Northern Ireland Economic Outlook

Highlights

NI growth in 2011 to be lacklustre (no more than +0.8%)

A very weak UK recovery (+1.3% in 2011)

The RoI economy will probably remain flat this year although the revised Euro bailout terms will help.

- There is modest growth in manufacturing exports, continued levels of foreign direct investment (FDI) and increased levels of research and development (R&D).
- Output remains flat or declining in the public sector, construction, retail and much of private services. There is some growth evident in manufacturing and tradable services due in part to exchange rate devaluations since 2007.
- Northern Ireland is already lagging the other 11 UK regions in terms of recovery, growth and employment – sluggish recovery in Britain and a continued financial crisis in the Republic of Ireland (RoI) means limited opportunities in two key external markets.
- However, the European debt crisis, the US economy and fears that the sovereign debt contagion will move beyond the Eurozone, will impact the pace of economic recovery.

PwC forecasts and economic indicators

GDP Growth (%)	2009	2010	2011	2012
Northern Ireland*	-4.5	0.8	0.8	1.6
United Kingdom	-5.0	1.3	1.3	2.2
Republic of Ireland	-7.5	-0.3	0.0	2.0

Source: *Office of National Statistics , PwC, Economic and Social Research Institute (2009-10) and Organisation for Economic Co-operation and Development (2011-12)*
Note: **NI output growth measured by Gross Value Added (GVA)*

Indicator	2009	2010	2011	2012
UK inflation (Q4)	2.1%	3.4%	4.2%	2.2%
UK base rate (Q4)	0.5%	0.5%	0.8%	1.9%
NI employment (annual average)	752,500	775,000*	770,000	775,000
NI claimant count (Jan 2011)	39,000	55,500	59,100	62,000

Source: *ONS, PwC, Labour Force Survey (seasonally adjusted, 16+), Nomis*
Note: **strong growth 2009-2010 may reflect growth in part-time employment*
Key: *Shaded boxes represent estimates or forecasts by PwC Economics Service*

Next Issue:
November 2011

Forecast
Northern Ireland economy to grow by no more than 0.8% in 2011.

1. Confidence

General confidence update…

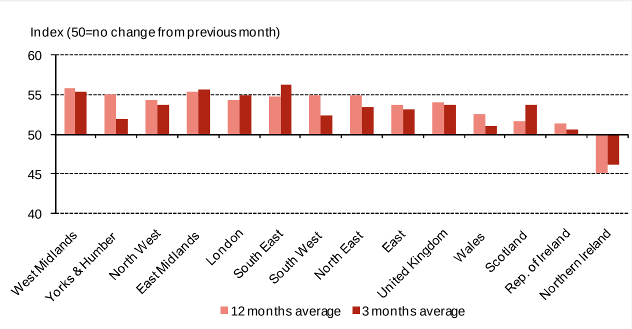
Recent months have delivered little heartening economic news for the UK in general and NI in particular. Consumer confidence has dropped, inflation remains high, UK bank lending to businesses has plummeted and the trade deficit has widened.

UK GDP grew by only 0.2% in the second quarter of 2011 (compared to 0.5% in quarter one). Whilst underlying UK growth may be better than 0.2% a quarter and we may still avoid a double dip recession, recovery is precariously weak and the UK is now unlikely to attain the 1.7% growth forecast by the Chancellor in the March 2011 Budget.

Business confidence remains low…

The Ulster Bank's Purchasing Managers Index for June showed that NI business confidence has continued to fall. New orders are decreasing and NI firms are experiencing a decline in output prices and a rise in input costs, resulting in falling profit margins. In contrast, business confidence is improving across the rest of the UK and in RoI.

Figure 1: PMI Output Index by region, 12 and three month average to June 2011



Source: Ulster Bank Purchasing Managers' Index (PMI)

Consumer confidence dips again…

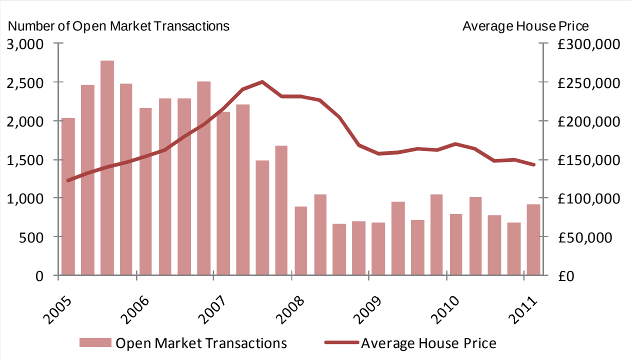
The Northern Bank's Consumer Confidence Index for Q1 2011 reported a further decline, with local consumers feeling the impact of the VAT increase and rising food and energy prices. Increasing concerns were expressed about the local labour market.

2. House prices and affordability

Average house price continues to fall…

The average house price fell by £6,000 to £143,918 according to the University of Ulster's Quarterly House Price Index (Q1, 2011). This was £25,600 lower than in the same period in 2010. While the number of transactions increased by 16% compared to Q1 2010 to 925 transactions, the level of activity was 55% lower than in the boom years of 2003-2007 when there was an average of 2,067 transactions in each quarter.

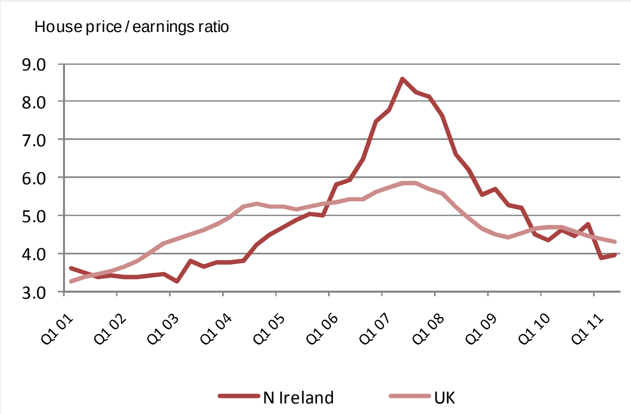
Figure 2: Housing market transactions and average price, 2005– 2011



Source: University of Ulster's Quarterly House Price Index

The latest survey from the Royal Institution of Chartered Surveyors (RICS) reported an increase in the number of transactions, but prices have continued to decrease. Vendors, particularly at the lower end of the market, have become more realistic about prices. This has encouraged investors and first time buyers to enter the market. Prospects are for continued growth in transaction numbers, with prices expected to remain unchanged at best although further price declines cannot be ruled out. The housing market in England appears similarly to be in the doldrums according to a review in PwC's July 2011 UK Economic Outlook.

Figure 3: House price to earnings ratio, 2001-2011



Source: Lloyds

Figure 3 shows the average house price in Northern Ireland is 3.9 times higher than average income. This ratio has fallen significantly from the peak of 8.6 in April 2006, but it is still significantly higher than a price/income ratio of 3.3 which prevailed in the early 2000s.

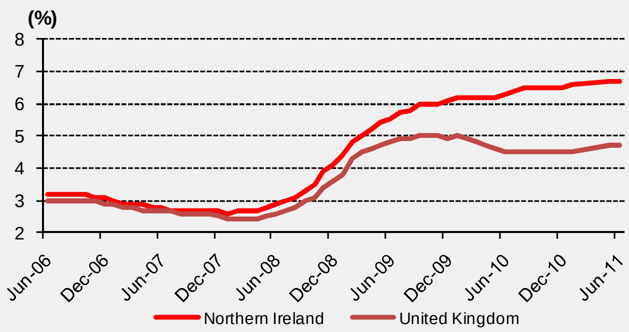
Based on this ratio, affordability has improved but the deposit requirements of lenders remain a barrier for many first time buyers. Weak consumer confidence and uncertain prospects for the labour market are spilling over to the housing market, which is dampening prospects.

3. Labour market

Claimant count rising…

The claimant count increased by 1,600 people over the past year to 59,700 people in June 2011, the highest figure since October 1986. The NI claimant count rate was the second highest regional figure in the UK at 6.7%, marginally lower than in the North East of England (6.8%). The average for the whole of the UK was 4.7%.

Figure 4: Claimant count, 2006-2011



Source: Nomis claimant count (seasonally adjusted)

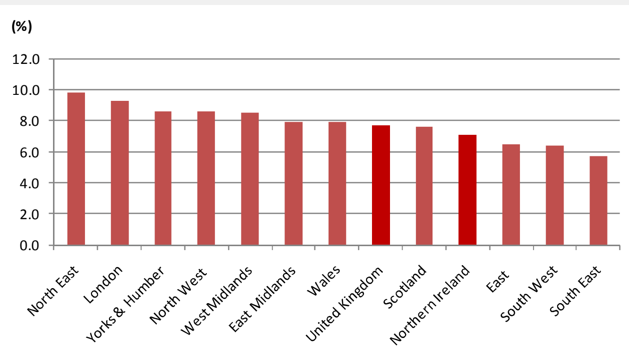
Figure 4 indicates that the divergence between NI and the UK has narrowed slightly, but the size of gap suggests that there are significant structural weaknesses in the local labour market.

Unemployment rate unchanged…

Using the alternative Labour Force Survey measure, the NI unemployment rate for March to May 2011 was unchanged at 7.1% compared to the same period in 2010. The unemployment total increased by 2,000 to 61,000 people, but a rise in the total number of people in employment offset the increase. Employment levels for March to May 2011 increased by 4% to 785,000 compared to the same period in 2010.

Figure 5 shows Labour Force Survey unemployment in NI at 7.1% compared to 7.9% for the UK.

Figure 5: ILO unemployment by region, Mar-May 2011



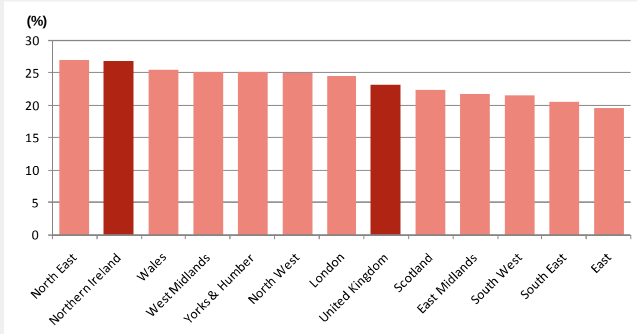
Source: Labour Force Survey (seasonally adjusted)

Note: Unemployment rate defined as number of persons unemployed as a percentage of the total workforce (16+).

Decrease in economic inactivity…

Between March and May 2011, Northern Ireland moved from having the UK's highest economic inactivity to the second highest rate at 26.7%. This represents a small improvement in relative performance. Historically, NI has had the highest rate of economic inactivity in the UK. The NI figure was still significantly higher than the UK average (23.1%). At 308,000 people, there was a 7% decrease (22,000 people) in the number of people of working age who were economically inactive.

Figure 6: Economic inactivity rate by region, Mar-May 2011



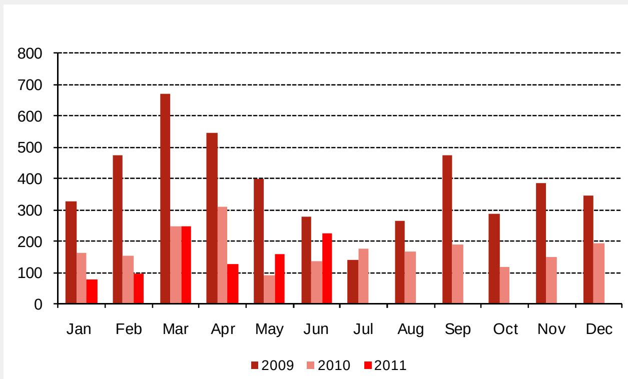
Source: Labour Force Survey (seasonally adjusted)

Note: Economic inactivity rate defined as total number of economically inactive in the working age population (16-60/65) as a percentage of the total working age population (16-60/65).

Redundancies decrease…

The total number of redundancies has decreased by 16% to 929 in the first half of 2011 compared to the same period in 2010.

Figure 7: Redundancies, 2009 - 2011



Source: Department of Trade, Enterprise and Investment

There was also better news for future employment with a number of significant job announcements. In the technology sector 72 jobs were announced by software provider Micro Focus UK. Security hub firm MITIE will create 38 new jobs, with Deloitte bringing 125 jobs to NI. In the agri food sector Monaghan Mushrooms will create a further ten jobs in addition to 60 jobs created earlier in the year. In the pharmaceutical sector Randox Laboratories will create 242 new jobs over the next three years. Chemical firm Dow Chemical Company will create 25 posts with another 35 jobs coming at the Terex Corporation.

These jobs are in addition to the 864 jobs reported in the March 2011 Economic Outlook. This brings major new job announcements to almost 1,500 so far this year, which outweighs the level of redundancies.

Invest NI results for the 12 months to 31 March 2011 indicate that the organisation exceeded its target with investment commitments by client businesses totalling £638m. Invest NI also attracted 41 inward investment projects promising 2,816 new jobs, while investment in R&D and innovation rose to £147m.

4. Future prospects

The International Monetary Fund (IMF) estimates that the world economy will grow by 4.3% in 2011 and 4.5% in 2012. However, global expansion remains unbalanced with stronger growth forecast in most emerging and developing countries, but weaker growth expected in developed economies. The Euro Area economies are forecast to grow at 2.0% in 2011 and 1.7% in 2012, however in the light of the current sovereign debt crisis there is no certainty as to future prospects. In contrast emerging and developing economies are forecast to grow by 6.6% and 6.4% for the same period.

Challenging times lie ahead for the UK economy, which should avoid a double dip recession, but growth in 2011 is likely to be less than 1.5% - a very slow recovery indeed. Although the government is anxious to retain the credibility of their fiscal consolidation, some degree of further quantitative easing (monetary relaxation) or even some degree of slowdown in the Budget cuts remain options.

NI lags the rest of the UK notwithstanding some encouraging gains in manufacturing, tradable services, exports and R&D, hence the relatively low anticipated growth of 0.8% for 2011. While our 2012 forecast remains at 1.6%, it is likely that this, too, will be marked down before the end of 2011. The debate about how to rebalance the NI economy is ongoing and a new Economic Strategy remains to be delivered. There is unlikely to be a single game changer to transform performance and, in the absence of a credible and radical transformation in economic policy and performance, the medium-term outlook for the region is not encouraging.

5. Sector dashboards

The dashboards aim to provide an overview of key data and issues in the private and public sectors in the coming months.

Private sector

	Employment			
Sector	***Mar 09***	***Mar 11***	***Change***	***Key Issues***
Construction	38, 920	33, 530	-13.8%	• Small rise in house sale transactions, but the market remains fragile. • The reduction in public sector capital spend will affect the larger civil engineering sector over the next four years.
Tourism and Leisure	52, 050	52, 850	1.5%	• Ongoing investments in large tourism projects (Titanic Quarter, Giant's Causeway Visitor Centre) provide the potential for medium/longer term growth.
Food processing	17, 230	16,580	-3.8%	• Global food market is very competitive with food price inflation at the highest level for two years. • Exchange rate competitiveness. • Latest figures report a decrease in consumer food purchases.
Financial services	32, 100	31, 800	-0.9%	• Markets remains uncertain with concerns around high debt levels and spillover effects from RoI.
Retail	116,040	114, 470	-1.4%	• Consumer confidence low. • Increased VAT impacting on sales, requiring strong promotional activity to maintain sales. • Low earnings growth has dampened consumer demand.
Manufacturing*	58,200	55, 060	-5.4%	• The challenges include increasing exports to more distant markets (e.g. BRIC countries) and additional improvements in R&D and innovation.

*excludes manufacture of food products

Public sector

Sector	***Overview***	***Key Issues***
Programme for Government (PfG)	The current Programme runs out this year	• The extent of progress in writing a new PfG remains unclear. • Can the previous commitment to the economy as top priority be preserved and reinforced?
Interest Rates	A decision for the Bank of England's Monetary Policy Committee	• Interest rates are expected to remain unchanged in the short term given the fragile economic recovery. • But they are expected to rise gradually towards the end of 2011 and through 2012 and 2013.
Economic Strategy	In the early stages of development	• Difficult to press ahead with some key decisions outstanding and unresolved e.g. a decision on the devolution of Corporation Tax varying powers; and a policy decision on whether to challenge the ending of Selective Financial Assistance.

6. Outlook - NI and Scotland: how they compare

On 5 July 2011, the new Scotland Bill Committee of the Scottish Parliament launched a consultation process to take the pulse of Scottish stakeholders as to the future shape and scope of a Scottish Executive with significantly greater devolved powers. This was partly prompted by the Scotland Bill - introduced by the UK Government in November 2010 - and which had its Report stage and third reading in the House of Commons on 21 June, before being dispatched to the House of Lords for scrutiny.

However, other factors are now in play. While the Scotland Bill reflected some amendments to the outcomes of the 2009 *Commission on Scottish Devolution* (the so-called Calman Commission), that was before the Scottish Parliamentary election on 5 May 2011 returned a majority SNP Government. Immediately post-election, First Minister, Alex Salmond, called for “improvements” to the Bill, including devolution to the Scottish Executive of the powers to set and vary Corporation Tax.

Just days after consultation ended on Treasury’s proposals to devolve Corporation Tax varying powers to Northern Ireland, HM Revenue & Customs (HMRC) further escalated the debate, issuing a paper estimating the impact of reducing the level of Scottish Corporation Tax to 12.5%.

Between now and early September, the new Scotland Bill Committee will test the support for both the Scotland Bill and the proposed “improvements”, ranging from a Scottish Income Tax and cutting Corporation Tax to the future of the Barnett formula and the Block Grant.

And while the notion of yet another Celtic competitor in the low Corporation Tax stakes is not going down well in some quarters of NI, the Scots are clearly not a bit bashful in their determination to make the most of devolution.

So just how well is the Scottish economy performing and are there any lessons the Northern Ireland Executive can learn from our neighbours across the North Channel?

Headline Performance…

After London and the South East, Scotland is one of the best performing of the 12 UK regions, with above-average growth in recent years. NI, on the other hand, has reflected a long term growth performance that has, at best, only tracked the UK average.

Fraser of Allander (FoA) (March 2011) indicates that Scottish growth (GVA per capita) averaged 2.0% over the period 1963-2009 compared to a UK average of 1.9%.

However, it is only since the early 1980s that NI growth rates have begun to match the UK average.

Perhaps the greatest difference between the two regions is their relative standing in terms of prosperity. Scotland has a level of GVA per capita close to the UK average and is narrowing the gap; NI has a longstanding position as one of the poorest UK regions with no real evidence that the gap is closing.

Figure 8: Scottish GVA per head compared to sample UK regions 2004-9 (UK average= 100)

	2004	*2005*	*2006*	*2007*	*2008*	*2009*
NI	80	80	815	80	79	80
London	162	165	166	169	172	170
SE	108	107	108	106	106	104
NE	78	79	78	77	78	79
Wales	78	75	75	75	74	74
Scotland	94	95	95	97	97	100

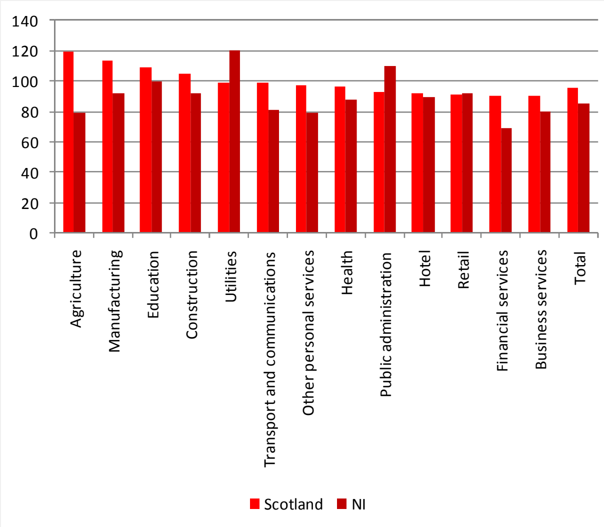
Source: ONS 2 August 2011, Productivity Measures by Region

Productivity and Structural weaknesses…

Notwithstanding the fact that Scotland appears to start from a better place than NI in terms of the comparative level of GVA per head, the FoA analysis suggests both regions have some similar structural weaknesses:

- **Narrow export base** - comparatively few firms contribute a large share of total exports (60 being responsible for about one half in Scotland) and a small range of sectors (e.g. chemicals, food and drink, tourism and banking in Scotland) selling to a limited number of countries.
- **Insufficient innovation** - R&D indicators are not that impressive in either region/nation.
- **Tourism**- a perception is shared that more could be done to increase the “quality” of the visitors attracted (notably in terms of per capita spending).

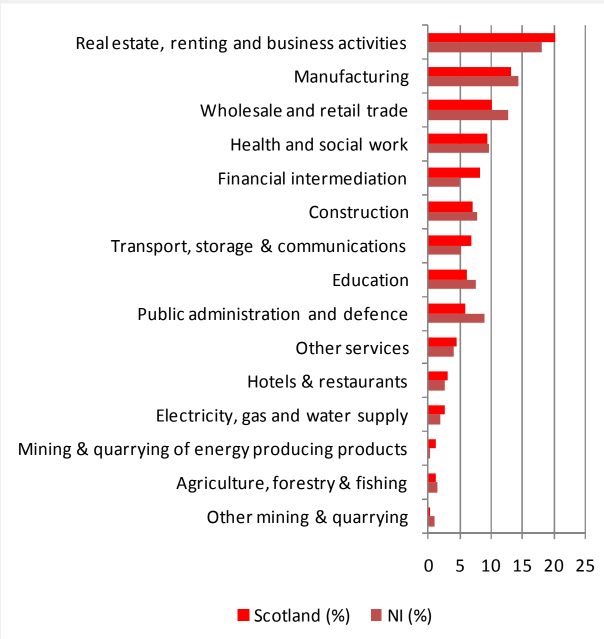
Figure 9: NI and Scotland relative sectoral productivity (GVA per worker), 2006 (UK= 100)



Source: Independent Review of Policy, 2009.

It is worth noting that NI sectoral productivity tends to match the UK average only in areas of public sector employment. Scottish productivity in key sectors like manufacturing, construction and agriculture are all significantly above the UK average, while comparable sectors in NI fall well below the UK average.

Figure 10: Composition of total GVA by sector, 2008 (%)



Source: Office for National Statistics, December 2010.

Some other key metrics:

Figure 11: Comparative Statistics

Metric	*Scotland*	*NI*	*UK*
FDI - jobs per million population 2002/3 - 2007/08	3,800	4,240	n/a
VAT stock per 10,000 working age population (2007)	431	594	525
VAT registrations/10,000 working age population (for 2007)	44	40	53
R&D expenditure (2009) £ million	644	297	15,624
R&D employment (2009) (Full Time Equivalents: 000's)	7	4	151
Subvention £ per head* (2007/08)	2,280	4,167	n/a

Source: IREP /ONS / DFP /NI Office / Scotland Office

*Note: *Scotland excludes revenues from North Sea oil and gas*

While Northern Ireland created relatively more FDI employment (in the five years under review 02/03-07/08) than any other UK region, this compared unfavourably to RoI's FDI inflows of in excess of 13,000 for the same period. However, in all other key metrics, particularly in R&D, NI significantly underperformed relative to Scotland and the UK average, with the per capita subvention (the excess of regional public spending over taxes collected) clearly indicating the real difference between the regions and the disproportionally high level of NI dependence on Westminster.

As has been mentioned, the debate in NI around reducing the rate of Corporation Tax has parallels in Scotland, with proponents claiming that Scotland now is in a position similar to that occupied by the Republic of Ireland in 1987, i.e. at the start of its long boom in FDI.[1] Opponents have however argued that comparisons with the RoI could be simplistic and, in any case, other factors may also explain recent very strong FDI performance in the RoI.[2] If the NI Assembly is given the power to vary Corporation Tax then it is almost inevitable the Scottish Government will ask for the same.

[1] *Herald Scotland* 4 November 2003, "Paul Krugman's analysis is superficial".

[2] Paul Krugman 2003, *Second Winds for Industrial Regions?* The Allander Series, Glasgow.

In summary, while some high-level similarities exist between the two regions there are significant differences in terms of economic performance and a real gap in relative performance which is epitomised by the divergence in the subvention between Scotland and NI, excluding the revenues from North Sea oil and gas.

Looking to the future, while Northern Ireland has historically performed better in terms of the (generally) higher GVA FDI, Scotland has built an infrastructure that has a high level of competitiveness and, in a paper on the Scottish economy, the economist, Paul Krugman (2003), argued that it may well be more meaningful to talk about competitiveness at the regional level than at the national level: *"…success for a regional economy … would mean providing sufficiently attractive wages and/or employment prospects and return on capital to draw in labour and capital from other regions. It makes sense, then, to talk about 'competitiveness' for regions in a way one wouldn't talk about it for larger units. This isn't just a linguistic distinction: it makes interregional growth rates much more sensitive than international growth rates to differences in efficiency… Regional growth is much more sensitive to differences in productivity performance." (2003, pp17-20).*

Krugman suggests that regional competitiveness has as much, if not more, to do with *absolute* advantage as with *comparative* advantage: that a region that is more efficient (productive) will be able to attract (and retain) labour and capital from other regions, and these factor inflows will tend to reinforce that region's (absolute) productivity lead still further.

If that is the case, Scotland has a significant advantage over Northern Ireland and, if the proposed amendments to the Scotland Bill are forthcoming, Scotland will become a strong competitor to Northern Ireland, even if NI wins the argument and Corporation Tax is reduced to match RoI's 12.5%.

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