

Northern Bank Quarterly
Economic Overview
Quarter 2 2011



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Summary of Quarter 2 2011 and economic outlook:

Global: The global recovery entered a soft patch at the end of Quarter 2 due to strong headwinds from higher oil prices, the Japanese earthquake and policy tightening in Asia. All of these factors have caused another global growth scare. The global inflation scare that prevailed in Quarter 1 has faded quickly as growth fears dominate. Global headline inflation is expected to fall sharply in the second part of the year and into 2012. However, as headwinds fade, we expect the global recovery to revive towards the end of this year and continue that growth into 2012. The recovery will continue to be moderate and be fragile in the advanced countries.

The US economy was particularly affected by higher oil prices in early 2011 and, despite a deal on its debt limit being reached at the last minute; it is still at risk of a downgrade in the months ahead. The systematic risks of downgrading US government debt are currently very difficult to assess. The euro area being an export-led economy has however been less hurt by the rise in oil prices. Following a strong start to 2011 we revise up European GDP growth this year to 2.2% from the previous 2.0%. Although the European recovery will slow somewhat in the rest of 2011 as the European debt crisis will continue and add uncertainty to the overall outlook.

In Asia, China has moved in line with expectations and slowed from the peak in growth in Quarter 1. Following the soft patch we expect the economy to pick up speed in late 2011 as lower inflation underpins consumption.

In terms of global interest rates, we do not expect Fed to embark on Quantitative Easing 3 and we expect the first hike in mid-2012. ECB is expected to deliver another three rate hikes before pausing. In China monetary policy will be tightened a bit further before going on hold during Q3.

United Kingdom: Provisional figures from the Office of National Statistics revealed that the United Kingdom grew by a mere 0.2 percent in Quarter 2, after 0.5 percent in Quarter 1. We continue to expect modest growth only going forward and foresee little or possibly no monetary tightening this year. Inflation in the UK is expected to remain elevated and this will continue to hamper household confidence and spending levels.

Northern Ireland: The Northern Ireland economy has remained fairly static over Quarter 2, with little evidence of new investment, but no significant deterioration either. The ILO

unemployment rate was 7.1 percent during March-May 11, a level which is significantly lower than many other international competitors. But Northern Ireland still continues to suffer from a growing pool of long-term unemployed and high inactivity levels. The latest Northern Bank / Oxford Economics data suggests that the local economy grew by a mere 0.3 percent in Quarter 2.

Northern Ireland Economic Summary		2009	2010	2011
Output	Northern Ireland GVA growth Annual Growth	-3.8%	1.3%	1.1%
	National annual GDP growth Annual growth	-4.6%	1.8%	1.5
Employment rate [March-May]		744,000 65.5%	776,000 68.3%	803,000 68.0%
Unemployment	ILO rate [March-May]	50,000 6.3%	59,000 7.1%	61,000 7.1%
	Claimant count [June]]	48,000 5.5%	56,100 6.3%	59,700 6.7%
Inflation	[CPI Q2] (y/y change)	2.1%	3.4%	4.4%
Interest Rate	[Bank of England official rate March]	0.5%	0.5%	0.5%

1. Gross output estimates

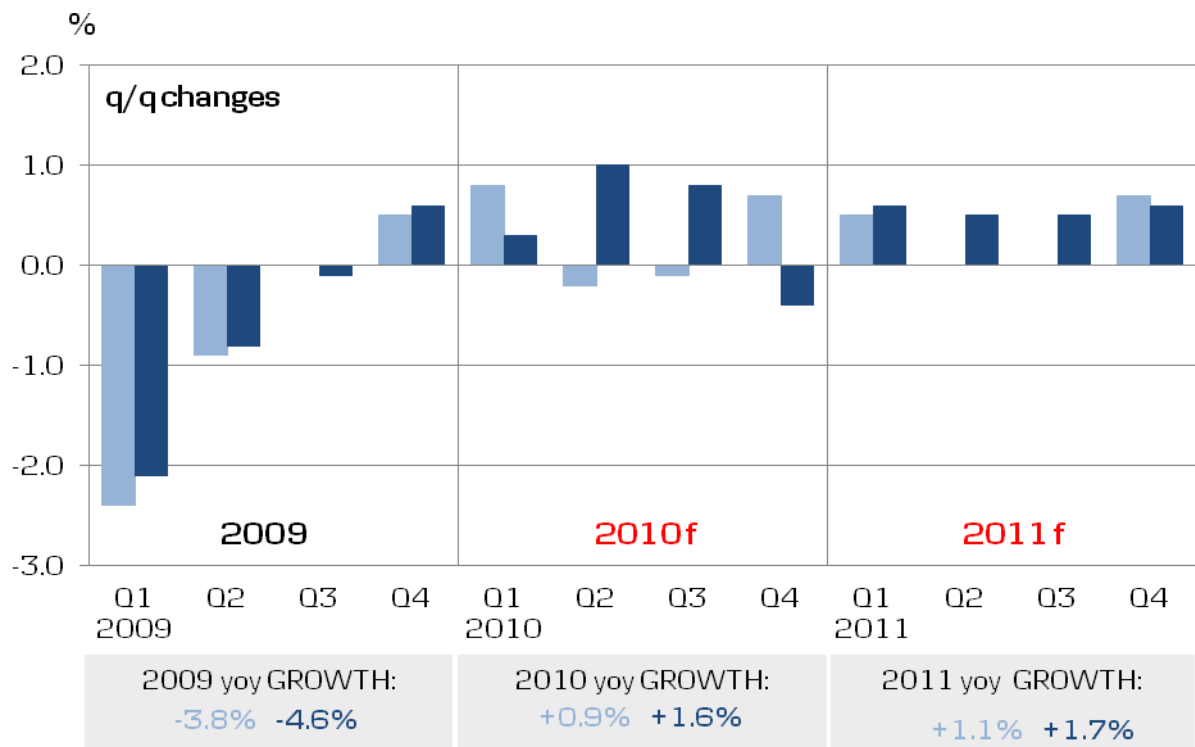
GDP United Kingdom

Provisional estimates from the Office for National Statistics (ONS) show that UK GDP grew by 0.2% in the Quarter 2 2011, compared with growth of 0.5% in the previous quarter. The latest Oxford Economics / Northern Bank, Sectoral Forecast report estimates that the annual growth rate for the UK economy in 2011 would be 1.5 percent year on year.

Economic Growth forecast for Northern Ireland

The Northern Bank/Oxford Economics Quarterly Sectoral Forecast report (April 2011) estimates that the local economy will grow by 1.1% over 2011 [see *Figure 1*]. Northern Ireland has seen a strong recovery in its manufacturing base, but other sectors such as construction and retail continue to show weak performances.

Figure 1.
Oxford Economics Q2 estimates and forecast of GVA growth in Northern Ireland and UK. (2009 - 2011).



Source: NorthernBank/OxfordEconomics.

■ Northern Ireland ■ UK

N.B.: Data for Northern Ireland output are available in the form of GVA (Gross value added), where GDP = GVA + Taxes - Subsidies on products (the latter two items are available only at a national level).

2. Labour market

Employment

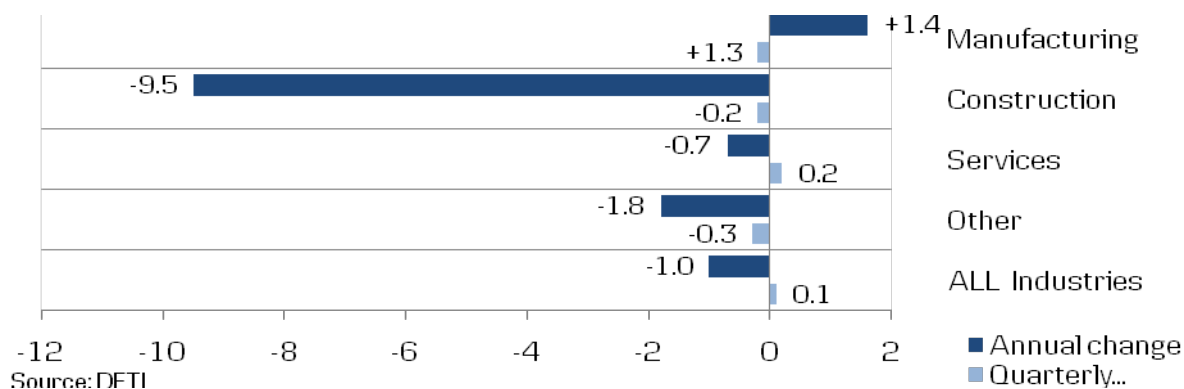
The latest *Monthly Labour Market Report* from the Northern Ireland Statistics & Research Agency (NISRA) shows that the number of people in employment in Northern Ireland during the three-month period March-May 2011 was estimated to be 803,000, equal to 68% of people aged 16-64. This represented an increase of 22,000 over the quarter and 29,000 over the year.

The Northern Ireland employment rate remained lower than the UK average 70.7% and was the second lowest of the twelve UK regions.

Sectoral employment data (published in July) for the Dec 10 - Mar 2011 period showed that the local manufacturing sector employed 160 less people over the quarter and Construction sector also saw a quarterly employment contraction of 60 people. There was an increase of 870 in employment in Services over the quarter.

Over the year manufacturing sector employment rose by 1.6%, while construction employment shrank by 9.5 percent. [see *Figure 2*].

Figure 2.
Employee jobs in Northern Ireland: Annual and quarterly changes by industry.
(March 2011).



Vacancies

The level of unfilled vacancies reported to the Department of Enterprise Trade and Investment (DETI) in the period ending 6^h May 2011 was 3,094, a decrease of 32 per cent relative to the same period last year, when vacancies stood at 4,242.

Labour Market Inactivity

The seasonally adjusted number of economically inactive persons in Northern Ireland in the period March-May 2011 was estimated at 540,000. The economic inactivity level decreased by 19,000 over the quarter and the year.

The working-age economic inactivity rate for Northern Ireland stands at 26.7%, significantly higher than the UK average (23.2%) and the second highest of the twelve UK regions.

Unemployment

- **Claimant Count (June 2011)**

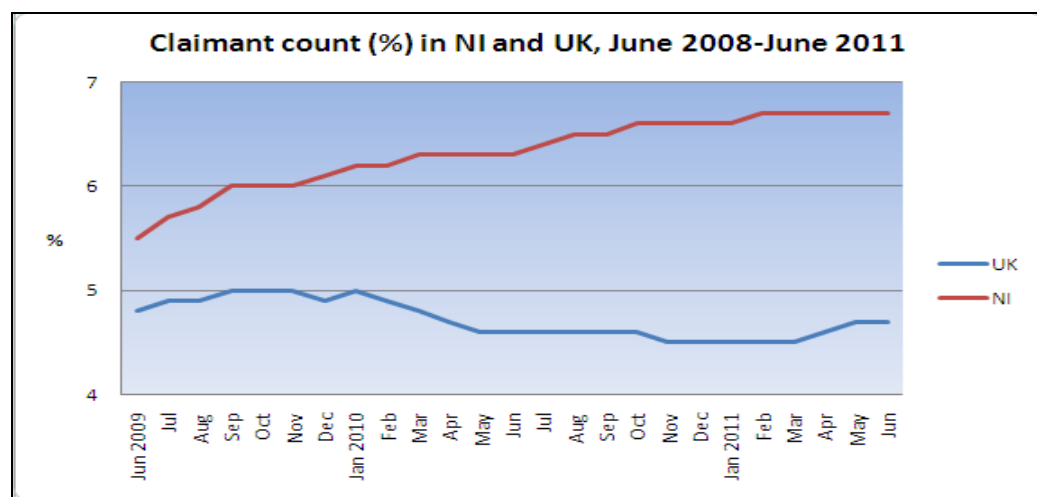
NISRA has reported that the seasonally adjusted claimant count in NI increased by 400 over the month to June 2011, it now stands at 59,700.

The local claimant count rate was 6.7% of the workforce, up 0.4 points from June 2010, and represents an increase of 3,600 in the number of claimants over the year [see Table 2].

In the UK, the claimant count rose by 63,900 in the second quarter 2011 and now sits at 1.52 million. The UK claimant count rate in June stood at 4.7%, up only 0.1 percentage points from a year earlier.

	Level Jun-2010	3-month change (level)	Annual change (level)	Rate % Jun-2011	Rate % Jun-2010
Northern Ireland	59,700	+700	+3,600	6.7%	6.3%
UK	1,520,100	+63,900	+50,900	4.7%	4.6%

Figure 3. :Claimant count rate in Northern Ireland and UK (June 2009 - June 2011).



- *ILO Quarterly Unemployment Rate (March-May 2011)*

The International Labour Organisation (ILO) seasonally adjusted unemployment rate for Northern Ireland was 7.1% in the three-month period March-May 2011. This represents a fall of 0.2 percentage point over the quarter and is unchanged relative to one year ago [see [Table 3](#)].

The Northern Ireland ILO unemployment level was estimated to be 61,000 in March-May, this was unchanged over the quarter but up 2,000 over the year.

The ILO unemployment rate for the UK was higher at 7.7% in the same period. The number of jobseekers at the national level fell by 26,000 over the quarter to reach 2.45 million.

	Level Mar-May 2011	3-month change (level)	Annual change (level)	Rate % Mar-May 2011	Rate % Mar-May 2010
Northern Ireland	61,000	0	+2,000	7.1%	7.0%
UK	2,450,000	-26,000	-23,000	7.7%	7.8%

See [Figure 4](#) below for the long-term trend in quarterly unemployment rates for both Northern Ireland and the UK as a whole.

Figure 4.
Historical unemployment in Northern Ireland and UK (March-May rates 1996-2011)

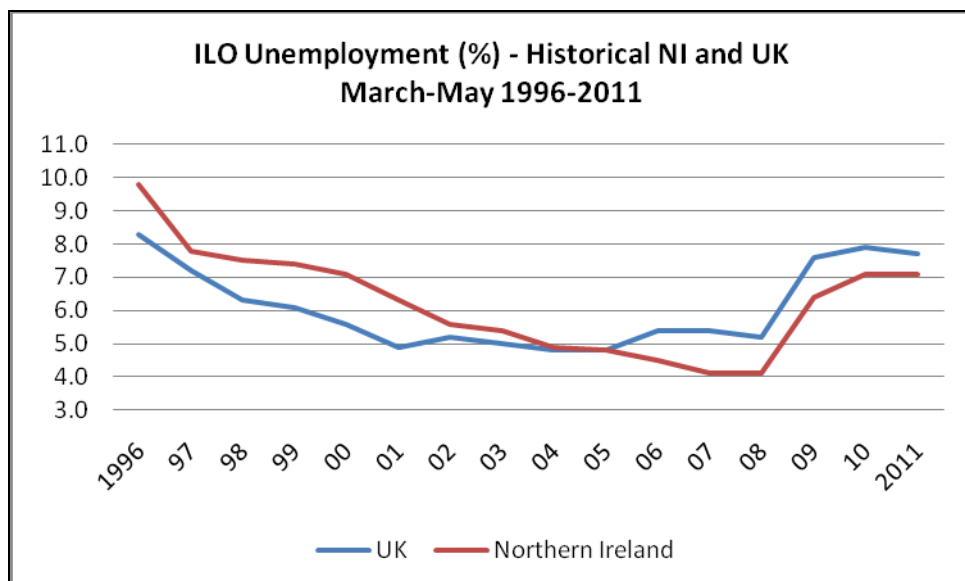
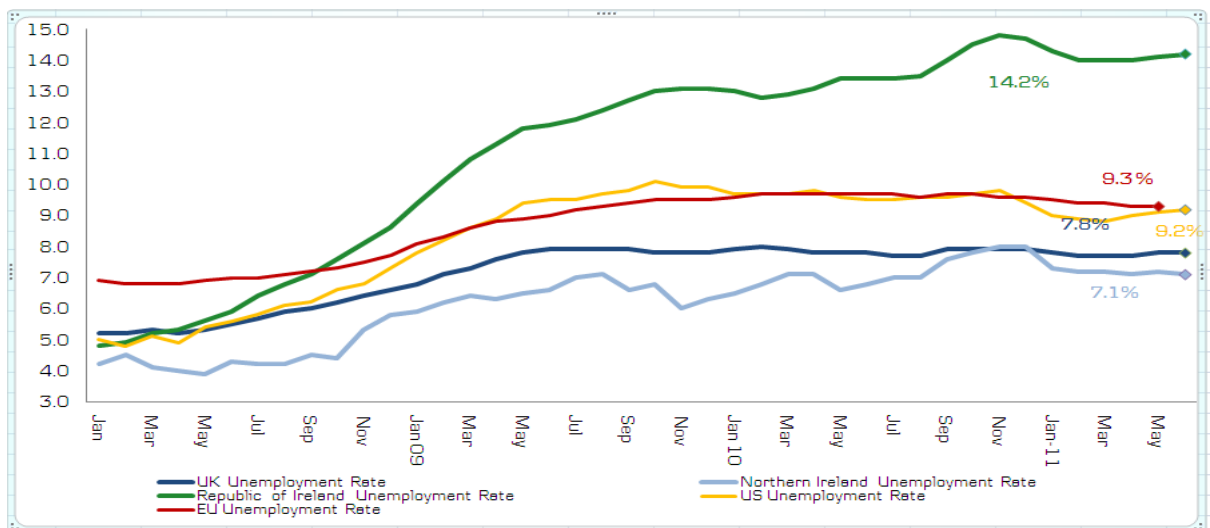


Figure 5 below shows the Northern Ireland and UK monthly ILO unemployment levels from 2008 onwards. Current levels remain well below levels in the USA, Eurozone and the Republic of Ireland.

Figure 5.
ILO Unemployment in Northern Ireland, UK compared to international comparators. (Jan 2008 - May/June 2011).



Redundancies

The Department of Enterprise, Trade and Investment (DETI) was notified of 224 confirmed redundancies in the month of June 2011, compared with 136 one year earlier. Quarter 2 saw the Department being notified of 507 confirmed redundancies, which was a fall of nearly 4 percent from the previous quarter. (See Table 4)

There have been a total of 929 confirmed redundancies from January 2011 to June 2011, a decrease of 15% from the previous year (1,099).

When examined at the District Council level, the majority of redundancies over the last year have occurred in the Belfast District Council area (32.3%) (623).

Table 4 below shows a breakdown of redundancies by industrial sector during Q2 2011 compared with Q2 2010.

Table 4. Redundancies in Northern Ireland.				
Industrial sector	Q2 2011		Q2 2010	
	number	%	number	%
Agriculture, Forestry and Fishing	-	-	-	-
Mining and Quarrying	-	-	-	-
Manufacturing	151	30%	134	25%
Electricity, Gas, Air Conditioning supply	3	1%	-	-
Water supply, sewerage, waste management	-	-	19	4%
Construction	12	2%	50	9%
Wholesale and Retail Trade	-	-	217	41%
Transport	44	9%	5	1%
Hospitality (Accommodation and Food service)	-	-	8	2%
Information and Communication	57	11%	21	4%
Financials and Insurance	164	32%	73	14%
Real Estate activities	-	-	-	-
Professional, scientific and technical activities	2	0.5%	-	-
Administrative and support service activities	5	1%	-	-
Public Administration	22	4%	1	0%
Education	45	9%	-	-
Health and Social Work	2	0.5%	-	-
Total	507	100%	528	100%

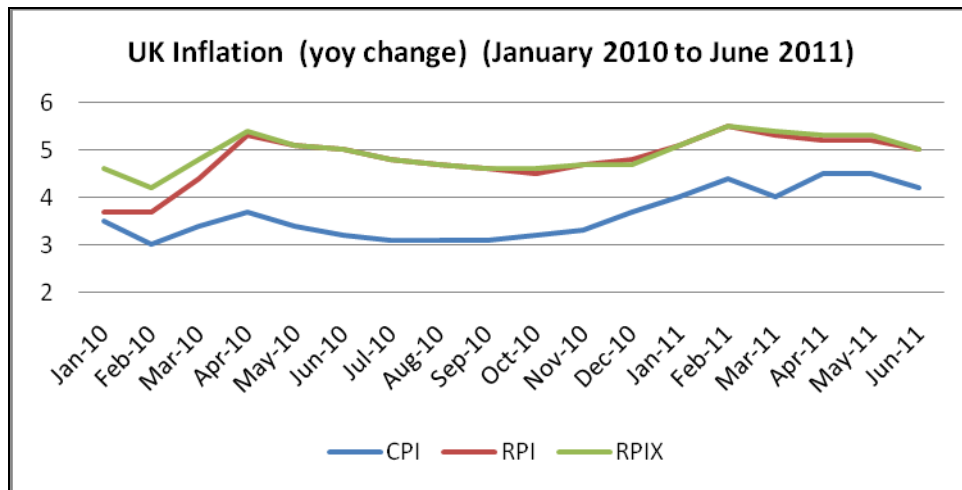
3. Inflation

Consumer price indices

In Quarter 2 2011 UK inflation levels remained well above the Bank of England's target level at 4.4% y/y, with the June figure sitting at +4.2% [see [Figure 6](#)]. This compares to the average inflation rate of 3.4 percent in Quarter 2 2010. The elevated inflation rate reflects the temporary impacts of three factors: the increase in VAT to 20%; higher energy prices; an higher import costs.

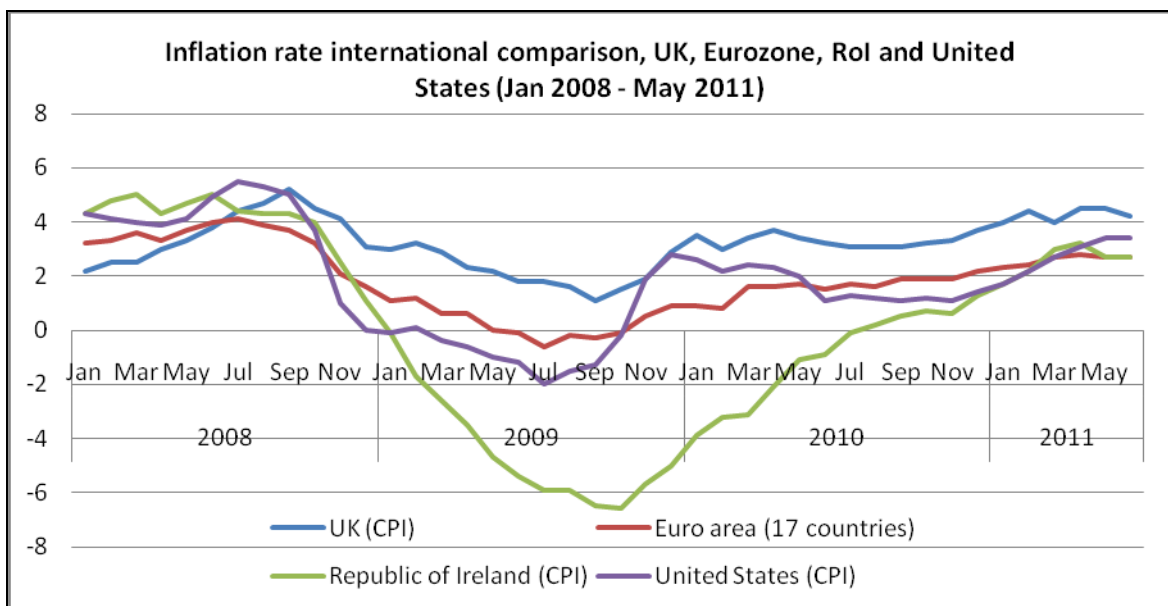
The RPI and RPIX indices (the latter excludes mortgage interest payments) averaged 5.2% in Q2 2011, compared with 5.3% in the previous quarter. The two indices have both maintained this elevated trend since mid-2010.

Figure 6.



Source: Office of National Statistics.

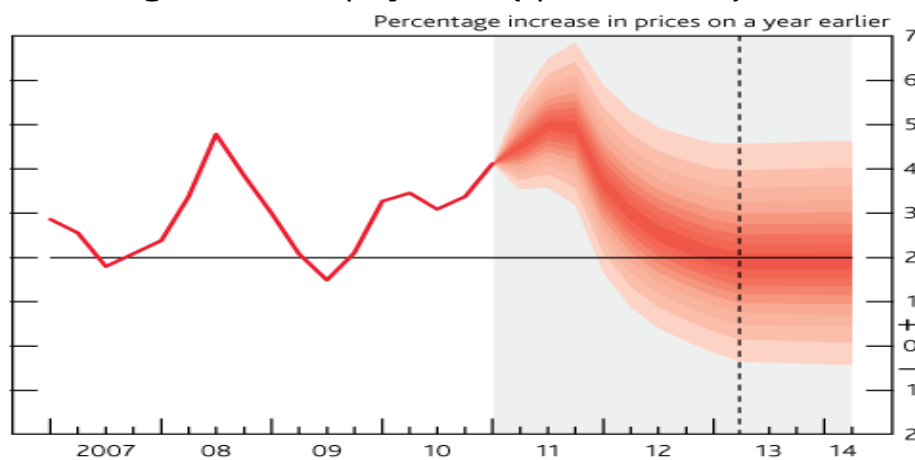
[Figure 7](#) presents an international comparison of consumer price growth since 2008.



Inflation forecast

According to Bank of England's "Inflation Report" published in May 2011, the UK inflation rate will most probably reach 5 percent this year and it is more likely than not to remain above the target rate throughout 2012. However, inflation is set to fall back in 2012 and into 2013 as the temporary impact from VAT, energy and import prices wanes and some downward pressures comes from spare capacity. However the Bank of England continues to stress the fact that inflation prospects remain highly uncertain. Risks to inflation currently relate to uncertainty in commodity markets and rising inflation expectations due to the persistent above-target trend. [see *Figure 8*].

Figure 8.
Bank of England inflation projections. (up to Q1 2014).



N.B.: BoE projections are made under the assumption of that the Bank Rate moves in line with market rates and the asset purchase programme remains steady at £200 billion.

4. Housing market

Northern Ireland

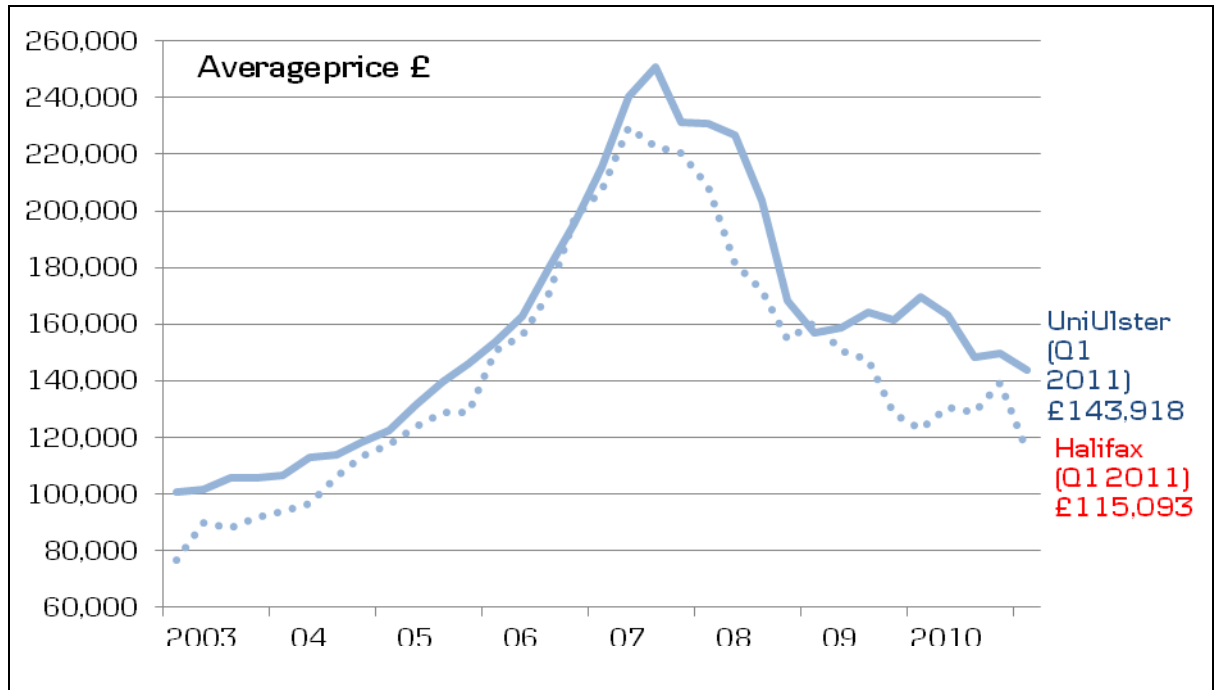
The University of Ulster Index examined house prices in Northern Ireland during Quarter 1 on the basis of a sample of 925 open market transactions (compared with only 684 in Q4 2010). The results for the latest quarter show that although activity was up, the average house price in Northern Ireland had fallen to £143,918 (a level last seen in 2005). The latest price represents a fall of 5.8 percent since Quarter 4 2010, and represents a fall of 15 percent from the same period one year earlier.

The UK Financial Services Authority¹ estimates the incidence of negative equity in Northern Ireland at 11.2%, more than twice the UK average of 5.2%. If accurate, this would equate to

¹ See: Financial Services Authority (FSA) March 2011, Prudential Risk Outlook
<http://www.fsa.gov.uk/pages/library/corporate/pro/index.shtml>

25,000 households. While this is not a surprise given the pronounced nature of the boom, this factor could act as a negative drag on the overall recovery of the regional market over a longer period of time.

Figure 9.
Northern Ireland House Price Indices.
(Q1 2003 - Q1 2011).



Source: University of Ulster / Halifax House Price Index

Oxford Economics: House Price Forecast

The Oxford Economics outlook for house price growth in Northern Ireland is shown in *Table 5* below. Positive growth is not expected to return until 2013.

	2011	12	13	14	15	16	2017
Northern Ireland	-3.7	-0.7	+2.9	+4.9	+4.9	+4.9	+4.4
UK	-1.3	-0.7	+4.1	+5.5	+5.0	+4.9	+4.9

Source: Oxford Economics

United Kingdom

According to the Halifax and Nationwide indices, average house prices at the national level have floated between £160,000 and £170,000 throughout 2010 and early 2011.

Despite having recorded stable prices in Quarter 1 2011, the mortgage lenders Halifax and Nationwide declared that the risks are on the downside (Halifax forecast a 2% decrease in UK house prices in 2011), due to sluggish market activity which is expected to persist during the whole year.

Republic of Ireland

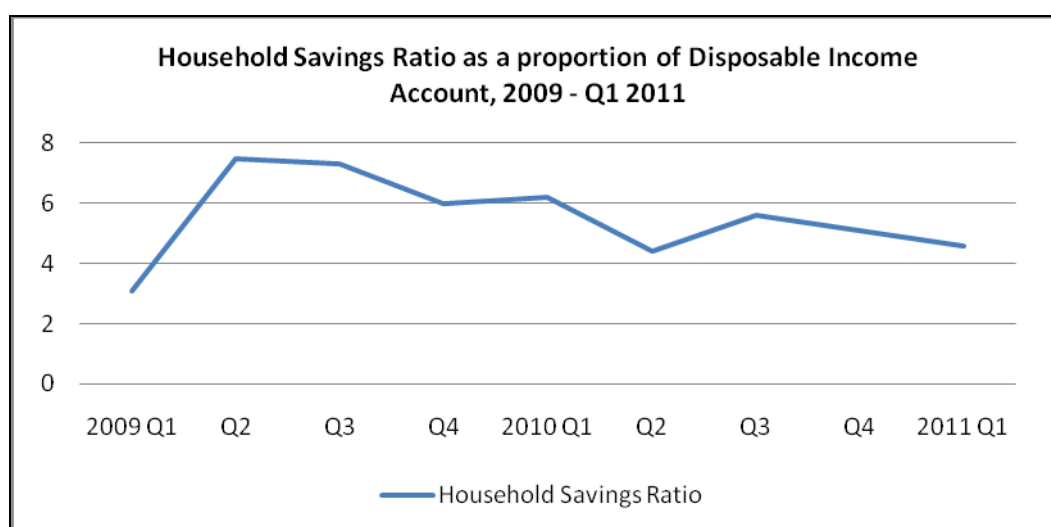
The traditional ESRI House Price Index for the Republic of Ireland has been discontinued and the Central Statistics Office (CSO) in the Republic have now launched a new national Residential Property Price Index which fulfils a new EU data requirement obliging all member states to produce comparable national residential property price indices. The index shows that at the national level, residential property prices in the year to March 2011 fell by 11.9%. Prices in Dublin fell by 13% in the year while outside Dublin prices fell by 11%. The new index does not publish average house prices.

5. Households and consumers

Households' resources

According to figures from the Office of National Statistics published on June 28th, Real Household Disposable Income fell by 0.8% during Quarter 1 2011 following a fall of 0.9% in Q4 2010 [see *Figure 10* below]. The household saving ratio was 4.6 per cent in the latest quarter, compared with 5.1 per cent in the previous quarter.

Figure 10

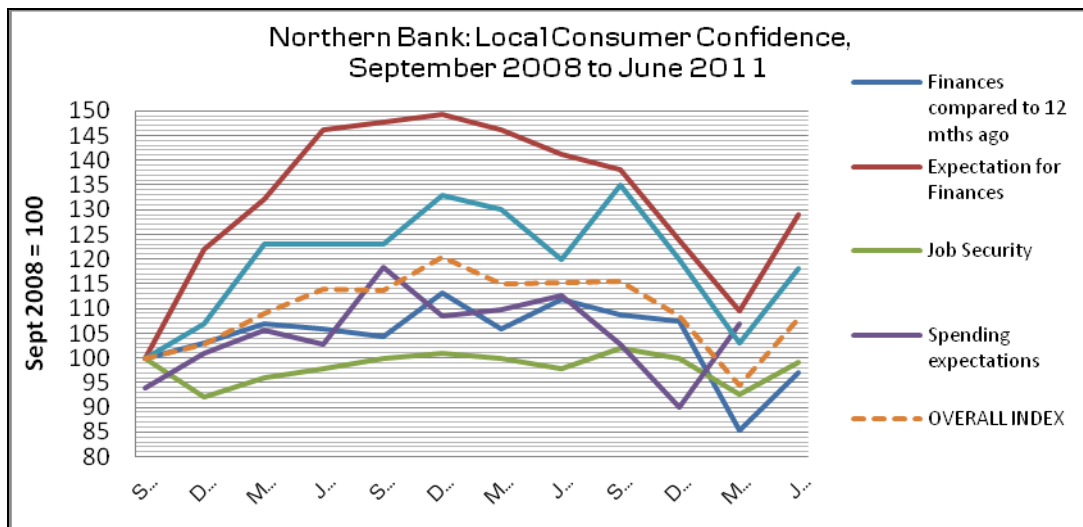


Consumer Confidence

Northern Ireland's Consumer Confidence index unexpectedly improved over the second Quarter of 2011 moving back from its lowest point since records began. The survey which was carried out in early June saw overall confidence rise in all aspects of the index from its low point of 94 (quarter one) to 108 in the latest results.

While the current level is still low by historical standards, the overall rate of improvement (14 points) represents the largest increase experienced in the last three years. Although all aspects of the survey improved, the primary driver of this latest upward shift in sentiment is attributed to consumers' 'expectations for future finances' and their 'expectations for spending'.

Figure 11.
Northern Bank Consumer Confidence Index for Northern Ireland.
(Sep 2008 - Mar 2011).



N.B.: The Northern Bank Consumer Confidence Index is compiled by surveying around 1,000 people in five key areas in Northern Ireland.

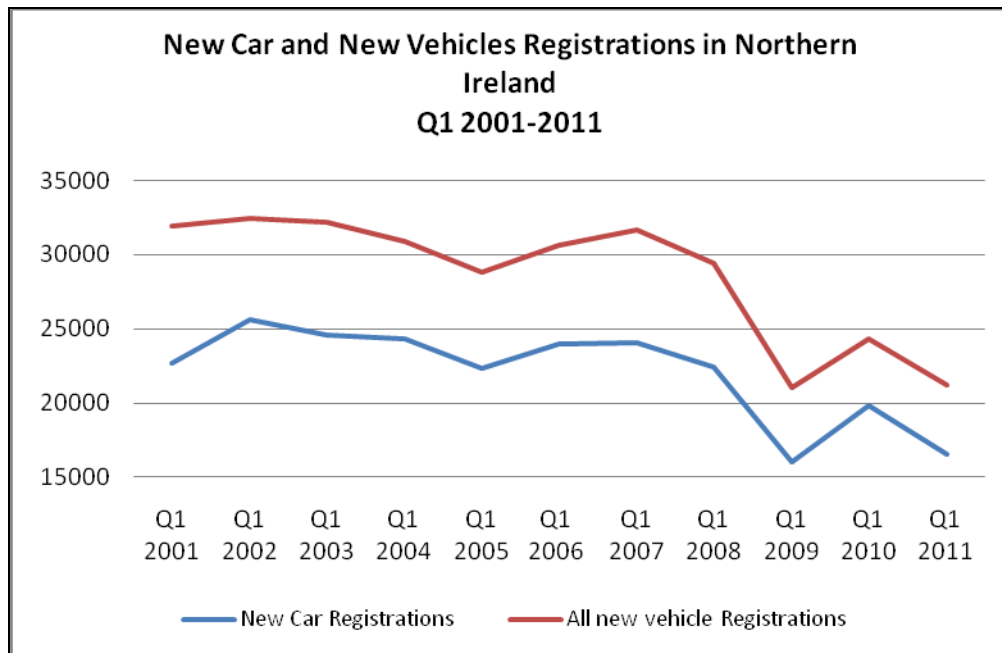
UK Consumer Confidence indices (Nationwide and GfK)

According to the GfK survey, UK confidence dropped in June 2011 with the overall index score decreasing four points to -25, six points lower than the same time last year. All aspects of the GfK measure decreased this month. The Nationwide confidence index dipped to 51 points in June following a substantial increase the previous month. Consumer expectations fell back during the month, while confidence in the present situation remained stable. Overall, UK confidence has returned to a level similar to January 2011.

New Vehicle Registrations

Data on new vehicle registrations in Northern Ireland were published by the Department of Regional Development in June. The new figures for Quarter-1 2011 show that 21,198 new *vehicles* were registered – the lowest level for this quarter for ten years. In the same quarter new *car* sales amounted to 16,586, down by 16.2% from the same period last year and down 24.5 % on the ten-year average (around 9,500).

Figure 12: New car first registrations and all purchased vehicles registrations in Northern Ireland. (Q1 2001 - Q1 2011).



Source: DRDNI, June 2011

6. Business Environment

NI Index of Services Q1

The most recent Index of Services released by DETI (on July 13th) for Quarter 1 2011 showed that local output levels in the service sector fell by 1.4% compared with the previous quarter. NI's private service sector output has declined by 16.3% from the peak recorded in Q3 2006. This was the fourth consecutive quarterly decrease in the overall Services index, after an earlier return to growth in Q4 2009 and Q1 2010. The decline this quarter in the NI series has been primarily driven by decreases in the Distribution (Wholesale and Retail) trade. Business Services and Finance fared worst over the year. The local service sector output was estimated to have fallen by 5.5% over the year.

NI Index of Production Q1

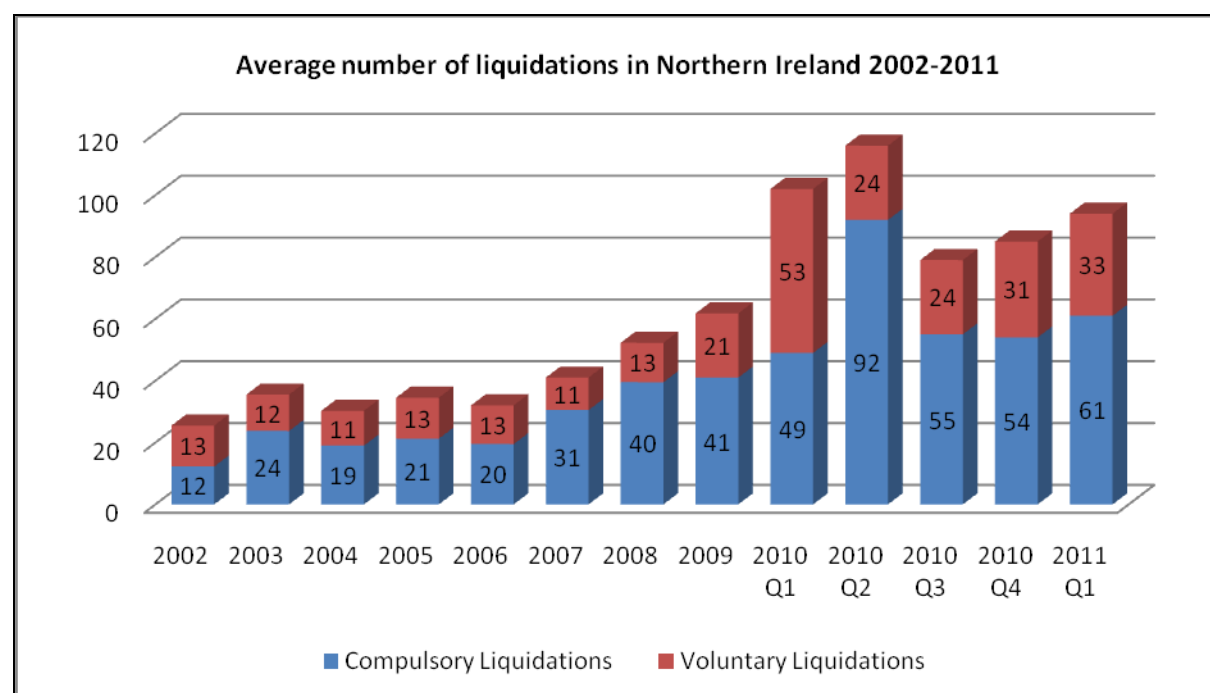
The DETI Index of Production for the first quarter of 2011 show output levels in Northern Ireland increased by 1.0% in real terms compared to Quarter 4 2010. This compares with a slight decrease (-0.1%) for the UK as a whole over the same period. The index has reported growth in five out of the last six quarters but is still 7.4% below the peak reached in Q2 2008.

Company liquidations.

Data from the Insolvency Service of the Department of Enterprise Trade and Investment (DETI) show a total of 94 company liquidations in Northern Ireland in Quarter-1 2011.

Compulsory liquidations increased slightly in Quarter-1 relative to the previous quarter and voluntary liquidations were marginally up. However, in terms of total liquidations, the figure for Quarter 1, although well above its long-term quarterly average, [see [Figure 13](#)] was down 7.8% compared with the same period one year earlier.

Figure 13: Average number of company liquidations every quarter in Northern Ireland. (Quarterly averages from 2002 to Q1 2011).



Bank of England: Agents' Summary of Business Conditions.

The Bank of England's latest "Agents' Summary of Business Conditions" (July 2011) is summarised below:

- The rate of growth of nominal spending on consumer goods and services remained sluggish.
- Activity in the housing market had softened in recent weeks.
- Overall, investment intentions continued to increase, although some firms had become a little more cautious.
- The rate of export growth remained strong. More firms had begun to switch resources from domestic to export marketing.
- Manufacturing output continued to grow, although more slowly for domestic markets than for export.
- Steady growth in output in the business services sector was also continuing.
- The level of construction output continued to rise very slowly but remained well below pre-recession levels.

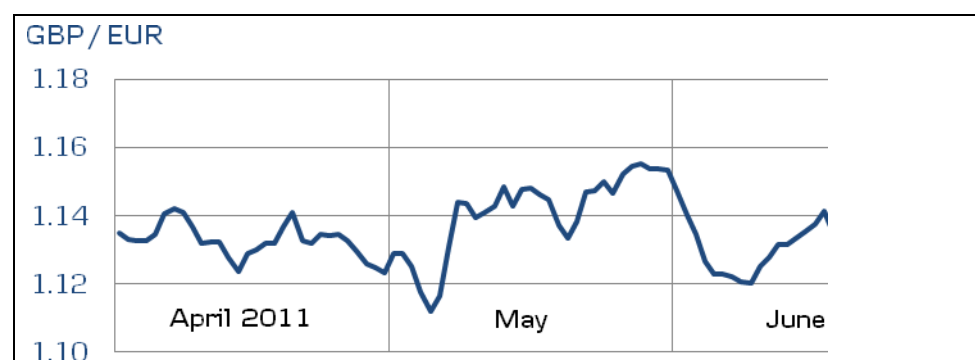
- Employment intentions indicated continuing job creation in the private sector in aggregate, though prospects in the consumer services sector were poor.
- The degree of capacity utilisation continued to increase gradually, with slack more evident in services than manufacturing.
- Growth in labour costs remained modest.
- Increases in the cost of raw materials showed signs of moderating, but concerns were concerned by prospects for energy prices.
- Inflation in the cost of imported finished goods was thought likely to persist somewhat longer than that of raw materials.
- Transmission from higher costs to output prices remained limited, putting pressure on firms' margins.
- The rate of inflation for consumer goods and services remained high.

Exchange rates and interest rates

Quarter 1 Exchange rates: £/€ and £/\$

Sterling slipped back from a high of 1.155 at the end of May to a low of 1.102 by the end of June. Adjustments were brought on predominantly by the Euro debt crisis during this time. Having depreciated by more than 25% in 2007-08, the pound has remained relatively stable in the period since. With UK monetary policy unlikely to be tightened anytime soon, the pound could potentially weaken a little more against the dollar. However, there may be room for a modest strengthening against the euro, reflecting enduring concerns about the sovereign debt crisis and the likelihood that the ECB will have to take a less hawkish stance in the coming months. The uncertain balance between the problems in peripheral economies and the core strength in the central European economies and Germany in particular mean there are sizeable risks to this forecast and plausible cases could be made for sterling moving in either direction in the short term.

Figure 14.
Exchange rates: GBP/EUR and GBP/USD.
(Quarter-2 2011).





Interest rates.

The Bank of England Rate is maintained at 0.5% since March 2009 and it is expected to remain at this level until the latter part of 2012 at the earliest. The 3-month LIBOR interbank rate (at which banks borrow funds from each other) averaged 0.82% throughout Quarter-2, whereas the 1 year LIBOR averaged 1.58 %

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- *ONS - Data from the "Claimant Count" statistics, as available on the ONS website.*
 - *ONS - Data from the "Labour Force Survey" as available on the ONS website.*
 - *ONS - Data from "Time Series Data - UK Economic Accounts" database.*
 - *ONS - Data from "Time Series Data - Consumer Price Indices" database.*
 - *The Insolvency Service - Insolvency Statistics, in particular the table "Insolvencies in Northern Ireland".*
 - *University of Ulster - "Northern Ireland Quarterly House Price Index - for Q1 2011" and previous releases.*

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