018, the joint lowest on record. Despite an expected rise in the average number of jobs in both 2018 and 2019, the annual average unemployment rate is forecast to be 3.5% this year and 3.8% next year, still low by historical standards but higher than the current rate. This is driven by an anticipated fall in economic inactivity as people begin to return to the labour force.

Forecast summary (%)

	2018	2019
UK GDP growth	1.6	1.6
NI GVA growth	1.0	1.2
NI consumer spending growth	0.7	0.9
NI employee jobs growth	0.4	0.2
NI unemployment rate	3.5	3.8
UK CPI inflation rate	2.5	2.2

Source: Oxford Economics, Danske Bank Analysis

Economic growth (Y-on-Y, %)



Source: Oxford Economics, Danske Bank Analysis

Key factors in the outlook

Household spending power gradually recovering

The pass-through of the post-referendum depreciation of sterling pushed the annual average rate of CPI inflation to a five-year high of 2.7% in 2017. With nominal wage growth remaining subdued, consumers endured a severe squeeze on their spending power. Current stronger labour market conditions in the UK and in Northern Ireland mean that wage growth could pick up this year as employers have to pay more to attract new workers and employees have more bargaining power. This has the potential to put upward pressure on inflation, but overall we think that inflation has now passed its peak and expect it to slow through 2018 to an annual average rate of 2.5% and to 2.2% in 2019. This reflects the fading, and the possible reversal, of the sterling effect and strong base effects coming into play. However, given that the decline in inflation is likely to occur only gradually, consumers will still face some pressure over the next two years. The recovery in household spending power is also expected to be constrained by rising interest rates and softer employment growth. And the latest Danske Bank Northern Ireland Consumer Confidence Index showed that local consumer sentiment at the end of 2017 fell to its lowest level since the end of 2013. We expect consumer spending in Northern Ireland to grow by 0.7% in 2018 and 0.9% in 2019.

Strong global growth supporting exports, but currency moves could affect the impact on GDP

Revisions to the historical data mean that net trade is now estimated to have lifted GDP growth by 0.6 percentage points in 2017, though we suspect that flows of non-monetary gold may have distorted this data upwards. We expect strong global growth to ensure that net trade continues to boost GDP growth this year. Based on monthly averages, the sterling effective exchange rate index appreciated by over 5% between October 2016 and March of this year. If sterling were to appreciate in the months ahead, then recent gains in competitiveness could begin to erode. However, exchange rates are difficult to predict, particularly given the uncertainty around Brexit.

Brexit uncertainty weighs on business investment

In 2017, business investment in the UK grew by just 2.4%, having risen by almost 5% a year from 2010-15. Corporate profitability remains firm but investment intentions are subdued, with Brexit-related uncertainty weighing negatively on investment decisions. This will likely persist until the UK's future trading relationship with the EU becomes clearer. We expect growth in business investment to remain relatively subdued, with capital spending in the UK rising by 1.7% in 2018 and 2.7% in 2019. Overall UK investment is projected to be a touch firmer than business investment in both years, growing by 1.8% and 3.0% respectively.

MPC set to hike interest rates twice in 2018

March's Monetary Policy Committee (MPC) meeting had echoes of the September 2017 meeting, with two members voting for an immediate rate hike and the majority using the minutes to give a strong signal they will follow suit in May. The MPC is becoming ever more certain that wage growth is accelerating, which it fears could stoke inflationary pressures. The Committee appear ready to gradually increase interest rates and we expect to see a rate hike at the May meeting, and then another one later in the year. We also expect that there will be a further tightening of policy in 2019.

Sectoral outlook

Economic growth forecast to be strongest in the services sectors
In 2018, we expect total GVA in Northern Ireland to grow by 1.0%. Growth is likely to continue to be underpinned by the **administrative & support, information & communication** and **professional services** sectors, following consistently strong performances for these three sectors in recent years. The latest Northern Ireland Index of Services data highlighted the strength of the business services and finance sector as it finished last year with some momentum, increasing by 1.1% over the quarter to 2017 Q4 and 5.3% over the year.

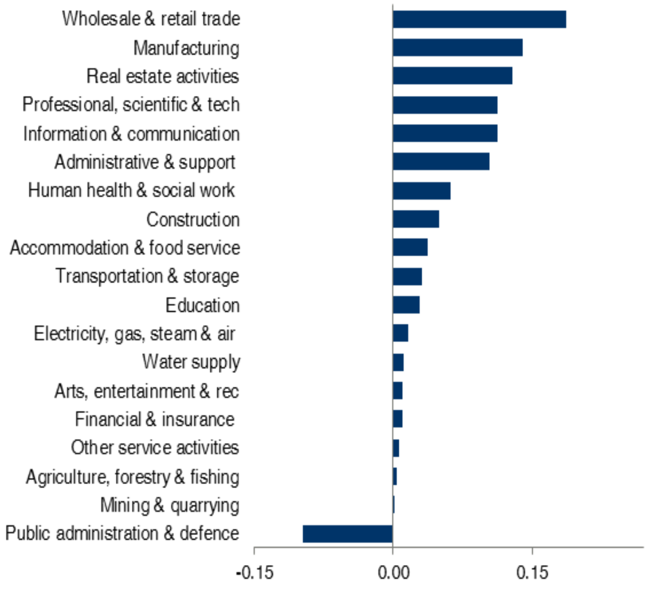
We have revised our expectation for GVA growth in the **wholesale & retail trade** sector slightly downwards to 1.3% in 2018 and 1.1% in 2019. While we expect some easing of the squeeze on household spending, this consumer-focused sector is forecast to stay under strain from the remaining pressure on consumers and the sharp fall in confidence seen at the end of 2017.

Growth in **manufacturing** output is forecast at 1.0% in 2018 and 1.2% in 2019. Data from the latest Index of Production shows that manufacturing output grew in 2017 Q4 by 0.9%, but fell by 6.9% over the year. The annual decline was driven by a sharp fall in output in the food, beverages and tobacco subsector.

Construction output in Northern Ireland is projected to increase this year and next year, despite a climate in which the sector in Great Britain experienced a further contraction in the three-month period to January 2018 – its ninth consecutive three-monthly fall. The Northern Ireland Index of Construction showed a continuation of the five-year high in construction output, rising by 1.2% between 2017 Q2 and 2017 Q3, and 11.3% compared to the previous year. We forecast that construction in Northern Ireland will grow by 0.7% in 2018 and 1.1% in 2019.

Public administration & defence is the only sector we expect to act as a drag on growth in 2018. The sector is forecast to contract by 1.2% in 2018 and a further 0.6% in 2019. It has been suggested that fiscal austerity measures may be loosened slightly in the autumn Budget, but we believe that they will continue to drag on GVA growth over the next few years.

Sector contributions to GVA growth in 2018



Source: Oxford Economics, Danske Bank Analysis

GVA (%)	2018	2019
Administrative & support	3.5	3.4
Information & communication	3.4	3.7
Professional, scientific & tech	2.6	3.1
Wholesale & retail trade	1.3	1.1
Real estate activities	1.3	1.2
Accommodation & food service	1.2	1.2
Electricity, gas, steam & air	1.1	1.0
Manufacturing	1.0	1.2
Arts, entertainment & rec	0.9	0.6
Water supply	0.8	1.1
Transportation & storage	0.7	0.9
Construction	0.7	1.1
Human health & social work	0.6	1.1
Education	0.5	0.8
Mining & quarrying	0.3	0.7
Financial & insurance	0.3	0.9
Agriculture, forestry & fishing	0.3	0.4
Other service activities	0.3	0.4
Public administration & defence	-1.2	-0.6
Total	**1.0**	**1.2**

Source: Oxford Economics, Danske Bank Analysis

Labour market outlook

Employment growth to lose pace in 2018
Northern Ireland is unlikely to maintain its pace of growth from 2017 when employment, measured by the number of employee jobs, grew by 1.6%. The number of employee jobs is expected to increase by 0.4% in 2018 and 0.2% in 2019.

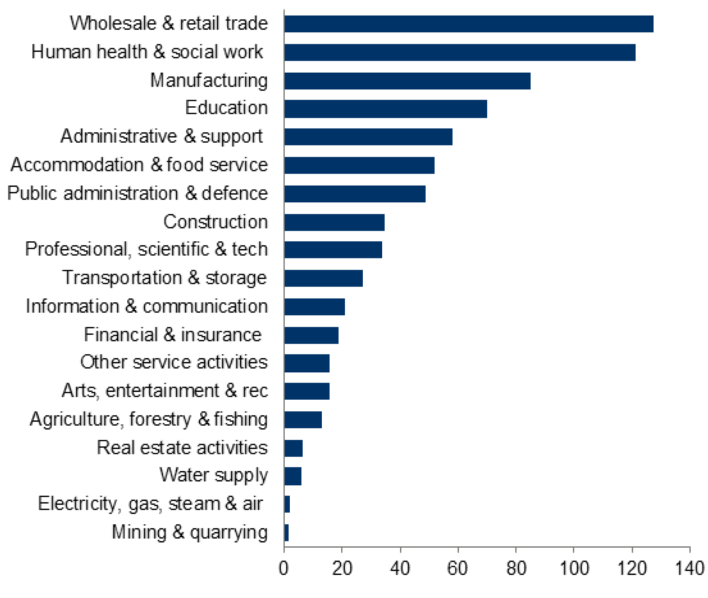
The **information & communication sector** is expected to have the fastest employment growth in 2018 of 2.1%, closely followed by **construction** and **administrative & support** services, each forecast to grow by 2%.

The number of **manufacturing** jobs is expected to increase by 0.7% in 2018, and 0.4% in 2019. The sector, which has the third largest number of employee jobs, showed stable growth throughout 2017 with quarter-on-quarter growth throughout the year – the first time it has avoided at least one quarterly decline in a year, based on data going back to 2005. Manufacturing GVA is forecast to pick up pace and grow alongside the Northern Ireland average, while employee jobs growth should continue its trend of just outpacing the average.

Wholesale & retail trade, the sector with the largest number of employee jobs, is expected to experience a decline in employment in 2018 with the number of jobs forecast to fall by 0.3%, and by a further 0.3% in 2019. Growth in consumer spending in Northern Ireland is expected to be modest in both 2018 and 2019, acting as a drag on employment in this sector.

The unemployment rate in Northern Ireland fell to its joint lowest rate in the period November 2017 – January 2018. A rate of 3.2% was recorded, down from 3.9% in the previous three-month period. While the economic inactivity rate also witnessed a fall of 1.2 percentage points, the November – January 2018 inactivity rate was still higher than the rate measured in the same period of the previous year. Therefore, the decrease in the unemployment rate over the past year can be partially attributed to an overall increase in the number of jobs but also an overall annual increase in the number of those leaving the labour market and becoming economically inactive. We expect the unemployment rate in Northern Ireland to be 3.5% in 2018 and 3.8% in 2019.

Employee jobs per sector in 2018 (000s)



Source: Oxford Economics, Dankse Bank Analysis

Employee jobs (%)	2018	2019
Information & communication	2.1	1.2
Construction	2.0	1.3
Administrative & support	2.0	1.1
Professional, scientific & tech	1.8	0.9
Transportation & storage	0.8	0.2
Manufacturing	0.7	0.4
Accommodation & food service	0.6	0.1
Education	0.3	0.0
Electricity, gas, steam & air	0.2	0.1
Human health & social work	0.2	-0.1
Arts, entertainment & rec	0.1	0.2
Agriculture, forestry & fishing	0.0	-0.1
Other service activities	-0.1	0.2
Financial & insurance	-0.1	-0.2
Real estate activities	-0.4	0.3
Wholesale & retail trade	-0.3	-0.3
Water supply	-0.4	-0.3
Mining & quarrying	-0.7	-0.3
Public administration & defence	-1.0	-1.3
Total	**0.4**	**0.2**

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 –** Stormont's political stalemate is continuing into a second year, with seemingly no current prospects of restoring the devolved institutions. Due to the continued deadlock, Westminster moved to create a Budget for Northern Ireland at the beginning of March. The Budget included an increase in the health budget, but will see household rates rise above inflation. The lack of political representation has led to the postponement of big issues such as healthcare reform, and the length of the impasse has caused frustration within the business community. Concern also exists regarding a lack of representation from Northern Ireland during the Brexit negotiations and on finding a way to avoid a hard border with the Republic of Ireland.

- **Brexit –** The Brexit negotiations are continuing following the sign-off by the EU's political leaders of a 21-month transition period to take effect from the end of March 2019, leaving existing trading arrangements in place until the end of 2020. Given the December deal and the agreement on a transition period, the chances of a no deal outcome are now less than they were just a few months ago, although there are still a number of issues to be negotiated. At present, the most pressing issue is the Northern Ireland border, including how the 'backstop' arrangement will be written into the agreement - a clause which could keep the province closely tied to the EU single market and customs union as a fallback measure if no other solution can be agreed upon. The latest version of the draft withdrawal agreement shows that this is still an area of disagreement.

- **Fiscal tightening –** The squeeze on welfare spending, along with other cuts to current spending and tax rises, means that fiscal policy will continue to exert a drag on growth over the next few years. Forecasts from the Office for Budget Responsibility imply that fiscal tightening will drag on GDP growth in each year between 2018/19 and 2022/23, with the peak impact of 0.4 percentage points falling in 2018/19. However, the Chancellor has hinted that he might loosen the purse strings slightly in the autumn Budget if the recent improvement in the public finances continues.

And the key global uncertainties include:

- **Rising protectionism –** President Trump's recent decision to impose US steel and aluminium tariffs has the potential to cause an upward trend in protectionism worldwide. China has already responded to the US tariffs with retaliatory measures, including duties on US food imports of up to 25%. While we expect the new tariffs to have minimal impacts at a macro level, the move signals a potential end to the trend of relatively unchanged tariffs since the financial crisis.

- **Italy's political stalemate –** Political uncertainty in Italy remains high as the March election resulted in a hung parliament, and the composition of the next government is still unknown. While the latest news on the Italian economy remains quite positive, the uncertainty poses a downside risk to growth.

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