Northern Ireland Quarterly Sectoral Forecasts

Forecast summary

In the first quarter of 2018, the Northern Ireland economy experienced a rather sluggish start to the year as a combination of above-target inflation, adverse weather conditions and continuing political uncertainty, regarding both the lack of an Executive and Brexit, acted as a drag on growth. The economy is expected to perform slightly better in the rest of the year but consumers and businesses are still facing challenges. Household spending power is slowly recovering but consumers remain under some pressure and heightened uncertainty surrounding Brexit is negatively affecting business investment. These factors are expected to lead to underwhelming economic growth of 0.9% in 2018 and 1.1% in 2019.

Economic growth driven by services

The services sector in Northern Ireland continued its trend of positive growth at the start of 2018, with output increasing by 0.7% over the quarter and outpacing the UK by 0.4 percentage points, according to the latest Index of Services data.

This strong performance in the services sector served to offset the decline in production output, which fell by 0.2% over the quarter, with a notably poor manufacturing performance. Manufacturing output contracted by 0.9% over the quarter and productivity is estimated to have fallen by 2.2%.

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

The rate of economic growth in Northern Ireland is expected to be relatively subdued, with an increase in GVA of 0.9% forecast for 2018. The first quarter of the year saw poor growth throughout the UK, in part due to adverse weather conditions. Growth is expected to be stronger in the rest of the year, but above-target inflation and high uncertainty remain constraining factors in both Northern Ireland and the wider UK.

We expect administrative & support, information & communication and professional services to be the three fastest growing sectors in Northern Ireland this year. Public administration & defence is expected to contract in 2018.

...and jobs growth is set to slow

Jobs growth remained strong in the first quarter of 2018, according to the recent Quarterly Employment Survey. The number of employee jobs increased by 0.8% compared with the previous quarter and 2.5% compared with 2017 Q1. We are forecasting that, on average, the number of jobs will increase by 0.7% this year and 0.2% next year.

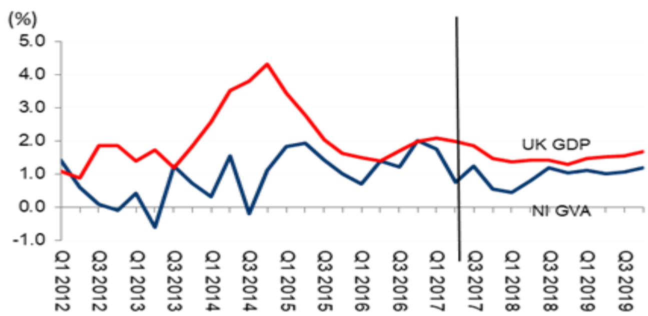
Unemployment in Northern Ireland increased to 3.3% in the February-April 2018 period, up slightly from the previous quarter. However, the high number of people who are registered as economically inactive means the labour market is not performing as strongly as the low unemployment rate alone would suggest. Looking forward, we expect the unemployment rate in Northern Ireland to average 3.3% in 2018 and 3.6% in 2019.

Forecast summary (%)

	2018	2019
UK GDP growth	1.3	1.4
NI GVA growth	0.9	1.1
NI consumer spending growth	0.7	0.8
NI employee jobs growth	0.7	0.2
NI unemployment rate	3.3	3.6
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 but still under pressure

CPI inflation averaged 2.7% in 2017, its highest rate in five years, causing a severe squeeze on household spending power. With the impact of the 2016 sterling depreciation now fading, inflation has begun to slow. However, there are a number of factors which could still apply some upward pressure to prices in the coming months. Higher oil prices means that the current downward trend in inflation could stall, despite strong base effects coming into play. Furthermore, the stronger labour market in the UK and Northern Ireland has the potential to push up wage growth as employees have more bargaining power, which could also lead to increases in inflation. While the monthly numbers could fluctuate, we believe that the annual rate of inflation will slow gradually, averaging 2.5% in 2018 and 2.2% in 2019. This is good news for consumers as gradually falling inflation should be accompanied by a period of positive real wage growth. However, this real wage growth is expected to be very modest and other factors such as the government's welfare reforms, potentially higher interest rates and softer employment growth are all likely to keep household spending power under some pressure. We expect consumer spending in Northern Ireland to grow by just 0.7% in 2018 and 0.8% in 2019.

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

Stronger global growth and a weak pound have been good news for exporting businesses over the last year and net trade is expected to remain a positive influence throughout 2018. But that support could fade if sterling continues to appreciate and erodes some of the recent gains in competitiveness. In addition to the potential recovery of sterling, global growth appears to be cooling slightly and the threat of trade wars poses a downside risk to the global economy in 2018 and beyond.

Brexit uncertainty weighs on business investment

While corporate profitability currently remains firm, 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 modest, with capital investment relatively weak in 2018 as a reaction to the lack of clarity regarding Brexit so far.

Next interest rate rise likely to come in 2018

Having sent strong signals that it planned to raise interest rates in May, the MPC pulled back after a poor outturn for GDP growth in the first quarter of the year, although the quarterly growth rate has been revised upwards by 0.1 percentage points since this decision was made. The Committee's default position still appears to be to increase interest rates gradually over the next few years so, provided that the data shows a rebound in growth in the second quarter, we expect the next rate rise to come in the second half of 2018 rather than being abandoned. We also expect to see one 25 basis point increase in 2019. However, given that we are projecting that economic growth will undershoot the MPC's forecast for next year, and amid continuing uncertainty around Brexit, the risks to our interest rate expectations are skewed to the downside.

Sectoral outlook

Economic growth forecast to pick up following poor opening to 2018
We have revised our forecast for GVA growth in 2018 slightly downwards following a poor start to the year, with year-on-year growth of just 0.5% estimated for the first quarter. However it is expected that growth will be stronger throughout the rest of the year, and is forecast to average 0.9% in 2018 and 1.1% in 2019. The Northern Ireland Index of Services data for 2018 Q1 reported that the dominant services sector underpinned growth, and offset the decline in production, with an increase in output of 0.7% over the quarter, and 1.1% over the year. The services sector should continue to drive growth in Northern Ireland, with strong performances forecast in the **administrative & support**, **information & communication** and **professional services** sectors.

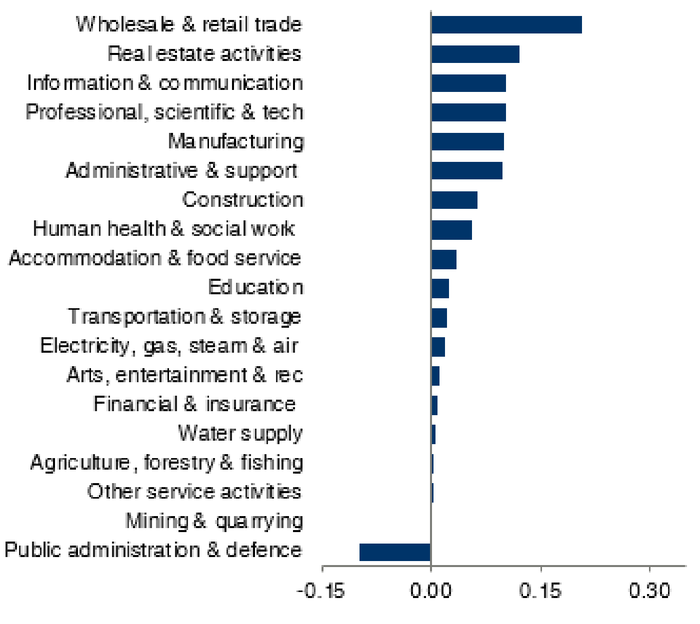
Following a rise in consumer confidence in Northern Ireland, and strong first quarter jobs data, we have revised our forecast for **wholesale & retail trade** up slightly to 1.4% in 2018 and 1.2% in 2019. The Danske Bank Northern Ireland Consumer Confidence Index for 2018 Q1 reported a bounce back in confidence at the start of the year, with increases in the parts of the index based on current and future finances, job security and expected spending on expensive items. However, consumer spending is still being dampened by above-target inflation and political uncertainty, and may also be impacted by potential interest rate rises over the next 18 months. These factors continue to limit growth in wholesale & retail trade and other consumer-focused sectors such as **accommodation & food services** and **arts, entertainment & recreation**.

Construction output in Northern Ireland is forecast to grow by 0.9% in 2018 and 1.3% in 2019, following a strong end to 2017 according to the latest Index of Construction data. Output grew by 1.8% over the final quarter of 2017 and 3.6% over the year, continuing the upward trend observed since 2014.

Growth in the **manufacturing** sector is forecast at 0.7% in 2018 and 1.0% in 2019. Data from the latest Index of Production showed a weak start to the year for Northern Ireland manufacturing output, contracting by 0.9% over the quarter and 7.3% over the year. High input costs (including rising oil prices) and the continuing uncertainty regarding future trade policy following Brexit are impacting potential growth in this sector.

Public administration & defence continues to have the weakest outlook in Northern Ireland, with a decline in output of 1.2% forecast for 2018 and a further 0.9% contraction expected in 2019. While the recent improvement in public finances may lead to a relaxing of austerity measures in the autumn Budget, we expect the sector to 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	3.2	3.5
Information & communication	3.1	3.4
Professional, scientific & tech	2.4	2.8
Wholesale & retail trade	1.4	1.2
Electricity, gas, steam & air	1.2	1.4
Real estate activities	1.2	1.2
Accommodation & food service	1.1	1.3
Arts, entertainment & rec	0.9	0.7
Construction	0.9	1.3
Manufacturing	0.7	1.0
Human health & social work	0.5	1.1
Transportation & storage	0.5	0.6
Water supply	0.5	0.9
Education	0.4	0.6
Financial & insurance	0.2	0.7
Agriculture, forestry & fishing	0.2	0.3
Other service activities	0.0	0.2
Mining & quarrying	-0.2	0.2
Public administration & defence	-1.2	-0.9
Total	**0.9**	**1.1**

Source: Oxford Economics, Danske Bank Analysis

Labour market outlook

Employment growth to be strongest in business services and construction

Employment in Northern Ireland, as measured by the number of employee jobs, is expected to increase by 0.7% in 2018 and 0.2% in 2019. The first quarter of 2018 witnessed strong growth according to the Quarterly Employment Survey, with total jobs growth enjoying its highest annual increase since 2005.

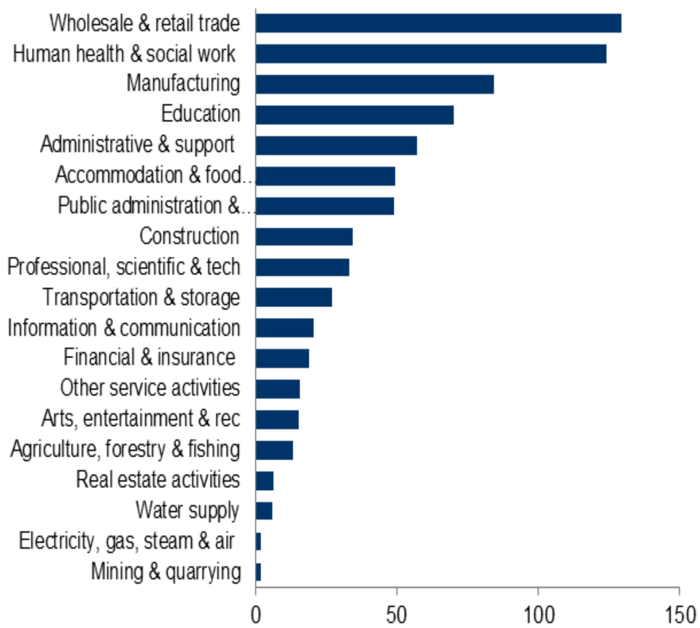
The **administrative & support** services sector is expected to have the fastest employment growth in 2018 of 2.5%, closely followed by **construction** and **professional, scientific & technical** services, which are forecast to experience jobs growth of 2.4% and 2.3% respectively in 2018.

We are forecasting that employment in the **manufacturing** sector will grow by 0.7% in 2018 and 0.4% in 2019. Despite the latest Index of Production data showing a decline in manufacturing output in the first quarter of 2018, the sector saw strong employment growth with around 1,200 additional jobs – the largest quarterly increase since 2014.

Wholesale & retail trade, the sector with the largest number of employee jobs in Northern Ireland, is forecast to experience a decline in the number of jobs of 0.1% in 2018 and a further 0.1% fall in 2019. Local consumer spending is expected to increase this year and next year, but the growth rates are likely to be relatively low at 0.7% in 2018 and 0.8% in 2019, and so this sector is expected to continue to face some challenges in the short-term.

The unemployment rate in Northern Ireland saw a slight increase to 3.3% in the February – April 2018 period, rising from the ten year low observed in the previous three month period. Despite this increase, the unemployment rate remains at a historically low rate, and is lower than the UK's rate of above 4% so far throughout 2018. The quarterly rise in Northern Ireland's unemployment rate can be attributed to an increase in male unemployment, from 3.9% in November 2017 – January 2018 to 4.5%, although the rise was partially offset by a fall in female unemployment which continued on a downward trend. We are forecasting that unemployment in Northern Ireland will average 3.3% in 2018 but rise to 3.6% in 2019.

Employee jobs per sector in 2018 (000s)



Source: Oxford Economics, Dankse Bank Analysis

Employee jobs (%)	2018	2019
Administrative & support	2.5	1.2
Construction	2.4	1.3
Professional, scientific & tech	2.3	1.1
Information & communication	2.2	1.4
Transportation & storage	0.9	0.7
Manufacturing	0.7	0.4
Accommodation & food service	0.6	0.2
Real estate activities	0.6	0.2
Arts, entertainment & rec	0.6	0.4
Electricity, gas, steam & air	0.5	-0.1
Human health & social work	0.5	-0.2
Education	0.4	0.1
Agriculture, forestry & fishing	0.3	-0.1
Water supply	0.3	-0.4
Other service activities	0.0	0.1
Financial & insurance	0.0	-0.1
Wholesale & retail trade	-0.1	-0.1
Mining & quarrying	-0.8	-0.2
Public administration & defence	-0.9	-1.5
Total	**0.7**	**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 –** Northern Ireland has now been without a devolved government since January 2017, following the collapse of the power-sharing administration. The lack of representation has resulted in Westminster legislating on behalf of the stalled Executive on some issues, including setting a budget and deciding on household rates. A recent ruling by the High Court regarding the approval of the construction of an incinerator concluded that civil servants in Northern Ireland do not have the power to make some decisions previously made by ministers, effectively stating that only Westminster can make policy decisions during this interim period. Concerns remain over the lack of representation for Northern Ireland, in particular at the talks around Brexit and the border with the Republic of Ireland. The uncertainty is negatively affecting both consumer and business confidence.

- **Brexit –** As the UK continues to make arrangements for leaving the EU in March 2019, there are still significant decisions to be made. The main stumbling block is the continuing deadlock regarding how a hard border with the Republic of Ireland will be avoided after the UK leaves the EU. With regards to the future trading relationship, the UK has yet to set out any meaningful, realistic and detailed plans for how it sees trade and border arrangements with the EU operating in the longer-term. With time running out, the UK Government now needs to accept that it is decision time and take the steps needed to minimise the damage Brexit will cause to the UK and Northern Ireland economies.

- **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 –** The US has extended the reach of its tariffs on aluminium and steel beyond China to other key trading partners including the EU and Canada. These protectionist measures have led to even higher geopolitical uncertainty and have lowered optimism about the global economic outlook given the increased risk of a cycle of tariff increases.

- **Uncertainty around oil supply –** There is a risk of a supply gap in the global oil market in the short-term. Output from Iran is likely to be impacted by the US decision to pull out of the Iran nuclear deal. Furthermore, Venezuela poses another supply risk, with workforce, infrastructure, hyperinflation and debt problems persisting. In order to meet steadily rising global demand, larger oil exporters such as Saudi Arabia may increase production to plug the gap, or alternatively the potential contraction in supply could lead to a spike in the oil price.

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