2018 Quarter 4

Northern Ireland Quarterly Sectoral Forecasts

Forecast summary

The modest economic performance in Northern Ireland continued into the third quarter of 2018. Growth was underpinned by the recovering production sector but the economy remained subdued due to high inflation, Brexit and other local political uncertainties. We estimate that economic growth in Northern Ireland will average 1.1% in 2018 and, assuming that Brexit occurs in an orderly fashion, we are forecasting growth of 1.2% in 2019.

Economic growth was driven by production in Q3

Output growth in Northern Ireland in the third quarter of 2018 was underpinned by an expansion in production output, according to the latest quarterly indexes. Production output rose by 2.4% over the quarter, and 6.6% compared with 2017 Q3.

On the other hand, services output decreased by 0.6%, the first fall in that index since 2017 Q2. This decline was mainly driven by quarterly falls in the retail, accommodation & food (-0.8%), and transport, information & communication (-1.7%) sectors.

2018 was a year of modest growth…

The slight upward revision of our economic growth forecast for 2018 to 1.1% is largely driven by the recovery of the production sector in the third quarter of 2018. However, consumer confidence remained strained because of above-target inflation, Brexit, and the lack of an Executive. Business investment was also subdued due to Brexit-related uncertainties. Both factors are expected to have constrained economic growth in 2018.

From a sector viewpoint, we expect administrative & support services, information & communication and professional services to have been the three fastest-growing sectors in Northern Ireland in 2018.

…with only a slight pick-up expected in 2019

The prospect of a cooling in inflationary pressures in 2019 is positive news for consumer spending power, although there will likely still be some pressure on household budgets. As such, the rate of consumer spending growth is expected to rise only slightly. Business investment is also likely to remain relatively subdued in 2019 as firms continue to face uncertainty about the UK's future, long-term trading relationship with the EU.

Overall, we are forecasting that economic growth will rise slightly to 1.2% in 2019. This is based on the assumption that a Brexit deal is reached and that the UK leaves the EU in an orderly manner, which, despite the ongoing political turbulence, we still expect to be the most likely outcome.

But the economy should continue to add jobs

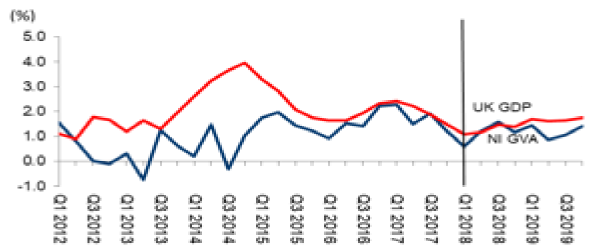
Jobs growth continued on its upward trend in the third quarter of 2018, according to the Quarterly Employment Survey. The number of employee jobs increased by 0.3% over the quarter, and by 2.0% compared with 2017 Q3. We are forecasting that the total number of employee jobs will increase by 1.9% in 2018, but the rate of jobs growth is expected to slow to 0.5% in 2019 as the labour market momentum begins to cool and firms are forced to shift their focus from hiring workers to increasing productivity.

Forecast summary (%)

	2018	2019
UK GDP growth	1.3	1.5
NI GVA growth	1.1	1.2
NI consumer spending growth	0.7	0.8
NI employee jobs growth	1.9	0.5
NI unemployment rate	3.8	4.1
UK CPI inflation rate	2.5	2.2

Source: Oxford Economics, Danske Bank Analysis

Economic growth (year-on-year)



Source: Oxford Economics, Danske Bank Analysis

Key factors in the outlook

Household spending power gradually recovering, but still under pressure

The cooling in inflationary pressures paused in the second half of 2018 but inflation should now continue on its descent, driven by the recent plunge in the oil price and the further weakening of the impact of the 2016 sterling depreciation. There is also the possibility that sterling could strengthen if a Brexit withdrawal deal is approved. We expect CPI inflation to decline from 2.5% in 2018 to 2.2% in 2019, so while slowing, the annual average is projected to remain above the Government's target. In addition to inflation gradually declining, firmer wage growth should also support household spending power, though there will be some offset from the Government's welfare reforms and higher interest rates. With the savings ratio already very low, we expect households to become more wary about borrowing, so that spending growth moves more into line with real incomes. We are forecasting that consumer spending growth in Northern Ireland will reach 0.7% in 2018 and rise just slightly to 0.8% in 2019, but this masks an acceleration in spending growth through 2019.

Boost to UK exports from global growth and currency movements is likely to fade

Although stronger global growth and a weak pound drove a marked pick-up in export growth in 2017, the boost from those factors has faded over the past year. Looking ahead, we expect global growth to cool as the impact of more protectionist trade policies are seen, with growth in world trade slowing in 2019. Our assumption is that a Brexit deal will be reached and that the UK will leave the EU in an orderly fashion. If this occurs and a no-deal Brexit is avoided, we would expect to see some appreciation in sterling. If sterling does appreciate, some of the competitiveness gains for net exporters will dissipate and, therefore, the boost to UK growth from the export channel is likely to fade.

Brexit uncertainty weighs on business investment

While UK firms seem to be in solid financial shape, they have been reluctant to spend, with business investment having fallen in each of the first three quarters of 2018. Uncertainty around Brexit has been a key factor and this is likely to persist until the UK's future, long-term trading relationship with the EU becomes clearer.

Interest rates to rise just once in 2019

Given the heightened short-term uncertainty around Brexit, we think it is unlikely that the Bank of England's Monetary Policy Committee (MPC) will make any changes to interest rates in the early part of 2019. The MPC has been suggesting for some time that the future path of UK interest rates, provided a Brexit deal is reached, will see Bank Rate rise gradually. With inflation expected to continue to gradually decline, uncertainty around the future relationship between the UK and the EU persisting and a need to tighten monetary policy slowly following a decade of close-to-zero interest rates, we expect to see only one rise in UK interest rates in 2019, perhaps some time around the middle of the year.

Less restrictive fiscal stance

The Budget saw the Chancellor take advantage of large favourable revisions to the Office for Budget Responsibility (OBR) borrowing forecasts to loosen the fiscal stance in 2019-20, through higher government spending (mostly via the NHS) and increases in income tax thresholds. As a result, fiscal policy should offer modest support to GDP growth in 2019, although the OBR forecasts imply that it will revert to dragging on growth in subsequent years.

Sectoral outlook

Economic growth remained modest in 2018 Q3

We have slightly revised our forecast for economic growth in Northern Ireland upwards, to 1.1% in 2018 and 1.2% in 2019. The latest Index of Production data showed a continued recovery from the four-year low in production output in 2017 Q3, but there was a fall in services output in the third quarter of 2018 – the first of the year – according to the Index of Services data. Despite the quarterly decline, the services sectors are still forecast to underpin growth in 2018 and over 2019, with **administrative & support services, information & communication** and **professional, scientific & technical services** leading the way.

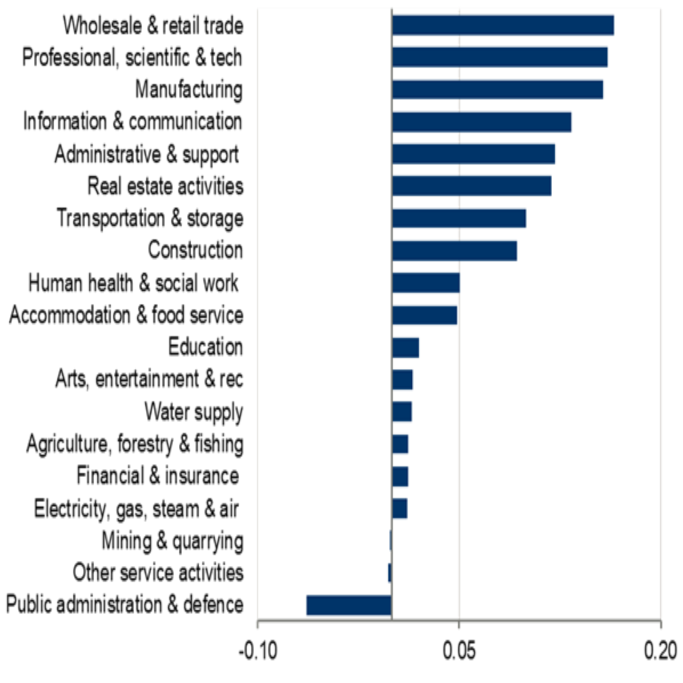
We have revised our forecast for output growth in the **wholesale & retail trade** sector to 1.1% in 2018 and 1.3% in 2019. The recent Index of Services data showed a 0.8% decline in the wholesale & retail trade and accommodation & food services sectors over the quarter to 2018 Q3. In addition, the 2018 Q3 Danske Bank Northern Ireland Consumer Confidence Index reported a further decline in consumer confidence, weighed down by concerns over the absence of an Executive, Brexit, and high inflation.

We expect growth in the **construction** sector to reach 1.3% in 2018. The latest Northern Ireland Quarterly Construction Bulletin pointed to a strong 2018 Q2. Within the construction sector, the strongest increase over the quarter was in housing activity (up 7.1%). The strong performance in housing is further supported by LPS data which showed the number of housing starts in the first three quarters of 2018 was the highest since 2007, while the number of completions was at its highest level since 2009. We are forecasting that the sector's strength will continue into 2019, with output growth rising to 1.4%.

Growth in the **manufacturing** sector has been revised upwards, and is now forecast at 1.1% in 2018. Data from the Index of Production points to a continued strong performance in the manufacturing sector, with both output and productivity in the sector increasing by 2.5% over the quarter to 2018 Q3. We expect the sector to grow by 1.2% in 2019.

Public administration & defence continues to have the weakest outlook of all the sectors of the Northern Ireland economy. Output is expected to contract by 0.8% 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	3.9	3.7
Information & communication	3.8	3.3
Professional, scientific & tech	3.7	3.5
Transportation & storage	2.4	1.5
Accommodation & food service	1.6	1.2
Construction	1.3	1.4
Arts, entertainment & rec	1.2	1.1
Real estate activities	1.1	1.5
Manufacturing	1.1	1.2
Wholesale & retail trade	1.1	1.3
Water supply	1.0	1.0
Agriculture, forestry & fishing	0.8	0.4
Electricity, gas, steam & air	0.7	1.1
Human health & social work	0.5	0.8
Education	0.3	0.5
Financial & insurance	0.3	0.7
Other service activities	-0.1	0.0
Mining & quarrying	-0.4	-0.2
Public administration & defence	-0.8	-0.9
Total	**1.1**	**1.2**

Source: Oxford Economics, Danske Bank Analysis

Labour market outlook

Employment growth in Northern Ireland continues to show strength
The Northern Ireland economy has continued to benefit from strong jobs growth. The latest data from the Quarterly Employment Survey (QES) showed an increase in the number of employee jobs of 0.3% in 2018 Q3 when compared with the previous quarter, and of 2.0% when compared with the same quarter in 2017. We estimate that employment growth will reach 1.9% for the whole of 2018. However, growth is expected to slow to 0.5% in 2019 as momentum begins to cool due to the little spare capacity left in the labour market and firms instead have to focus on increasing productivity.

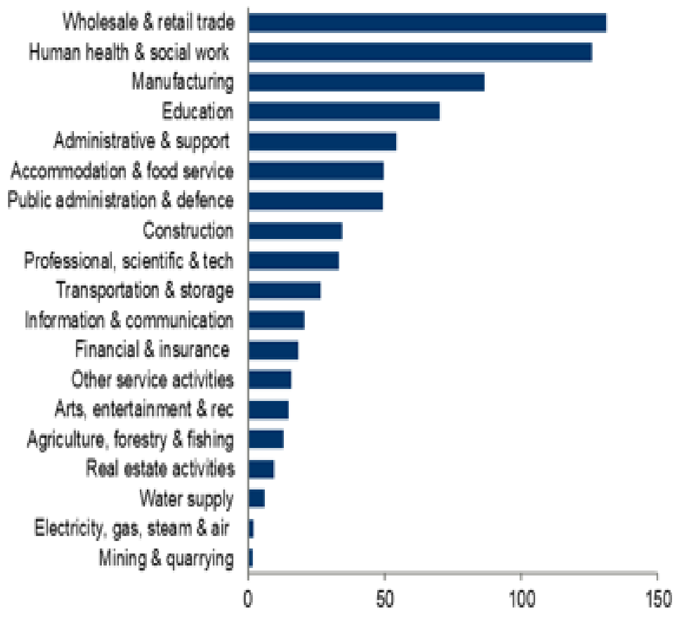
The smaller production sectors, **water supply** and **electricity, gas, steam & air**, are expected to see the largest percentage increases in employment in 2018, rising by 7.8% and 3.9% respectively, while employment in **manufacturing** is expected to rise by 3.6%. The latest Index of Production data showed increases in output in each of these three sectors in 2018 Q3, both over the quarter and over the year.

We have revised our forecast for employment growth in the **wholesale & retail trade** services sector downwards, largely due to revisions in the QES data for 2018 Q2. The most recent Index of Services data showed a decline in output of 0.8% over the quarter to 2018 Q3, with output up just 0.3% compared with the same quarter last year. The sector is forecast to see employment growth of 1.1% in 2018 and 0.5% in 2019.

The rate of jobs growth in the **construction** sector has also been revised downwards, to 2.5% in 2018. The latest QES data included a downward revision in 2018 Q2, now recording a 0.9% decline as opposed to growth in the previous release. Over the quarter to Q3, construction jobs growth rose again by 0.8%, and was up 1.0% compared with 2017 Q3. In 2019, employment in the construction sector is expected to increase by 0.9%.

The unemployment rate in Northern Ireland fell back to 3.9% in the Aug-Oct 2018 period, having reached a high this year of 4.3% in Jun-Aug. This decline in unemployment is partly explained by people moving out of the workforce, as the number of economically inactive increased in the same three-month period. We expect the unemployment rate in Northern Ireland to average 3.8% throughout 2018, and rise to 4.1% in 2019.

Employee jobs per sector in 2018



Source: Oxford Economics, Dankse Bank Analysis

Employee jobs (%)	2018	2019
Water supply	7.8	0.9
Electricity, gas, steam & air	3.9	0.4
Real estate activities	3.8	1.4
Information & communication	3.8	1.1
Other service activities	3.7	0.7
Manufacturing	3.6	1.0
Accommodation & food service	3.4	0.7
Professional, scientific & tech	3.1	1.0
Construction	2.5	0.9
Human health & social work	2.1	0.7
Administrative & support	2.1	0.7
Wholesale & retail trade	1.1	0.5
Agriculture, forestry & fishing	1.1	0.4
Arts, entertainment & rec	0.6	0.2
Mining & quarrying	0.4	-0.1
Education	0.4	0.2
Financial & insurance	-0.3	-0.1
Transportation & storage	-0.4	0.1
Public administration & defence	-0.5	-0.5
Total	**1.9**	**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 –** Despite being less than three months away from the date upon which the UK is scheduled to leave the EU, there is still a large degree of uncertainty regarding the final Brexit outcome. A vote in the House of Commons on the draft withdrawal agreement was postponed in December, with the vote now scheduled to take place in mid-January. Our expectation is that a no-deal Brexit will be avoided, and that the UK will leave the EU at the end of March with a deal and enter into a transition period. The forecasts presented above are based on that expectation coming to fruition. However, it is important to note that the likelihood of the draft agreement receiving parliamentary approval at the first attempt appears slim. As such, a range of potential Brexit scenarios remains possible, one of which is a no-deal Brexit. While considered an unlikely outcome, a no-deal Brexit, and the disruption that it would result in, is undoubtedly the biggest risk facing the UK and Northern Ireland economies at present.

- **Political uncertainty –** Northern Ireland has been without a devolved government since January 2017, following the collapse of the power-sharing administration. This political uncertainty is adversely impacting consumer and business confidence. And with political stability an important factor when attracting foreign investment, the lack of an Executive is undermining investment potential. A new bill to hand some decision-making powers to civil servants, under guidance issued by the Secretary of State, was passed into law at the beginning of November 2018. This bill aims to both facilitate the provision of public services and provide breathing space for politicians in Northern Ireland to resume negotiations. However, with the political impasse continuing, the absence of a functioning government is still acting as a drag on the Northern Ireland economy.

And the key global uncertainties include:

- **Trade wars –** Despite a recent easing of trade tensions, protectionism remains a worry for 2019. A key concern is whether the US and China will be able to reach an agreement on trade between the two countries. The preliminary EU-US trade talks appear to have removed the threat of additional tariffs – but this has yet to be confirmed, and any impact on car tariffs would likely do damage to the EU economy.

- **Potential US slowdown –** Strong fundamentals and lingering fiscal stimulus should make this the longest US expansion on record by mid-2019. But growing headwinds from higher input and borrowing costs, increased trade protectionism and slower global growth are expected to lower US GDP growth by the end of 2019.

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