Northern Ireland Quarterly Sectoral Forecasts

Forecast summary

The Northern Ireland economy grew in the final quarter of 2021 and is estimated to have expanded again in the first quarter of 2022. However looking forward, the outlook for the economy is particularly uncertain as the war in Ukraine, high inflation, changes to the economic policy environment and Covid-19 all have the potential to impact economic performance. We expect the pace of economic growth to weaken as high inflation squeezes consumer incomes and both fiscal and monetary policy are becoming less accommodative. As such, we have downgraded our forecasts and now expect the Northern Ireland economy to grow by around 3.6% in 2022 and about 1.7% in 2023.

The Northern Ireland economy is growing but the pace of expansion looks set to slow

Northern Ireland's economic recovery continued in the final quarter of 2021, with the Composite Economic Index increasing by 1.2%. The Index of Production showed that output increased by 1.1%, up from 0.6% in 2021 Q3. Activity in all four of the production sectors increased, with the utilities sectors recording the fastest rates of growth. Services activity also expanded with the Index of Services growing by 1.3%. Business services & finance reported the largest increases in output with transport, storage, information & communication and other services also growing during the quarter. However, wholesale & retail trade recorded a fall in output of 0.5%.

The impact of the Omicron coronavirus variant on economic growth in the first quarter of 2022 is likely to be lower than we initially expected but the pace of growth is expected to slow in the second quarter of the year as high inflation squeezes consumer spending power. Inflationary pressures are expected to continue weighing on growth during the second half of the year and into next year. Overall and after growing by an estimated 6.8% in 2021, we are forecasting that the Northern Ireland economy will grow by around 3.6% in 2022 – down from the 4.0% projection in our previous report – and by about 1.7% in 2023.

The labour market is in a relatively strong position with further jobs growth expected

The Northern Ireland labour market continues to perform well with a number of indicators signalling rising employment levels. The latest data from the Quarterly Employment Survey showed a 0.4% quarterly rise in the number of employee jobs in Northern Ireland in 2021 Q4. This lifted the total number of employee jobs above its pre-pandemic level and to a new series high. However, the sector performance varied, with only nine of the 19 broad sectors reporting growth.

The HMRC Pay As You Earn data for February 2022 showed that the number of payrolled employees increased by 0.5% over the month and by 5.4% over the year to a record high of 777,300.

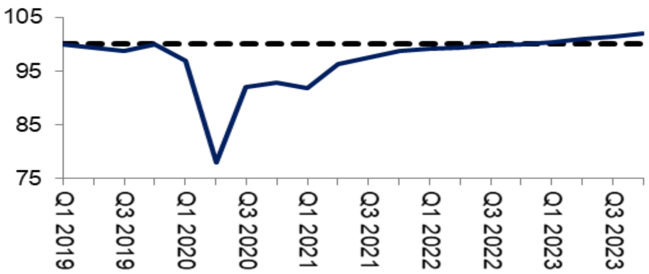
The number of people on the claimant count declined by 2.3% in February 2022 compared with January. The ILO unemployment rate also fell over the November - January 2022 period to 2.7% – significantly below the historical 20-year average of 5.3% - and the employment rate was above its historical average.

Given the recent strength of the labour market, we are forecasting that the annual average number of employee jobs in Northern Ireland will increase by around 1.1% in 2022, followed by a further rise of 0.6% in 2023. We also expect the unemployment rate to average about 3.2% in 2022 and 3.4% in 2023.

Forecast summary (%)			
	2021	2022	2023
UK GDP growth	7.4	3.8	1.8
NI GVA growth	6.8	3.6	1.7
NI consumer spending growth	5.7	4.5	1.2
NI employee jobs growth	0.2	1.1	0.6
NI unemployment rate	3.5	3.2	3.4
UK CPI inflation rate	2.6	7.2	3.8

Source: Oxford Economics, Danske Bank Analysis

NI Gross Value Added (Index: 2019 Q4 = 100)



Source: Oxford Economics, Danske Bank Analysis

Key factors in the outlook

High inflation eroding real wages and squeezing consumer spending

Inflation in the UK is currently at a 30-year high, with the annual rate of price rises reaching 6.2% in February 2022. Inflation is expected to rise further over the next few months due to a combination of higher fuel prices, upward pressure on global goods prices from supply-chain disruption and the rise in energy prices. The war in Ukraine is also likely to keep energy and food prices higher for longer, so we have revised our forecasts for inflation upwards. We now expect CPI inflation to average 7.2% this year and 3.8% in 2023. With the rate of nominal wage growth unlikely to keep pace with inflation, we expect to see a fall in real wages in 2022 which in turn will exert a squeeze on consumer spending.

The strength of the labour market should provide some support for consumer spending

At a time when high inflation is squeezing consumer spending growth, the strong labour market may give some support to spending levels. The number of payrolled employees in February 2022 and employee jobs in 2021 Q4 in Northern Ireland where both at series highs and the unemployment rate for the November-January 2022 period was just 2.7%, well below its long-term average. The relatively strong labour market data shows that many people are still in work and that demand for labour remains robust. Consumer spending is also likely to be influenced by some households being able to spend a proportion of the excess savings they accumulated during 2020 and 2021. Overall, we are forecasting that consumer spending in Northern Ireland will grow by around 4.5% in 2022 and by 1.2% in 2023.

Changes to fiscal policy

The UK Government has been unwinding the extensive support provided in the early stages of the pandemic and attempting to strengthen the public finances. A temporary 1.25 percentage point rise in National Insurance contributions took effect from April 2022, and will be replaced by a Health and Social Care Levy in 2023, while most income tax allowances and thresholds have been frozen in cash terms for the next four years. In addition, Corporation Tax is scheduled to rise from the current 19% to 25% from April 2023. However, the Chancellor's March 2022 Spring Statement did provide some support to households through a cut to fuel duty and an increase in the National Insurance threshold.

Monetary policy becoming tighter

The Bank of England's Monetary Policy Committee (MPC) raised Bank Rate to 0.75% in March 2022 with further increases expected to try and bring inflation back to its 2% target over the medium-term. It's important to note that a large part of the recent rise in inflation is due to external and supply-side factors including increases in energy and commodity prices. Higher prices for necessities such as food, fuel and energy are likely to weigh on consumer demand for other goods and services and could contribute towards a slowdown in price rises and economic activity levels even without further base rate increases, making future monetary policy decisions complicated. At this stage, and recognising the considerable uncertainty, we expect the MPC to increase Bank Rate once or twice more in 2022, with base rate finishing this year at around 1.00% or 1.25%.

Extra trade frictions due to Brexit

Firms in Northern Ireland and across the UK are continuing to face enhanced trade processes following the UK's exit from the European Union. The implementation of the Northern Ireland Protocol has also led to new processes for local firms when purchasing certain goods. Negotiations are continuing regarding the future implementation of the Protocol but the path towards reaching agreement is not straightforward. For now, uncertainty remains elevated and this may continue to impact consumer and business confidence.

Continued recovery in business investment

The early stages of the recovery in business investment across the UK have been slow, with business investment in 2021 Q4 still around 8.6% below its pre-pandemic level. This creates the potential for a continued 'catchup' back towards more normal levels. Some businesses also accumulated excess cash holdings during the pandemic and that should help to support the recovery while the two-year 'super-deduction' tax incentive, which is scheduled to remain in place until the end of March 2023, is also expected to encourage firms to bring forward capital spending.

The outlook for the UK economy

The UK economy continued to expand in the final quarter of 2021 with GDP growing by 1.3%, slightly faster than the 0.9% growth observed in quarter three. Within **private consumption**, spending by consumers grew by 0.5% over the quarter with growth likely held back by the emergence of the Omicron coronavirus variant towards the end of the year. **Government spending** increased by 1.5% with Covid-19 related expenditure, including the vaccine booster programme, contributing towards a rise in health spending. **Total investment** expanded by 1.1% with business investment rising by 1.0%, although investment by firms still has some ground to make up to return to its pre-coronavirus level. **Exports** rose by 6.9% over the quarter and **imports** increased by 0.3%.

The more timely monthly GDP data showed that output levels in the UK economy increased by 0.8% in January compared to the previous month. This more than made up for the 0.2% drop in activity in December and supports the view that the impact of the Omicron coronavirus variant on the economy was smaller than initially expected. At a sector level, **services** output grew by 0.8% with the consumer-facing wholesale and retail trade and accommodation and food services sectors returning to growth after experiencing falls in activity in December. **Production** output expanded by 0.7% and **construction** activity also increased compared with the previous month, by 1.1%.

The outlook for the UK economy is particularly uncertain. We expect GDP to grow again this year, but at a slower rate than we projected in our last report primarily due to higher inflation – which is being influenced by the war in Ukraine and other factors – weighing more heavily on consumer spending, tighter economic policy and falling consumer and business confidence. We are forecasting that UK GDP will grow by around 3.8% in 2022 and 1.8% in 2023. We expect aggregate **private consumption** to grow by about 4.8% this year but to slow to 1.2% next year and for **investment** levels to grow by around 5.1% this year and 3.5% next year.

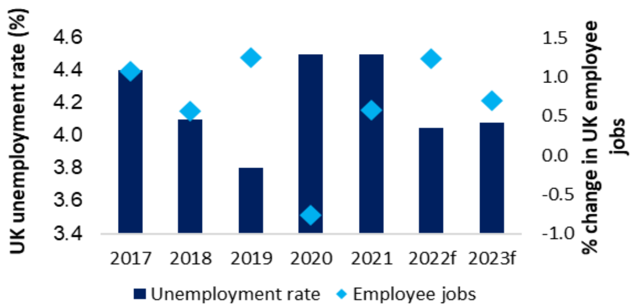
A number of recent data points emphasise the tightness of the UK labour market. The number of payrolled employees increased by 0.9% over the month to February 2022 to a series high. The number of **employee jobs** increased in the final quarter of 2021 by 0.5%. The employment rate increased slightly over the quarter to November – January 2022 to 75.6% and the **unemployment rate** dropped to 3.9%. In addition to this, and having been on an upward trajectory throughout last year, job vacancies climbed further to a new record high of 1.3 million in the three months to February 2022 and the ratio of unemployed people per job vacancy fell to 1.0 in the November – January 2022 period, the lowest since records began.

Given the strong demand for labour, we are projecting that the average annual number of **employee jobs** in the UK will grow by around 1.2% in 2022 and by 0.7% in 2023. We also expect the **unemployment rate** to average 4.0% this year and 4.1% next year.

Inflation in the UK increased again in February 2022 to 6.2%, its highest rate since March 1992. The rate of price rises is project to increase further and we expect CPI **inflation** to average 7.2% in 2022 and 3.8% in 2023.

UK GDP forecasts (%)			
	2021	2022	2023
UK GDP growth	7.4	3.8	1.8
Private Consumption	6.2	4.8	1.2
Investment	5.9	5.1	3.5
Government Consumption	14.3	2.5	1.5
Exports of Goods and Services	-1.3	4.7	4.5
Imports of Goods and Services	3.8	6.0	4.0

Source: Oxford Economics, Danske Bank Analysis



Source: Oxford Economics, Danske Bank Analysis

Northern Ireland sectoral outlook

The economy is expected to continue growing but at a slower rate than observed in recent quarters
The Northern Ireland economy continued to grow in 2021 Q4 and is estimated to have grown again in the first quarter of 2022 as the economic impacts of the Omicron coronavirus variant appear to have been more moderate than initially expected. While Covid-19 remains a source of uncertainty, other factors including the sharp rise in inflationary pressures and the war in Ukraine have led us to reduce our forecast for output growth in Northern Ireland. We now expect GVA to increase by 3.6% in 2022 and by 1.7% in 2023, slightly lower than our projected growth rates for UK GDP.

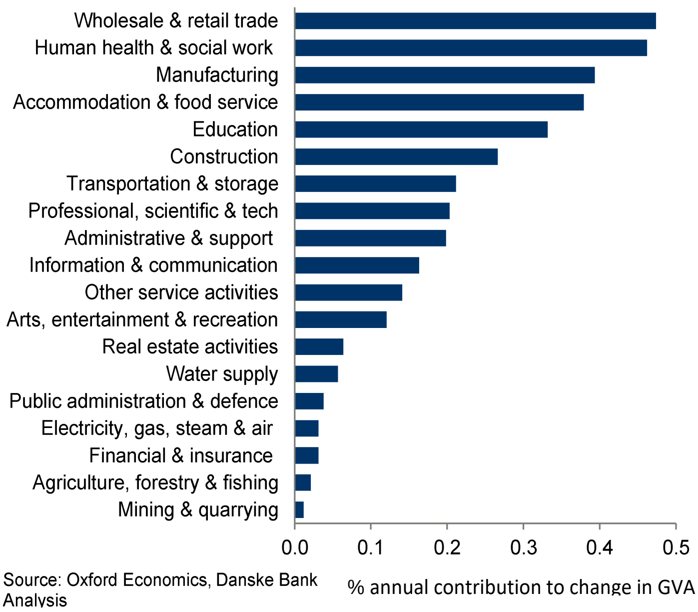
After experiencing the fastest rates of growth in 2021, **accommodation & food services** and **arts, entertainment, & recreation** are set to grow at the strongest pace again in 2022, with output levels projected to rise by 16.2% and 10.5% respectively. These sectors were among the most negatively impacted by the pandemic and so their strong growth rates are from a low base and reflect the extent of the drop in annual activity levels experienced during 2020. As we move into 2023, the rate of expansion in these sectors is expected to slow considerably as the rebound effects fade away and, as largely consumer-focused sectors, the squeeze on household spending from high inflation weighs on growth. This squeeze on spending, combined with falling consumer confidence levels and supply chain disruption is expected to hold back growth in the **wholesale & retail trade** sector. We think output will expand by around 3.4% in 2022 and 0.8% in 2023, below the rate projected for the overall economy.

The **other services** and **administration and support services** sectors are expected to grow relatively strongly in 2022 and in 2023 as they continue to make up the ground lost in 2020 as a result of the pandemic.

Output growth in the **manufacturing** sector is projected to be lower than the rate forecast for the overall economy in 2022, increasing by around 3.0%. Upward price pressures for raw materials, energy and wages as well as ongoing supply constraints are likely to continue to negatively impact the sector. These issues are also expected to affect the outlook for both the **construction** and **agriculture, forestry, & fishing** sectors in which we are forecasting that output will increase by around 3.7% and 1.2% respectively in 2022.

We are forecasting that output in the **information & communication** and **professional, scientific & technical services** sectors will grow by around 5.3% and 4.6% respectively in 2022. In 2023, we expect output growth in these industries to be around 3% which is above that for the overall economy in both years. These sectors were relatively strong performers prior to the onset of the pandemic and we expect that to continue to be the case.

Sector contributions to GVA growth in 2022



Source: Oxford Economics, Danske Bank Analysis

GVA (%)	2022	2023
Accommodation & food service	16.2	0.8
Arts, entertainment & recreation	10.5	0.6
Other service activities	7.6	4.3
Administrative & support	7.0	3.4
Education	6.1	0.7
Transportation & storage	5.8	2.0
Information & communication	5.3	2.9
Professional, scientific & tech	4.6	3.0
Mining & quarrying	4.2	1.5
Human health & social work	4.0	0.2
Construction	3.7	2.5
Water supply	3.6	1.1
Wholesale & retail trade	3.4	0.8
Manufacturing	3.0	3.1
Electricity, gas, steam & air	2.0	1.9
Agriculture, forestry & fishing	1.2	2.0
Financial & insurance	0.7	2.1
Real estate activities	0.5	2.1
Public administration & defence	0.5	0.1
Total	**3.6**	**1.7**

Source: Oxford Economics, Danske Bank Analysis

Northern Ireland labour market outlook

Amid strong demand, the labour market expansion is expected to continue in 2022
The labour market in Northern Ireland appears to be in a relatively strong position with demand for workers remaining robust. However, slower expected economic growth and the prevailing labour shortages have led us to moderate our labour market outlook for 2022, with the annual average number of employee jobs now forecast to increase by 1.1%. The pace of jobs growth is then projected to slow to around 0.6% in 2023. This is broadly similar to our expectations for the wider UK economy.

As their recoveries from the pandemic continue, we expect relatively strong jobs growth within the hospitality and tourism-related sectors as businesses within them continue to work towards returning to their pre-pandemic activity levels. We expect the **arts, entertainment, & recreation** sector to see the largest percentage rise in employee jobs in 2022, growing by 3.4%. This is closely followed by the **transportation & storage** sector which we expect will experience a rise in employment of 3.3%. The annual average number of employee jobs in the **accommodation & food services** and **wholesale & retail trade** sectors is forecast to increase by around 2.2% and 1.5% respectively in 2022.

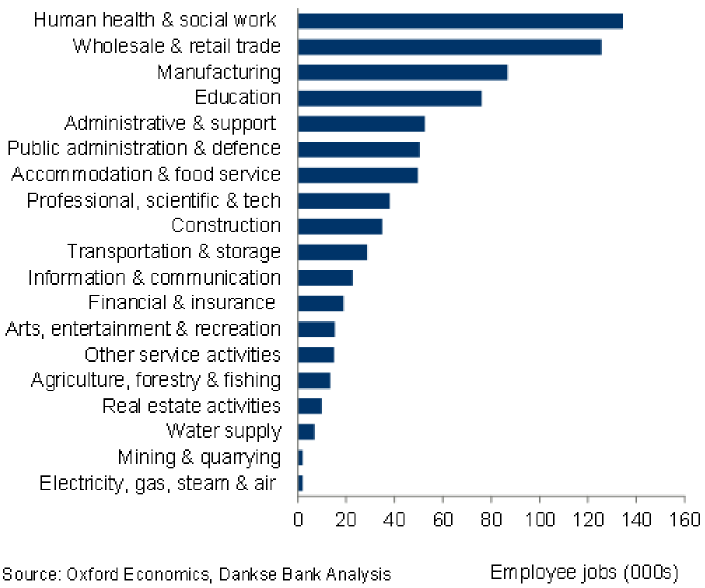
The business services sectors are expected to see a slowdown in the pace of job creation this year. The **information & communication** sector is projected to experience jobs growth of 2.3% in 2022, compared with an increase of 6.9% in 2021. We are also forecasting that employment in the **administrative and support services** and **professional, scientific, & technical services** sectors will increase by about 1.6% and 0.8% respectively, down from 2.3% and 3.2% in 2021. However, the pace of jobs growth within these sectors is forecast to increase in 2023.

Employment growth is expected to return to the **construction** sector this year, with employee jobs forecast to increase by 2.0%. **Manufacturing** employment is also forecast to rise by 0.3% in 2022 but then decline in 2023 as skills shortages and longer-term trends towards more automation reduce the number of jobs in the sector.

After experiencing above average growth in 2021, employment in the **public administration & defence** sector is expected to see only modest growth in 2022, rising by just 0.2%. This is forecast to be followed by a fall in employment of 0.8% in 2023. **Education** is expected to follow a similar trend with growth of 0.3% forecast this year, followed by a decline of 0.3% in 2023. By contrast, employee jobs in the **human health & social work** sector is forecast to increase by around 0.6% in 2022, followed by a further rise of 0.7% in 2023.

The unemployment rate fell over the quarter to 2.7% in the November-January 2022 period, significantly below the historical 20-year average of 5.3%. We are forecasting that the unemployment rate in Northern Ireland will average around 3.2% in 2022 and 3.4% in 2023.

Employee jobs per sector in 2022



Source: Oxford Economics, Danske Bank Analysis

Employee jobs (%)	2022	2023
Arts, entertainment & recreation	3.4	2.4
Transportation & storage	3.3	0.2
Information & communication	2.3	2.2
Accommodation & food service	2.2	0.7
Construction	2.0	1.3
Administrative & support	1.5	2.2
Wholesale & retail trade	1.5	1.4
Other service activities	1.1	2.7
Electricity, gas, steam & air	1.1	0.2
Agriculture, forestry & fishing	0.8	0.2
Professional, scientific & tech	0.8	1.3
Mining & quarrying	0.7	-0.3
Financial & insurance	0.7	-0.3
Human health & social work	0.6	0.7
Real estate activities	0.5	0.2
Water supply	0.4	0.2
Education	0.3	-0.3
Manufacturing	0.3	-0.8
Public administration & defence	0.2	-0.8
Total	**1.1**	**0.6**

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 considered to be more elevated than is normally the case. The main sources of uncertainty include:

- **Persistent inflation and supply chain disruption** – Inflation in the UK is already at a 30-year high and is expected to rise even further. This inflation is being partly driven by higher fuel, energy and commodity prices and by supply chain disruption exerting upward pressure on global goods prices. The war in Ukraine is also likely to further exacerbate the already high inflation prevalent in the UK and in other advanced economies. High inflation erodes consumers' purchasing power and puts upward pressure on businesses' costs, which can lead to a squeeze on household spending and act as drag on business investment. If inflation runs even higher than expected and remains at more elevated levels for a longer period of time, it has the potential to constrain economic growth even further. Monetary policy decisions could also become increasingly complicated with a possibility that Bank Rate would need to be increased at a faster pace to contain the rate of price rises, which would also weigh down on economic activity. And persistent supply chain disruption could adversely impact activity in goods-based businesses if they are unable to source the goods they sell or need as an input into their own processes.

- **Prolonged uncertainty around the implementation of the post-Brexit trading arrangements** – An agreement between the UK and the EU on the implementation of the Northern Ireland Protocol is yet to be reached and there is no current timeline around when the current negotiating process could conclude. As such, the uncertainty around the post-Brexit trading arrangements in Northern Ireland looks set to continue. In the short-term, the challenges that some businesses are facing in relation to the current arrangements, particularly with regards to the new checks and processes required when moving some goods from Great Britain to Northern Ireland, will continue. In the medium to longer-term, there is the potential for the arrangements to present opportunities for firms in Northern Ireland but a stable solution to the current issues is likely to be needed to give both local and international firms the certainty they need to pursue those potential opportunities. The current situation is fragile and remains a significant source of uncertainty for consumers and businesses.

- **Coronavirus** – Covid-19 case numbers in Northern Ireland and across the UK remain relatively high. While the vaccine programme has enabled the restrictions in place over the last two years to be largely removed, the emergence of a new variant that causes a greater risk to people's health and exerts excess pressure on the health service remains a possibility. If restrictions needed to be reintroduced in response to such a variant, there would likely be adverse implications for economic growth.

In addition, a key global uncertainty relates to:

- **The war in Ukraine** – The war in Ukraine is expected to impact the UK and Northern Ireland economies mainly through higher inflation and potentially through adverse impacts on consumer and business sentiment. How the crisis evolves over the weeks and months ahead remains particularly uncertain. However, if the war were to be prolonged or to escalate further, the human consequences would be tragic and the economy could be negatively affected if, for example, energy prices remained higher for longer and if sentiment levels were adversely impacted over a longer period of time.

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Contact details

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