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Northern Ireland Economic Outlook

Measuring the extent of recovery

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1. Highlights and key messages

Summary

We expect Northern Ireland (NI) to deliver gross value added (GVA) growth of 1.4% in 2016, a small decrease on 2015; the region will remain the poorest-performing of the 12 UK regions. Overall UK growth is expected to be 2.2% in 2016, the same as last year, with any gains from cheap oil offset by the impact of a higher exchange rate and difficulties in emerging markets.

Globally, risks to sustained recovery, include continued uncertainty in the Eurozone, serious slowdown in China and global interest rates in the wake of the Fed's 0.25% increase.

We expect modest property price growth at about the UK average. However, the legacy of the mid 2000s property bubble is a fragile housing market with high levels of indebtedness.

November's *Fresh Start* political Agreement has provided the basis for a balanced budget in 2016-17. The welfare crisis was addressed by way of a four year programme of transitional protections and there will be a small increment to NI's block grant.

Fresh Start also provides for the devolution of Corporation Tax powers in 2018 - providing this is sustainable in fiscal terms.

After four years, during which NI manufacturing bucked the previous trend and expanded output and employment, output in that sector is shrinking.

Some of that shrinkage is attributable to the appreciation of Sterling against the Euro; NI remains much more dependent in proportional terms on the EU market than the rest of the UK. Another weakness has been the high cost of electricity for large industrial users, quoted by Michelin as one reason for closing its Ballymena plant in 2018.

ONS data show NI delivered the second lowest employment growth amongst the 12 UK regions in the two years to September 2015. Only Scotland had lower growth and the NI rate of increase was about 40% of the top regions in England - London and the East of England.

NI economic growth was estimated as 2.2% in 2014 and estimated to be 1.5% in 2015, with a further decline to 1.4% in 2016, but returning to 1.5% in 2017.

UK economic growth was 2.9% in 2014 and projected to be 2.2% in both 2015 and 2016, with a slight increase to 2.3% in 2017.

Republic of Ireland (RoI) economic growth was 6.0% in 2014 and estimated to be 7.0% in 2015, with 5.5% projected for 2016 and 4.3% for 2017.

Table 1.1: Growth projections

GDP growth (%)	*2014*	*2015*	*2016*	*2017*
NI	2.2	1.5	1 .4	1.5
UK	2.9	2.2	2.2	2.3
RoI	6.0	7.0	5.5	4.3

Source: Office for National Statistics (ONS), Central Statistics Office (RoI), PwC (NI 2014-17, RoI 2016-17 and UK 2015-2017).

Table 1.2: Key Indicators

	2013	*2014*	*2015*	*2016*
UK consumer price inflation (annual average)	2.6%	1.5%	0.0%	1.2%
UK interest base rate (Q4)	0.5%	0.5%	0.5%	0.75%
NI claimant count (seasonally adjusted, December)	59,000	49,700	38,700	41,000

Source: ONS, NISRA, Nomis, PwC (inflation, claimant count and interest rate 2016).

The Spending Review 2015 implies a 5% real reduction in NI's funding allocation for current departmental spending during 2015-16 to 2019-20, with a small growth in capital budgets. However the scale of that reduction is smaller than that during the Spending Review 2010 and much less onerous than that experienced by many Whitehall Departments.

Given NI's low productivity, high numbers of SMEs and the greater prevalence of low pay, current UK government policy poses a double challenge. First, from the reduction in welfare support for the low paid and, second, from the introduction of a new, higher National Living Wage.

The Chancellor has identified a relatively low level and low growth of productivity as the key strategic weakness of the UK economy. Evidence suggests that NI has even greater need to address its productivity shortfall. Until NI productivity levels increase significantly, the economy will not demonstrate sustained and meaningful growth.

Uncertainties remain in global energy markets, but inflation is likely to remain well below the Bank of England's 2% target.

2. NI Recovery Measures: Introduction

Economic commentary understandably focuses on questions about growth in the short term such as by how much will output in the NI economy grow this year or next year? However, another question is also interesting, "given that the NI economy has been growing now for about three years, how much ground has been made up in terms of moving back towards the peak achieved just before the banking crisis and housing market slump which began in mid 2007?"

For the overall UK economy such questions can be answered using the quarterly GDP statistics. For example, in Quarter 3 (Q3) 2015 it was indicated that total UK output was about 6% greater than the level achieved at the pre-crisis peak in 2008.

NI does not have quarterly GVA data. The available GVA data are on an annual basis and not very timely. We do have the Northern Ireland Composite Economic Index (NICEI), a data series generated by the Northern Ireland Statistics and Research Agency (NISRA). This provides an approximation of movements in total output or income in the NI economy.

To the extent that the NICEI has displayed substantial volatility on a quarter to quarter basis it may be useful to supplement that measure with additional economic indicators. Our approach is therefore to use the NICEI as one of a range of indicators.

For example, to indicate the extent of recovery in the labour market we consider a measure of the unemployment rate (claimant count) and change in employment, both in aggregate and by broad sector.

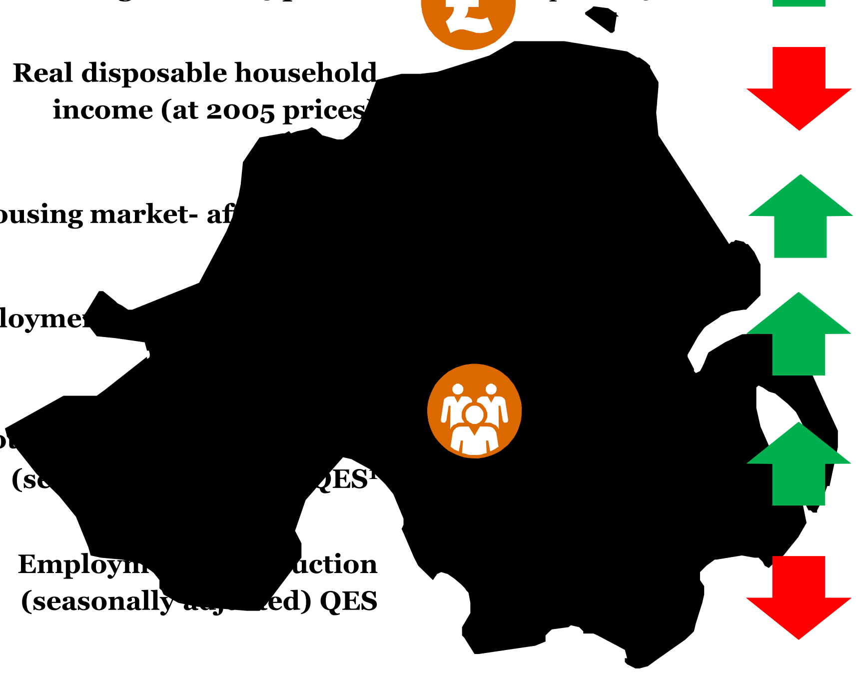
In some cases identifying an indicator is not straightforward. For example, how should we best measure "recovery" in the housing market? Whilst an individual household who bought a house just before the peak of that market in the summer of 2007 might judge recovery in terms of how far prices have returned to the 2007 level, we doubt if such a return is either feasible or even desirable in any short to medium term sense. We have decided that a measure of house price affordability (proxied by average prices relative to average earnings) provides the best measure of a recovery in terms of increasing economic welfare broadly defined. We have taken the average price/earnings ratio for the average of the four quarters of 2005 as the best measure of "normality" with respect to affordability. We took that period rather than the level during, say 2005-7 when affordability was unusually low, or, the level during the more recent 2010-13 period, when affordability was unusually high.

We measure the current unemployment level compared to its pre-crisis low or trough value and then "invert" the index number. The extent to which the index value is less than 100 then shows how much further unemployment needs to fall to get back to its previous low.

As the following section indicates, the exact time when each indicator peaked varied but in broad terms the indicators point to either 2007 or 2008 as representing the previous peak in the NI economy. The Appendix provides more precise details. So in summary, these recovery measures show how much further the NI economy still has to climb to get back to its pre-crisis levels.

3. NI Recovery Measures - Dashboard

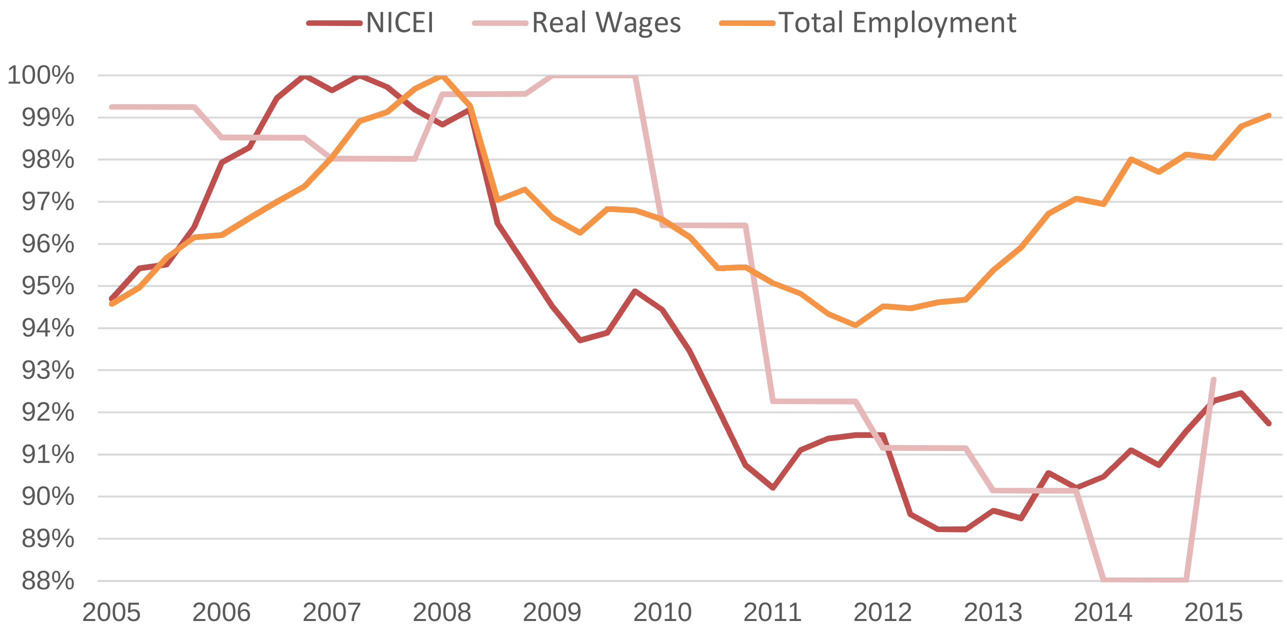
	Current value	Most recent movement	Recovery measure value (pre -crisis peak = 100)
NICEI	102.1 (Q3 2015)	↓	91.7
Real wages (Gross Weekly Earnings –at 2005 prices)	£298.8 (April 2015)	↑	92.8
Real disposable household income (at 2005 prices	[illegible]	↓	88.7
Housing market- af	[illegible]	↑	90.9
Employme	[illegible]	↑	99.3
To (s QES[1]	[illegible]	↑	99.1
Employ uction (seasonally ed) QES	[illegible]	↓	63.5
Employment-manufacturing (seasonally adjusted) QES	80,460 (Sep 15)	↑	96.2
Employment-services (seasonally adjusted) QES	597,630 (Sep 15)	↑	102.3
Unemployment rate (Claimant count)	4.3% (Dec 15)	↓	60.5



1 The Quarterly Employment Survey (QES) relates to employee jobs. Each quarter the QES sample of approximately 5,500 businesses is asked to supply NISRA with employment data for each of their business activities. The survey covers all employers with at least 25 employees, all public sector employers and a representative of smaller firms. It should be noted that the survey counts the number of jobs rather than the number of persons with jobs, e.g. a person holding a full-time job and part-time job will be counted twice.

4. Commentary: The mountain peak still to be reached

Figure 4.1: NI Recovery Measures: 100%= pre-crisis level



NI's economic recovery began in mid 2013 but two and a half years later most of the indicators suggest that a lot of ground still has to be made up. Much of the mountain peak still has to be climbed.

In late 2015 unemployment levels are still substantially above the pre-crisis levels. Real wages and household income are still 7.2% and 11.3% below their pre-crisis peak values in real terms respectively.

A more much more optimistic story is told by the employment measure. As of September 2015, the total number of employees had almost regained its previous pre-crisis peak level, just 0.9% below the peak value in March 2008. By implication, NI has had something of a jobs recovery though one with little productivity growth, or even one accompanied by a productivity decline.

The employment figures themselves should be caveated. They make no allowance for changes in the numbers of part-time workers or the number of hours worked. An increase in the number of persons in employment might be judged less impressive if the average number of hours being worked by each person had dropped. Whether this was the case is considered in the Appendix.

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Appendix: NI Recovery Measures- Further details

Indicator	Date of pre-crisis peak value	Pre-crisis peak value	Most recent value	Most recent value as a % of pre-crisis peak value (pre-crisis level=100)
NICEI	Q2 2007	111.3	102.1 (Q3 2015)	91.7
Real wages (Gross Weekly Earnings), 2005 prices	2009 (annual)	£322.1	£298.8 (April 2015)	92.8
Real disposable household income (real – deflated by CPI), 2005 prices	2007 (annual)	£12,852	£11,396 (2013)	88.7
Housing market-affordability	2005 Q1-Q4 average	6.44	5.85 (Q3 2015)	90.9
Employment rate (LFS)	Feb-April 2007 (3 month rolling average)	69.3%	68.8% (Sep-Nov 2015)	99.3
Total (all sector) employment (seasonally adjusted) QES	March 2008 (quarterly)	734,930	727,930 (September 2015)	99.1
Employment-construction (seasonally adjusted) QES	December 2007 (quarterly)	46,600	29,610 (September 2015)	63.5
Employment-manufacturing (seasonally adjusted) QES	March 2008 (quarterly)*	83,600	80,460 (September 2015)	96.2
Employment-services (seasonally adjusted) QES	June 2008 (quarterly)	584,470	597,630 (September 2015)	102.3
Unemployment rate (Claimant count)	Jan/Feb 2008 (monthly)	2.6%	4.3% (Dec 15)	60.5

*: Manufacturing employment has been in trend decline since at least the 1960s. In that sense there was no "pre-crisis peak". We used the level in March 2008 given that *total* employment peaked at that time.

Appendix: NI Recovery Measures- Further details

A note on employment trends

The Quarterly Employment Survey (QES) measure indicates that by Quarter 3 2015 total employment (i.e. employees) had more or less regained its pre-crisis level. Given that the output measure, NICEI, indicated that the volume of output remained 8% below its peak, the extent of recovery in this measure of employment might seem surprising. However, it is necessary to bear in mind the way in which employment is defined in the QES. That definition is restricted to employees and gives equal weight to full- and part-time employees. It therefore does not allow for changes in the total number of hours worked.

Given this, it may be of note that the growth in part-time employment has been proportionally greater in NI than in the UK as a whole, NI part-time employment has grown from 21.6% of the total in 2007 to 24.7% in 2013 whereas in the UK the respective figures are 25.4% in 2007 and 26.9% in 2013 (it is also important to note that LFS defines full-time as anyone working more than 16 hours per week). All this suggests that any growth in the QES count of the number of employees may exaggerate the increase in the number of full-time equivalents.

In terms of the total hours worked, in NI, this increased by 1.0% between October 2007-September 2008 and late 2015, whereas in the UK in the same time period, total hours worked increased by 4.1%.[1] In terms of employment in that period, NI employment grew by 1.2% and in the UK it grew by 2.8%.[2] We can therefore calculate that NI hours per person decreased slightly (-0.2%) since October 2007 -September 2008 and UK hours per person rose slightly, 1.3% in the same time period. Once again, in both an absolute and comparative sense, the recovery in the NI labour market looks less robust than the QES figures suggest.

Finally, NI has also had less growth in self-employed employees when compared to elsewhere in the UK, the NI self-employed rate, as a proportion of the total number of employees plus self-employed, fell from 14.9% in 2007 to 13.9% in 2013 but in the UK the self-employed rate rose from 13% to 14.4%.

[1] ONS Regional Labour Market Statistics, December 2015.
[2] Nomis, Annual Population Survey dataset. Note, this uses as a wider Labour Force Survey based definition which includes the self-employed (hence, contrasts to the QES).