



Northern Ireland
Assembly

Research and Library Service Briefing Paper

Paper 51/11

21 March 2011

NIAR 325-11

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Economic Briefing: March 2011

This paper summarises current economic conditions in Northern Ireland. It provides an overview of a range of economic indicators, including current growth projections, labour market and property market conditions, as well as the outlook for inflation / interest rates. Key data and messages are presented upfront in the Summary to provide an 'at a glance' synopsis of the NI economy.

Summary: Economic Indicators

Growth (GVA)		Estimates of the increase in total output of the NI economy (as measured by GVA) in 2010 range from 0.5% to 1.2% ¹ The average local forecast for growth in NI in 2011 is 1.3%; considerably below the rate projected for the UK (2% ²)
Employment ³		The Quarterly Employment Survey is a measure of changes in employee jobs; the survey indicates that, as at December 2010, there have been falls of 1,880 and 8,200 in employee jobs over the previous quarter/year respectively.
Unemployment		The unemployment rate increased by 0.4 percentage points over the quarter Nov 2010-Jan 2011, and by 1.7 percentage points over the year, to 8.0%. This represents the largest annual increase in the UK.
Claimant Count		The claimant count now stands at 6.6% of the workforce, representing an increase of 6.3% (3,500) over the year. This is higher than the UK average rate (4.5%) and is the joint highest of all 12 UK regions. NI has reported the highest monthly and annual increases (%) in the UK.
Economic Inactivity		The NI working age economic inactivity rate stands at 28.4%; this is significantly above the UK average (23.3%) and is highest in UK.
Redundancies		The rate of redundancies appears to be slowing; over the latest 12 month period, there were decreases from the previous year of 45% and 53% in the number of <i>proposed</i> and <i>confirmed</i> redundancies, respectively.
House Prices		NI house prices have undergone the most severe corrections in the UK since peak (August 2007). Unlike many other UK regions, NI prices have continued to fall over the last year
Inflation		Inflation rate has increased further, reaching 4.4% in Feb 2011 – remains considerably above the BoE target of 2%
Interest Rates		Despite inflationary pressures, the Monetary Policy Committee (MPC) once again opted to maintain base rate at 0.5% in March 2011.

¹ Sourced from local forecasters, namely Ulster Bank, PwC and Oxford Economics

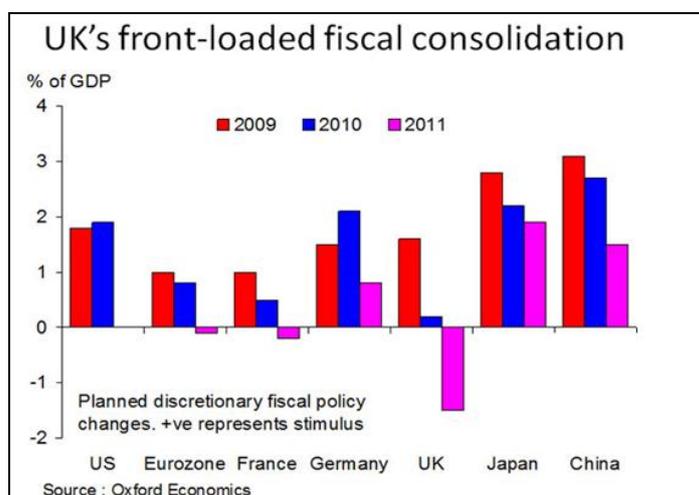
² As per International Monetary Fund (IMF)

³ Official 'employment' data is not presented here as it is arguably misleading as an indicator of labour market conditions. The Quarterly Employment Survey is used instead; it is considered preferable in that it reflects *jobs* rather than *employees*

Factors Affecting Economic Outlook

Global Economy: Global growth in 2011-12 is likely to be driven by emerging and developing economies, whilst advanced economies continue to face considerable downside risks. The US recently reported higher than expected output, potentially reducing the risk of a ‘double-dip’ in the global economy. However, inflationary pressures represent a key risk to sustained recovery. The ongoing crisis in the Middle East and recent earthquake and tsunami in Japan also present downside risks to the extent/pace of global economic recovery, as do sovereign debt concerns in the Euro zone.

UK Economy: The UK Government has opted to cut public expenditure levels deeply and quickly⁴, whereas other governments have favoured additional economic stimulus. The figure below shows the extent of the UK austerity plans - whether this proves to be ‘too much too soon’ remains to be seen.



Source: IPPR (<http://www.ippr.org/articles/?id=4368>)

NI Economy: In NI, the outlook remains challenging, to say the least. The Government’s spending cuts are yet to hit the economy; these equate to some £4bn for NI between 2011 and 2015 and are likely to have a disproportionate impact locally. NI might also be particularly vulnerable to increases in interest rates, which are looking increasingly probable in the short to medium term. Upside/downside risks specific to the NI economy include:

Upside Factors – NI Economy	Downside Risks – NI Economy
Number of high profile investment announcements in February	Remaining constraints on availability/affordability of credit
Corporation Tax cut looking likely ⁵	Exposure to/association with troubled economy in ROI, and to NAMA
Recent easing in rate of contraction in business activity (Ulster Bank PMI)	Relative size of public sector means that cuts in DEL might have disproportionate impact in NI, as may reform of welfare system (cuts in AME) ⁶ .
Number of proposed/confirmed redundancies down significantly on last year	Relatively small private sector (with limited export base) may struggle to ‘pick up the slack’
	Housing market remains volatile and has undergone most severe price corrections in UK. Confidence levels (and consumption) have suffered accordingly.
	Consequently high levels of negative equity and risk of repossession makes NI particularly vulnerable to interest rate increases.
	Unlike many other UK regions, labour market conditions in NI are continuing to deteriorate

⁴ The rationale for this is to ensure a credible debt reduction plan so as to protect the UK’s credit rating; should money markets perceive higher risks, it would become more expensive for the UK to service its debt

⁵ Could arguably be perceived as a downside risk, since there will be considerable risks/costs associated with implementation

⁶ Departmental Expenditure Limits (DEL) and Annually Managed Expenditure (AME)

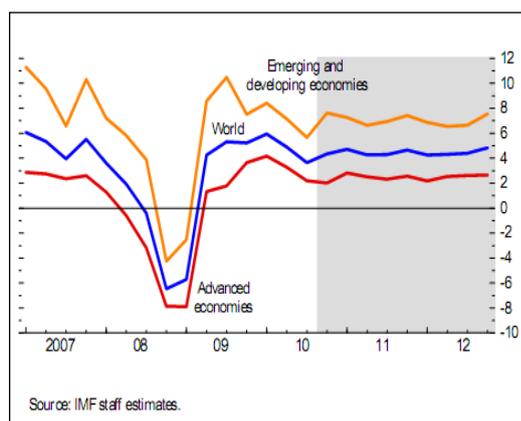
1 Economic Growth (GVA/GDP)

The total output of the NI economy, as measured by Gross Value Added (GVA), is estimated to have increased by between 0.5% and 1.2% in 2010 (refer Figure 4)⁷.

1.1 Global Outlook

According to International Monetary Fund (IMF) projections, global output will increase by 4.5% in 2011 and 4.4% in 2012⁸. As shown in the figures below, much of this growth is expected to be driven by emerging and developing Economies, including those of Brazil, Russia, India and China (BRIC), ASEAN-5 (Indonesia, Malaysia, Philippines, Thailand and Vietnam), as well as Sub-Saharan Africa. The outlook for advanced economies, (many of which have been exposed to the Credit Crunch and associated impacts on public finances), is less favourable. In this sense, a two-speed recovery is largely anticipated; downside risks to recovery in advanced economies remain heightened, whereas emerging and developing economies are facing the risk of overheating⁹.

Figure 1: Global GDP Growth¹⁰



Source: IMF

Figure 2: IMF World Economic Outlook Projections (% Change): Selected Countries

	2009	2010	Projections	
			2011	2012
UK	-4.9	1.7	2	2.3
Euro Area	-4.1	1.8	1.5	1.7
Advanced Economies	-3.4	3	2.5	2.5
Emerging and Developing	2.6	7.1	6.5	6.5
US	-2.6	2.8	3	2.7

Source: IMF

1.2 UK/NI Outlook

Oxford Economics projects that NI will lag behind the UK until the second quarter of 2011, after which there should be a convergence in growth rates (Figure 3). However, this forecast is underpinned by arguably optimistic assumptions regarding the performance of a number of sectors in Northern Ireland¹¹. Downside risks are considerable; it is therefore possible that more adverse outturns will be experienced and growth rates could be lower. Figure 4 shows that other local forecasters are expecting lower rates of growth in 2011. **The average local forecast for growth in 2011 is 1.3%; considerably below that for the UK (2%) (IMF).**

⁷ Official GVA data for 2010 is not yet available; however, Oxford Economics, PwC and Ulster Bank estimate that the growth has been in this range

⁸ Global projections have been revised downwards, since last IMF forecasts, for 2011 (4.5% versus 4.8%) and upwards for 2012 (4.4% versus 4.2%) - World Economic Outlook, IMF, October 2010

⁹ Inflationary pressures are increasing in some emerging economies; this has been driven in part by strong capital inflows

¹⁰ Percent; quarter over quarter, annualised - <http://www.imf.org/external/pubs/ft/weo/2011/update/01/pdf/0111.pdf>

¹¹ For example, Oxford acknowledges considerably downside risks regarding the performance of the construction and retail sectors.

Figure 3: Actual/Forecast GVA Growth in UK and NI (%)

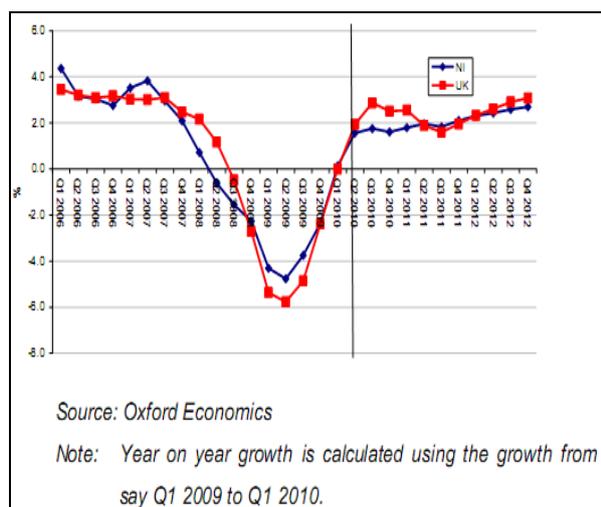


Figure 4: Growth Estimates/ Projections (% Real Terms) NI 2010-12

	Projections		
	Estimate	2011	2012
	2010	2011	2012
Oxford Econ	1.2	1.8	2.3
PwC	0.8	1.0	-
Ulster Bank	0.5	1.0	1.0-1.5

Source: Private communication with forecasters

1.3 Key Risks to Economic Recovery in NI

The outlook for the NI economy depends upon a variety of factors; however, some of the key threats to sustained economic recovery include:

- **Inflationary pressures** are persisting, making interest rate hikes a more likely prospect in the short to medium term. This could be particularly problematic for NI, given extreme house price corrections since peak, and consequently high levels of negative equity. Interest rate rises will put an additional squeeze on homeowners’ repayment capacity and further increase the risk of repossessions.
- **Extent of impending £4bn spending cuts**; whilst spending cuts are facing the entire UK, NI might be disproportionately impacted for following reasons:
 - Particular reliance on Public Sector employment/expenditure
 - Relatively small private sector/export base
 - High rate of economic inactivity
 - Labour market conditions continue to deteriorate (unlike other UK regions)
 - Particular reliance on welfare state and thus particularly vulnerable to welfare reform
 - Property market remains volatile, with falling prices still a feature
 - Relationship with ROI and associated exposure to financial issues there;
 - Remaining constraints on availability/affordability of credit¹² (particularly given specific nature of NI banking sector¹³);

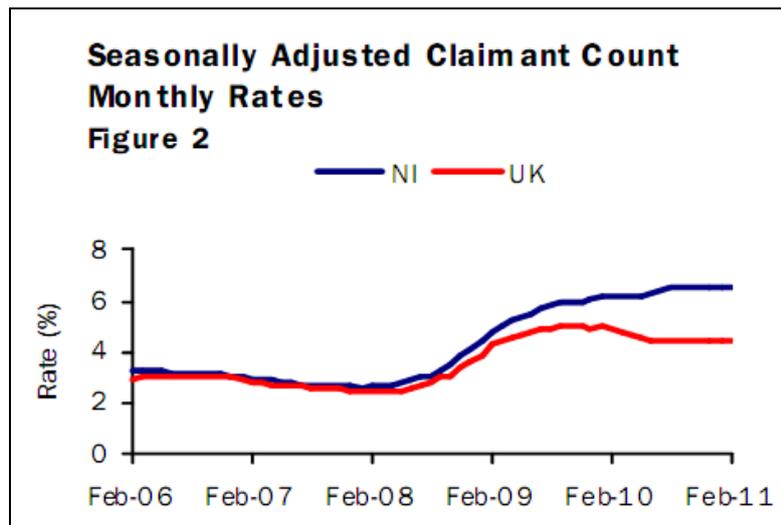
¹² Anecdotal evidence suggests businesses are still encountering problems in accessing and/or affording credit. This is also supported by recent surveys conducted by the Institute of Directors on bank lending in NI

2 Labour Market Trends¹⁴

The impact of the recession on the NI labour market continues to be reflected in official labour market data:

The claimant count in NI now stands at 59,100 (6.6% of the workforce in February 2011); this represents an increase of 6.3% (3,500) over the year. Figure 5 shows that the rate has diverged considerably from the UK average since the start of 2008.

Figure 5



Source: DETI

The Quarterly Employment Survey indicates that **there were decreases in total employee jobs of 1,880/8,200 over the last quarter/year¹⁵**. Figure 6 indicates that a total of 40,610 jobs have been lost so far, as a result of the recession. Figure 7 shows the sectoral composition of losses incurred over the last year/quarter; the construction industry continues to suffer significantly (-1,480 jobs over the quarter), as does the services sector (-1,270 jobs over the quarter)¹⁶.

Correspondingly, the unemployment rate is estimated at 8.0%, up 0.4 percentage points over the quarter and 1.7 percentage points over the year. This was the largest annual increase among the twelve UK regions. The rate is now equal to the overall UK average (8.0%), but remains below that of the EU (9.6%) and ROI (13.8%)¹⁷. **The rate of working age economic inactivity in NI stands at 28.4%**; as has historically been the case, this is significantly higher than the UK average rate (23.3%) and is the highest of the twelve UK regions.

¹³ NI has a relatively concentrated banking sector, with four 'leading' banks, two of which are Irish owned and thus exposed to the outworkings of NAMA, etc.

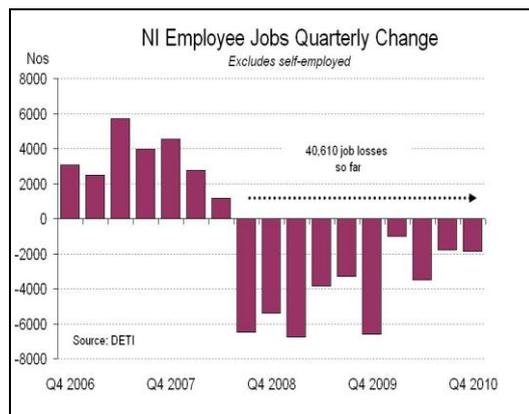
¹⁴ *Monthly Labour Market Report*, March 2011, DETI

¹⁵ Official 'employment' data is not presented here as it is arguably misleading as an indicator of labour market conditions. The Quarterly Employment Survey is considered preferable in that it reflects *jobs* rather than *employees*

¹⁶ Seasonally adjusted

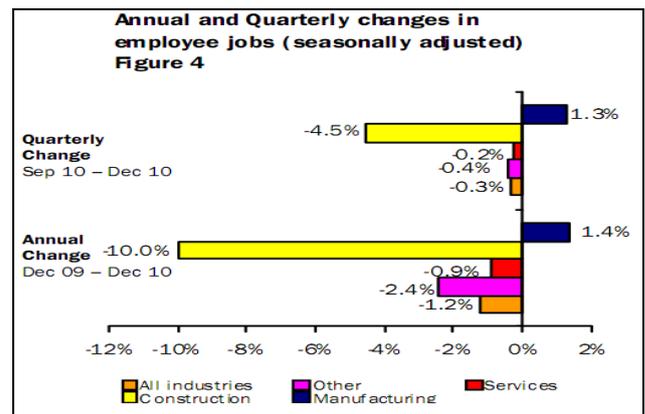
¹⁷ Rates for EU and ROI as at December 2010

Figure 6



Source: Ulster Bank

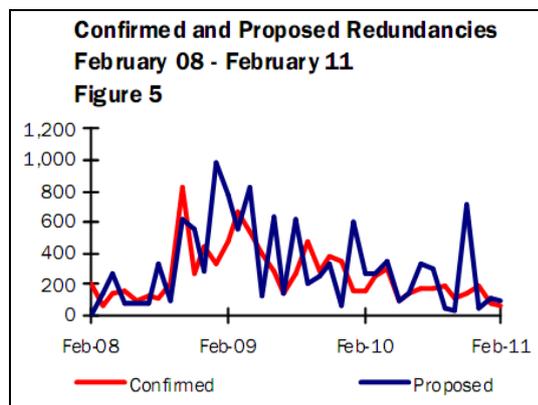
Figure 7



Source: DETI

On a more positive note, there are some signs of improvements reflected in proposed redundancy data. Whereas the above labour market statistics are lagged indicators of economic performance, proposed redundancies might be a more accurate reflection of current (and projected future) business conditions. **Over the latest 12 month period, there was a decrease of 45% in the total number of proposed redundancies compared to the previous year.** In terms of *confirmed* redundancies, there has been a decrease of 53% from the previous year (figure 8)¹⁸.

Figure 8



Source: DETI

Another positive development for the local labour market has been the announcement, in February, of a number of high profile investments including BT, Camden Group, Bombardier and Schrader Electronics¹⁹.

Equally, the recent press coverage in respect of the possibility of a cut in corporation tax in NI would suggest that the prospects for the local labour market might be bolstered in coming years. This would be particularly beneficial for the local economy if any resulting jobs were high value-added in nature, enabling improved productivity levels in NI. However, it is worth noting that there would also be considerable costs associated with implementing the proposed cut (since it would result in a reduction in the block grant) and thus any potential benefits would be unlikely to accrue for some time.

¹⁸ However, there is significant volatility in this measure, with a considerable spike having occurred in late 2010.

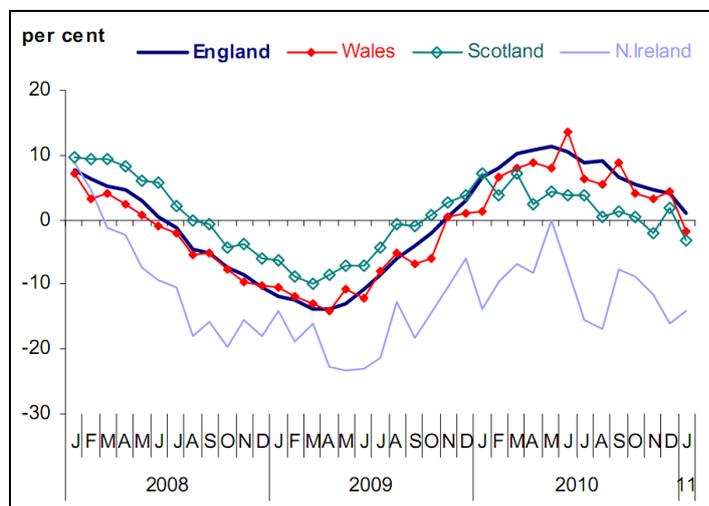
¹⁹ Weekly Economic Update, Northern Bank, 7 March 2011

3 Housing Market Trends

3.1 House Prices²⁰

As described in a previous Economic Briefing (November 2010), **NI property prices have undergone the most severe corrections in the UK since the peak** (August 2007)²¹. It is worth highlighting, however, that NI underwent a similarly unique 'spike' in prices, prior to the downturn. Nonetheless, the extent of the downward spiral in NI property prices has severely impacted confidence levels, and accordingly, consumption in general. The local housing market remains volatile. Data produced by Communities and Local Government (CLG) (March 2011) indicates that while average prices *increased* during the year in England (1.0%), they *decreased* in Wales by 1.8%, in Scotland by 3.2% and in Northern Ireland by 14.1% (figure 9).

Figure 9: House price rates of change by country (12 month % change)



Source: <http://www.communities.gov.uk/documents/statistics/pdf/1864282.pdf>

The University of Ulster House Price Index (February 2011) also indicates that **house prices in NI are continuing to fall. The University of Ulster survey indicates that there has been an annual weighted decline in average sale prices of 7.7%**. There was relatively little change over the quarter²², with a 0.1% weighted increase having been recorded. This is consistent with the findings of the Royal Institute of Chartered Surveyors (RICS) Housing Market Survey. This indicated that some 46% of surveyors in Northern Ireland were reporting price falls in February 2011²³, as opposed to just 28% in January 2011. Other regions fared considerably better; for example, the equivalent figure in Scotland for February 2011 was just 16%²⁴.

Despite overall declining prices, trends in average prices have varied significantly depending on property type (figure 10); terraced houses and townhouses have experienced the most severe price

²⁰ Updated house price data from Nationwide, Halifax and Ulster Bank was not available at the time of writing

²¹ In August 2010, average house price falls from the peak in NI were estimated at -41.8%, compared to a UK average of -3.5%
NI Housing Market Update, Ulster Bank, October 2010

²² Between Q3 2010 and Q4 2010

²³ 51% reported no change and 2% reported increases

²⁴ http://www.rics.org/site/download_feed.aspx?fileID=8970&fileExtension=PDF

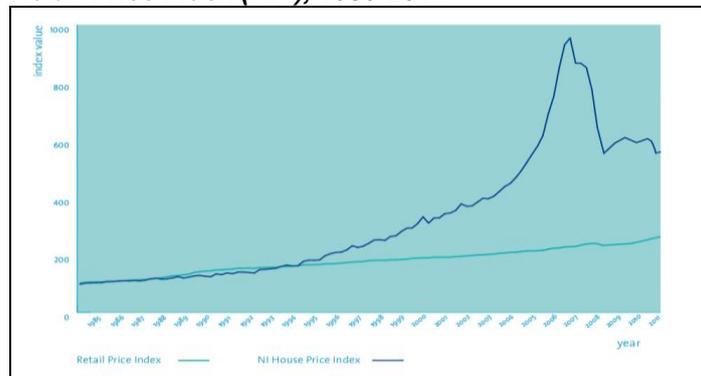
reductions over the year (-21.1%), whereas apartment values have in fact increased (7.1%) and the value of detached houses has remained largely unchanged (0.4%). Figure 11 shows the extent of the property 'bubble' in NI; the house price index deviated considerably from the Retail Price Index (RPI), peaking in August 2007. Prices have fallen considerably since, and appear to be tending towards more sustainable levels.

Figure 10: University of Ulster Quarterly House Price Index (Q4 2010)

Annual % change and average price			
Market sector	Annual Change	Average Price Quarter 4	Average Price Annual
Terraced/townhouse	-21.1%	£98,584	£107,836
Semi-detached house	-9.6%	£138,427	£140,980
Detached house	0.4%	£251,225	£275,555
Semi-detached bungalow	-17%	£111,212	£127,323
Detached bungalow	-4.5%	£188,718	£192,778
Apartment	7.1%	£133,428	£133,124

Source: <http://www.rpp.ulster.ac.uk/housing-index.php>

Figure 11: NI House Price Index relative to Retail Price Index (RPI), 1985-2011



3.2 Availability of Mortgages

A key challenge to the recovery of the local housing market, and indeed to the recovery of the economy as a whole, is the remaining constraint on the availability of affordable credit. This is a global issue; in the wake of the credit crunch banks have become more risk averse and have sought to recapitalise balance sheets. However, this issue might be particularly pertinent in an NI context. There are four 'leading banks' in NI, two of which are Irish owned²⁵ and thus relatively exposed to the financial issues in ROI, and the outworkings of the National Asset Management Agency (NAMA). As outlined above NI has also undergone the most severe house price corrections in the UK. This means that there might be particular constraints on the availability of finance (for mortgages and otherwise) in NI, potentially curtailing the pace/extent of housing market recovery.

3.3 Risk of Repossession

According to Homeloan Management Limited (HML), UK repossessions are expected to fall during the first half of 2011 and rise during the second half of the year. In total, HML forecasts that some 33,000 homes (0.3% of all mortgaged properties) will be repossessed across the UK during 2011. HML indicates that **Northern Ireland is expected to experience the worst rate of repossessions in the UK (0.83%, equivalent to 2,540 homes)**. This rate is considerably above other UK regions; the estimate for Wales is 0.37%, Scotland 0.33%, London 0.34%, South West 0.18%. This is likely to be due to the fact that, as mentioned previously, NI has undergone the most severe house price corrections in the UK and is geographically and commercially associated with the troubled economy of ROI. As outlined in section 1, NI is also disproportionately vulnerable to the impending cuts in public expenditure.

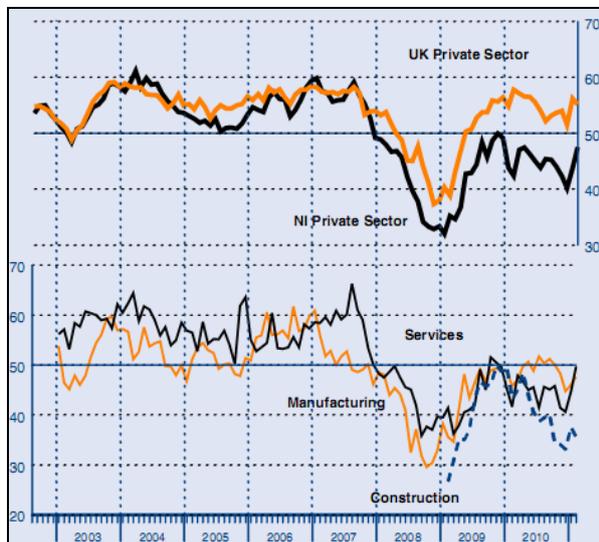
²⁵ First Trust and Bank of Ireland are Irish owned. The other two 'leading banks' are Northern Bank and Ulster Bank

4 Business Environment

4.1 Business Activity

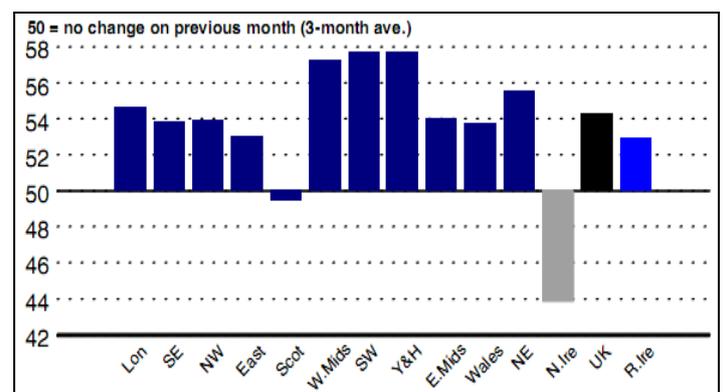
Ulster Bank’s Purchasing Managers’ Index (PMI) indicates that, **although there was a further reduction in NI private sector activity during February, this was at the slowest rate since December 2009**. The index indicates that business activity fell in all NI sectors in February; however the construction industry recorded the sharpest reduction by far (refer figure 12 – index readings above 50.0 signal an increase on the previous month while readings below 50.0 indicate a decrease). **Figure 13 shows the performance of the NI private sector relative to the rest of the UK; NI has fared particularly badly over the last 3 months**. Scotland was the only other region to post a (much smaller) decline over the 3 months to February 2011; it is of note that there was in fact an expansion in ROI output, despite the financial and economic problems there.

Figure 12: Output/Business Activity



Source: Ulster Bank PMI

Figure 13: Output/Business Activity across UK (Average last 3 mths)



Source: Ulster Bank PMI

4.2 Availability of Finance

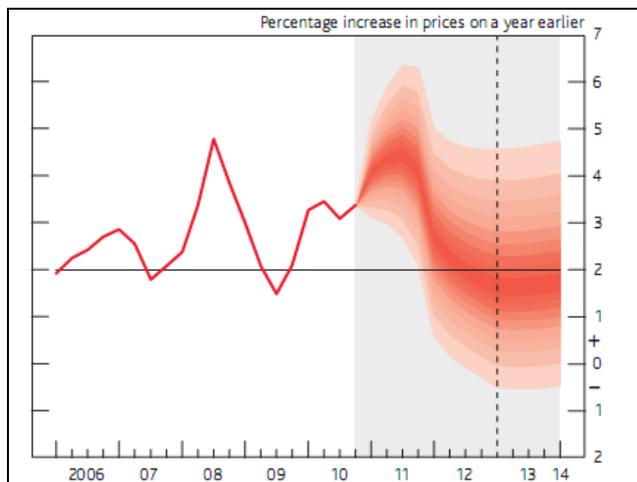
Recent surveys, carried out by the Institute of Directors, have indicated that businesses continue to encounter difficulties in terms of the availability and/or affordability of credit. Businesses in NI may face particular difficulties in accessing/affording credit due to the fact that local banks’ propensity to lend might have been affected by the particular deterioration in property values in NI, as well as their exposure to the economic/financial problems in the Republic of Ireland, including the National Asset Management Agency (NAMA). NI has had the lowest take-up rate in the UK of the Government’s bank lending schemes, including the Enterprise Finance Guarantee (EFG) Scheme.

5 Inflation / Interest Rates

The outlook for inflation has risen markedly over recent months. Latest data indicates that it measured 4.4% in February 2011, up from 4% in January 2011²⁶. Figure 14 shows the Monetary Policy Committee's collective judgement for the outlook for Consumer Price Index (CPI) inflation; it is anticipated that inflation could range between 4% and 5% in the near term (a rate considerably above the Bank of England's target of 2%). The latest Bank of England Inflation Report (February 2011) attributes this to the increase in VAT, higher energy and import prices and some rebuilding of companies' margins.

However, the *general consensus* of the MPC²⁷ is that inflation may fall back²⁸. However, the Inflation Report acknowledges that the medium term prospects for inflation are highly uncertain (hence the width of the fan projection in Figure 14).

Figure 14: CPI inflation projection based on market interest rate expectations and £200bn asset purchases



Source: Bank of England

The inflationary outlook is important in that it implies a continued pressure on the Bank of England to increase the Base Rate from its current low of 0.5%, (although this needs to be balanced against the associated threats to sustained economic recovery). This could significantly impede economic recovery. Simulation work carried out by Oxford Economics suggests that ***an increase in the UK Base Rates to 2% (from the current rate of 0.5%) in 2011 and 3.5% by the end of 2012 would severely dampen economic recovery.*** Their model indicates that this would take GDP growth down by 0.2 percentage points in 2011 and 1.2 percentage points in 2012, resulting in significant job losses in Northern Ireland²⁹.

²⁶ <http://www.statistics.gov.uk/pdfdir/cpi0311.pdf> (22 March 2011)

²⁷ The numbers of members voting for an increase in the Base Rate, although still in the minority, has risen over recent months reflecting concerns that the margin of spare capacity may not be sufficient to outweigh inflationary concerns

²⁸ Due to downward pressure on wages and prices

²⁹ Quarterly Sectoral Forecasts, Oxford Economics/Northern Bank, Q1 2011