2018 Quarter 3

Northern Ireland Quarterly Sectoral Forecasts

Forecast summary

The pace of economic growth in Northern Ireland picked up in the second quarter of 2018 but the performance of the economy is likely to remain subdued due to Brexit-related uncertainty and above-target inflation. A lack of clarity around the terms of the UK's exit from the European Union and the continued political impasse are continuing to undermine confidence throughout Northern Ireland. However, on a positive note, the rate of jobs growth has been strong and this looks to be putting upward pressure on wage growth. We are forecasting that economic growth in Northern Ireland will average 1.0% in 2018 and 1.1% in 2019.

Economic growth regains momentum

Output growth in Northern Ireland picked up momentum in the second quarter of 2018, following a poor start to the year. According to the latest quarterly indexes, both the services and production sectors experienced an increase in output over the quarter, of 1.3% and 0.9% respectively.

Tourism in Northern Ireland also remained strong, with overall expenditure in the 12 months to March 2018 increasing by 9% compared with the 12 months to March 2017.

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

The second quarter of 2018 saw an anticipated pick-up in economic growth, as the temporary factors that dragged on the economy in the first quarter came to an end. However, with above-target inflation continuing to exert pressure on consumers' purchasing power, and Brexit-related uncertainty weighing on business investment, we expect overall growth in 2018 to remain relatively subdued at 1.0%, with only a marginal increase to 1.1% next year.

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

…but the jobs market remains strong

Jobs growth remained positive in the second quarter of 2018, according to the recent Quarterly Employment Survey. The number of employee jobs increased by 0.3% over the quarter and 2.1% compared with 2017 Q2. Total employee jobs growth is forecast to be 1.8% in 2018, but to slow to 0.5% in 2019.

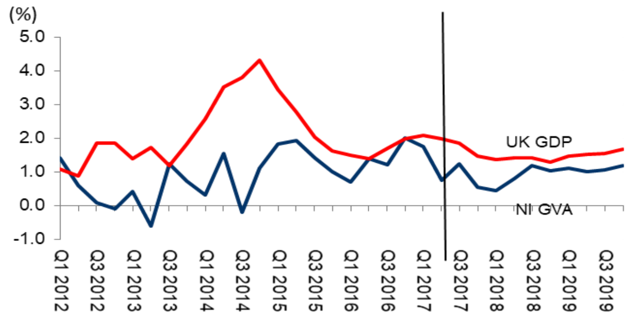
Unemployment in Northern Ireland has increased and in the May-July period, it reached 4.0% for the first time this year. Compared with the previous three-month period, the number of people in employment and the number classified as economically active both increased. This suggests that the unemployment rate is rising as more people are entering the workforce, having previously been inactive. Overall, we are forecasting an average unemployment rate of 3.9% in 2018 and 4.2% in 2019.

Forecast summary (%)

	2018	2019
UK GDP growth	1.3	1.5
NI GVA growth	1.0	1.1
NI consumer spending growth	0.7	0.8
NI employee jobs growth	1.8	0.5
NI unemployment rate	3.9	4.2
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. But inflation slowed in the early part of this year as the impact of the 2016 sterling depreciation faded. Since then, higher oil prices, rises in domestic energy bills and a renewed weakness in sterling have all applied upward pressure to inflation and contributed to increases in the headline inflation rate over the summer. However, despite the rise observed recently, and the potential for inflation to bounce around its current rate somewhat over the short-term, the general trend over the next 12-18 months is still likely to see inflation coming down. This is expected to be a consequence of the relatively modest growth in domestic expenditure in the economy and the impact of the initial sterling depreciation fading even further. We expect CPI inflation to average 2.5% this year, and then to slow to 2.2% in 2019. This expected fall in inflation would ease the pressure on household budgets, but it is projected to be a gradual process. And with the savings ratio already very low, we expect households to become more reticent about borrowing, such that spending growth moves closer into line with real income growth. We expect consumer spending growth in Northern Ireland to remain subdued, at 0.7% in 2018 and 0.8% in 2019.

Boost to UK exports from global growth and currency movements is likely to fade
Stronger global growth and a weak pound drove a marked pick-up in export growth and meant that net trade surpassed expectations regarding its impact on GDP throughout 2017, and it is expected to remain a positive influence throughout 2018. But, looking ahead, this support is likely to begin to weaken. We expect global growth to cool slightly as the impact of more protectionist trade policies are seen. In addition, the value of sterling is likely to be impacted, one way or another, by the Brexit process. Exchange rate movements are incredibly difficult to predict, but if the UK and EU reach a Brexit agreement and begin to make good progress towards determining their future relationship, there is some potential for sterling to strengthen and this would erode some of the increased competitiveness that the post-referendum depreciation provided to UK exports.

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. We expect growth in business investment to remain relatively modest given the lack of clarity regarding Brexit and the UK's long-term trading relationship with the EU.

Interest rates to remain at 0.75% over the rest of 2018, with one rise expected in 2019
As anticipated, the Monetary Policy Committee voted to raise Bank Rate to 0.75% at its August meeting, and unanimously voted to keep monetary policy unchanged at the September meeting. Though it suggested that its August Inflation Report forecasts remained on track, the committee stated that the degree of downside risk had increased due to rising concerns about global growth and increased Brexit uncertainty. The MPC continues to signal that further interest rate rises are likely, but that increases will take place at a gradual pace. Against this backdrop, we expect no further changes to interest rates this year and just one 25 basis point increase in 2019.

Sectoral outlook

Economic growth picked up in 2018 Q2, but remains subdued
Our forecast for GVA growth in Northern Ireland has been revised upwards slightly to 1.0% in 2018. The second quarter of the year saw a pick up in the pace of growth (partly due to the end of some temporary impacts), with the Indexes of Production and Services both pointing to a higher rate of economic growth in that period. However, the outlook for the year as a whole remains underwhelming given continued high inflation and Brexit-related uncertainty. In addition, the prospects for growth have been dampened by the sharp fall in consumer confidence observed in the 2018 Q2 Danske Bank Northern Ireland Consumer Confidence Index. The business services sectors, namely **administrative & support**, **information & communication** and **professional, scientific & technical services** are forecast to continue to underpin economic growth over the next two years.

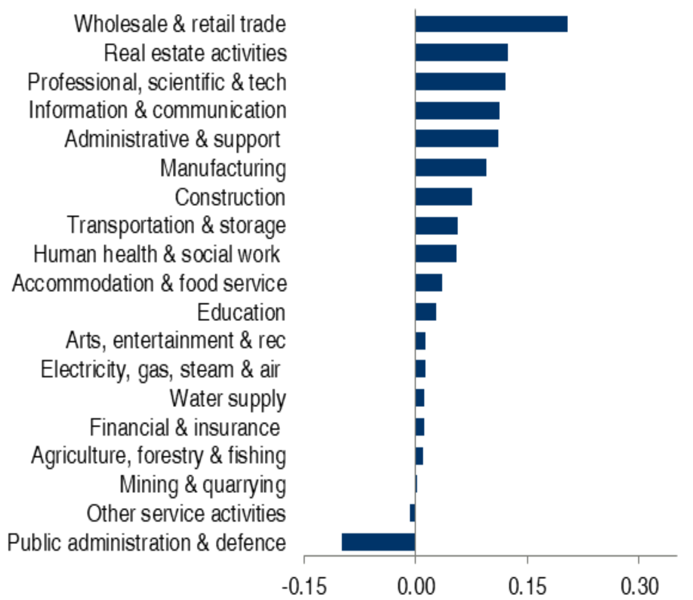
The **wholesale & retail trade sector** is forecast to experience growth of 1.5% in 2018, slowing to 1.1% in 2019. Consumers' purchasing power is expected to remain under pressure over the rest of this year and into next year as inflation is projected to remain above the Bank of England's 2% target going into 2019.

Growth in the **construction** sector is forecast to be 1.0% in both 2018 and 2019. The latest Quarterly Construction Bulletin data points to a poor opening to 2018, with both quarterly and yearly decreases across all measures of construction output. While there is some concern around public construction output due to the lack of an Executive and therefore delays in approving major investment projects, the poor growth in the first quarter can also be attributed, at least partially, to adverse weather conditions. Looking at the output data for Great Britain, construction seems to have picked up pace again and we expect Northern Ireland to have followed a similar trend.

Growth in the **manufacturing** sector is forecast at 0.7% in 2018 and 1.4% in 2019. Data from the latest Index of Production pointed to a strong second quarter for the sector in Northern Ireland, with output increasing by 1.3% over the quarter.

Public administration & defence continues to have the weakest outlook of the sectors of the Northern Ireland economy. Output is expected to contract by 1.2% in 2018 and by a further 0.9% in 2019.

Sector contributions to GVA growth in 2018



Source: Oxford Economics, Danske Bank Analysis

GVA (%)	2018	2019
Administrative & support	3.5	3.2
Information & communication	3.3	2.9
Professional, scientific & tech	2.9	2.8
Wholesale & retail trade	1.5	1.1
Transportation & storage	1.3	1.0
Real estate activities	1.2	1.4
Accommodation & food service	1.2	1.2
Arts, entertainment & rec	1.1	0.7
Construction	1.0	1.0
Water supply	0.8	1.5
Electricity, gas, steam & air	0.8	1.0
Manufacturing	0.7	1.4
Mining & quarrying	0.7	0.4
Agriculture, forestry & fishing	0.7	0.3
Human health & social work	0.5	0.8
Education	0.4	0.3
Financial & insurance	0.3	0.7
Other service activities	0.1	0.0
Public administration & defence	-1.2	-0.9
Total	**1.0**	**1.1**

Source: Oxford Economics, Danske Bank Analysis

Labour market outlook

Northern Ireland economy set to continue adding jobs

Despite the subdued economic growth environment, the labour market in Northern Ireland continues to surprise on the upside with data from the Quarterly Employment Survey pointing to a strong first half of the year. The latest data for the second quarter of 2018 showed the number of jobs up by more than 2% compared to the same period in 2017. Therefore, we have revised our forecast for employee jobs growth upwards to 1.8% in 2018 and 0.5% in 2019.

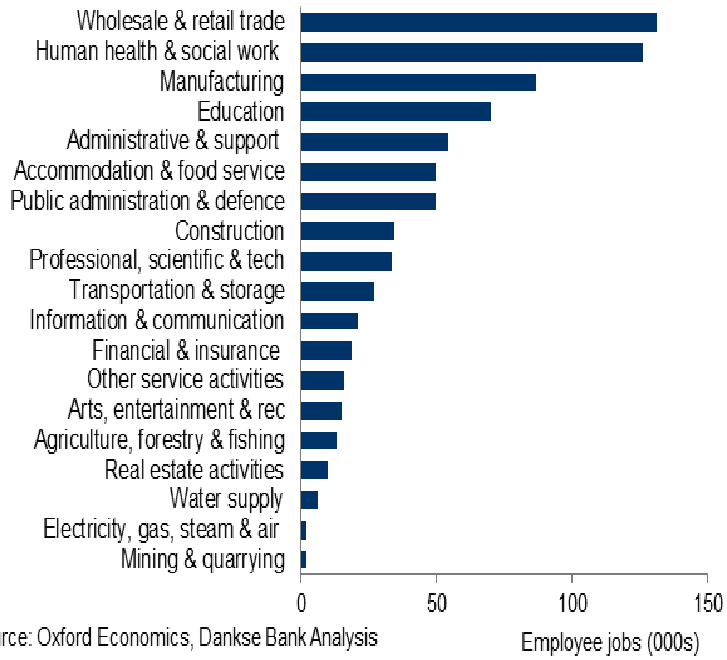
The production sectors are forecast to lead the way in terms of employment growth in 2018, with the number of jobs in the **water supply** sector expected to increase by 6.4% and the number of **manufacturing** jobs set to rise by 3.7%. The latest Index of Production data shows that, on a quarter-on-quarter basis, production output has increased for three consecutive quarters in Northern Ireland. However, in the UK, output is estimated to have fallen in the second quarter of the year. Output in Northern Ireland is continuing to recover from the sharp fall experienced in 2017, and therefore we have revised the employee jobs growth forecast for these sectors upwards to reflect this.

We have revised our forecast for employment growth in the **wholesale & retail trade** sector upwards on the back of strong quarterly employment data for the first half of the year. In addition, the most recent Index of Services data pointed towards a growing retail sector, with output in the combined retail trade & accommodation and food sector growing by 0.3% over the quarter and 2.7% over the year. We are forecasting jobs growth of 1.3% in 2018 and 0.5% in 2019 in the retail sector.

The rate of jobs growth in the **construction** sector has been revised upwards, to 2.9% in 2018. The number of construction jobs increased by 0.4% over the quarter to 2018 Q2 and 2.9% over the year, according to the Quarterly Employment Survey.

The unemployment rate in Northern Ireland was 4.0% in the May-July 2018 period, continuing on its upward trend following a ten-year low observed in the first quarter of 2018. However, at the same time as the unemployment rate increased, the total number of people in employment increased and the number of economically inactive people fell. Therefore, the increase in the unemployment rate may be due to people that were previously inactive deciding to enter the workforce, perhaps encouraged by the recent data showing UK-wide wage growth. We expect the unemployment rate in Northern Ireland to average 3.9% throughout 2018 and 4.2% in 2019.

Employee jobs per sector in 2018



Source: Oxford Economics, Danske Bank Analysis

Employee jobs (%)	2018	2019
Water supply	6.4	1.6
Manufacturing	3.7	1.0
Professional, scientific & tech	3.3	0.8
Administrative & support	3.1	0.7
Other service activities	3.0	1.3
Construction	2.9	0.8
Information & communication	2.5	0.7
Accommodation & food service	2.1	0.9
Real estate activities	2.0	0.6
Human health & social work	1.9	0.6
Wholesale & retail trade	1.3	0.5
Electricity, gas, steam & air	1.3	0.7
Agriculture, forestry & fishing	1.0	0.2
Arts, entertainment & rec	0.7	0.5
Education	0.5	0.3
Public administration & defence	-0.2	-0.5
Transportation & storage	-0.4	0.1
Financial & insurance	-0.7	-0.8
Mining & quarrying	-2.9	-1.6
Total	**1.8**	**0.5**

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:

- **Brexit –** It is now just under six months until Brexit formally occurs. However, the UK and EU have still not reached a Withdrawal Agreement that would see the UK leave the European Union in a managed and orderly way. In recent weeks, the Brexit process has entered a particularly tense period given the outcome of the informal EU summit in Salzburg, the Labour and Conservative party conferences and the close proximity of the October European Council meeting. It remains our assumption that the UK and EU will eventually reach an agreement. However, at this stage it is unfortunately not yet possible to rule out a 'no deal' Brexit taking place in March 2019. A 'no deal' Brexit would undoubtedly lead to negative economic consequences for both Northern Ireland and the wider UK and, as such, it is the most significant risk facing the economy at this time.

- **Political uncertainty –** Northern Ireland has been without a government since January 2017, following the collapse of the power-sharing administration. Given a proposal is in place to bring forward legislation allowing Northern Ireland departments a larger degree of flexibility and decision-making powers, it seems that an imminent return of the Executive is not expected any time soon. Brexit negotiations are continuing, and one of the major stumbling blocks in the process relates to the backstop arrangement to avoid a hard border between Northern Ireland and the Republic of Ireland. There are concerns that the lack of an Executive and a functioning Assembly means that Northern Ireland is not adequately represented during these critical talks. The uncertainty regarding the ongoing political impasse has been cited as having a negative impact on both consumer and business confidence.

- **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. The Prime Minister has announced a sizeable increase in funding for the NHS, but this looks set to be largely financed by tax rises which could be announced in the Budget this autumn.

And the key global uncertainties include:

- **Rising protectionism –** Protectionism remains the most high-profile downside risk to global growth forecasts. The US government is ready to impose further tariffs on the Chinese economy, and further retaliation in such a scenario is likely. However, it would take a major and rapid escalation of tariffs and other trade restrictions to tip the global economy into recession.

- **Monetary policy normalisation –** As central banks begin to normalise monetary policy, the risk of unintended policy consequences increases – even gradual tightening at a national level might trigger a substantial tightening of global liquidity conditions.

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