Northern Ireland Quarterly Sectoral Forecasts

Forecast summary

The Northern Ireland economy is expected to experience a significant contraction in 2020 due to the coronavirus pandemic. The latest data shows that economic output fell in the first quarter of the year, but the fall in the second quarter is likely to be substantially larger due to the imposition of the lockdown restrictions and the temporary closure of many businesses. Given the ongoing easing of the restrictions, the economy should return to growth in 2020 Q3 but the recovery is expected to be a gradual one. Overall, we are forecasting that the Northern Ireland economy will contract by around 11% in 2020 followed by growth of about 7% in 2021.

Sharp falls in output expected in both the first and second quarters of the year…

The Northern Ireland economy experienced a sharp fall in activity in the first quarter of this year, despite the lockdown restrictions only coming into effect towards the end of March. The latest official data showed that services output fell locally by 4.2% while production activity declined by 3.2%. Both of these falls were larger than those experienced in the wider UK, suggesting that the fall in overall economic output in Northern Ireland likely exceeded the 2.2% decline in UK GDP in 2020 Q1. However, the fall in output in 2020 Q2 is expected to be much larger as some degree of lockdown restrictions were in force throughout the entire April – June 2020 period.

…but the economy is projected to return to growth in 2020 Q3

With the lockdown restrictions now being eased, we expect the local economy to return to positive growth from the third quarter of 2020 onwards. However, the recovery is likely to be a gradual one as we assume that some social distancing measures remain in place for a period of time and that consumers and businesses behave relatively cautiously, constraining the pace of at which spending and investment levels begin to rebound.

Brexit also remains a key issue for local businesses. We assume that the UK and the EU are able to conclude a free trade agreement by the end of this year. As such, new trading arrangements, including the operation of the Protocol on Ireland and Northern Ireland, take effect from the beginning of 2021. However, we assume that some trade frictions, including on the movement of goods between Great Britain and Northern Ireland, are introduced when the transition period ends.

Overall, we expect economic output in Northern Ireland to decline by around 11% in 2020 and then grow by about 7% in 2021. However, despite the relatively strong annual growth forecast for next year, economic output is still expected to be around 3-4% below its pre-coronavirus level in the final quarter of 2021.

Employment is set to fall in 2020 but should begin to recover in 2021

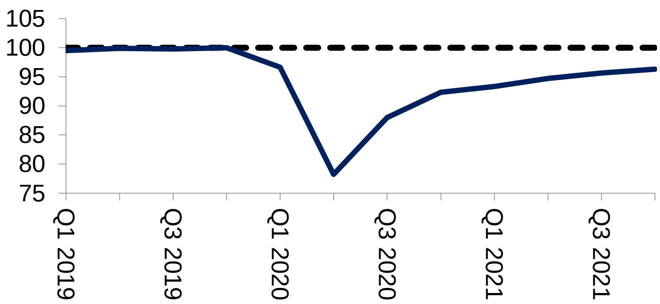
Government policy measures have helped to limit the immediate impact of the pandemic on employment levels, but the latest data has still shown a weakening in the local labour market. The claimant count measure of unemployment increased from just over 3% of the workforce in March 2020 to 7% in May. And the labour market is expected to weaken further over the rest of the year. We expect the number of employee jobs to fall by around 2.8% in 2020 and the annual average unemployment rate to increase to 5.5%. However, we do expect to see some recovery in the labour market in 2021 with the number of jobs rising by 0.4% and the annual unemployment rate coming down slightly to 5.3%.

Forecast summary (%)

	2020	2021
UK GDP growth	-10.0	6.5
NI GVA growth	-11.0	7.0
NI consumer spending growth	-12.5	7.5
NI employee jobs growth	-2.8	0.4
NI unemployment rate	5.5	5.3
UK CPI inflation rate	0.7	1.2

Source: Oxford Economics, Danske Bank Analysis

NI GVA (Index 2019 Q4 = 100)



Source: Oxford Economics, Danske Bank Analysis

Key factors in the outlook

Key factors underpinning the fall in output in the first half of 2020:

Temporary closure of firms
At the height of the lockdown restrictions, many businesses that were classed as non-essential temporarily closed. Some firms also opted to close and to furlough workers due to both safety reasons and because restrictions on movement caused a sharp drop in customer demand. The Office for National Statistics (ONS) Business Impact of Covid-19 survey for the period 6 – 19 April 2020 (when the lockdown measures were at their most stringent) showed that 27% of the responding businesses from Northern Ireland had temporarily paused trading at that time.

Lower discretionary spending
The combination of the closure of many businesses in which people spend money, social distancing measures and subdued confidence levels are all expected to have contributed to a sharp fall in discretionary consumer spending in the first half of the year. In addition, lower incomes for furloughed workers or people who have become unemployed is also likely to have depressed spending levels. We are forecasting that annual consumer spending in Northern Ireland will fall by about 12.5% in 2020.

Lower working hours
The February – April 2020 Northern Ireland Labour Market Report showed that the average weekly number of hours worked during the period was 30.2. This was 3.7 hours lower than in the previous year and was the lowest number of average hours worked on record. The temporary closure of firms discussed above is clearly one factor that will have reduced the number of hours worked but people working for businesses that continued to trade during lockdown may have seen their hours reduced due to lower demand. The closure of schools may also have led working parents to reduce their hours to care for children.

Key factors impacting the recovery in economic activity from 2020 Q3:

Government policy initiatives providing support to businesses and employees
The UK Government has launched a number of initiatives designed to support firms and workers to manage the disruption brought about by the coronavirus pandemic. These schemes are not only crucial to helping firms to manage their immediate cash flow and revenue challenges, but will be an important factor in supporting their recovery. For example, the Job Retention Scheme, which runs until October 2020, should allow firms to gradually bring employees back to work as they build up activity over the coming months. We believe these initiatives will help to limit the overall number of job losses and business insolvencies and support the economy to return to positive growth from 2020 Q3 onwards.

Loose monetary policy facilitating a return to economic growth
At its June 2020 meeting, the Bank of England's Monetary Policy Committee (MPC) maintained Bank Rate at its historic low of 0.1% and expanded its quantitative easing programme by a further £100bn. We believe that the measures taken by the MPC over recent months will support the return to positive economic growth but do not expect any further changes to interest rates this year. We also believe that any additional policy support for the economy is more likely to come through fiscal policy rather than monetary policy measures. However if the MPC did decide to loosen policy further, we think another expansion of the asset purchase programme is more likely than another cut to interest rates.

More cautionary consumer and business behaviours
While consumer spending and business activity are likely to increase gradually through the second half of 2020 and into 2021, we think that people and firms will behave more cautiously than they did prior to the pandemic. Consumers may not visit crowded areas as frequently as they used to and people may also hold back on making expensive purchases, especially if the labour market weakens further over the rest of this year, as we expect it to. Businesses are likely to want to build up their cash reserves again and may have to make changes to their current operations once the Brexit transition period ends, so they are expected to behave relatively prudently with regards to sanctioning new capital expenditure projects.

Sectoral outlook

The economy should return to positive growth from 2020 Q3, but the recovery is likely to be a gradual one
The baseline forecast is predicated on economic output gradually increasing as the lockdown restrictions continue to be eased. The recovery is likely to have gathered pace from mid-June with the reopening of non-essential retail stores and should strengthen further in July as the hospitality sector begins to open up again. However, some social distancing restrictions are likely to remain in place for a longer period of time while the risks associated with the virus remain elevated, limiting the pace at which activity can rebound. We are forecasting that economic output in Northern Ireland will contract by around 11% this year but expect the economy to grow by about 7% in 2021.

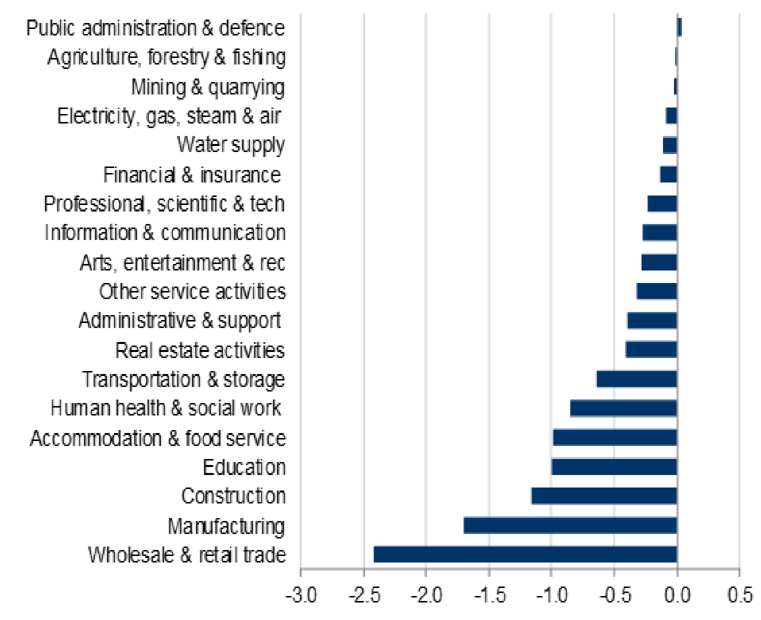
In 2020 we think that all sectors, except **public administration and defence**, are likely to experience a fall in output. However, the extent of the annual contraction is likely to vary considerably across the different sectors. Those most impacted by the lockdown and the ongoing social distancing measures – including **accommodation & food services** and **arts, entertainment & recreation** – are likely to experience the greatest falls in economic activity this year, of around 38% and 25% respectively.

The **wholesale & retail trade** sector has seen a sharp drop in activity, and we are now forecasting that it will experience an annual fall in output of about 17% in 2020. A significant proportion of consumer spending occurs in crowded retail areas, many of which were, until recently, temporarily closed. But social distancing rules rightly remain in place and are likely to limit activity in this sector compared to pre-coronavirus trends. Continued spending on essential items and online orders may somewhat offset these impacts, meaning that the industry isn't expected to be quite as severely impacted as the other consumer-focused sectors.

Transportation & storage, **construction** and **manufacturing** are also expected to experience steep declines in output, contracting at a sharper rate than the overall economy. Extensive shutdowns, in addition to a sharp fall in orders, are two factors which have impacted upon activity. Further disruption related to the end of the Brexit transition period is likely to pose challenges for manufacturing and transportation businesses at the start of next year, which may hold back the pace of recovery in 2021.

Some sectors which are expected to prove more resilient to the current recession are those in which workers are most able to work from home. Examples include the **professional, scientific & technical services** and the **information & communication** sectors, where output is forecast to fall by 5.6% and 7.6% respectively. These sectors are expected to rebound to be among the fastest growing over the medium term in Northern Ireland, as they were prior to the pandemic.

Sector contributions to GVA growth in 2020



Source: Oxford Economics, Danske Bank Analysis

GVA (%)	2020	2021
Public administration & defence	0.4	0.2
Agriculture, forestry & fishing	-0.8	0.3
Financial & insurance	-3.5	0.5
Real estate activities	-3.6	1.1
Professional, scientific & tech	-5.6	3.4
Water supply	-6.7	4.2
Information & communication	-7.6	5.5
Electricity, gas, steam & air	-7.9	5.1
Human health & social work	-8.2	6.3
Mining & quarrying	-8.2	5.0
Manufacturing	-11.9	7.2
Administrative & support	-12.6	8.5
Construction	-16.4	9.9
Transportation & storage	-16.6	13.4
Wholesale & retail trade	-17.1	13.6
Education	-18.4	12.1
Other service activities	-18.9	10.6
Arts, entertainment & rec	-25.2	16.7
Accommodation & food service	-38.2	26.7
Total	**-11.0**	**7.0**

Source: Oxford Economics, Danske Bank Analysis

Labour market outlook

Job losses are expected, but government support schemes should limit the long-term impacts
The latest Quarterly Employment Survey showed that the number of employee jobs in Northern Ireland increased by 0.4% in the first quarter of 2020. However, more timely indicators, such as the claimant count measure of unemployment have signalled a weakening in the local labour market in recent months. We think that the government support measures will be relatively successful at limiting the overall number of job losses, but nevertheless, we do still expect the labour market to weaken further over the remainder of 2020. We are projecting that the number of employee jobs will fall by around 2.8% in 2020 and that the annual average unemployment rate could increase to 5.5%, with the quarterly rate rising above this later in the year. However, we do expect to see some recovery in the labour market in 2021 with the number of jobs rising by 0.4% and the annual average unemployment rate coming down slightly to 5.3%.

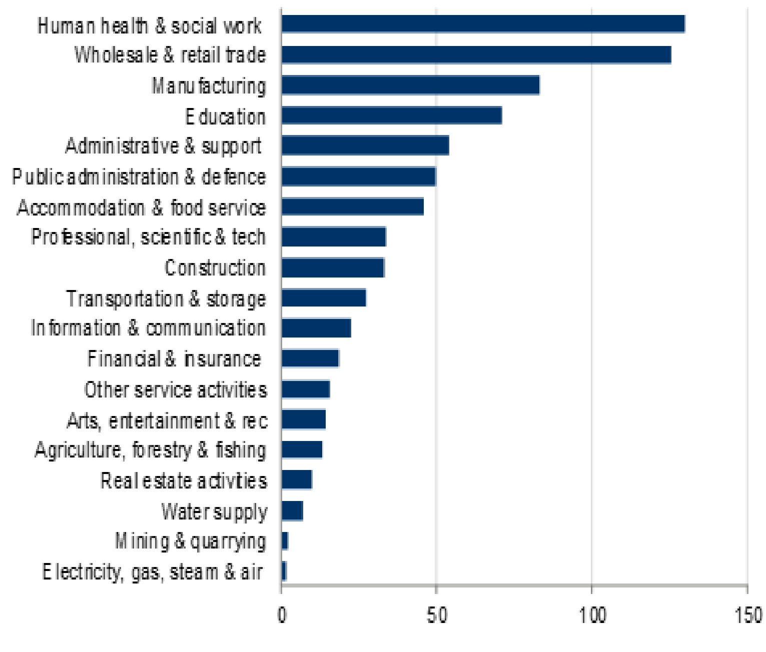
At a sector level, **human health & social work** and **public administration & defence** are both expected to experience increases in employment of around 0.6% in 2020. These sectors are likely to see increased demand in the short-term to provide additional public services during the pandemic. **Education** is expected to see only a small fall in the number of jobs of 0.2%, as the temporary school closures are unlikely to lead to large scale job losses.

The business services sectors are forecast to experience declines in employment this year. The **information & communication**, **professional, scientific & technical services** and **administration & support services** sectors are expected to see job losses, but at a more modest pace than the average for the overall economy given that workers in these sectors are most able to work from home. We expect employment in each of these sectors to return to growth in 2021.

Despite the policy measures put in place by the Government to try to minimise redundancies, we still expect there to be significant job losses in the consumer-focused sectors in 2020. **Accommodation & food services** and **arts, entertainment & recreation** are forecast to experience contractions in employment of around 9.8% and 8.1%, followed by modest growth in 2021.

Similarly, both **construction** and **manufacturing** are also set to experience job losses this year of over 4% and 5% respectively. But we expect that the total number of jobs in both sectors will increase marginally in 2021 as economic activity increases.

Employee jobs per sector in 2020



Source: Oxford Economics, Danske Bank Analysis

Employee jobs (%)	2020	2021
Human health & social work	0.6	0.0
Public administration & defence	0.6	-0.2
Education	-0.2	0.0
Agriculture, forestry & fishing	-0.4	0.1
Financial & insurance	-0.5	-0.2
Electricity, gas, steam & air	-0.7	-0.1
Mining & quarrying	-0.9	-0.3
Water supply	-1.1	-0.3
Other service activities	-1.1	0.3
Information & communication	-1.1	0.4
Real estate activities	-1.5	0.2
Administrative & support	-1.7	0.3
Professional, scientific & tech	-1.9	0.4
Wholesale & retail trade	-4.3	0.3
Construction	-4.6	0.2
Transportation & storage	-4.9	0.2
Manufacturing	-5.7	0.3
Arts, entertainment & rec	-8.1	2.0
Accommodation & food service	-9.8	3.5
Total	**-2.8**	**0.4**

Source: Oxford Economics, Danske Bank Analysis

Risks and uncertainties

While there is always uncertainty around economic forecasts, the extent of the risks and uncertainties around these projections is much more elevated than is normally the case. In addition, we would note that the risks around this set of forecasts continue to be weighted more towards the downside. The main sources of uncertainty include:

- **Coronavirus** – The coronavirus pandemic remains the most significant risk facing the economy and there are a number of downside events that could materialise in the second half of 2020 or into 2021. A second wave of coronavirus infections could result in renewed lockdown restrictions, perhaps at a local level, with businesses once again being asked to temporarily close. The extent to which government policy measures succeed in limiting the number of job losses and business insolvencies could be smaller than assumed in our modelling, leading to a slower recovery to pre-coronavirus output levels. Plus, the effects of the lockdown could lead to even greater changes in consumer and business behaviours towards more precautionary spending habits than we have assumed, which would serve to further constrain the pace of growth in consumer spending and business investment.

- **Brexit** – the UK formally left the EU on 31 January 2020 and is now in a transition period during which trading arrangements between the two economies remain unchanged from what they were previously. Negotiations on a new free trade agreement have been taking place for several months now but progress to date has been relatively limited. Disagreements exist around the extent to which the UK should continue to follow EU 'level playing field' requirements, which include rules on competition and state aid, environmental standards and workers' rights, after the transition period ends, as well as on fisheries policy and access to fishing waters. However, both sides have committed to try and make more progress in the negotiations over the summer months. The UK Government recently decided not to extend the transition period beyond the end of 2020, so it appears as if the talks will need to have concluded by the end of this year. With regards to Northern Ireland, the Protocol on Ireland and Northern Ireland now looks set to become operational from the beginning of January 2021. However, there is still a lack of clarity on how the Protocol will be implemented, including around the potential impacts on goods trade between Great Britain and Northern Ireland. While the Protocol will come into effect regardless of whether the UK and EU agree a new free trade agreement or not, it is important to note that the more distant the trading relationship between the UK and the EU, the more stringent the application of the Protocol is likely to be. Our forecast assumes that the two sides will ultimately reach a free-trade agreement, which keeps trade between the UK and EU largely tariff-free and has some success in limiting the introduction of non-tariff barriers. However, we do still assume that there will be some new barriers to trade and that serves to limit the pace of economic recovery next year. However, if the UK and EU are not able to reach an agreement, this would present further challenges to businesses, and lead to even greater than assumed trade frictions on the movement of goods between Great Britain and Northern Ireland. This would likely slow the pace of the economic recovery expected in 2021 and could also lead to economic output in the UK being lower over the medium and longer-term.

In addition, a key global uncertainty is that:

- **The global recession deepens** – While we anticipate a short, sharp recession globally as a result of the coronavirus pandemic, there is a risk that the short-term economic costs from the lockdown restrictions and the wider disruption are larger and more drawn out, or that such losses are exacerbated by spill-overs to the real economy from tighter financial conditions. There is also the risk that the pandemic will have long-term scarring effects on economies around the world, with unemployment running at higher rates and firms and households taking a more cautious approach to spending for a longer period of time and in many different economies. This would prolong the duration of the global recession and the amount of time needed for economic output to return to its pre-coronavirus level.

Disclaimer and copyright

Danske Bank Disclaimer

Issued by Northern Bank Limited trading as Danske Bank (the "Bank" or "we").

This report is for information purposes only, is not intended as an offer or solicitation, nor is it the intention of the Bank to create legal relations on the basis of the information contained in it. So far as the law or regulation allow, we disclaim any warranty or representation as to the accuracy or reliability of the information and statements in this report. We will not be liable for any loss or damage suffered from relying on this report. This report does not purport to contain all relevant information. Recipients should not rely on its contents but should make their own assessment and seek professional advice relevant to their circumstances.

Danske Bank is a trading name of Northern Bank Limited which is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Registered in Northern Ireland (registered number R568). Registered Office: Donegall Square West Belfast BT1 6JS. Northern Bank Limited is a member of the Danske Bank Group.

Danske Bank

The information in this document has been prepared in conjunction with Oxford Economics.

Oxford Economics Disclaimer

Because of the uncertainty of future events and circumstances and because the contents are based on data and information provided by third parties upon which Oxford Economics has relied in producing its reports and forecasts in good faith, Oxford Economics does not warrant that its forecasts, projections, advice, recommendations or the contents of any report, presentation or other document will be accurate or achievable and Oxford Economics will not be liable for the contents of any of the foregoing or for the reliance by the customer on any of the foregoing.

OXFORD ECONOMICS

Copyright

Contact details

Conor Lambe
Chief Economist
Email: conor.lambe@danskebank.co.uk
Twitter: @ConorLambe
LinkedIn: Conor Lambe