Northern Ireland Quarterly Sectoral Forecasts

Forecast summary

The UK economy contracted in the third quarter of 2022 and we think that economic activity in Northern Ireland is also likely to have declined. Output is then projected to fall further in the final quarter of the year and through most of next year with both economies experiencing a period of recession as a number of factors adversely impact activity levels. Inflation is expected to decline gradually during 2023 but remain elevated and weigh down on household purchasing power. Consumer confidence is also particularly low and monetary policy is tightening. We expect the Northern Ireland economy to grow by around 4.0% in 2022, which reflects an element of recovery from the pandemic. Looking forward, and while noting the considerable uncertainty around the outlook, we are forecasting that output in Northern Ireland will contract by about 1.0% in 2023.

High inflation, low confidence and tighter monetary policy expected to weigh on economic activity

After growing in the first half of the year, the UK economy contracted by 0.2% in the third quarter of 2022. In Northern Ireland, the latest output data relates to the second quarter of the year when, after expanding in quarter one, the Composite Economic Index declined by 0.1%. We think the local economy also contracted in quarter three.

With high inflation continuing to squeeze household purchasing power, consumer confidence particularly low in Northern Ireland and the wider UK and monetary policy tightening, we expect activity levels in both economies to decline again in the final quarter of the year and through most of next year with the Northern Ireland and UK economies experiencing a period of recession.

Overall, and in annual terms, we are forecasting that the Northern Ireland economy will grow by around 4.0% in 2022. However, it is important to note that this rate of economic expansion reflects an element of recovery from the impacts of the coronavirus pandemic. With regards to 2023, the outlook for the economy remains highly uncertain but we have revised our previous forecast for a fall in activity of 0.5% downwards and now expect the local economy to experience an annual contraction in output of about 1.0%.

The labour market remains strong but is showing signs of weakening amid the challenging economic backdrop

The Northern Ireland labour market is in a relatively strong position but there are some signs that it is beginning to weaken. On the positive side, the employment rate increased by 0.4 percentage points over the quarter to 70.1% in the July – September 2022 period. The HMRC Pay As You Earn data showed that the number of payrolled employees increased by 0.2% over the month in October.

However, the unemployment rate increased by 0.3 percentage points over the July – September 2022 period, up to 3.0%. In addition, the number of people on the claimant count increased by 1.4% in October 2022 compared with September, the second monthly increase in a row, following 18 consecutive months of declines.

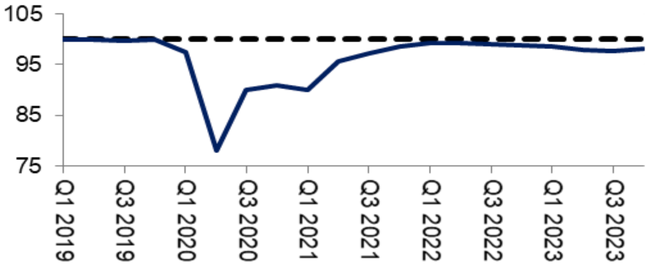
Although there are some signs the labour market is beginning to weaken, the strong jobs growth observed in most of the year underpins our view that the annual average number of employee jobs in Northern Ireland will increase by around 2.7% in 2022. However, we are forecasting that the annual number of employee jobs will fall by around 1.0% next year as the demand for labour is adversely impacted by the weaker economic environment. We are also projecting that the unemployment rate in Northern Ireland will average around 2.9% this year, before rising to an average of 3.9% in 2023.

Forecast summary (%)

	2021	2022	2023
UK GDP growth	7.5	4.4	-0.9
NI GVA growth	7.0	4.0	-1.0
NI employee jobs growth	0.1	2.7	-1.0
NI unemployment rate	4.0	2.9	3.9
UK unemployment rate	4.5	3.7	4.4
UK CPI inflation rate	2.6	9.1	7.5

Sources: ONS, NISRA, Oxford Economics, Danske Bank Analysis

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



Sources: Oxford Economics, Danske Bank Analysis

Key factors in the outlook

High inflation squeezing consumer spending power

The annual UK CPI inflation rate increased to a multi-decade high of 11.1% in October 2022, more than five times its 2% target rate. We expect the rate of price rises to peak in the final quarter of this year as the UK Government's Energy Price Guarantee serves to constrain inflation in the short-term. Looking forward, we expect inflation to decline gradually during 2023 but it is still expected to average around 7.5% over the year. This would be lower than the 9.1% we are forecasting for 2022 but still well in excess of the target rate. As such, real income growth and household spending power are likely to remain under pressure in 2023 with annual consumer spending likely to decline.

Changes to fiscal policy

Fiscal policy in the UK has been particularly fluid over the last few months. The Government announced a range of expansionary fiscal measures in September, the majority of which were then reversed in October before a wider re-evaluation of fiscal policy within the Autumn Statement in November. In the short-term, fiscal policy will provide some support to households and businesses, particularly with regards to energy prices. The Energy Price Guarantee discounts the per unit rate of energy for UK households. The measure is currently set to remain in place until April 2024 but from April 2023, the extent of the government support is set to reduce. For businesses, its not yet clear what support will be available once the Energy Bill Relief Scheme ends in March 2023. A previous rise in National Insurance Contributions has also been reversed. However, there are ways in which fiscal policy will tighten next year including the rise in the rate of Corporation Tax and the continued freeze in income tax thresholds. Fiscal policy is now also set to be tighter over the medium-term as the UK Government focuses on the sustainability of the public finances.

Tighter monetary policy with further Bank Rate rises expected

The Bank of England's Monetary Policy Committee (MPC) increased Bank Rate by 75 basis points to 3.00% at its November policy meeting, which was the eighth consecutive rise in Bank Rate. While inflation is expected to peak in the final quarter of 2022 and to decline next year, it is still projected to remain above its 2% target rate throughout 2023 and there is considerable uncertainty around the outlook for the rate of price rises. The MPC is unlikely to want to risk inflation running higher or remaining elevated for longer and will probably want to prevent expectations of higher inflation becoming embedded across the economy. As such, we expect the Committee to raise Bank Rate again at its December meeting and for the policy rate to reach a peak of 4.00% in the first quarter of 2023.

Resilient labour market providing some support to consumer spending

While high inflation is putting household finances under pressure, the robustness of the labour market may give some support to spending. The unemployment rate is currently relatively low in both Northern Ireland and in the wider UK and, while we expect unemployment to rise gradually moving forward, the rate is still expected to be relatively low when considered against the challenging economic backdrop. While this is unlikely to offset the squeeze on household spending power, it should give consumer expenditure some support.

Extra trade frictions due to Brexit

Businesses across the UK are continuing to face trade barriers following the UK's departure from the European Union (EU). The Northern Ireland Protocol has also led to new processes for local firms when purchasing certain goods from the rest of the UK, such as food products. While the UK and the EU are attempting to reach an agreement on how the Northern Ireland Protocol should be implemented in the future, an imminent breakthrough appears unlikely and it is not yet clear when or exactly how the issues around the Protocol may be resolved.

The outlook for the UK economy

After growing in the first two quarters of the year, the UK economy moved into contractionary territory in 2022 Q3 with GDP falling by 0.2%. Within **private consumption**, real consumer spending declined by 0.5% as households cut back on discretionary purchases. **Government spending** increased by 1.3% compared with a decline of 1.5% in the previous quarter. Total **investment** rose by 2.5%, although this growth was predominantly driven by government investment as uncertainty and higher interest rates likely held back business investment, which fell by 0.5%. **Exports** – which were heavily influenced by movements of non-monetary gold – increased by 8.0% and **imports** fell by 3.2%, meaning net trade made a positive contribution to GDP for the second quarter in a row.

The monthly GDP data showed that UK economic activity fell by 0.6% in September, with the extra public holiday for the funeral of Queen Elizabeth II a contributory factor. However, there were also underlying weaknesses weighing on economic activity. The wholesale and retail trade sector, which is particularly exposed to the squeeze on consumer spending, made a large contribution to the 0.8% fall in overall **services** output. **Production** output increased by 0.2% in September, marking its first monthly rise since May. **Construction** output grew by 0.4% in September, following growth of 0.6% in August. Regarding the last quarter of the year, the return to a normal complement of working days should deliver a mechanical boost to GDP but, amid the growing headwinds, we still expect output levels to decline when compared with the third quarter of the year.

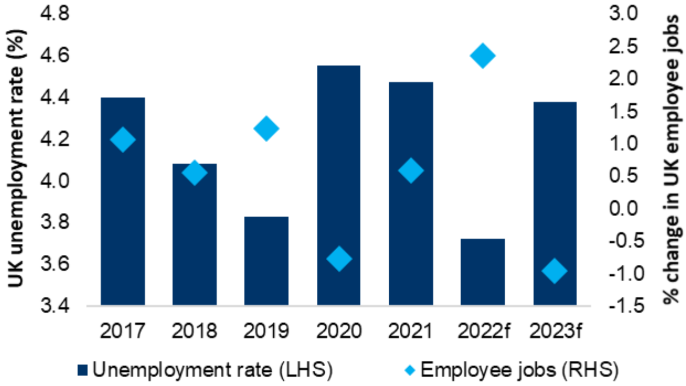
We have maintained our forecast for UK GDP growth from our last report at 4.4% for 2022. However, we now expect the UK economy to contract by around 0.9% in 2023, down from a fall of 0.5% expected in our previous report. With high inflation weighing on household spending power, we expect aggregate **private consumption** to fall by 1.0% next year, slightly more than the decline in overall GDP, after growth of around 4.8% this year. We are also projecting that **investment** levels will grow by 5.8% in 2022 but fall by around 1.6% in 2023, again greater than the expected fall in overall GDP. **Government consumption** is projected to grow by 1.8% in 2022 and then by a higher 4.5% in 2023, partially mitigating the falls in private consumption and investment.

The latest UK labour market data continued to point towards a tight jobs market but with some signs of softening beginning to emerge. The **unemployment rate** dropped to 3.6% in the third quarter of the year, although this was mainly as a result of a further rise in economic inactivity, with the employment rate remaining broadly unchanged over the same period. Meanwhile, the number of job vacancies fell further in the three months to October to 1.23 million, the lowest since autumn 2021. Given the resilience of the labour market throughout most of this year, we are forecasting that the annual average number of **employee jobs** in the UK will grow by around 2.4% in 2022. However, subdued demand in the economy in 2023 is likely to lead to companies holding back when it comes to hiring and therefore we expect a decline of 1.0% in the number of employee jobs in 2023. This is expected to push up the annual average **unemployment rate** from 3.7% this year to 4.4% in 2023.

UK CPI **inflation** rose to a multi-decade high of 11.1% in October, up from 10.1% in September. We expect the rate of price rises to peak in the final quarter of 2022 and decline gradually during 2023, though remain above the 2% target. We are forecasting that **inflation** will average around 9.1% in 2022 and 7.5% in 2023.

UK GDP forecasts (%)	2021	2022	2023
UK GDP growth	7.5	4.4	-0.9
Private Consumption	6.2	4.8	-1.0
Investment	5.6	5.8	-1.6
Government Consumption	12.6	1.8	4.5
Exports of Goods and Services	-0.3	8.9	2.5
Imports of Goods and Services	2.8	12.7	0.6

Sources: ONS, Oxford Economics, Danske Bank Analysis



Sources: ONS, Oxford Economics, Danske Bank Analysis

Northern Ireland sectoral outlook

Economic output expected to fall in 2023, with consumer-focused sectors projected to face challenges

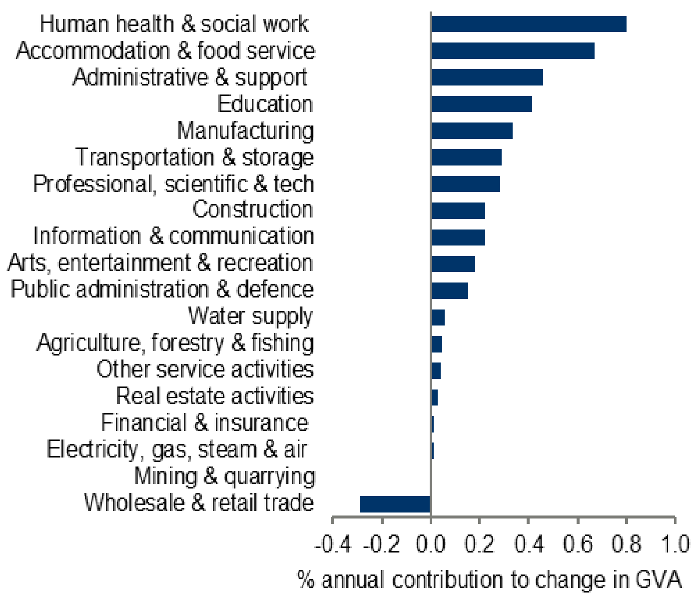
The Northern Ireland Composite Economic Index fell slightly in the second quarter of 2022 and we expect economic output to decline in the third quarter of the year, similar to the wider UK economy. The public holiday for the funeral of Queen Elizabeth II is likely to contribute to a decline in output in Northern Ireland in quarter three, but the negative impact of high inflation is expected to be a bigger driver. The final quarter of the year should have a normal complement of working days, so this will provide some support to output levels relative to quarter three, but we still expect economic activity to decline. For 2022, we are forecasting that economic output in Northern Ireland will grow by around 4.0% but this relatively strong growth rate reflects an element of recovery from the coronavirus pandemic. With regards to 2023, the outlook is highly uncertain but we have revised our forecast for the annual change in output downwards and now expect the Northern Ireland economy to contract by about 1.0% next year.

Given the adverse impacts of high inflation on household purchasing power and the falls in consumer confidence shown by the Danske Bank Northern Ireland Consumer Confidence Index, sectors of the economy which are reliant on consumer spending are likely to face a challenging 2023. We are forecasting that the **wholesale & retail trade** sector will experience the deepest contraction of around 4.5% next year, after experincing an expected fall in output of around 2.2% in 2022. Given the sector is the largest in the economy, it is the main contributor to the overall decline in output next year. Other consumer-focused sectors including **accommodation & food services** and **arts, entertainment & recreation** are also projected to experience falls in output in 2023 following very strong rates of growth in 2022 as annual output recovered from the impacts of the pandemic. Activity levels are forecast to decline by around 3.9% and 3.8% respectively in the two sectors next year.

The **manufacturing** sector is projected to grow by around 2.1% this year before experiencing a decline in output of about 1.1% in 2023. Weak demand for consumer goods is adding to the ongoing pressures facing the sector from high energy and raw material costs and disruption to supply chains. Inflation is also likely to be having adverse impacts on the **construction** sector. Output in the sector is forecast to fall by 1.0% next year, following expected growth of about 3.0% this year. Falls in activity in 2023 are also forecast in the **real estate activities** and **financial & insurance** sectors.

The **information & communication** and **professional, scientific & technical services** sectors – traditionally strong performers in Northern Ireland and less exposed to the squeeze on consumer spending – are both forecast to grow by 0.1% next year. Although this would represent a stronger performance than that of the overall economy, it is a significant slowdown compared with their expected 2022 growth rates. **Education** and **administrative & support services** are among the other sectors forecast to avoid a decline in annual output in 2023.

Sector contributions to GVA growth in 2022



Sources: Oxford Economics, Danske Bank Analysis

GVA (%)	2022	2023
Accommodation & food service	27.8	-3.9
Arts, entertainment & recreation	20.8	-3.8
Administrative & support	14.6	0.2
Transportation & storage	9.0	0.0
Human health & social work	8.0	0.0
Education	7.6	0.3
Professional, scientific & tech	6.9	0.1
Information & communication	5.8	0.1
Water supply	3.6	0.0
Construction	3.0	-1.0
Mining & quarrying	2.9	-0.6
Other service activities	2.6	-0.4
Agriculture, forestry & fishing	2.4	0.1
Manufacturing	2.1	-1.1
Public administration & defence	2.1	0.0
Electricity, gas, steam & air	0.5	0.0
Financial & insurance	0.3	-0.2
Real estate activities	0.2	-0.5
Wholesale & retail trade	-2.2	-4.5
Total	**4.0**	**-1.0**

Sources: Oxford Economics, Danske Bank Analysis

Northern Ireland labour market outlook

After a strong expected performance for jobs growth in 2022, employment is forecast to fall next year

Despite the economic challenges and the high uncertainty levels, Northern Ireland's employment data has been relatively robust for most of this year and, as such, we are forecasting that the annual average number of employee jobs will increase by around 2.7% in 2022. However, the momentum in the labour market appears to be slowing as we head into 2023. With annual economic output expected to decline in 2023, we are projecting that the average number of jobs will fall by around 1.0% next year, a downward revision of 0.3 percentage points compared with our previous report.

The largest declines in output in 2023 are expected to occur in the consumer-focused parts of the economy and, as such, we expect these sectors to also experience declines in the number of employee jobs. Employment in the **wholesale & retail trade** sector is projected to decline by around 2.6% in 2023. For the **arts, entertainment & recreation** sector, employee jobs are projected to contract by 2.0%, following expected growth of 2.4% in 2022. The number of jobs in the **accommodation & food services** sector is also expected to decline in 2023, by around 1.7%.

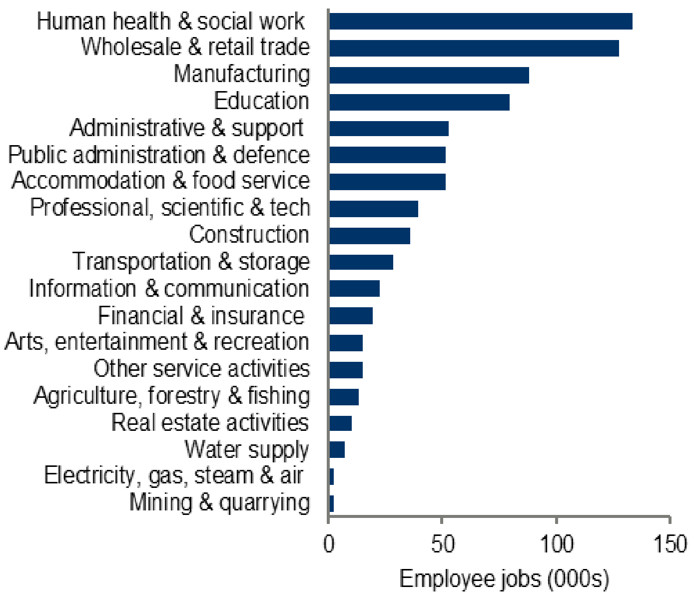
The **manufacturing** sector, which is experiencing cost challenges from high energy prices and is also likely to be impacted by the longer-term trend towards increased automation, is forecast to experience a decline in the number of jobs of around 2.2% in 2023, after projected growth of 1.9% in 2022. In addition to the four sectors already mentioned, **administrative & support services** is another sector expected to see significant job losses next year. The sector is forecast to experience a contraction of 1.7% in employment though it is worth highlighting that this sector includes recruitment agencies that employ staff which work in other industries.

An expected slowdown in housing market activity given the squeeze on household incomes, low confidence levels and the rise in interest rates, combined with a weaker outlook for overall investment activity, is expected to impact employment levels in the **construction** industry. The number of employee jobs in the sector is forecast to decrease by 0.6% in 2023, following projected growth of 4.7% this year. The **real estate activities** sector is also expected to see a decline in jobs next year, of around 0.5%.

With less reliance on consumer spending, the two sectors expected to experience the strongest rates of jobs growth next year are the **information & communication** and **professional, scientific & technical services** sectors. Annual employment in these sectors is projected to rise by 1.3% and 1.0% respectively in 2023, following expected growth of 0.6% and 5.4% in 2022.

Northern Ireland's unemployment rate in the July – September 2022 period was 3.0%, 0.3 percentage points higher than in the April – June period, but below both its long-term average and the UK rate of 3.6%. We are forecasting that unemployment in Northern Ireland will average around 2.9% in 2022, before increasing to an annual average of 3.9% in 2023 as employment levels decline.

Employee jobs per sector in 2022



Sources: Oxford Economics, Dankse Bank Analysis

Employee jobs (%)	2022	2023
Accommodation & food service	6.1	-1.7
Professional, scientific & tech	5.4	1.0
Construction	4.7	-0.6
Education	4.3	-0.2
Electricity, gas, steam & air	4.1	-0.9
Financial & insurance	3.7	-0.5
Wholesale & retail trade	3.5	-2.6
Transportation & storage	3.2	-0.5
Administrative & support	2.4	-1.7
Arts, entertainment & recreation	2.4	-2.0
Water supply	2.4	-0.3
Public administration & defence	2.1	-0.5
Manufacturing	1.9	-2.2
Other service activities	1.2	-0.4
Information & communication	0.6	1.3
Human health & social work	0.1	-0.3
Real estate activities	0.0	-0.5
Agriculture, forestry & fishing	-0.9	0.1
Mining & quarrying	-1.9	-0.4
Total	**2.7**	**-1.0**

Sources: 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** – Inflation in the UK is at a multi-decade high and while we think it will peak in the final quarter of 2022, the decline back towards its 2% target is likely to be gradual. If inflation were to decline more slowly than anticipated and run higher than forecast, it has the potential to constrain economic activity even further. Factors which could see this come about include firms having to raise prices in response to higher costs such as energy costs, rising wages feeding into increased prices or if supply chain issues begin to become more widespread. More prolonged inflation could also mean that the Bank of England's Monetary Policy Committee would need to increase Bank Rate even higher than the 4.00% peak that we expect in an attempt to contain the rate of price rises and that could further dampen economic output.

- **Prolonged political uncertainty, including around the implementation of the post-Brexit trading arrangements** – Northern Ireland has not had a fully functioning Executive since February 2022 and Ministers are no longer in place, with issues around the implementation of the Northern Ireland Protocol the main factor preventing the re-establishment of the political institutions. Renewed attempts appear to be underway to find a negotiated solution to the issues surrounding the Protocol but finding a solution that is acceptable to all parties and is also consistent with the practicalities involved in international trade will not be straightforward. The current situation is fragile and remains a source of uncertainty for businesses and consumers. In addition, the lack of an Executive has also created uncertainty around wider policymaking in Northern Ireland.

- **Skills shortages and recruitment challenges** – Across the economy, many businesses are facing difficulties when it comes to finding and recruiting the skills they need to bring into their organisations. In the *2022 Q3 Quarterly Economic Survey* published by the *Northern Ireland Chamber of Commerce and Industry* and *BDO* it was reported that 93% of the manufacturing businesses and 84% of the services firms that responded to the survey were facing difficulties when it came to recruiting staff. While we expect unemployment to rise, this competition for workers is one of the reasons that we think the extent of the increase may be lower than what might typically be assumed given the challenging economic environment. Skills shortages and recruitment challenges could weigh on economic activity levels and taking steps to address this challenge, alongside other labour market issues such as low productivity and high levels of economic inactivity, could be pursued in an attempt to improve the rates of potential economic growth over the longer-term.

In addition, a key global uncertainty relates to:

- **The war in Ukraine** – The economic consequences of the war in Ukraine on the UK and Northern Ireland economies have included higher commodity prices, in particular for oil and gas, and disruption to supplies of inputs from Russia and Ukraine. The war has also likely weighed on consumer and business sentiment. The exact length and outcome of the war remain uncertain. However, if the war and the associated geopolitical tensions were to be particularly prolonged or to escalate further, in addition to the tragic human consequences that could ensue, the performance of the economy could also be negatively affected.

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