Northern Ireland Quarterly Sectoral Forecasts

Forecast summary

The Northern Ireland economy experienced a sharp contraction in the first half of 2020 due to the coronavirus pandemic. A gradual return of economic activity now looks to be underway but the recent rise in the number of Covid-19 cases and the need for new restrictions demonstrates the fragility of the recovery. Plus with the end of the Brexit transition period also rapidly approaching, there is a great deal of uncertainty and risk to the outlook. We are continuing to forecast that the Northern Ireland economy will contract by around 11% in 2020 and then grow by about 7% in 2021.

The coronavirus pandemic led to a sharp fall in output in the first half of the year…

The coronavirus pandemic had a striking impact on economic activity in Northern Ireland in the first half of 2020. The latest Index of Services data showed that output was 23.1% lower in the second quarter of 2020 than it was in the final quarter of 2019, before the onset of the pandemic. In addition, the Index of Production figures showed that output in those sectors was 20.4% lower in 2020 Q2 than at the end of last year.

…with a gradual, albeit fragile, economic recovery now appearing to be underway

The economic recovery now appears to be underway in Northern Ireland and we expect the third quarter output data to show a reasonably strong increase in activity. But most of the initial gains from re-opening the economy after lockdown are now behind us and with recent rises in the number of Covid-19 cases and the need for tougher restrictions to be imposed, we expect economic growth rates to begin to moderate in the final quarter of the year.

The end of the Brexit transition period is also expected to impact the pace of the economic recovery. We continue to believe that the UK and the EU will agree and implement the terms of a new free trade deal from January 2021, at which point the Northern Ireland Protocol will also take effect. However, we assume that some trade frictions, for example on the movement of goods between Great Britain and Northern Ireland, will be introduced when the transition period ends.

Overall, we are continuing to forecast that economic output in Northern Ireland will decline by around 11% in 2020 and then grow by about 7% in 2021. However, it is clear that there are a number of headwinds facing the local economy and 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 levels are expected to decline in 2020 and 2021

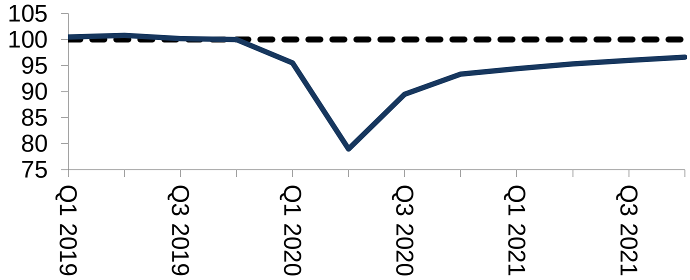
Government policy measures have helped to limit the impact of the pandemic on employment levels to date, but the latest data has shown a weakening in the local labour market. The number of employee jobs fell by 0.2% in the second quarter of the year and the claimant count measure of unemployment has been elevated for some months now. We expect the labour market to weaken further over the rest of this year and into 2021. We are projecting that the average number of employee jobs will fall by around 1.3% in 2020 with a further decline of 2.8% in 2021, and that the annual average unemployment rate will increase to 4.3% in 2020 and rise further to 6.5% in 2021.

Forecast summary (%)

	2020	2021
UK GDP growth	-10.0	6.5
NI GVA growth	-11.0	7.0
NI consumer spending growth	-13.0	7.5
NI employee jobs growth	-1.3	-2.8
NI unemployment rate	4.3	6.5
UK CPI inflation rate	0.7	1.4

Source: Oxford Economics, Danske Bank Analysis

NI GVA (Index: 2019 Q4 = 100)



Source: Oxford Economics, Danske Bank Analysis

Key factors in the outlook

The extent of restrictions to limit the spread of coronavirus

The gradual easing of the Government's lockdown restrictions was the main driver of the expected increase in economic activity in the third quarter of the year. Most local businesses are now open again, albeit many of them are experiencing lower turnover levels than before the pandemic. As such, the initial rise in economic activity from businesses reopening has likely passed and economic growth rates are expected to moderate in the final quarter of the year. In addition, the increase in the number of Covid-19 cases in recent weeks has led to new restrictions being imposed. These are not as stringent as the full lockdown imposed earlier in the year, but could still limit economic activity in certain sectors.

More cautionary consumer and business behaviours

We expect people and firms to behave more cautiously in the months ahead for a number of reasons, with knock on consequnces for consumer spending and business investment levels. The increase in Covid-19 cases may lead people to visit places where they would interact with other people and spend money less frequently. A rise in unemployment and reduced job security may also lead people to hold back on making expensive purchases. Business are likely to behave more prudently with regards to spending on new investment projects given the high degree of both Covid-19 and Brexit-related uncertainty.

Government policy initiatives providing support to businesses and employees

Government policy measures have proven to be a key source of support for the economy in recent months and are expected to play an important role in the recovery from the pandemic. The Coronavirus Job Retention Scheme has been particularly important in preventing a large pick-up in unemployment thus far but it will finish at the end of October. It will be replaced by a new Job Support Scheme, which will involve the Government and employers making a contribution towards the wages of staff members who can only return to work on a part-time basis. The new scheme should encourage the sharing out of work in affected sectors, and reduce job losses, but only to a limited degree. Other measures, such as the extension of the VAT cut for the hospitality and tourism sectors and changes to the Government-backed business loan schemes should also provide some support to businesses.

Loose monetary policy facilitating a return to economic growth

At its September 2020 policy meeting, the Bank of England's Monetary Policy Committee (MPC) voted to keep Bank Rate at its historic low of 0.1% and to maintain the size of its quantitative easing programme at £745 billion. We expect interest rates to remain at 0.1% throughout the rest of this year and believe that, if the MPC decides to loosen policy further, another expansion of the asset purchase programme is more likely than another cut to Bank Rate.

Extra trade frictions due to Brexit

The Brexit process remains highly uncertain and the impact that it will have on the Northern Ireland economy depends on whether or not the UK and the EU can reach a free trade deal and what the subsequent impacts of any such agreement are for the implementation of the Northern Ireland Protocol. We believe the UK and the EU will agree a deal, but still expect there to be some degree of increased trade frictions, including on the movement of goods between Great Britain and Northern Ireland, and that is likely to be a drag on the pace of economic growth in 2021.

Sectoral outlook

Economic recovery underway but there are challenges on the horizon

The coronavirus pandemic continues to dominate the short-term outlook for the Northern Ireland economy. Activity is likely to have picked up in most sectors of the economy in the third quarter of 2020 but there are headwinds facing the recovery. The recent rise in Covid-19 cases emphasises that at least some social distancing restrictions are likely to remain in place for a longer period of time and stricter measures could still be imposed. In addition, worries are resurfacing with regards to Brexit, with firms finding it hard to prepare for the end of the transition period given the high levels of uncertainty and the fact that many of them are still focused on managing the impacts of the pandemic. We are forecasting that economic output in Northern Ireland will contract by around 11% this year and that the economy will grow by about 7% in 2021.

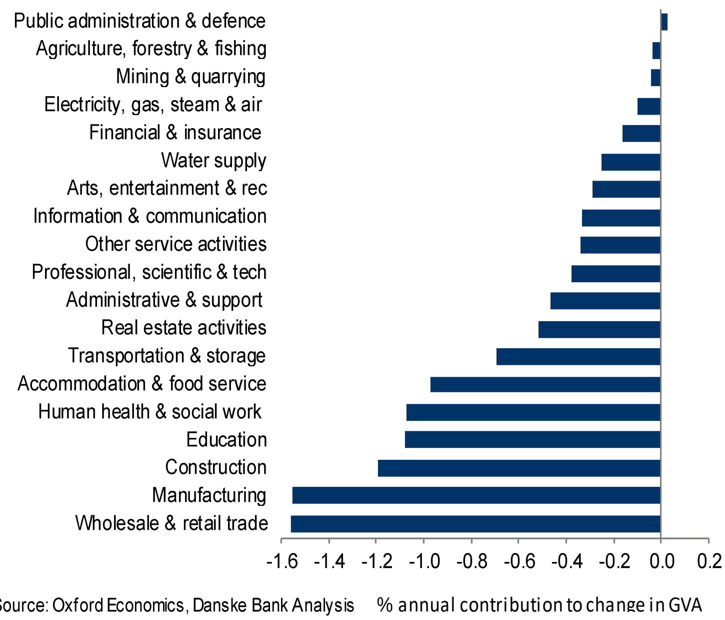
The **accommodation and food services** sector is still edging out of lockdown, and its trajectory over the next two or three months is particularly difficult to plot, but our estimate is that it will experience an annual output fall of around 37% in 2020, the largest of any sector. This is followed by **arts, entertainment & recreation**, another sector in which the recovery is likely to be constrained given the need for continued social distancing measures. We expect activity in this sector to decline by approximately 26% in 2020. Both of these sectors are expected to rebound relatively strongly in 2021, but overall activity levels at the end of next year are still likely to be below where they were prior to the onset of the pandemic.

The **wholesale & retail trade** sector has also faced challenges due to the pandemic, and we are now forecasting that it will experience an annual fall in output of 11.1% in 2020. The sector has not been as impacted as the other consumer-focused sectors as the shift to online shopping, continued purchases of essential items and the pickup in household spending during the summer months have all provided some support to businesses. But nevertheless a significant proportion of consumer spending does occur in crowded retail areas and so continued social distancing rules are likely to limit the extent of activity in this sector compared to pre-coronavirus trends.

Manufacturing and **construction** are expected to experience large falls in output this year while the closure of schools and education facilities during the lockdown period is expected to lead to a sharp fall in activity in the **education** sector in 2020.

With the exception of **public administration & defence**, all sectors are expected to contract this year, yet sectors such as **professional, scientific & technical services** and **information & communication**, where people and businesses have been able to adapt to remote working, are expected to experience relatively smaller falls in activity in 2020. These sectors are expected to be among the fastest growing over the medium-term in Northern Ireland, as they were prior to the pandemic.

Sector contributions to the change in GVA in 2020



Source: Oxford Economics, Danske Bank Analysis

GVA (%)	2020	2021
Public administration & defence	0.4	0.3
Agriculture, forestry & fishing	-2.1	0.8
Financial & insurance	-4.2	0.8
Real estate activities	-4.6	2.0
Electricity, gas, steam & air	-8.8	5.5
Professional, scientific & tech	-8.9	5.8
Information & communication	-9.2	5.6
Human health & social work	-10.3	6.3
Manufacturing	-10.8	8.1
Wholesale & retail trade	-11.1	9.3
Water supply	-14.8	9.2
Administrative & support	-15.0	9.0
Mining & quarrying	-15.3	9.5
Construction	-16.9	10.3
Transportation & storage	-17.9	13.5
Education	-19.8	12.1
Other service activities	-20.1	11.4
Arts, entertainment & rec	-25.8	17.3
Accommodation & food service	-37.4	27.2
Total	**-11.0**	**7.0**

Source: Oxford Economics, Danske Bank Analysis

Labour market outlook

Greater job losses are expected as the Job Retention Scheme comes to an end

Given the Government support measures to limit the number of job losses, the full labour market impacts associated with the coronavirus pandemic are likely still to be felt. The latest unemployment rate, of just 2.9% for Northern Ireland, relates to the May – July 2020 period but the rate is expected to rise sharply in the coming months. As the Job Retention Scheme comes to an end, we expect the labour market to weaken further over the remainder of 2020. We are projecting that the annual number of employee jobs will fall by around 1.3% in 2020 and by a further 2.8% in 2021. The annual average unemployment rate could increase to 4.3% in 2020, with the rate expected to rise to between 7-8% in the final quarter of the year, and then average 6.5% in 2021.

At this stage of the year, employee jobs data is available for the first half of 2020. The latest Quarterly Employment Survey, which relates to 2020 Q2, showed a modest decrease in the total number of jobs but employment has so far been relatively well protected this year with some sectors actually experiencing relatively strong employment growth in the first half of 2020. These trends are reflected in the change to our forecasts, with the expected deterioration in the labour market impacts now pushed into the latter half of this year and the early part of 2021.

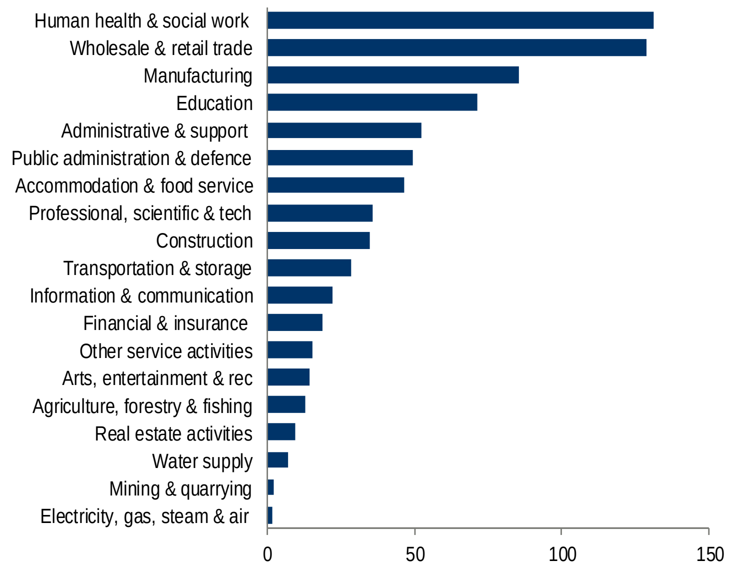
Given the data for the first half of the year, several sectors are now expected to experience an increase in the average number of jobs in 2020. This includes the **electricity, gas, steam and air** sector, the **professional, scientific and technical services** sector, and the **water supply** industry, all of which experienced increases in employment between 2019 Q4 and 2020 Q2, and are now expected to see annual jobs growth this year.

Construction, **finance & insurance**, and **transport & storage** are also now forecast to experience a rise in the average number of jobs in 2020. The outlook for **human health & social work** has improved given the strong rise in employment in 2020 Q2 and it is now expected to experience an annual increase in the number of jobs of around 1.8% in 2020.

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 8.3% and 5.9% respectively. Similarly, **wholesale & retail trade** and **manufacturing** are also set to experience job losses this year.

The outlook for 2021 is more pessimistic and, in annual average terms, all sectors are forecast to see a reduction in the number of jobs. The consumer-focused sectors are again expected to experience some of the biggest losses. **Transport & storage** is expected to suffer a contraction in employment of 2.5% in 2021 and **manufacturing** is projected to see job losses of just over 3% in both 2020 and 2021.

Employee jobs per sector in 2020



Source: Oxford Economics, Danske Bank Analysis

Employee jobs (%)	2020	2021
Electricity, gas, steam & air	9.8	-3.6
Professional, scientific & tech	2.8	-3.1
Water supply	2.4	-3.8
Human health & social work	1.8	-1.8
Financial & insurance	0.6	-3.1
Construction	0.4	-2.3
Agriculture, forestry & fishing	0.4	-1.7
Transportation & storage	0.3	-2.5
Mining & quarrying	0.2	-3.9
Public administration & defence	0.2	-0.7
Education	-0.1	-0.6
Real estate activities	-0.3	-2.2
Information & communication	-0.8	-1.3
Wholesale & retail trade	-1.8	-3.4
Manufacturing	-3.2	-3.1
Other service activities	-3.4	-2.6
Administrative & support	-5.1	-3.2
Arts, entertainment & rec	-5.9	-4.2
Accommodation & food service	-8.3	-8.5
Total	**-1.3**	**-2.8**

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 more elevated than is normally the case and the risks are weighted 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 final quarter of 2020 or into 2021. The recent increase in the number of Covid-19 cases has already resulted in the introduction of new restrictions which could dampen activity, particularly in consumer-focused sectors. Should further measures need to be introduced, such as the introduction of another short lockdown period, that would have implications for the economic recovery. The rise in the spread of the virus 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 recovery in consumer spending and business investment. The labour market impacts could be more severe if the end of the Job Retention Scheme causes an even sharper spike in unemployment as, despite the introduction of the Job Support Scheme, firms see a strong case for reducing headcounts rather than moving their workers on to part-time hours.

- **Brexit –** Negotiations on the future relationship between the UK and the EU are ongoing, with a deal needing to be agreed and ratified before the transition period ends on 31 December 2020. The two main areas of disagreement that still exist between the teams of negotiators are around fisheries and state aid. Our forecasts assume that the UK and the EU are able to conclude and implement a free trade agreement by the beginning of January 2021 which keeps trade between the two economies largely tariff-free and has some success in limiting the introduction of non-tariff barriers. From a local perspective, the Northern Ireland Protocol will become operational from the beginning of next year but there is still a lack of clarity around how it will be implemented and the impact that it will have on goods trade between Great Britain and Northern Ireland, with at least some new trade frictions likely to arise. If the UK and the EU are not able to agree a deal, then the implementation of the Protocol will likely be more stringent. In such a 'no trade deal' scenario, it is expected that the pace of economic recovery in both Northern Ireland and the wider UK would be slower.

In addition, a key global uncertainty is that:

- **The global economic outlook deteriorates –** While we anticipate the coronavirus pandemic to have caused a short, sharp recession globally and for the world economy to gradually recovery as we move through 2020 and 2021, there is a risk that the short-term economic costs from the lockdown periods 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, thus weakening the pace of the global recovery and lengthening the amount of time needed for economic output to return to its pre-coronavirus level.

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