Northern Ireland Assembly

Research and Information Service Briefing Paper

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Economic Briefing: June 2011

This paper provides an overview of economic data and factors affecting the outlook for the NI/UK economies. Key data and messages are presented upfront to provide an 'at a glance' synopsis of economic conditions.

Key Economic Data[1]

Growth Forecasts		Whilst positive growth continues to be projected for 2011/12, forecasts have been revised downwards for both UK and NI since last economic briefing. Latest IMF estimates indicate that the UK economy will grow by 1.5% and 2.3% in 2011/2012. NI is expected to lag behind the UK in 2011/12.
Labour Market[2]		
Unemployment		The unemployment rate in NI is now 7.2%. This represents a decrease of 0.8 percentage points over the quarter, but an increase of 0.1 percentage points over the year.
Claimant Count		The claimant count now stands at 6.7% (59,500) of the workforce, representing an increase of 7% over the year. The current rate is considerably higher than UK average rate (4.6%) and is joint highest of all UK regions.
Economic Inactivity		The number of economically inactive persons in NI fell over last quarter/year. However, NI's working age inactivity rate (27.7%) remains considerably above UK average (23.3%)
Redundancies		There continues to be an easing in confirmed redundancies rate in NI; although there has been a slight uplift between May & June, there was decrease of 41% in last 12 months
Consumer Confidence		
Consumer Confidence		The latest Northern Bank survey of Consumer Confidence in NI (June 2011) has improved unexpectedly, having declined to its lowest point since records began in April.
New Car Registrations		According to DRD statistics, the number of new cars registered between January and March 2011 (16,586) was significantly below the equivalent period in 2010 (19,796).
Other Data		
Inflation		Inflationary pressures continue to persist; the CPI reached 4.5% (RPI 5.2%) in May. This remains considerably above the BOE's target of 2%. Despite this, the MPC has continued to vote in favour of maintaining base rate at 0.5%
Index of Services		The Index reflects a further deterioration in conditions in NI private sector output. UK data indicates tentative signs of improvement, but this is not yet evident in NI private sector.
Purchasing Managers Index (PMI)		Ulster Bank's PMI continues to indicate a contraction in private sector activity. This is in contrast with the expansionary trends being reported in the UK and ROI.

[1] All abbreviations are explained in body of report

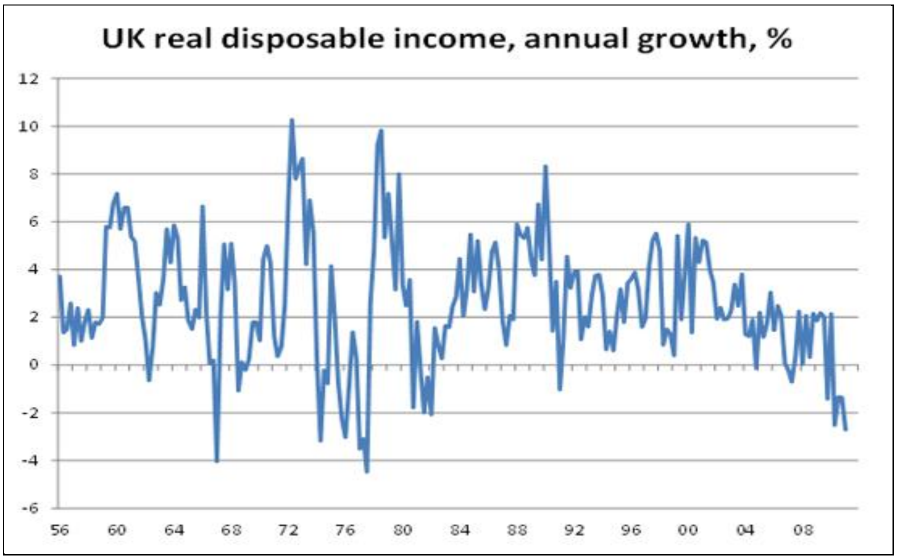
[2] Arrows are reflective of annual trends in labour market indices. All other arrows indicate latest trends.

Summary of Factors Affecting Economic Outlook - UK/NI

The global recovery remains fragile. While some economic commentators suggest that the risk of a double-dip has receded, it does remain nonetheless. Downside risks to recovery in the UK/NI economies include:

- ***The Government's austerity measures***. As outlined in previous economic briefings, the UK Government's plans for fiscal consolidation are 'front-loaded' relative to other countries[3]. Whilst necessary to ensure a credible debt reduction plan and thus protect the country's credit rating, the scale and timing of the cuts represent a risk to the stability/pace of economic recovery.

- ***Inflationary pressures are persisting***. The Consumer Price Index reached 4.5% in May 2011[4]. Households' real incomes are thus being squeezed, and this will be further exacerbated by interest rate increases (which are becoming increasingly inevitable as MPC seeks to retain credibility in enforcing the Bank's target inflation rate of 2%, and avoid wage inflation/associated inflationary spiral). Data for March 2011 indicates that UK households have seen the biggest fall in disposable income for more than thirty years[5] (refer figure below[6]). This trend in disposable incomes is an unusual feature of the current recovery; the recoveries of the 1980s and 1990s occurred in periods of rising (or at least flat) levels of real disposable income[7]. Falling incomes are likely to act as a drag on economic recovery.



Source: Institute for Public Policy Research

[3] Relative to the Eurozone, in general, and to US, France, Germany, Japan and China, specifically. Refer http://assist.assemblyni.gov.uk/services/rsrchlib/products/researchpubs/dept/fp/2011/carson5111.pdf, page 3

[4] The Retail Price Index (RPI) reached 5.2% over the year to May 2011 http://www.statistics.gov.uk/cci/nugget.asp?id=19

[5] Office for National Statistics data for end of March indicates that real incomes fell 2.7%, a fall not seen since 1977. This is attributed to higher taxes, domestic bills and inflation. http://www.bbc.co.uk/news/business-13948326

[6] Figure 1 is sourced from IPPR paper *The Squeeze Intensifies,* June 2011

[7] http://www.iod.com/mainwebsite/resources/document/iod_pulse_1103.pdf

- ***The housing sector remains fragile***. This is particularly the case in NI, where prices are in fact continuing to fall[8]. Associated with this is the issue of constrained bank lending levels, which is also particularly problematic in NI given local banks' exposure to the severe house price corrections in NI, as well as the economic/financial woes in ROI.

- ***Impending tightening in bank regulation.*** Whilst vital in enhancing the stability of the sector and in preventing future credit crises, tighter regulation may add to existing constraints on bank lending levels in the short/medium term, as banks seek to recapitalise to meet new solvency requirements (7% as per Basel III, although Osbourne may require UK banks to hold 10%[9]).

- ***Ongoing concerns about banking sector losses*** (which might only fully emerge in the wake of interest rate increases as repayment capacity becomes squeezed). Thus far, this risk has been largely contained by policy responses such as the European Financial Stability Facility. However, concerns remain. ***Concerns regarding sovereign default risks in Eurozone also remain***. The Governor of the Bank of England, Sir Mervyn King, has identified the debt problems of Greece and other countries as *"the most serious and immediate risk"* to UK banks. The Bank's Financial Policy Committee has thus called for an audit of UK banks' exposure to the Eurozone debt crisis[10]. The situation in Greece remains particularly worrying. Should Greece default, not only would banks incur losses, but they would be likely to invoke their credit default swaps, thus creating large losses for insurance companies.

- ***Confidence levels remain low*** (in view of austerity cuts, upwards interest rate expectations, fragile housing sector, constraints on bank lending, Eurozone worries, etc.). Higher rates of precautionary savings are likely to remain a feature, thus acting as a drag on consumption.

Upside Risks? Discussions regarding the potential for a lowering of the rate of corporation tax in Northern Ireland are ongoing. It might be argued that this represents a potential 'upside risk' to economic growth in Northern Ireland. The impact on confidence levels would most likely be generally favourable (although this would need to be balanced against the perceived risks and costs associated with the proposal)[11]. There is therefore an associated possibility that the local private sector could recover more quickly than anticipated. However, other projected economic benefits (job creation, improved productivity, etc.) presume that there is a supply of Foreign Direct Investment (FDI) - perhaps less of a certainty in the current economic environment - with a specific sensitivity to the corporation tax rate. The corporation

[8] http://www.bankofireland.co.uk/bank-of-ireland-group/financial-news/boi-house-price-index/ and http://rpp.ulster.ac.uk/research/housing-index/q1-2011.pdf
[9] http://www.guardian.co.uk/business/2011/apr/11/lloyds-sell-more-branches-banking-commission
[10] http://www.bbc.co.uk/news/business-13901685
[11] It is possible that this is being reflected in the Northern Bank's Consumer Confidence survey, which has shown an unexpected improvement.

tax rate is undoubtedly an important determinant of FDI flows; however, the exact scale and timing of any associated effect remains to be seen.

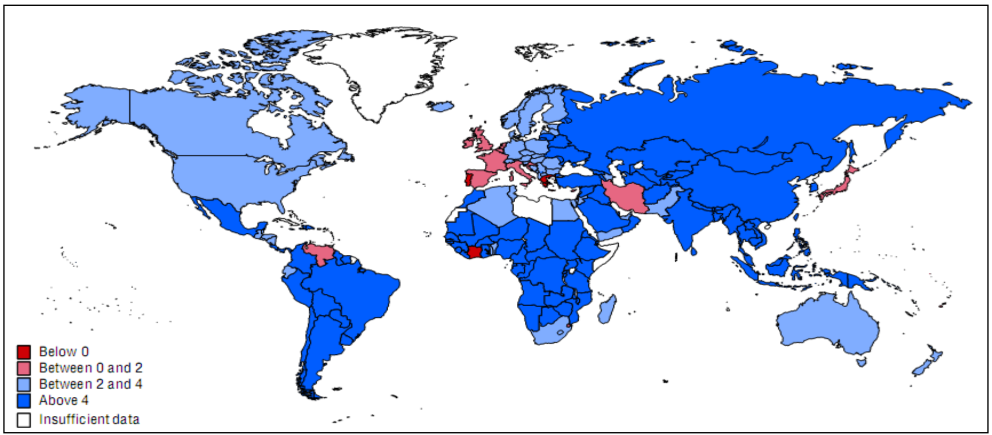
In the context of proposed changes to the corporation tax rates, it is worth ***mentioning the high levels of Air Passenger Duty currently imposed in NI***. Continental Airlines has expressed concern as to the sustainability of the Belfast to New York flight, due to the high level of APD paid (some £60 for this flight, as opposed an equivalent charge of €3 in Dublin). This is of considerable economic consequence, and in fact could act as a disincentive for FDI into NI. The Continental Airlines flight to New York is believed to be worth in the region of £20m to the local economy[12]. The economic importance of the flight was highlighted recently when the Managing Director of Citgroup stated that they would have to seriously reconsider their operations in NI – which employ some 1200 staff[13] – if the flight was cancelled[14].

[12] http://www.northernbank.co.uk/en-gb/About-the-bank/Bank-in-brief/Economic-Research/economic-update/2011/Pages/270611.aspx
[13] http://www.belfasttelegraph.co.uk/business/top-100-companies/company-list/article15139841.html
[14] As stated by Brian McAreavey at a recent conference

1 Growth Forecasts (GVA/GDP)

Latest International Monetary Fund (IMF) projections (June 2011) indicate that the global economy will grow by 4.3% in 2011 (revised downwards from 4.4% in April) ***and 4.5% in 2012*** (unchanged).

Figure 1: Global Average Projected Real GDP Growth (%) during 2011-12



Source: International Monetary Fund (IMF), April 2011

In global terms, the UK, and indeed much of the Eurozone, is expected to recover at a relatively slow rate during 2011-12 (Figure 1). As illustrated in the map, the global recovery is thus expected to be a 'two-speed' one. Much of the 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. Latest growth forecasts for the UK in 2011 and 2012 are summarised in the table below. ***IMF forecasts suggest that the UK will grow at a rate of 1.5% and 2.3% in 2011 and 2012, respectively***[15]. OECD and European Commission (EC) projections differ slightly:

Table 1: Leading Forecasts for Growth in UK 2011-2012

	IMF (June 2011)		OECD (May 2011)		EC (May 2011)	
	2011	2012	2011	2012	2011	2012
UK	1.5%	2.3%	1.4%	1.8%	1.7%	2.1%

It is anticipated that the recovery in NI will be slower and more protracted than the UK average. Forecasts for growth in the NI economy in 2011 range from 0.5% (Ulster Bank) to 1.1% (Oxford Economics). Economic performance in 2012 is also expected to be significantly below that of the UK; Ulster Bank is forecasting 1% growth[16].

[15] Figure 1 presents growth forecasts as at April 2011. These were updated in June 2011 (Table 1) – the UK is now therefore just outside the 'red' category; however, map remains broadly reflective of comparative global projections.
http://www.imf.org/external/pubs/ft/weo/2011/update/02/index.htm

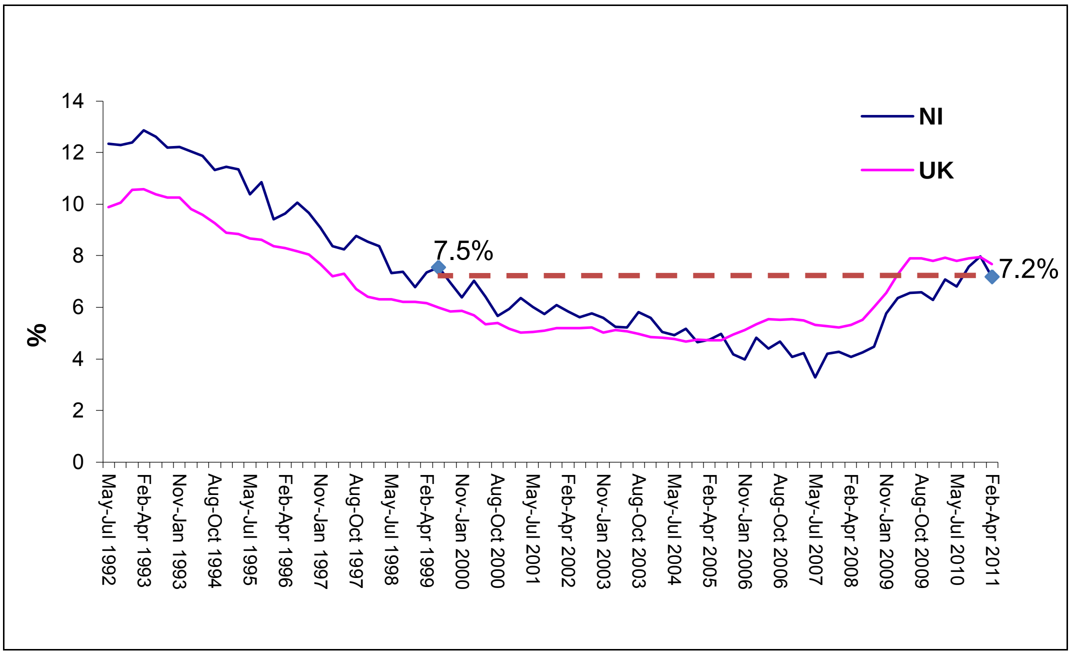
[16] Private correspondence with Richard Ramsey, Ulster Bank

2 Labour Market Trends

The impact of the recession continues to be reflected in local labour market data:

- ***The unemployment level in NI (7.2%) has fallen slightly over the last quarter, (from 8.0%). Nonetheless, Figure 2 shows that the rate remains at just below levels last reported in May-July 1999 (7.5%). This indicates that the impact of the global recession on local labour market conditions; approximately twelve years of progress has effectively been eliminated.***

Figure 2: Unemployment Rates (Seasonally adjusted)

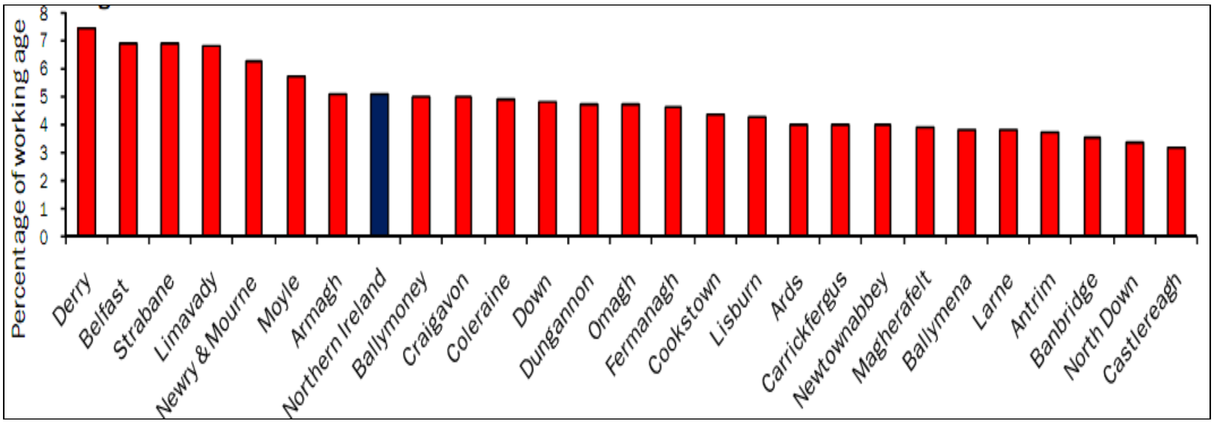


Source: Produced using data provided by DETI

- The unemployment rate does not fully reflect the relatively high rate of economically inactive (individuals neither in nor looking for work) in Northern Ireland. ***The working age economic inactivity rate in NI stands at 27.7%; a rate considerably above the UK average (23.3%) and the highest of the twelve UK regions.*** The rate of economic inactivity in fact fell by 4,000 over the quarter and by 3,000 over the year; however, this is not necessarily reflective of improved labour market conditions (for example, it is possible that a number of 'economic inactive' individuals have merely transferred to 'claimant count').

- ***The claimant count rate in NI is continuing to rise, and now stands at 6.7% of the workforce – a rate higher than the UK average (4.6%) and joint highest among the 12 UK regions.*** This represents an increase of 3,900 (7.0%) over the year. ***At District Council Area level, the areas that incurred the greatest rises in claimant count levels over the year to May 2011 were Ards (16.7%), Armagh (10.8%) and Banbridge (10.4%).*** Figure 3 shows current claimant count rates by District Council Area.

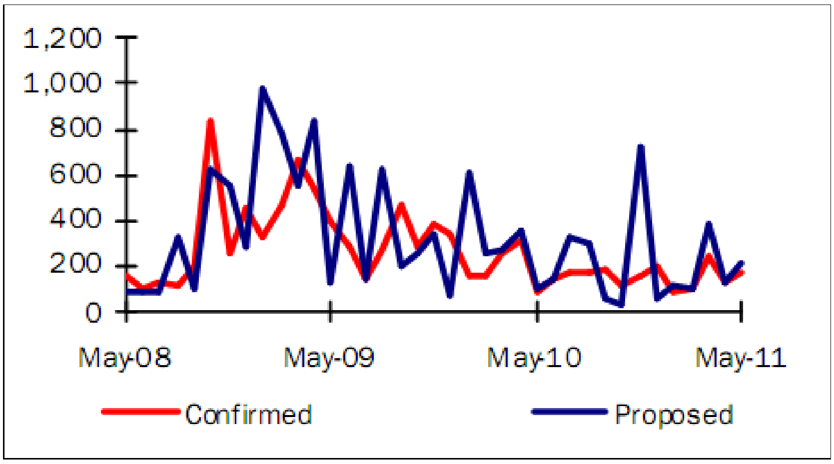
Figure 3: Claimant Count Rates by District Council Area



Source: DETI Labour Market Report (June 2011)

- On a more positive note, as reported in previous briefings***, there continues to be some easing in the rate of confirmed redundancies in NI. Whilst there has been a slight uplift in numbers between May and June (Figure 4), over the latest twelve month period there were a total of 1,844 confirmed redundancies; a decrease of 41% from the previous year (3,143).*** However, it is worth highlighting that employers are only legally required to notify the Department of impending redundancies of 20 employees or more***. The redundancy statistics are thus likely to be understated***; nonetheless, the trends outlined should be broadly reflective of changing conditions.

Figure 4: Confirmed and Proposed Redundancies May 08 – May 11

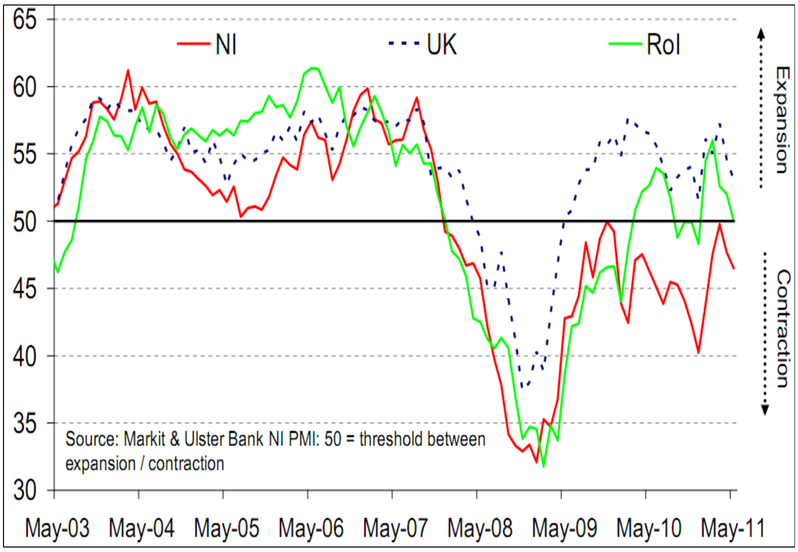


Source: DETI Labour Market Report (June 2011)

4 Business Activity

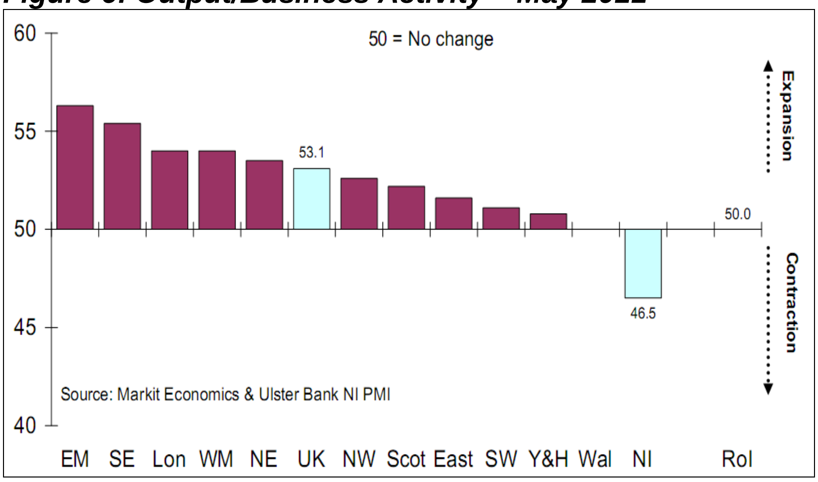
- ***Purchasing Managers' Index (PMI)*** [17]***:*** PMIs are monthly surveys of private sector companies which provide an advance indication of conditions in the private sector economy by tracking variables such as output, new orders, employment and prices across different sectors. The most recent Ulster Bank Northern Ireland Purchasing Managers Index (published in June 2011) indicates that private sector conditions are still deteriorating in Northern Ireland. ***This indication that private sector activity is continuing (as at May 2011) to contract in NI is in contrast with the expansionary trends (albeit at declining rates) currently being reported in the UK and ROI (Figure 5).*** Figure 6 shows that NI is, in fact, the only UK region in contraction.

Figure 5: Private Sector Business Activity - PMIs (monthly)



Source: Ulster Bank

Figure 6: Output/Business Activity – May 2011



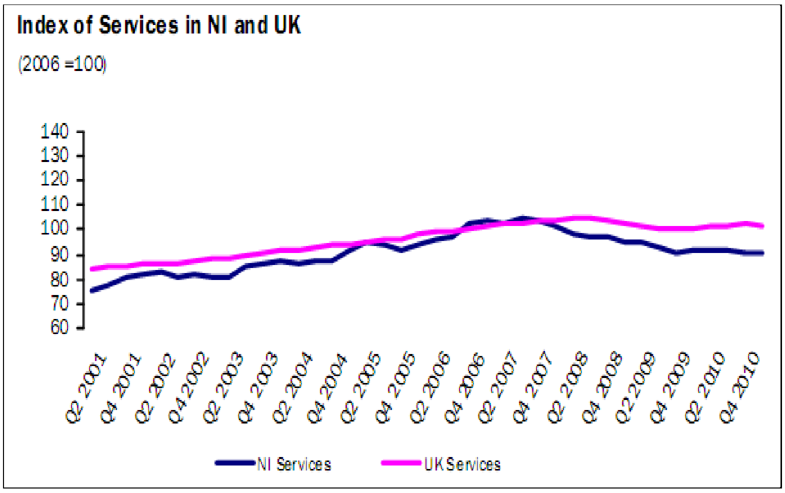
Source: Ulster Bank

[17] Ulster Bank, June 2011 (Based on May 2011 data)

- In sectoral terms, the Ulster Bank data indicates that the local construction sector continues to be the worst performer (amongst the construction, services and manufacturing sectors). However, the rate of contraction in the other two sectors has increased over recent months.

- ***Index of Services:*** The Department for Trade and Enterprise (DETI) Index of Services is an experimental quarterly survey of companies which measures changes in private sector output**. *Data for Q4 2010 is consistent with that shown above in that it indicates a divergence in private sector conditions between NI and the UK. Whilst UK private sector services are showing tentative signs of improvement, there is no such tendency, as yet, in NI*** [18]. Over the quarter the sub sector which contributed most to the decrease in the Index was Distribution – Wholesale and Retail (-1.8%). On a more positive note, the following sectors reported increases: Business Services and Finance (3.1%), Other Services (2.0%), Hotels and Restaurants (4.0%) and Transport, Storage and Communications (0.6%).

Figure 7: Index of Services in NI/UK



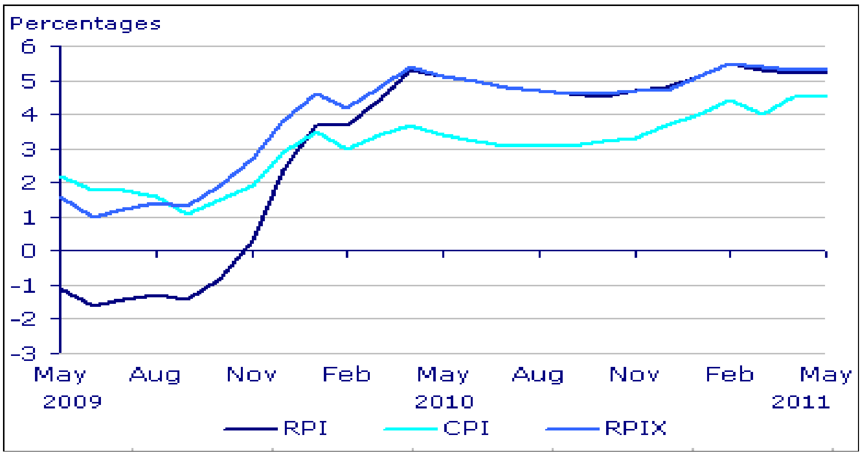
Source: DETI (April 2011)

[18] http://www.detini.gov.uk/dfp_sa_ios_publication_q4_2010_-_april_2011.pdf

5 Inflation/Monetary Policy

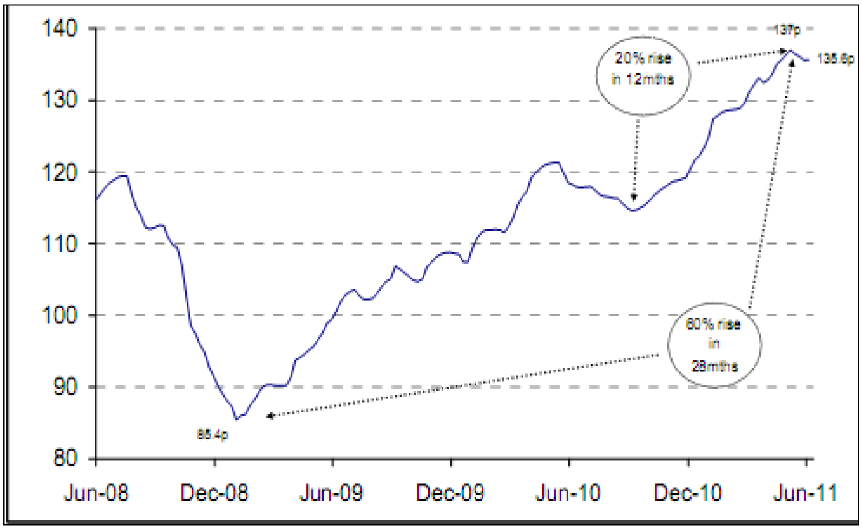
Inflationary pressures continue to persist; recent (May 2011) data indicates that the inflation rate (as measured by the Consumer Price Index, CPI) remained unchanged from April at 4.5% (Figure 8)[19]. This remains considerably above the Bank of England's target of 2%. However, much of the upward inflationary pressure may be attributed to external factors and, as such, may not represent 'core inflation'. Rising fuel and energy costs have had a significant impact in this regard; Figure 9 shows the extent of price hikes over recent years. Accordingly, the majority of the Monetary Policy Committee members continue to hold the view that interest rate increases would be premature and have maintained the Bank's base rate at 0.5%.

Figure 8: Inflation Rates



Source: ONS

Figure 9: UK Weekly Petrol Price (Pence Per Litre)



Source: Ulster Bank

[19] Or 5.2% on the basis of the Retail Price Index (RPI) http://www.statistics.gov.uk/cci/nugget.asp?id=19