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Briefing Paper

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Maureen O’Reilly

Economic Briefing (November 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.

Key Economic Data

Growth Forecasts	⇩	Growth in the NI and UK economies is expected to be negligible during 2011/12. UK growth forecasts have been significantly downgraded with growth of 0.7% in 2011 and 0.6% in 2012 (EC) anticipated. NI is expected to continue to lag behind the UK during 2011/12.
Inflation/Monetary Policy	⇩	The increase in the cost of living eased slightly in October. The CPI fell to 5.0%, slightly lower than September's 3 year high of 5.2%. It is still more than twice the Bank of England's 2% target. CPI inflation is expected to continue to slow into 2012 as prices start to fall and the impact of factors such as the VAT increase starts to diminish.
Labour Market		
Unemployment	⇔	The unemployment rate in NI currently stands at 7.3% (July-September 2011), unchanged from the previous quarter but up 0.3 percentage points over the year. The overall UK rate stands at 8.3% placing NI 4th lowest among the twelve UK regions. Almost one in five 18 to 24 year olds in NI are currently unemployed (19.1%).
Claimant Count	⇧	The claimant count now stands at 6.9% or 60,700 people (October 2011). This is considerably higher than the UK rate (5.0%) and places NI 2nd highest among the UK regions. Although up by 4.3% over the year NI experienced the lowest annual increase in claimant count unemployment of any UK region.
Economic Inactivity	⇧	The NI economic inactivity rate currently stands at 27.1% of the working age population. This is up by 7,000 over the last quarter but down by 14,000 over the year. It remains significantly higher than the UK average (23.3%) and the highest of all UK regions.
Redundancies	⇩	Confirmed redundancies in NI have continued to fall. There were 1,733 notified redundancies over the year to 31st October 2011. This is down 30% compared to the same period last year and 60% lower than their peak in 2009. Only those employers with 20+ employees are legally required to notify redundancies. This rules out the majority of NI businesses.
Consumers		
Consumer Confidence	⇩	Local consumer confidence has fallen considerably in the 3rd quarter of 2011 (Northern Bank) largely driven by a deterioration in household finances and financial uncertainty going forward. Consumer confidence across the UK more widely has also plummeted. The Nationwide Consumer Confidence survey found that confidence in October had fallen to the lowest level since the survey began in May 2004.
Retail	⇩	NI has experienced one of the largest falls in shopper footfall of the UK regions (NI -5.5% vs. UK -2.3%) during July to October according to the British Retail Consortium. The outlook going forward is pessimistic with NIRTA recently claiming that NI has the highest shop vacancy rate in the UK.
New Car Registrations	⇩	The number of new cars registered between April and June 2011 (12,164) was 15% lower compared to the same period in 2010 (14,041). Registrations peaked in 2007 at just under 71,000 but have fallen significantly since then (54,443 in 2010).
House Prices	⇩	House prices are continuing to fall in NI although the rate of decline is slowing. According to The University of Ulster's Quarterly House Price Index, the average house price stood at £139,691 (Q3 2011). The weighted rate of annual decline has slowed to 7.5% from 15.3% recorded in the second quarter of this year. The number of transactions has increased although the level of activity remains significantly below that experienced during the housing boom.
Business		
Business Activity	⇩	Business activity in the NI private sector is still contracting but has declined at its slowest rate since March (Ulster Bank PMI October). This is in contrast to the UK and Ireland where private sector output is continuing to expand. Input costs have been rising faster in NI vis-à-vis the rest of the UK.
Index of Production	⇩	Output in the production sector, largely made up of manufacturing, contracted in Qtr 2 2011 by 4.1% (-1.2% UK). This is however only the second fall in production output in NI over the last eight quarters. The NI Production Index remains almost 20% below its peak in Q4 2007.
Index of Services	⇧	There are tentative signs of improvement in the services sector where output rose marginally (+0.6%) for the first time since quarter 4 2009. This was slightly higher than the UK (+ 0.2%).

Summary of Factors Affecting the Economic Outlook

Recovery has stalled. The crises in the euro zone in particular along with the slowdown in global growth are now having very severe repercussions for the UK and NI economies. These factors dominate potential downside risks to recovery. Key areas of exposure include:

- **Economic growth prospects globally have been significantly downgraded.** The European Commission[1] points to the fact that global growth has been affected not only by spillovers from the European sovereign debt crisis but also by a lack of momentum in any US recovery and a moderation in the high growth rates previously experienced by emerging market economies such as China. World trade has slowed down strongly in recent months.

- **The euro zone faces huge challenges.** The sovereign debt crisis has intensified and broadened. There is likely to be a prolonged period of subdued growth within the euro area until some form of effective and collective action is taken. **EU growth is expected to remain at a near standstill during 2012 and return to slow growth in 2013.**

- **Northern Ireland's traded sector has significant exposure to the euro zone area.** Almost £2.4bn manufacturing sales were made to the 17 euro zone countries during 2009/10 representing 45% of all exports. Ireland alone accounts for 28% of NI manufacturing exports.

- **Prospects for the UK economy have worsened.** The Bank of England has recently stated that the UK now has a one in three chance of going back into recession. They also state that the absence of a "credible and effective policy response" by the euro area poses "the single biggest risk to the domestic recovery"[2]. Other key concerns include the further erosion of household incomes (and hence spending power) and the ability of businesses and households to access credit.

- **The government's timetable for tackling the deficit is running behind schedule.** Stagnation in the economy means that insufficient revenue is being generated to pay down debt despite significant public sector cutbacks. This means that austerity measures could last into 2016/17.

- **The risk factors for Northern Ireland are significant**. Aside from its wider exposure to the risks above, NI is only now beginning to feel the impact of the Government's austerity measures. Any hopes for the private sector to take up the slack in the short to medium term are extremely limited against a back drop of numerous challenges for businesses and households. Factors include falling household incomes, consumer confidence and lack of demand for products and

[1] European Economic Forecast, Autumn 2011, European Commission
[2] Bank of England Inflation Report, November 2011

services. According to the PMI, Northern Ireland businesses are also potentially facing greater cost pressures compared to other regions of the UK. Very difficult trading conditions into 2012 will put more businesses at risk of closure.

- **The strains on the banking sector persist** and there are now fresh concerns over the emergence of a new credit crunch. Since the euro zone crisis escalated over the summer, UK lenders have found it increasingly hard to raise funds. This is concerning given the potential impact on businesses and households going forward not only in terms of their ability to access finance but also in terms of banks passing on higher funding costs.

- **Investment plans are being put on hold**. Invest NI recently “handed back” £17.5m to the Department of Finance and Personnel (DFP) in under spend while a further £5m of Invest NI’s budget was reallocated to Tourism Ireland. This was attributed to a substantial deterioration in market conditions since February 2011. This has meant that some of the larger companies in which Invest NI have made significant financial commitments are putting investment plans on hold or proceeding at a much slower pace than originally anticipated.

There have been some positive economic developments in NI in recent months. These “upside” factors include:

- **A number of significant investment announcements have been made by Invest NI over recent months.** These include Capita (336 jobs) and PWC (247 jobs). The Enterprise Minister also officially opened the Allen & Overy offices in Belfast in November with plans for 317 jobs. Some of these jobs have been assisted through a new initiative by Invest NI called the Boosting Business Initiative. This is a package of new and revamped measures aimed at boosting support to existing clients and the broader business base. The Initiative includes a Jobs Fund (formerly the Short Term Aid Scheme) with a budget of £19million to help businesses create job opportunities. It has a target of promoting 5,000 jobs over the period 2011-15.

- **Air passenger duty (APD) for direct long-haul routes from Northern Ireland airports was cut** on the 1st November. Rates have now fallen to £12 per passenger in economy (previously £60) and £24 for business and first class passengers (previously £120). The move guarantees the continued operation of the Continental Flight from Belfast International to New York/Newark which was under threat to relocate to Dublin. Air Travel Tax in the Republic of Ireland is just 3 euro to any destination. Over the last week four airlines from the UK and Ireland have called on the UK government to completely scrap APD although this tax is estimated to generate more than £2bn for the UK economy. In its recently launched draft Programme for Government (2011-2015) the NI Executive have committed to eliminating APD on all long haul flights should tax raising powers by devolved.

- **The draft Programme for Government (2011-2015) and its supporting Investment and Economic strategies have been met with general positivity**

from the business and wider community. The draft Programme was launched for consultation on 17th November outlining 76 commitments over the next four years. They include major objectives such as support in the promotion of more than 25,000 new jobs, achieving £300m investment through foreign direct investment *(FD*I), increasing the value of manufacturing exports by 15% and supporting £300m business research and development. The Programme also outlines plans for a £50m 'liquidity fund' for small and medium-sized enterprises.

- **A number of significant announcements are anticipated in the Coalition's Autumn Statement (29th November).** This will include details of a major credit easing scheme to help small and medium-sized businesses borrow money.

- **There has been a slight easing in inflationary pressures during October** and the Bank of England has put forward a convincing argument that inflation will continue to ease into 2012. This is attributed to a number of factors including the adjustment to January's VAT hike to 20% and a view that, given falling global demand, further sharp increases in world commodity prices are unlikely.

1. Growth Forecasts

The **Northern Ireland** economy is expected to grow by just 0.6% during 2011 and maintain this negligible level of growth into 2012[3]. In fact the latest Northern Bank/Oxford Economics quarterly forecast report suggests that NI experienced no growth during the last quarter. Particular concerns going forward include Northern Ireland's exposure to a much more fragile UK recovery, its greater reliance on the Republic of Ireland (RoI) economy and inherent weaknesses in both the size and structure of the NI private sector. As a result Northern Ireland is likely to grow at a much slower rate than the UK as a whole.

Table 1: Forecast Growth for the NI Economy (GVA)

	2009	2010	2011	2012
NI Output (GVA)	-4.5%	0.8%	0.6%	0.6%

Source: PWC Economic Outlook, November 2011

The **UK** economic outlook has been deteriorating quite rapidly over recent months. Output in the third quarter of 2011 grew marginally by 0.5%, slightly higher than expected. However, there are concerns that the economy may contract in the fourth quarter against a background of ongoing fiscal consolidation, the escalating euro zone crisis and high inflation. The Bank of England believes growth will remain sluggish in the near term and highly uncertain in the short to medium term. The economy is likely to at best stagnate in 2012 and some commentators believe it could potentially re-enter a recessionary phase. The European Commission has made a very significant adjustment to its UK GDP growth forecasts for 2011 and 2012. The 2011 forecasts have been revised downwards by one full percentage point to 0.7% (spring forecast 1.7%). There has been an even more serious adjustment to the 2012 forecast, revised downwards to 0.6% compared to a spring estimate of 2.1%. While the Commission expects unemployment rates in most countries to consolidate around their current level, it forecasts the UK unemployment rate to continue to rise during 2012.

[3] Northern Ireland Economic Outlook, PWC, November 2011

Table 2: Forecast Growth for the UK Economy

	BoE (Nov 2011)		EC (Nov 2011)		IMF (June 2011)	
	2011	2012	2011	2012	2011	2012
UK	1%	1%	0.7%	0.6%	1.1	1.6

Source: Bank of England, European Commission, International Monetary Fund

The **global economy** has been severely weakened by recent events in the euro zone and has entered what has been described as “a dangerous and uncertain phase”[4]. Growth has become more uneven, confidence has fallen sharply and downside risks are growing. In 2011 there has been a much slower recovery in advanced economies and a large increase in fiscal and financial uncertainty particularly since August. As a result worldwide 2012 growth projections for almost every single country/area have been revised downwards. “Contagion” is the key message as concern increases around the ability of many countries to stabilize their public debt. Any sense of control when this involved small peripheral countries such as Ireland has radically diminished as further debt crises in core euro zone economies such as Italy have emerged. With declining growth prospects significant concerns have spread beyond the euro zone to include the US and Japan. The global economy is therefore expected to grow by 3.7% in 2011 and 3.5% in 2012.

[4] Christine Lagarde, Address to the 2011 International Finance Forum, Beijing, November 9, 2011.

Table 3: Forecast Growth Rates – Selected Countries/Areas

	GDP Growth		Unemployment Rate		Inflation	
	2011	2012	2011	2012	2011	2012
United Kingdom	0.7%	0.6%	7.9%	8.6%	4.3%	2.9%
Ireland	1.1%	1.1%	14.4%	14.3%	1.1%	0.7%
Euro zone (17)	1.5%	0.5%	10.0%	10.1%	2.6%	1.7%
EU (27)	1.6%	0..6%	9.7%	9.8%	3.0%	2.0%
United States	1.6%	1.5%	9.0%	9.0%	3.2%	1.9%

Source: European Economic Forecast - Autumn 2011, European Commission

The crisis in the **Euro zone** has deepened and broadened. This has meant that the economic outlook for some countries is changing on an almost daily basis, an unprecedented state of affairs. GDP increased by just 0.2% in the third quarter of 2011. The European Commission has downgraded their growth forecast for the euro zone to 0.5% for 2012 compared to their spring estimate of 1.8%. This reflects the anticipated impact of very recent events around the further deepening of the Greek debt crisis and revelations around the extent of the Italian debt crisis. The **wider EU** area is also expected to stagnate. The European Commission point out that, given the fragility of recent growth forecasts, the risk of recession is not insignificant.

The **Irish** economy has started to grow again fuelled by a strong performance in export markets. Multinationals have dominated export growth although there have also been some gains by domestic businesses seeking out new markets. Export growth forecasts for Ireland have however recently been downgraded due to concerns over global demand. Domestic demand continues to be subdued and the housing market remains depressed. Unemployment is expected to stay up around the 14% level although the effects of outward migration may have some impact in bringing this down. On the plus side there appears to be relatively more confidence in Ireland's ability to deliver on its debt plan compared to other crisis euro zone economies (Portugal, Italy, Greece and Spain) reflected in the recent decision by EU leaders to cut the cost of Irish bailout loans. Ireland is one of only a small number of euro zone countries to have its 2011 growth forecast revised upwards in the latest EC forecast report.

The **United States** recovery lost some momentum during 2011 and the economy is now expected to expand by just 1.6% over the year. There has been a rebound in growth in the 3rd quarter of 2011. However, the IMF still points to concerns going forward around a whole host of issues including fiscal uncertainty, weakness in the housing market and household finances, renewed financial stress, and subdued consumer and business sentiment.

Table 4: Forecast Growth in Emerging Economies

Emerging Economies		**"BRIC" countries**							
		Brazil		Russia		India		China	
2011	2012	2011	2012	2011	2012	2011	2012	2011	2012
6.0%	5.9%	3.6%	4.0%	3.9%	3.8%	7.5%	7.5%	9.2%	8.6%

Source: European Economic Forecast - Autumn 2011, European Commission

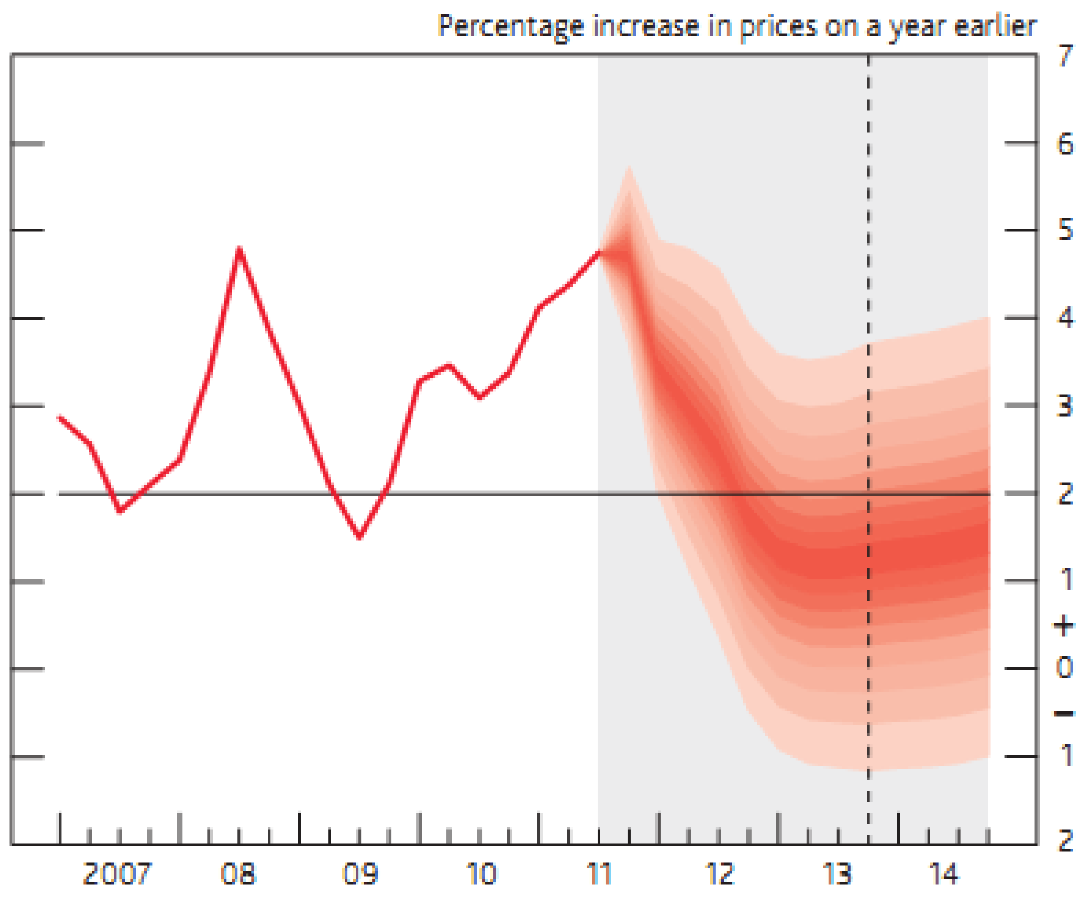
There is some uncertainty around prospects for **emerging market economie**s as wider global factors impact. However, growth is expected to remain fairly resilient at around 6%. The **BRIC** economies (Brazil, Russia, India and China) are the fastest growing and largest emerging market economies. Their growth rates are expected to be largely stable over 2011/2012 reflecting a much lower exposure to the global financial crisis than the US or Europe. China is expected to lead the way, growing by around 8.6% during 2012.

2. Inflation/Monetary Policy

At 5.0%, CPI inflation fell slightly on the September rate (5.2%). However, it is still remains well above the Bank of England's 2% target. RPI inflation, which includes mortgage interest payments, also slowed to 5.4% (5.6% in September). The largest downward pressures came from a fall in the cost of food (due to significant and widespread discounting by supermarkets and good harvests for certain produce), air fares and petrol. Food prices fell by almost 1%, their largest fall for a September to October period since 1996. Partially offsetting this were upward pressures from increases in the cost of clothing, electricity and gas. Domestic generated inflation is running well below 2% which is consistent with poor retail sales figures. The Bank of England believes that inflation is at or close to its peak and expects price rises to slow during 2012.

Figure 1: CPI inflation projection based on market interest rate expectations and £275 billion asset

purchases



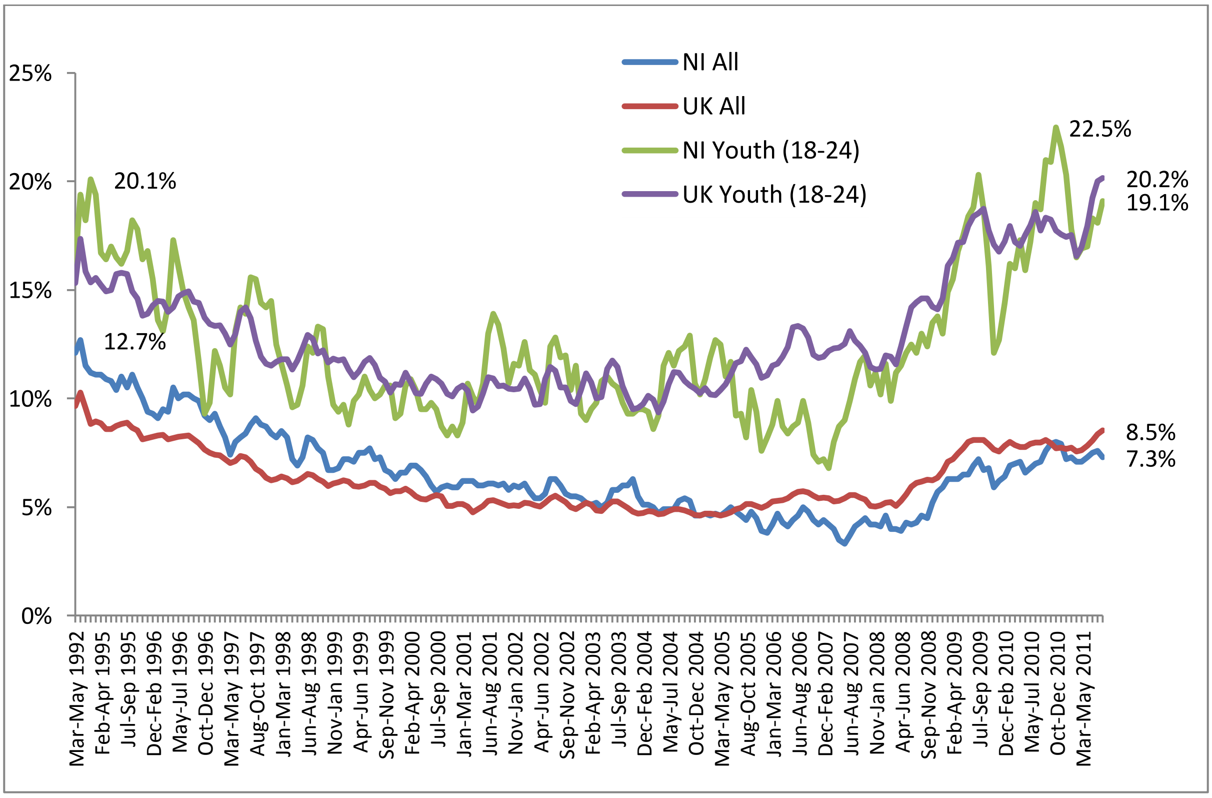
Source: Bank of England Inflation Report, November 2011

Interest rates have now been at 0.5% for 32 months. In October the BoE injected a further £75bn into the UK economy through quantitative easing (QE) or money printing. It had already bought £200bn of gilts through its first round of QE in 2009.

3. Labour Market Trends

There has been relatively little movement in NI's unemployment rate during 2011 although it has more than doubled since the recession took hold. The NI unemployment rate currently stands at 7.3% (July to September) or 63,000. This is unchanged over the quarter and up just 0.3 percentage points on the year. In fact NI is the only region of the UK to see a fall in the numbers unemployed over the previous quarter. The NI rate is lower than the UK average (8.3%) and 4th lowest of the UK regions. It is also below the European Union average of 9.7% (Sept. 2011) and half the Republic of Ireland's unemployment rate (14.4%). Unemployment in NI was at its lowest rate in 20 years during 2007 (3.3% May-July 2007).

Figure 2: Unemployment Rates (Seasonally Adjusted)



Source: DETINI/ONS

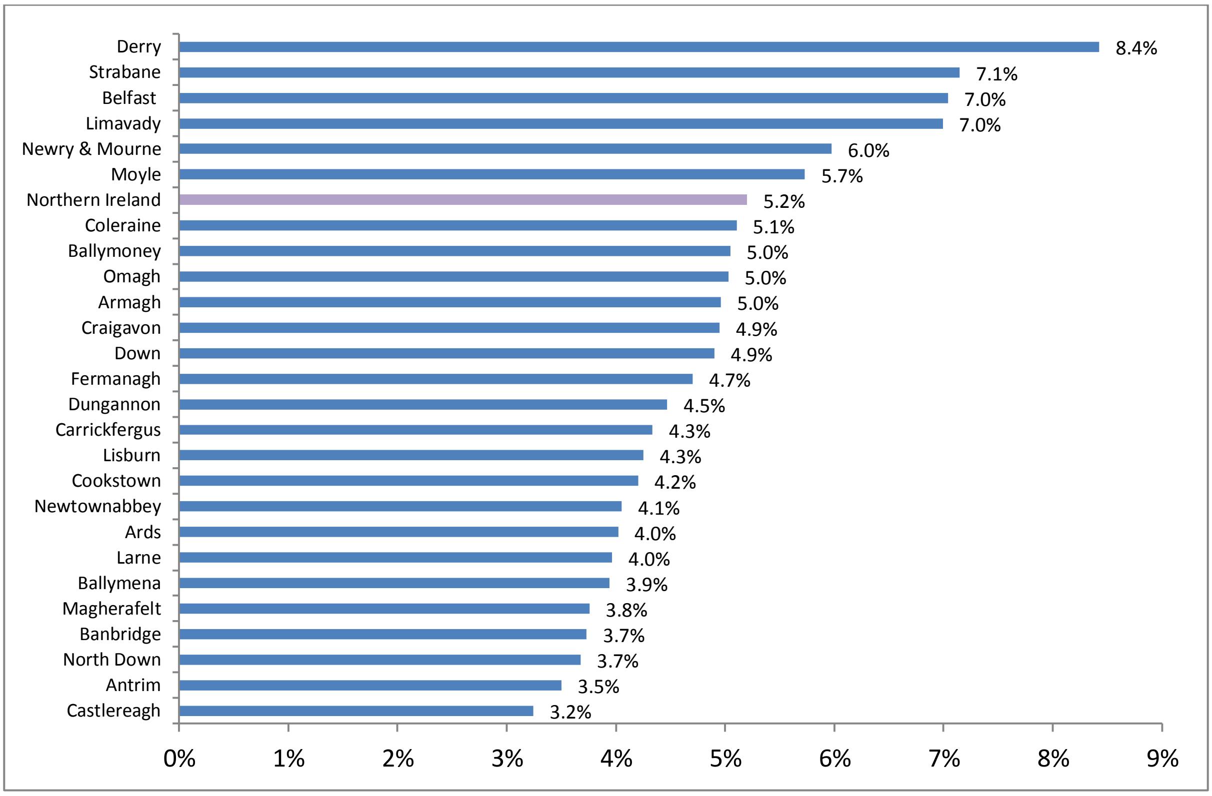
However, youth unemployment in NI has soared over the last few years. The youth unemployment rate currently stands at 19.1% (19.6% UK) or 22,000, a rate last experienced in the early/mid 1990s. The total number of young people out of work across the UK has now hit a record high of more than one million and is believed to be at its worse level in 23 years. Long-term unemployment also remains a serious issue. Some 40% of unemployed people in NI have been jobless for more than one year. Particular concerns are emerging over long-term youth unemployment.

High rates of economic inactivity have been a prevailing problem for NI, even during the "boom" years. The working age economic inactivity rate currently stands at 27.1% (23.3%

UK), highest of the UK regions. The number of economically inactive has increased by 7,000 during the latest quarter but has in fact fallen over the year by 14,000. NI has a much higher proportion of the economically inactive who do not want a job compared to the UK (85% NI vs. 75% UK working age). The North West records the highest working age inactivity rate while the North of NI registers the lowest.

The claimant count rate places NI in a very different position as regards unemployment. The rate currently stands at 6.9% of the workforce, significantly higher than the UK average (5.0%) and second highest of the UK regions. There are currently 60,700 individuals in NI claiming unemployment related benefits, up 100 people in October and 2,500 over the year. NI has however had the lowest annual increase in claimants (+4.3%) compared to any other UK region (UK +9.3%). Derry, Strabane, Belfast and Limavady councils have the highest claimant count rates. The largest increases in claimant count numbers over the last year have been in Derry (+12.2%) and Fermanagh (+9.2%). West Belfast and Foyle have recently been ranked at numbers three and four in a league table of UK constituencies worst affected by unemployment.

Figure 3: Claimant Count Rates by District Council Area (October 2011)



Source: DETINI

(The NI rate of 5.2% is % of those of working age as opposed to the workforce)

The number of redundancies in NI continues to fall. In total, 1,733 redundancies were confirmed with DETI over the year to 31st October, down by 30% from the previous year

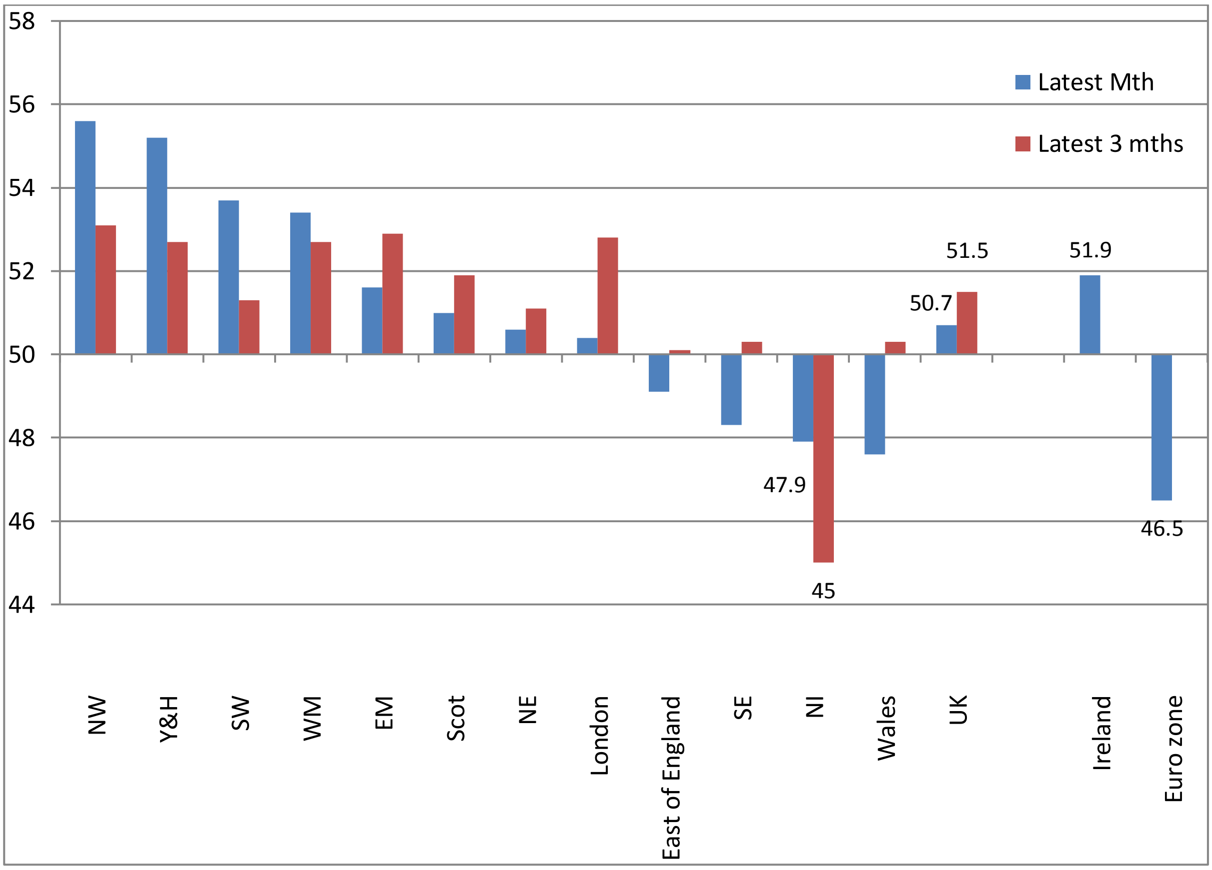
(2,486) and 60% lower than their peak in 2009 (4,575). One-fifth of redundancies during 2011 have been in manufacturing, a large proportion of which are in the food sector. The construction sector has accounted for a further 15% of confirmed redundancies. However, employers are only legally required to notify of impending redundancies of 20 or more employees. Given that 95% of VAT/PAYE registered businesses in NI have less than 20 employees, these figures are likely to be an underestimate of the full extent of redundancies here.

4. Business Activity

The **Purchasing Managers Indices** (PMI) are monthly surveys which provide an up-to-date indication of private sector activity in terms of output, new orders, employment and prices. They are available in 32 countries and key regions including the euro zone. Recent outcomes include:

- Private sector activity in Northern Ireland is continuing to contract although the pace of contraction has slowed. Weak underlying demand is the key issue as new orders continue to fall. While construction and services activity remains very weak, manufacturing has shown some signs of improvement. The sector posted its fastest rate of output growth since February along with an increase in new orders and some jobs growth. It is too early to say that manufacturing is in recovery. More widely, the rate of inflation is accelerating in Northern Ireland as input costs rise faster than the UK average. Job losses here appear to have stabilised.
- Although a number of UK regions recorded falling output in October, when taken over the latest three months Northern Ireland is the only region recording a contraction in private sector output. Private sector output is still growing modestly in the UK.
- Business activity in the euro zone is contracting at its fastest pace since mid-2009. Business confidence has continued to decline, hitting a two and-a-half year low, while jobs growth is stagnant. Spain and Italy had the steepest rates of reduction in business activity while France has also fallen into decline. Germany and Ireland have had modest activity growth during October.

Figure 4: Private Sector Business Activity (October 2011)



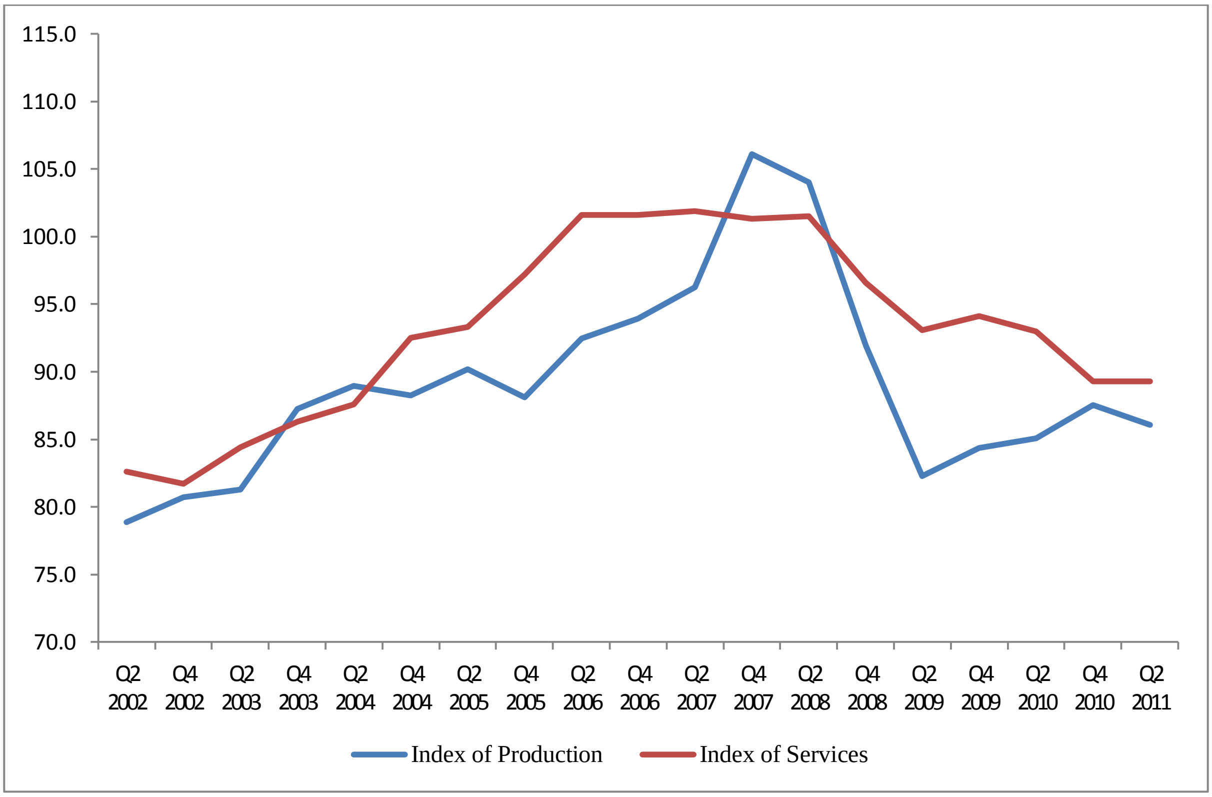
50= threshold between expansion/contraction

Source: Ulster Bank/Markiteconomics

The Index of Production and Index of Services (DETINI) are short-term measures of change in the output of the private production (largely manufacturing) and services sectors respectively.

Production activity in NI contracted during the second quarter of 2011 by 4.1% (-1.2% UK). This is however only the second fall in output in the last eight quarters. The NI Production Index remains some 18.9% below the peak recorded in Q4 2007, whilst the UK index has fallen by just over half that figure at 10.6% during the same time period. There was a very steep drop in production output in NI towards the end of 2008/beginning of 2009. Manufacturing comprises the main element (83%) of the production index. Manufacturing output levels in Northern Ireland have fallen by 3.3% over the previous quarter while largely unchanged in the UK (+0.2%). The NI manufacturing index is still some 20.8% below the peak in Q4 2007.

Figure 5: NI Index of Production and Index of Services (2008=100)



Source: DETINI

Provisional results from the second quarter of 2011 show that services output in Northern Ireland rose marginally (+0.6%) for the first time since quarter 4 2009. This compares to a rise of 0.2% in the UK as a whole. Growth in Business Services, Transport and ICT offset falls in Retail and Hospitality. Business Services followed by Retail and Hospitality have experienced the sharpest decline in output during the last four years of the downturn.