October 2022

Northern Ireland Quarterly Sectoral Forecasts

Forecast summary

The performance of the UK and Northern Ireland economies weakened in the second quarter of 2022 when compared with the first quarter of the year and, looking forward, there are a number of headwinds that are likely to weigh on output levels. High inflation is continuing to squeeze household spending power and erode consumer confidence with the rate of price rises expected to remain elevated over the coming months. Increased prices are also putting pressure on businesses' costs and monetary policy is tightening. In light of these challenges, we now expect the Northern Ireland economy to grow by around 4.1% in 2022 but contract by about 0.5% in 2023. It's important to note that the economic outlook is particularly uncertain at this time and that these forecasts reflect economic data and events up to 13th October 2022.

Economic outlook weakening as high inflation and low confidence are weighing on demand

The UK and Northern Ireland economies both grew in the first quarter of 2022. UK GDP expanded by 0.7% and the Northern Ireland Composite Economic Index increased by 0.6%. In quarter two, however, the performance of the two economies weakened. The revised UK GDP data showed a quarterly increase in output of just 0.2% as high inflation squeezed household spending power and the winding down of Covid-related activities impacted output levels. In Northern Ireland, the Composite Economic Index contracted by 0.1%.

We expect the UK and Northern Ireland economies to continue weakening in the third and fourth quarters of the year as high inflation and low consumer confidence weigh on household spending. The cap on energy prices, announced by the UK Government in September, is expected to limit the peak in inflation and therefore provide some support to household spending levels relative to if prices had not been contained. The economic policy environment is also particularly fluid at this time with fiscal policy loosening but monetary policy becoming more contractionary.

Overall, and in annual terms, we are forecasting that the Northern Ireland economy will grow by around 4.1% in 2022 but contract by about 0.5% in 2023. It is important to note that the annual rate of economic expansion in 2022 reflects an element of recovery from the coronavirus pandemic. Our projection for next year represents a downward revision to our previous 2023 forecast that economic output would grow by around 1.0%.

The labour market remains resilient but economic headwinds are expected to begin to take their toll

Northern Ireland's labour market continues to perform relatively strongly despite the challenging economic backdrop. The Quarterly Employment Survey showed that the number of employee jobs increased by 1.4% in the first quarter of the year, and by a further 0.4% in quarter two, bringing the number of jobs to a record high of 797,840. The unemployment rate for June – August 2022 was 3.0%, up 0.4 percentage points from the previous three-month period but still low by historical standards. The more timely HMRC Pay As You Earn data showed that the number of payrolled employees decreased by 0.1% over the month but increased by 2.6% over the year in September 2022.

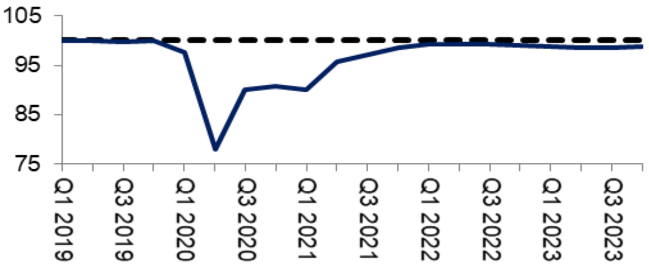
The strong jobs growth observed so far this year underpins our view that the annual average number of employee jobs in Northern Ireland could increase by around 2.6% in 2022. However, we expect the number of jobs to fall by about 0.7% next year as demand for labour is adversely impacted by businesses facing higher costs and household spending being squeezed. We are forecasting that the unemployment rate in Northern Ireland will average around 2.9% in 2022 and 3.7% in 2023.

Forecast summary (%)

	2021	2022	2023
UK GDP growth	7.5	4.4	-0.5
NI GVA growth	7.0	4.1	-0.5
NI consumer spending growth	5.8	4.6	-0.5
NI employee jobs growth	0.1	2.6	-0.7
NI unemployment rate	4.0	2.9	3.7
UK CPI inflation rate	2.6	9.0	6.0

Source: ONS, NISRA, 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 incomes and squeezing consumer spending

The annual UK CPI inflation rate declined slightly from 10.1% in July to 9.9% in August but remained close to five times the Bank of England's 2% inflation target. The cap on energy prices is expected to constrain the peak in inflation to somewhere between 10.5% and 11.0% in the final quarter of 2022. However, other factors including supply chain disruption, increases in food prices and domestic factors, such as wage increases, are also exerting upward pressure on prices. We are forecasting that inflation will average around 9.0% in 2022, up from our previous expectation of 8.5%. We expect inflation to fall as we move through 2023, with the 2-year household energy price cap helping to facilitate this, and are projecting that the annual average rate of price rises will be around 6% next year. High inflation is putting significant pressure on people's real incomes and, in Great Britain, real regular earnings (excluding bonuses) declined by 2.9% over the year to June – August 2022. While the pressure on household finances is likely to be lower than if there had not been an energy price cap, high inflation is still expected to weigh on real incomes with consumer spending likely to be squeezed throughout the remainder of this year and into 2023.

Changes to fiscal policy

During September, the UK Government announced a number of fiscal policy measures. Energy prices were capped for households for 2 years and for businesses for 6 months, with targeted supported expected to be provided to some firms after the 6-month period ends. The Government also announced a range of tax changes including the reversal of the 1.25 percentage point rise in National Insurance Contributions, the reversal of the planned increase in Corporation Tax and a cut in the basic rate of income tax from 20% to 19% to take effect in April 2023, alongside a number of other policy changes. These measures – especially the energy price cap – are expected to offer some support to the economy in the short-term. However, financial markets reacted negatively to the fiscal announcement given the potential implications for government borrowing and public debt, with the medium-term impacts of the policy announcement not yet clear.

Tighter monetary policy with further base rate rises expected

The Bank of England's Monetary Policy Committee increased Bank Rate by 50 basis points to 2.25% in September, the seventh meeting in a row at which the committee raised base rate. While the energy price cap is expected to limit the peak in inflation, the rate of price rises is still at particularly elevated levels. Other factors, such as higher food prices and wage increases in the tight labour market, are also putting upward pressure on prices and the tax cuts announced by the UK Government also have the potential to add to inflation meaning further rises in Bank Rate are expected. We think base rate could rise to around 4.0% in the first quarter of 2023 and this tightening of monetary policy is likely to offset some of the fiscal stimulus. With monetary and fiscal policy pulling in opposite directions, the economic policy environment is currently very uncertain.

Resilient labour market providing some support to consumers

While high inflation is putting household finances under pressure and squeezing spending power, the robustness of the labour market may give some support to consumers. The unemployment rate is quite low in both Northern Ireland and in the wider UK and while we expect unemployment to rise gradually over the rest of this year and into next year, 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 spending some support.

Extra trade frictions due to Brexit

Businesses across the UK are continuing to face barriers to trade following the UK's departure from the European Union. The implementation of the Northern Ireland Protocol has also led to new processes for local firms when purchasing certain goods from the rest of the UK and it is not yet clear how or when issues around the Protocol may be resolved.

The outlook for the UK economy

The UK economy grew by 0.7% in the first quarter of 2022 but by a slower 0.2% in the second quarter of the year. Within **private consumption**, real consumer spending grew by 0.1% compared with a rise of 0.6% in the previous quarter. High inflation squeezing household finances and the sharp drop in consumer confidence likely contributed to this slowdown in growth. **Government spending** decreased by 1.5% compared with the previous quarter with the winding down of Covid-19 testing and vaccinations contributing towards a decrease in health spending. **Total investment** declined by 1.4%, although business investment increased by 3.7% and government investment fell over the quarter. **Exports** increased by 3.6% and **imports** decreased by 1.5%, meaning net trade made a positive contribution to GDP after having made a negative one in the first quarter of the year.

The monthly GDP data showed that UK economic activity fell by 0.3% in August, after output had risen by 0.1% in July. **Production** output decreased by 1.8% in August, marking three monthly falls in a row. The **services** sector also experienced a 0.1% fall in output. However **construction** output grew by 0.4% in August. Given the fall in output in August and the additional bank holiday in September, we expect GDP to decline in the third quarter of the year.

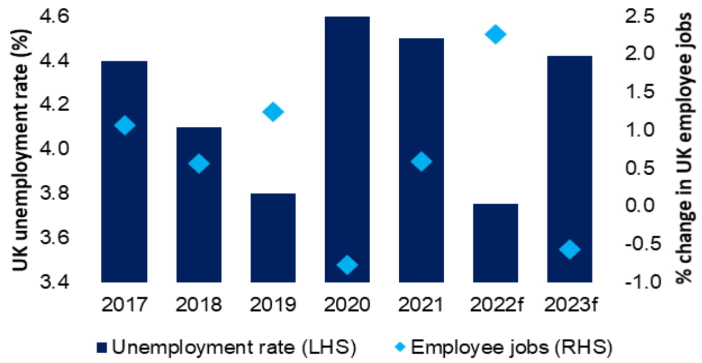
Our expectations for UK economic growth this year have been revised upwards but this is largely due to the impacts of the revisions to historical economic data. We now expect UK GDP to grow by around 4.4% in 2022, with growth concentrated in the first half of this year. However, our GDP forecast for 2023 has been revised substantially downwards to an annual decline of about 0.5%, with high inflation, low consumer confidence and rising interest rates among the factors expected to weigh on economic activity. We are forecasting that **private consumption** will grow by around 5.1% in 2022 but this high rate of expansion still reflects an element of recovery from the sharp fall during the pandemic and we expect annual consumption to decline by about 0.5% in 2023. We are also projecting that **investment** levels will grow by 5.4% this year but by just 0.3% next year.

The UK labour market remains relatively strong with the **unemployment rate** of 3.5% in June – August 2022 lower than in the preceding three-month period. The number of payrolled employees also rose by 0.2% in September. However, the **employment rate** in June – August was slightly lower than in the preceding period and, in the three months to September 2022, job vacancies decreased. Given the resilience of the labour market to date during 2022, we are forecasting that the annual average number of **employee jobs** in the UK will grow by around 2.3% in 2022, before declining by 0.6% in 2023, as hiring cools in line with weaker economic activity. This is expected to push up the annual average **unemployment rate** to 4.4% in 2023, from 3.8% this year.

UK **inflation** declined slightly in August 2022 to 9.9%, though the rate of price rises was still close to five times the Bank of England's two percent target rate. We expect **inflation** to peak in the final quarter of 2022 at around 10.5%-11.0%, with CPI projected to average around 9.0% in 2022 and 6.0% in 2023.

UK GDP forecasts (%)			
	2021	2022	2023
UK GDP growth	7.5	4.4	-0.5
Private Consumption	6.2	5.1	-0.5
Investment	5.6	5.4	0.3
Government Consumption	12.6	1.3	3.0
Exports of Goods and Services	-0.3	6.7	4.6
Imports of Goods and Services	2.8	14.0	0.4

Source: ONS, Oxford Economics, Danske Bank Analysis



Source: ONS, Oxford Economics, Danske Bank Analysis

Northern Ireland sectoral outlook

Economic performance expected to weaken as inflation, low confidence and monetary policy weigh on demand

Economic output in Northern Ireland increased in the first quarter of 2022 but the Composite Economic Index declined in the second quarter of the year. The main driver behind this softening is likely to have been the negative impact of high inflation and lower confidence levels on consumer spending, but other factors such as the end of free Covid-19 testing and the extra bank holiday at the start of June also likely dampened activity. Given the revisions to the historical UK GDP data published by the ONS, we have re-estimated levels of gross value added in Northern Ireland and this has led to an upward revision to our forecast for economic growth in 2022. We are now projecting that the Northern Ireland economy will expand by around 4.1% in 2022 but then contract by about 0.5% in 2023.

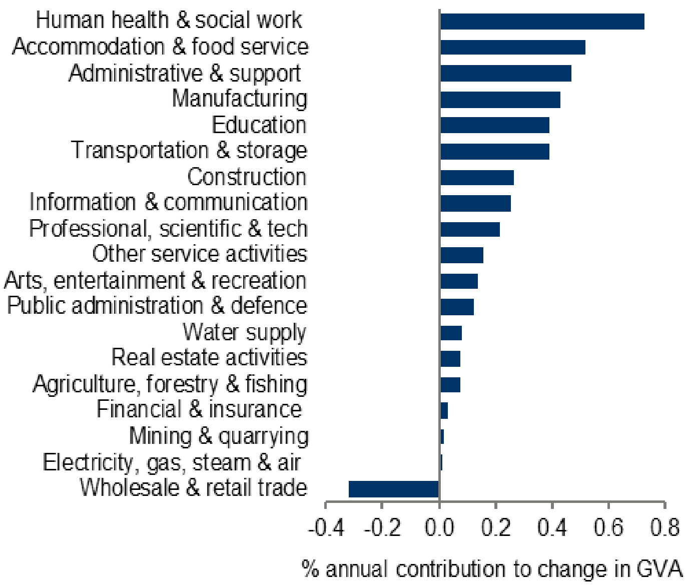
Accommodation & food services is forecast to be the fastest growing sector in Northern Ireland in 2022, growing by around 23.3% this year. The sector's output is estimated to have fallen substantially in 2020 as a result of the pandemic, giving it greater scope for recovery in the following years. The **arts, entertainment & recreation** sector is also expected to exhibit strong growth of about 13.9% as it continues to recover from the pandemic. These high growth rates largely reflect relatively low levels of activity in 2021, and the associated rebound effects in 2022 are likely to mask the impact of weaker consumer spending on these sectors. The squeeze on household purchasing power is more evident in the forecasts for 2023 when output in both sectors is expected to fall.

Expected output growth in the **wholesale & retail trade** sector has been revised down to -2.2% in 2022 and -3.9% in 2023, meaning it is likely to be the weakest-performing sector this year and next. The latest Danske Bank Consumer Confidence Index showed a sharp quarterly decline in consumer confidence in 2022 Q2, with the impact of higher prices on household finances the main cause of the decline in sentiment.

The **manufacturing** sector is projected to lag the overall economy in 2022, with output levels forecast to increase by 3.1%. Inflationary pressures on raw inputs, energy and wages, as well as global supply chain issues and skills shortages, are expected to continue to hold back the sector. These issues are also expected to affect the outlook for the **construction** industry, in which we are forecasting growth of around 3.8% this year.

The **professional, scientific & technical services** and **information & communication** sectors – traditionally strong performers in Northern Ireland in the years prior to the pandemic – are expected to grow by about 5.3% and 7.4% respectively in 2022. In 2023, both sectors are expected to experience slight increases in annual activity.

Sector contributions to GVA growth in 2022



Source: Oxford Economics, Danske Bank Analysis

GVA (%)	2022	2023
Accommodation & food service	23.3	-3.0
Administrative & support	15.9	1.1
Arts, entertainment & recreation	13.9	-2.3
Transportation & storage	9.5	0.4
Other service activities	8.9	0.9
Education	8.1	0.7
Information & communication	7.4	0.3
Human health & social work	6.4	0.1
Water supply	5.9	0.3
Professional, scientific & tech	5.3	0.1
Mining & quarrying	4.9	0.0
Construction	3.8	-0.4
Agriculture, forestry & fishing	3.5	0.3
Manufacturing	3.1	0.0
Public administration & defence	1.6	0.3
Financial & insurance	0.8	0.0
Electricity, gas, steam & air	0.8	0.5
Real estate activities	0.6	-0.6
Wholesale & retail trade	-2.2	-3.9
Total	**4.1**	**-0.5**

Source: Oxford Economics, Danske Bank Analysis

Northern Ireland labour market outlook

Demand for labour remains resilient but the economic headwinds are likely to have an impact

Despite the weakening economic outlook, Northern Ireland's labour market picture remains relatively encouraging at this point. The employment data has continued to be strong and our expectation for employment levels in 2022 is higher than in our previous report, with the annual average number of employee jobs now forecast to increase by 2.6%, compared with 1.2% previously. However, the number of jobs is forecast to fall by around 0.7% next year as the impact of the slowing economy feeds through to the labour market.

After experiencing back-to-back contractions in employment in 2020 and 2021, the **accommodation & food services** sector is expected to experience the fastest rate of jobs growth across the sectors in 2022, of around 6.0%. **Wholesale & retail trade** – Northern Ireland's second largest sector in employment terms – is also projected to see robust growth, of around 3.6% this year. Similar to our output forecasts, the relatively strong jobs growth expected for these largely consumer-focused sectors at a time when high inflation and low confidence are weighing down on household spending reflects their continued recovery from the impacts of the pandemic. The **arts, entertainment & recreation** sector, which was also adversely impacted by pandemic restrictions, is forecast to see employee jobs growth of about 2.1% this year.

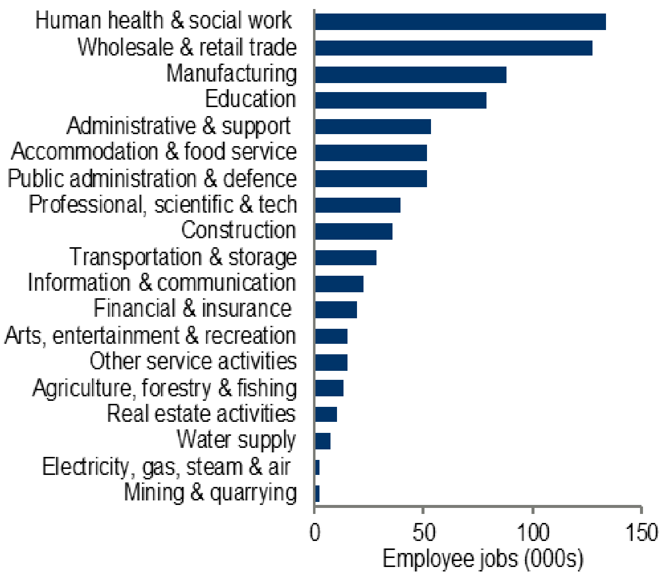
Professional, scientific & technical services is forecast to be the second fastest growing sector in terms of employment this year, with the number of jobs projected to expand by around 5.1%. After growth of 6.6% in 2021, employment in the **information & communication** sector is expected to slow this year, down to just 0.2%. Both of these business services sectors are projected to experience jobs growth next year, but the former's growth is expected to be notably slower than its growth in 2022.

The number of employee jobs in the **manufacturing** sector is forecast to increase by 2.0% in 2022, but then decline in 2023, as the weaker economic outlook, skills shortages and trends towards increased automation reduce employment levels. Employment in the **construction** sector is projected to rise by 4.6% this year but decline by 0.6% next year.

The number of jobs in the **public administration & defence** sector is projected to grow by about 2.0% in 2022, followed by a 0.7% fall in 2023. The **education** sector is forecast to follow a similar path with growth of 4.2% this year, before a decline of 0.6% in 2023. After expanding in the pandemic years of 2020 and 2021, the number of jobs in the **human health & social work** sector is expected to decrease by around 0.2% in 2022 and 0.5% in 2023.

Northern Ireland's unemployment rate in the June – August 2022 period was 3.0%, below both its long-term average and the UK rate of 3.5%. We are forecasting that unemployment in Northern Ireland will average around 2.9% in 2022, before increasing to 3.7% in 2023 as employment levels decline.

Employee jobs per sector in 2022



Source: Oxford Economics, Danske Bank Analysis

Employee jobs (%)	2022	2023
Accommodation & food service	6.0	-0.8
Professional, scientific & tech	5.1	0.7
Construction	4.6	-0.6
Electricity, gas, steam & air	4.2	-0.8
Education	4.2	-0.6
Financial & insurance	3.6	-0.4
Wholesale & retail trade	3.6	-1.1
Transportation & storage	3.2	0.2
Administrative & support	2.5	-0.8
Water supply	2.5	-0.2
Arts, entertainment & recreation	2.1	-1.4
Manufacturing	2.0	-1.8
Public administration & defence	2.0	-0.7
Other service activities	1.1	-0.7
Information & communication	0.2	1.2
Human health & social work	-0.2	-0.5
Real estate activities	-0.2	-0.8
Agriculture, forestry & fishing	-0.9	0.1
Mining & quarrying	-1.8	-0.3
Total	**2.6**	**-0.7**

Source: Oxford Economics, Danske Bank Analysis

Risks and uncertainties

While there is always uncertainty associated with economic forecasts, the extent of the risks and uncertainties around these projections is considered to be higher than is normally the case. The main sources of uncertainty include:

- **Persistent inflation** – Inflation in the UK is considerably above the Bank of England's 2% target rate and while the energy price cap is likely to contribute to the rate of price rises coming down in 2023, other factors are still exerting upward pressure on prices. Food price inflation increased to 13.4% in August, the tight labour market and higher wages could exert upward pressure on prices and the fiscal changes announced by the Government could also be inflationary. If inflation runs higher than forecast and remains at more elevated levels for a longer period of time, it has the potential to constrain economic growth even further. More prolonged inflation could also mean that Bank Rate would need to be increased even higher to contain the rate of price rises and that would further dampen economic activity.

- **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 with issues around the implementation of the Northern Ireland Protocol the main factor preventing the re-establishment of the political institutions. With the new Prime Minister now in place, renewed attempts to find a negotiated solution to these issues appear to be underway but finding a solution that is acceptable to all parties and is also consistent with the practicalities involved in global trade will not be easy. The current situation is fragile and remains a source of uncertainty for businesses and consumers.

- **Uncertainty around economic policy** – Following the UK Government's fiscal announcement in September 2022, the economic policy environment has become more uncertain with fiscal policy and monetary policy seemingly pulling in opposite directions. If this uncertainty were to continue for a prolonged period of time that could adversely impact confidence levels across the economy.

- **Coronavirus** – While the risk to the economy posed by coronavirus appears to be smaller now than during the last two years, there remains a possibility that new variants of the virus may emerge. If these were to result in more severe illness and put more strain on the healthcare system, then it may be necessary to reinstate some coronavirus restrictions, and this would likely have adverse consequences for economic activity levels.

In addition, a key global uncertainty relates to:

- **The war in Ukraine** – The economic impacts 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 some inputs. The war has also likely weighed on household and business sentiment. How the crisis evolves from here remains uncertain. However, if the war and the associated geopolitical uncertainty 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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This report takes account of events and economic data published up to Thursday 13th October 2022.

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

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Contact details

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