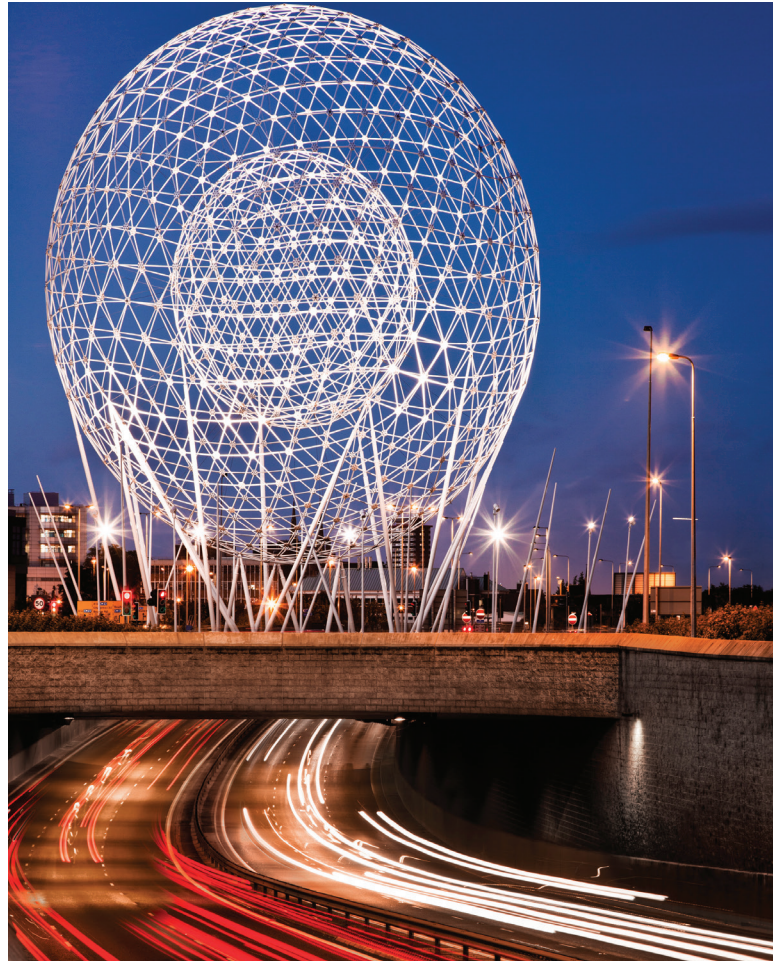


Northern Ireland Economic Outlook Avoiding recession



Highlights and key messages

Summary

The deceleration in Northern Ireland’s economic recovery is likely to continue; recession should be avoided, but only just.

With output still around 7% below the pre-recession peak, the region is not generating the productivity gains that will create wealth and increase wages. Despite recent strong service sector recovery, the local private sector lacks the critical mass to drive recovery at the rate experienced elsewhere in the UK.

We expect Northern Ireland (NI) to deliver gross value added (GVA) growth of 1.2% in 2016, down on 2015, while remaining the poorest-performing of the 12 UK regions.

NI property prices should deliver very modest growth – well below the UK average, with post-Referendum uncertainty, compounding the high levels of indebtedness.

After five years, during which NI manufacturing bucked the previous trend and expanded output and employment, output has stalled since early 2015, while overall UK manufacturing activity continues to recover. A lower exchange rate creates some opportunities but the extent of these remain to be seen.

The Executive has published a Framework for the next (2016-21) Programme for Government. The focus on outcomes is commendable but, in the light of the recent OECD report (July 2016), even 14 outcomes may be too many. It is worth noting that the Framework pre-dates the EU Referendum vote.

“Brexit means Brexit,” the PM has confirmed. NI should work on the principle that this is inevitable (even if it is not) and focus on developing radical options for growth and international competitiveness (see appendix 3). New signatures on the traditional cheques that fund the status quo will not even close the existing prosperity gap with the rest of the UK.

Last October’s Spending Review set the general context for public spending over this mandate – a moderate real terms reduction in current spending with funding for capital broadly flat. It remains to be seen what the regional impact will be of any relaxation in UK fiscal policy.

Also uncertain is the extent to which EU funding for Northern Ireland will be replaced by the UK central government. The long-term future of the Barnett Formula, as we currently understand it, looks even more doubtful.

Post-Referendum uncertainty makes it less likely that the Executive will attempt to agree a multi-year budget covering the remaining years after 2016-17 and running up to the next election. A one-year revenue budget seems more likely, with the Executive still having to demonstrate to HM Treasury the fiscal sustainability of a Corporation Tax cut in 2018.

Uncertainties remain in global energy markets, but given recent increases, inflation is likely to begin to creep towards the Bank of England’s 2% target.

Economic growth in NI, RoI and UK in 2016

NI economic growth

2.2% in 2014
1.5% in 2015
1.2% projected for 2016
0.3% in 2017

Republic of Ireland (RoI) economic growth

6% in 2014
7.8% in 2015
4.5% projected for 2016
3.3% in 2017

UK economic growth

2.9% in 2014
2.3% in 2015
1.8% projected for 2016
0.7% in 2017

Growth projections

GDP growth (%)	2014	2015	2016	2017
NI	2.2	1.5	1.2	0.3
UK	2.9	2.3	1.8	0.7
RoI	6.0	7.8	4.5	3.3

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

*Using an earlier measure by the Central Statistics Office rather than their latest figure which was 26.6%. The latter figure was boosted by some very high investment figures by subsidiaries in the RoI.

Key Indicators

	2013	2014	2015	2016	2017
UK consumer price inflation (annual average)	2.6%	1.5%	0.0%	0.7%	1.8%
UK interest base rate (Q2)	0.5%	0.5%	0.5%	0.25%	0.10%
NI claimant count (seasonally adjusted, July 2016)	62,800	52,900	43,000	36,100	39,000

Source: ONS, NISRA, Nomis, PwC (inflation 2016 and 2017, claimant count 2017 and interest rate 2016 and 2017).

NI recovery measures:

Thinking about how far we are from the peak

Economic commentary
understandably tends to focus on the short-term – “how much will output in the NI economy grow this year or next year?” or “what’s the prognosis for inflation/property prices / unemployment?”

However, given that the Northern Ireland (NI) economy has been growing now for about three years, it is also worth asking how much ground has been made up over the longer term. If the region’s peak economic performance occurred just before the banking crisis and housing market slump, which began in mid 2007, just how much of the lost ground has the economy clawed back?

For the UK economy overall, these questions can be answered using the quarterly GDP statistics. For example, in Quarter 2 (Q2) 2016, total UK output was about 8% greater than the level achieved at the pre-crisis peak in 2008.

Unfortunately NI does not have quarterly GVA data and 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 is important to supplement that measure with additional economic indicators. We’ve therefore opted for a range of indicators, to define and measure the **Northern Ireland recovery dashboard**.

These are:

- NICEI;
- Real disposable household income;
- Employment rate;
- Employment in key sectors;
- Claimant count unemployment; and
- House price affordability.

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 opted for 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. The index is calculated such that values greater than 100 indicate affordability is higher than in 2005 and values less than 100 indicate affordability is lower than in 2005.

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 most cases the indicators point to either 2007 or 2008 as representing the previous peak in the NI economy. Appendix 2 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.

NI Recovery Dashboard

	Current value	Recovery measure value (pre-crisis = 100)		Current value	Recovery measure value (pre-crisis = 100)
 NICEI	103.0 (Q1 2016)	92.7	 Total (all sector) employment (seasonally adjusted) QES ¹	735,010 (March 16)	100.3
 Real wages (Gross Weekly Earnings – at 2005 prices)	£298.8 (April 2015)	92.8	 Employment-construction (seasonally adjusted) QES	30,040 (March 16)	64.3
 Real disposable household income (at 2005 prices)	£14,645 (2014)	89.0	 Employment-manufacturing (seasonally adjusted) QES	80,640 (March 16)	96.5
 Housing market – affordability	5.92 (Q2 2016)	108.8	 Employment-services (seasonally adjusted) QES	601,620 (March 16)	103.0
 Employment rate (Labour Force Survey)	69.0% (April-June 16)	99.6	 Unemployment rate (Claimant count)	4.0% (July 16)	65.0

¹The 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.

Commentary

The mountain peak still to be reached

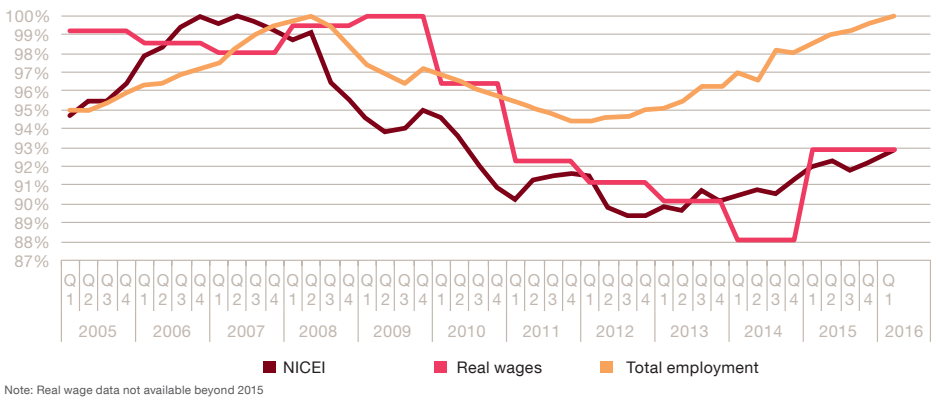
The most recent economic indicators suggest that NI's recovery continues, but some indicators remain well below, even the pre-downturn level. The latest NICEI results showed that NI economic activity increased by 0.4% in real terms between Q4 2015 and Q1 2016, broadly similar to the increase of 0.5% between the Q4 2015 and Q1 2016. The Q1 2016 NICEI result is also 0.7% higher in real terms than the level in Q1 2015.

The latest NICEI results suggest that NI is still experiencing a recovery but with volatility in the rate of growth and the level of output in Q1 2016 remains about 7% below its pre-crisis peak. Real wages too, are still around 7% below where they were a decade ago in 2005.

Overall employment continues to recover, with the LFS employment rate reaching 69.0% for the three month rolling average covering April-June 2016. Total employment as of March 2016 also reached 735,010 and is now at 100.3% of the pre-crisis peak. Once again there is evidence that NI is at the least having a reasonably strong jobs recovery. This jobs recovery tends to be focused in the service sector where job numbers are 3.0% above the pre-crisis peak. In construction and manufacturing, employment has increased slightly since mid 2015. Appendix 1 compares recent trends in unemployment rates in NI and the UK.

What is clear from the recovery indicators – which indicate a story of jobs growth without a comparable gain in productivity or wealth creation – is that it is misleading – indeed even dangerous – to focus on employment as the yardstick for recovery. This should have important implications for the Executive's consideration of the new Programme for Government and refreshed Economic Strategy.

NI Recovery Measures: 100% = pre-crisis level



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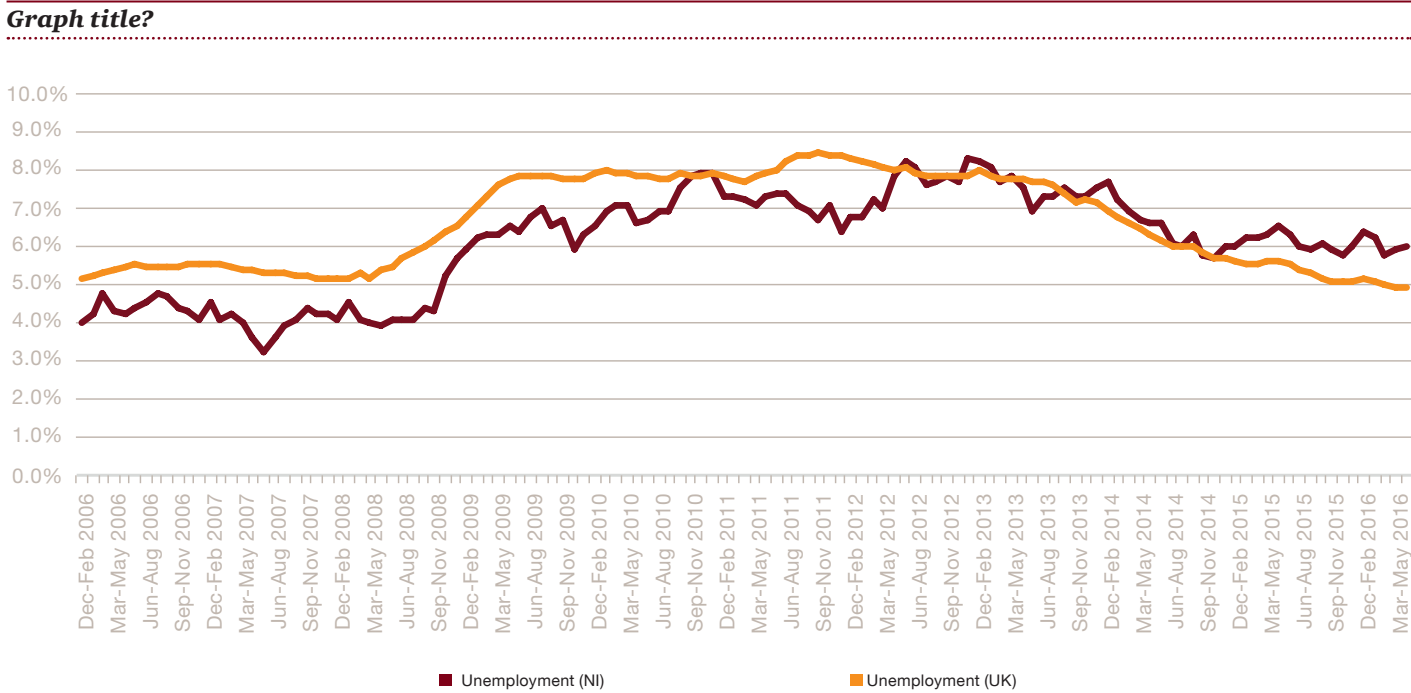
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Appendices

Appendix 1:

Comparative trends in the labour market, LFS unemployment rates NI and UK, 2006-16



The data in the graph relates to unemployment rates in NI and the UK and is drawn from the Labour Force Survey (LFS). (We were unable to use claimant count figures to compare NI and the UK given that the roll-out of Universal Credit in GB implies that the Job Seekers Allowance (JSA) figure now significantly undercounts total unemployment.) The LFS uses the International Labour Organisation (ILO) definition of unemployment; those who are able to start work in the two weeks following the LFS interview who had either looked for work in the four weeks prior to the interview or were waiting to start a job they had already obtained.

The LFS unemployment rate for April-June 2016 was estimated as 6.0%. This was a decrease of 0.1% points over the quarter and a decrease of 0.5% points over the year. The graph implies that following a year and half – early 2013 to mid 2014 – during which there was a substantial decline in unemployment in NI, since mid 2014 unemployment has roughly stabilised.

Rates have in fact levelled off at a higher level than the UK average which was 4.9% in April-June 2016. The marked slowdown in economic growth which is on the cards for the rest of this year and then into 2017 implies that small-to-moderate increase in the unemployment level is quite likely.

Using the ILO definition, recent unemployment rates in NI are below those in the RoI, 7.8% in May 2016, and also the EU average, 8.6% in May 2016. The long term unemployment rate (those out of work for more than one year) and youth (aged 18-24) rate in NI have been declining but remain substantially higher than the UK averages.

Appendix 2:

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	111.1	103.0 (Q1 2016)	92.7
Real wages (Gross Weekly Earnings), 2005 prices	2009 (annual)	£322.1	£298.8 (April 2015)	92.8
Real disposable household income, 2014 prices	2007 (annual)	£16,445	£14,645 (2014)	89.0
Housing market – affordability	2005 Q1-Q4 average	6.44	5.92 (Q2 2016)	108.8
Employment rate (LFS)	Feb-April 2007 (3 month rolling average)	69.3%	69.0% (April-June 16)	99.4
Total (all sector) employment (seasonally adjusted) QES	June 2008 (quarterly)	732,910	735,010 (Mar 2016)	100.3
Employment-construction (seasonally adjusted) QES	December 2007 (quarterly)	46,710	30,040 (Mar 2016)	64.3
Employment-manufacturing (seasonally adjusted) QES	March 2008 (quarterly)*	83,580	80,640 (Mar 2016)	96.5
Employment-services (seasonally adjusted) QES	June 2008 (quarterly)	584,050	601,620 (Mar 2016)	103.0
Unemployment rate (Claimant count)	Jan/Feb 2008 (monthly)	2.6%	4.0% (July 2016)	65.0

*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 June 2008 given that total employment peaked at that time.

Appendix: 3

NI Recovery Measures – Further details

A note on employment trends

The Quarterly Employment Survey (QES) measure indicates that by Quarter 1 2016, total employment (i.e. employees) had regained its pre-crisis level, albeit the volume of output remained 7% below its peak. So, it is necessary to bear in mind that QES employment is restricted to employees and gives equal weight to full – and part-time employees, where the LFS defines full-time as anyone working more than 16 hours per week. It therefore does not allow for changes in the total number of hours worked and implies that any growth in the QES count of the number of employees may exaggerate the increase in the number of full-time equivalents.

The growth in part-time employment has been proportionally greater in NI than in the UK as a whole, where 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

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%.

¹ONS Regional Labour Market Statistics, December 2015.

²Nomis, 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).

A note on Brexit and NI sectoral performance

The outcome of Brexit for NI is more likely to be relatively favourable or, at least, any harm is likely to be minimised if the Executive can clearly identify what its key priorities are for NI in a post-Brexit world and negotiates vigorously for these to be included within the UK's negotiating position. For the purposes of planning, consideration of sectoral prospects should not automatically assume continued unfettered Single Market access. Some issues are undernoted:

Manufacturing

NI is one of the UK regions with the highest rate of dependency on the EU market. HMRC suggest that, in 2015 55% of all NI exports were sold to EU markets (RoI being NI's biggest single export market), as against 48% for the overall UK. We recommend rigorous market research of the non-EU markets to identify the key barriers to exports and how such barriers might be overcome. The emphasis should be on the US and Canada, the rest of the Commonwealth and the Emerging Markets.

Food processing

Food processing in NI has grown rapidly since 2008 and, as in the rest of the UK, is highly dependent on EU markets (and particularly on RoI), with the EU external tariffs on some dairy products as high as 35%. Around 27% of UK food products come from the EU, offering opportunities for replacement, while a focus on new, non-EU markets is vital

Farming

NI's food processing industry is closely linked to primary production within the region, while RoI processors could be disrupted as NI farm products lose their EU origin status. Farming is also an important sector in its own right, with about 30,000 farms in NI. The political feasibility of 100% replacement of existing EU farming subsidies by the UK government is questionable as, in proportion to relative sizes of output, the rate of support in NI was about three times that in England. Exploiting natural advantages, grass-based farming; reputational advantages – traceability of livestock, and R&D offer more scope. New Zealand has managed the transition to a low subsidy approach to agriculture and at the same time agriculture's share of GDP at about 5% is now several times higher than it is in NI.

Notes

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