Ulster University
Economic Policy Centre

Outlook
Summer 2017

Better than expected, less than needed

Economic performance continues to be steady, if not spectacular, and given the very significant changes globally, nationally and locally, the economic performance has been more positive than many had anticipated. One lesson for economists over this last year is that the fundamental spending decisions of businesses and consumers is less influenced by economic commentary than one would expect. However, given the ongoing uncertainties following the General Election, policy makers should not be complacent about the longer term economic outlook.

Due to the potential for significant policy shifts with respect to migration, trade, funding and borders, the range of potential labour market outcomes in the longer term remains wide. This presents a challenge to key decisions makers in business and government alike.

The UUEPC forecasts have been revised modestly since our Winter 2016 forecast, with the 10 year labour market projections being revised down marginally to 28,800 jobs (from 32,500 previously). As recognised in previous outlook reports, the primary risk to economic growth remains a squeeze on incomes and the subsequent impact on consumer spending.

Key Forecasts

Northern Ireland

	2016	2017	2018	2019	2020
GVA(1) growth rate	1.5%	1.1%	1.2%	1.2%	1.4%
Unemployment rate(2)	3.0%	3.0%	3.0%	3.2%	3.1%
Employment growth: Full time	6,900	2,900	1,300	-1,600	2,200
Employment growth: Part time	7,500	2,500	300	-1,200	800
Average House price	£123k	£127k	£130k	£134k	£138k

United Kingdom and global forecasts

	2016	2017	2018	2019	2020
GVA(1) growth rate	1.8%	1.6%	1.4%	1.4%	1.6%
Unemployment rate(2)	1.4%	1.4%	1.4%	1.5%	1.4%
Average House price	£212k	£220k	£226k	£235k	£243k

Macro-economic variables

	2016	2017	2018	2019	2020
Interest Rates(3)	0.4%	0.3%	1.0%	1.5%	2.0%
Inflation(4)	0.7%	3.0%	3.0%	3.3%	2.9%

Note 1: Gross Value Added (GVA) is the preferred measure of economic activity. It is similar to Gross Domestic Product (GDP) but excludes the impact of taxes and subsidies (most notably VAT)
Note 2: Claimant count rate as a % of 16 – 64 population. GB claimant count rate impacted by transition to Universal Credit
Note 3: Bank of England base rates
Note 4: UK Consumer Prices Index (CPI)

In this edition

- **Wider range of outcomes –** given the scale of the uncertainty following the EU referendum and the more recent UK General Election, the range of possible economic outcomes is considerable. The difference measured in total economic output (GDP or GVA) terms may appear relatively modest, however in employment terms it is much more significant.

- **Critical role of the consumer –** the UK and NI economies are very reliant on consumer spending as a driver for economic growth compared to other developed economies. This will not change in the short term and therefore the future fortunes of the economy are closely linked with the fate of the consumer.

- **Income growth is vital –** overall real wage growth (i.e. above inflation) has been flat for the last ten years yet consumer spending has continued to grow on the back of increased employment levels and higher borrowing. As employment growth slows, real incomes must rise if the consumer spending trend is to continue without adversely impacting household debt levels.

- **The changing nature of employment in Northern Ireland –** the headline employment data looks positive, however, a detailed analysis highlights that significant structural changes in the nature of work have occurred. These include greater numbers of part-time workers and greater challenges in particular for male full-time workers.

- **Does the Northern Ireland wage gap matter? –** the gap in wages between NI and the Great Britain (GB) average is a common measure used to highlight the weaknesses in the local economy. However, a lower cost of living has created a number of interesting differences in spending patterns.

Wider range of outcomes

It has been well documented that the immediate economic impact of the EU referendum result has been less significant than many anticipated. However, looking forward, the short term outlook is increasingly uncertain particularly given the shock UK General Election result. In addition, the longer-term impact will be entirely dependent on the final deal reached with the EU and subsequently with other international trading partners. It is around these trading relationships where the greatest level of uncertainty exists.

As in our previous outlook, the UUEPC has developed upper and lower case employment forecast scenarios. A damaging and poorly coordinated Brexit combined with a squeeze in real incomes could see employment levels fall by 8,200 over the next ten years. In contrast, a trade-friendly smooth transition Brexit combined with convergence with UK average economic performance could see employment levels increase by 87,500 by 2026. The most likely outcome, our central estimate, is 28,800 jobs created over the same period.

Table 1: Sectoral employment forecast 2016-26 across scenarios

	Worst case (Pessimistic)	Central estimate (Expected)	Best case (Optimistic)
Production and Manufacturing	-10,000	1,400	5,500
Construction	1,200	2,400	5,900
Public sector services	-1,100	-500	10,800
Private sector services	1,600	25,400	65,600
Total	**-8,200**	**28,800**	**87,500**

Note: Totals may not sum due to rounding.

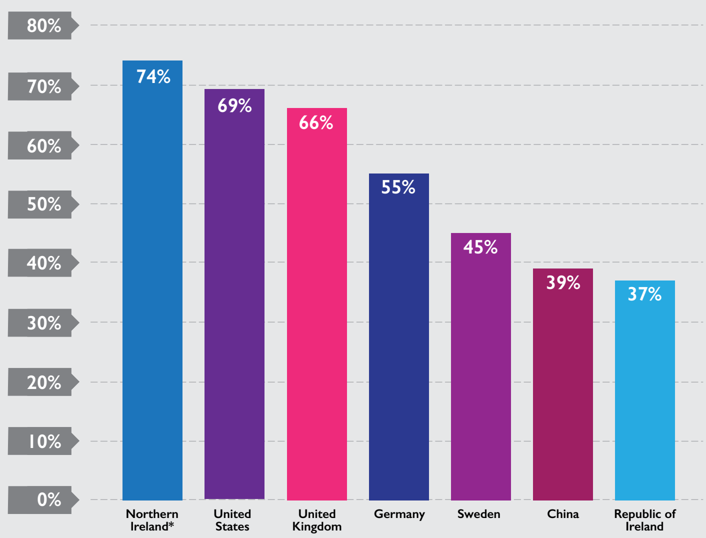
Critical role of the consumer

The UK and NI economies are more heavily reliant on consumer spending as a driver for economic growth than other advanced nations (see Chart 1). By way of example, trade is a more significant component of growth in the Republic of Ireland and Germany, given their strong export focus, and countries such as Sweden have a strong reliance in Government spending. Therefore, from a UK perspective, continued economic growth both locally and nationally is very closely linked with the continued financial health of the consumer.

Increasing business investment and/ or improving the trade balance would reduce the reliance on the consumer and have long been desired economic policy outcomes of successive governments but will not be resolved in the short term. In addition, although the UK Government has pushed back its target date for a balanced budget from 2020/21 to 2025/26, it is not obvious that a large fiscal stimulus (either increased spending or lower taxes) would be implemented if consumer spending started to contract. Although it is too early to speculate, one potential consequence of the June 2017 General Election may be a further easing of austerity.

Inflation is another key economic metric in this debate. There is an argument that after years of near zero

CHART 1: CONSUMER SPENDING AS A % OF OVERALL GDP, 2016



Source: ONS, Oxford Economics, Department for the Economy (*NI only 2012), UUEPC analysis

inflation, an increase above the Bank of England target rate of 2% would be helpful at least in the short term. In particular, inflation would help erode high levels of debt at both the national and individual consumer levels, however, whilst inflation may help borrowers it punishes savers, a point often overlooked when the focus is on debt.

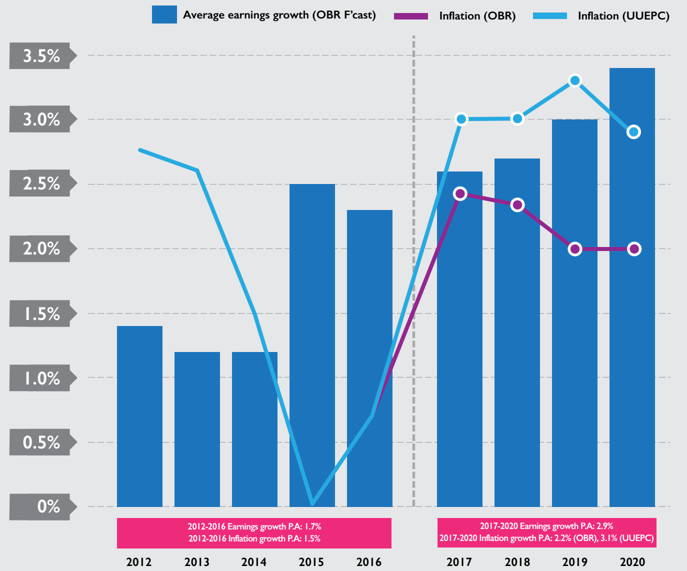
Income growth is vital

Although inflation helps to erode debt (maintained in nominal terms), real income growth (i.e. above the rate of inflation) is vital to continue servicing the debt and allowing continued growth in consumer spending. The Office of Budget Responsibility (OBR) March 2017 outlook forecasts wage growth marginally above inflation (see Chart 2), indicating real wage growth increasing over the next five years. The UUEPC macro-economic model also anticipates similar nominal wage increases but crucially, higher inflation is forecasted. Thus eroding real wage growth.

The case for nominal wage growth is strong: the labour market is tightening; there are reported skills shortages across a range of sectors; fears of future immigration controls reducing the future supply of labour; and increased wage demands on the back of higher inflation. However many of these factors have existed for some time, for example, the UK employment rate is at records levels (74.8%) and unemployment is at a 42 year low of 4.7%. Yet, despite these labour market conditions, earnings growth has been subdued and this is confirmed in the latest Bank of England Agents Report (May 2017) which found that pay awards "*remain clustered around 2%-2.5% across the economy*". Therefore, there is no immediate evidence that incomes will start to increase at a faster pace.

In the short term, the OBR forecasts public sector pay restraint will remain with nominal increases of approximately 1.5% p.a. out to 2019. This is below the projected level of inflation, indicating that real income squeezes are in store for public sector workers.

CHART 2: NOMINAL EARNINGS GROWTH AND INFLATION, UK, 2012 - 2020



Source: OBR (Economic & Fiscal Outlook March 2017), ONS, UUEPC Summer Outlook 2017
Note: The inflation data and forecasts presented are based on the ONS Consumer Price Index (CPI) measure

Near zero nominal increases in earnings may not be welcome, but are tolerable when inflation is very low, however with inflation above 2.5% and several years of pay restraint in the recent past, industrial tensions are likely to rise. Added to the pressures of the Brexit negotiations and the associated political difficulties that will create for the UK Government, maintaining public sector pay restraint will be a challenge over the next Westminster Parliamentary period.

The changing nature of employment in Northern Ireland

Understanding the reasons for low earnings growth is critical to developing appropriate policy responses. In the first instance, labour market weaknesses exist below the headline figures including significant 'underemployment' (i.e. where people work fewer hours than they would like or at a level below which they are qualified to work). Furthermore, since 2012, part-time employment has been growing at a faster pace than full-time employment (8% P/T compared to 6% FT).

In addition, there has been a significant increase in self-employment, which can be seen as positive in terms of increased levels of entrepreneurialism but the greatest level of growth has been seen in part-time self-employment (12,000 compared to just 5,000 additional full-time self-employed). This may suggest a growth in the gig economy which is attractive to employers as it reduces the need to make employers National Insurance and pension contributions.

This changing nature of employment suggests that despite record high levels of employment, there is greater additional supply in the labour market than the headline figures may suggest. As a result, there could be significant scope for further labour market tightening before pressure to increase earnings picks up. The UUEPC are researching the underlying hidden labour market weaknesses and the nature of employment beyond the headline data.

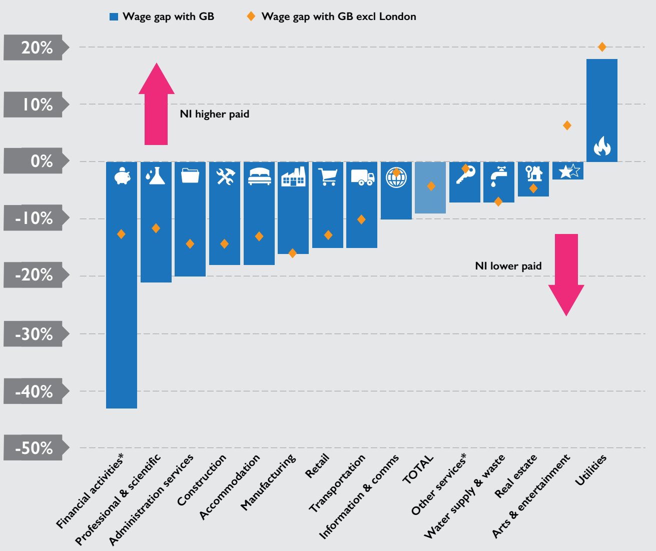
Does the Northern Ireland wage gap matter?

Economic forecasts tend to focus primarily on GDP (and/ or GVA). This is an important measure for determining change in economic activity and comparing performance across different economies. However, it is an imperfect measure at a regional level. As a result, the UUEPC also focuses on labour market performance across sectors and wage analyses to obtain a better understanding of overall living standards and economic activity.

The average full time wage in NI is £26,070 compared to £28,560 across Great Britain (GB) as a whole, resulting in a wage gap of 8.7%. At the headline level this is quite significant, however, removing London from the analysis (given its lack of comparability with the local economy) the gap reduces to only 3.6%.

Taking a more detailed sectoral view, some interesting patterns emerge (see Chart 3). For example, the financial sub-sector has a much lower average earnings than other GB regions, but, removing London from the analysis reduces the gap from 43% to 13%. HM Treasury analysis has shown a strong link between productivity and wages and therefore a desire to see higher wages requires an increase in productivity. In general, lower wages in NI are often explained by lower levels of productivity due to a higher concentration of lower productivity sectors, such as agriculture, and a greater focus on lower value-added activities within individual sectors, such as financial services.

CHART 3: THE NI-GB WAGE GAP, SELECTED PRIVATE SECTOR INDUSTRIES (FULL-TIME MEDIAN ANNUAL WAGE, 2016)



Source: ONS ASHE 2016, NISRA, UUEPC analysis
Note 1: Sectoral weighted average calculated for GB excl London using regions with available data for 2016
Note 2: Sectors with * denote mean wage used due to data limitations
Note 3: Agriculture, Mining and Employers as households excluded due to data limitations

Understanding if this income gap matters at the individual level is more nuanced than first appears. An ambition to increase earnings to a level closer to the UK average is appropriate, but it is also important to reflect the overall cost of living. A significant portion of overall household spending is allocated to housing, which in NI is only 12% compared to 22% in the UK as a whole. The impact of lower housing costs along with the "super parity" issue (i.e. people from NI pay lower taxes/ public sector charges than those in GB on similar incomes, such as prescription charges, tuition fees and public transport), has resulted in local households having different spending patterns compared to the rest of the UK (see Table 2).

Table 2: Profile of consumer spending, across the 12 UK regions

Regional ranking of total spending by category		
Category	Highest weekly expenditure (£)	NI rank
Food and non-alcoholic drinks	Northern Ireland	1
Alcoholic drink, tobacco and narcotics	Northern Ireland	1
Clothing and footwear	Northern Ireland	1
Housing (net)[1], fuel and power	London	12
Household goods and services	London	7
Health	East/South East	8
Transport	South East	7
Communication	Northern Ireland	1
Recreation and culture	South East	11
Education	London	8
Restaurants and hotels	London	2

Source: Living Costs and Food Survey, UUEPC analysis

As a proportion of overall spending, NI households spend least on housing and most on food, alcoholic drinks, clothing and communications relative to other UK regions. NI is also second only to London in hospitality (restaurants and hotels) expenditure.

Given the different weightings of expenditure across the regions, uniform price changes in goods across the UK has a different impact in each region. The UUEPC research has indicated that NI has faced relatively weaker price pressures compared to other parts of the UK. For example, a representative basket of household expenditure in NI costs 1.0% more in 2016 relative to 2013, whereas in London a representative basket costs 2.5% more over the same period.

NI's weaker price pressures has been driven by a number of factors including items such as transport and clothing, which make up a greater share of NI spending. This has been a good news story in recent years, but if the cost of clothing or oil were to increase significantly in next few years, it would have a proportionately greater impact on NI consumers. This is now more likely given the depreciation of Sterling.

The UUEPC is completing research on consumer spending and incomes in NI compared to other UK regions, which will be published later in the summer.

1 Housing costs refer to all housing related costs including, inter alia, mortgage payments, rents, domestic rates, water charges, housing maintenance etc. These figures represent an average cost across all households. These averages will be lower than expenditure specifically for mortgage holders and renters as there are a number of households which are associated with no mortgage payments.

Sectoral Outlook

Manufacturing

The manufacturing sector has enjoyed four years of strong growth since the trough of the recession in 2012. The sector has created 10,300 jobs, equivalent to 13% growth and has been the fastest growing sector of the NI economy. This is in contrast to manufacturing in the rest of the UK which has grown by only 2% over the same period.

The overall outlook remains positive as some of NI's main export markets, including the EU, are posting stronger economic growth and Sterling depreciation improves price competitiveness. However, employment growth is likely to stall because of the high profile closure and redundancy announcements at JTI, Michelin, Bombardier, Shrader and Caterpillar which will be largely implemented in 2017/18.

Based on average manufacturing productivity levels, a contraction of 3,000 jobs (approximately equivalent to the announced closures listed above) would reduce overall NI GVA by approximately 0.5%. This is a key driver in the reduced level of NI GVA growth in the UUEPC 2017 forecast.

Construction

The construction sector in NI has been severely impacted since the economic downturn, with employment levels still 34% below the 2007 peak. Since 2013, the sector has experienced a gradual recovery creating nearly 2,000 jobs (3.4% increase). Encouragingly, as measured by the NI Construction Output, 2016 ended positively with output volumes increasing by 12.8% over the year. This is the highest level of output growth reported in the last 5 years.

The outlook for the sector is mixed. Residential development should be positive as historic supply constraints provide a basis for continued modest growth in prices. In addition, commercial development, particularly in the hospitality and office sub-sectors, are also experiencing an increase in activity. However, the political stalemate at Stormont could result in delays to public sector infrastructure projects.

Private sector services

Private sector services continue to be the most important component of the overall economy in NI accounting for two in every three jobs created since 2012. There is an encouragingly broad distribution of jobs created across the services sector, including higher value adding sub-sectors such as ICT and professional services. However, the growth in consumer spending discussed elsewhere in this outlook has not translated into increased employment in the retail sector as it strives to improve productivity.

Looking forward, short-term sentiment indicators such as the Purchasing Managers Index and consumer confidence measures are positive and in the longer term, the UUEPC forecasts suggest that private sector services will continue to be the leading driver of job creation in the economy, creating 25,000 jobs over the next 10 years.

Public sector services

Employment levels across the public sector as a whole have been broadly flat, increasing by just 6,800 since 2012 (a rise of just 2.6%). The health sector has seen its budget protected as it deals with a range of challenges including the increased demands of an aging population. As a result, employment levels in the health sector continues to increase. Employment in education has experienced moderate expansion but public administration has continued to see employment levels contract.

The process of re-balancing the economy from the public sector to the private sector is taking place partially due to government spending constraints and employment growth being restricted to the private sector.

Looking forward, although the budget outlooks are unclear, the UUEPC has assumed that the next UK Government will maintain a constraint on fiscal spending. However, it is recognised that the UK General Election result could see a brake applied to austerity, which would increase the number of public sector jobs.

Sectoral employment actual and forecast (000's)

Industry:	2008-12 (Recession)	2012-16 (Recovery)	2016 –26 (Forecast)
Agriculture	0.8	-1.8	0.0
Mining and quarrying	0.3	0.5	0.0
Manufacturing	-11.8	10.3	1.5
Utilities	0.3	1.8	0.5
Water supply and waste	0.0	0.3	-0.6
Construction	-26.8	1.8	2.4
Retail	-13.3	-1.5	-1.0
Transportation	-0.5	5.8	2.8
Restaurants and hotels	-0.8	6.8	4.0
ICT	-1.0	3.0	4.0
Financial services	-1.5	0.5	1.0
Real estate	-0.3	-0.8	0.2
Professional and scientific	-0.3	6.3	5.6
Administration services	-3.0	10.0	6.0
Public administration	-4.0	-4.8	-3.5
Education	-2.3	2.5	-1.3
Health	2.8	9.0	4.3
Arts and entertainment	0.0	1.5	1.5
Other services	-0.3	6.3	1.3
TOTAL	**-61.5**	**57.3**	**28.8**

Headline sectoral GVA forecasts (% p.a.)

	2016	2017	2018	2019	2020
Production and Manufacturing	3.2%	-1.9%	1.3%	1.2%	1.6%
Construction	-2.3%	0.1%	0.9%	0.9%	0.4%
Public sector services	-2.0%	1.0%	0.7%	0.6%	1.1%
Private sector services	3.3%	2.5%	1.6%	1.6%	1.6%
Total	1.5%	1.1%	1.2%	1.2%	1.4%

Outlining the research agenda

The UUEPC research agenda is focused on the strategic economic priorities of the NI economy. The UUEPC has been working on a wide range of research projects over the last six months and to ensure maximum impact with policy makers and Ministers, our publication schedule has been revised to align more closely with the restoration of the NI Assembly.

The UUEPC is continuing to work on the following projects:

Economic modelling and forecasting

- **UUEPC UK and NI macro-economic model** – the team continue to develop the macro-economic forecasting model in partnership with the Judge Business School, University of Cambridge. The model provides the basis for all the UUEPC's economic forecasts and facilitates scenario analysis across a range of policy outcomes.
- **UUEPC Local Government economic model** – the UUEPC is also developing its NI local government economic model, to provide bespoke forecasts to individual councils and to assist in the identification of appropriate economic development policies.

Core research

- **Introducing a Derelict Land Levy** – this project considers the impact and implications of introducing this new levy as a tool for either Central or Local Government to encourage greater development of sites which are currently derelict. The approach of taxing land rather than buildings would represent a significant departure from current thinking.
- **Consumption-led growth in an era of squeezed incomes** – this research provides an overview of recent consumer trends, highlighting the importance of the consumer to continued growth in the UK and NI economies. The research also includes analysis of the cost pressures and income squeezes potentially facing local households.
- **Brexit and the Border Corridor** – the UUEPC has been working with its Local Government sponsors and councils in the Republic of Ireland to understand the implications of Brexit, particularly in the border region, covering areas such as trade, migration, investment, cross-border commuting and tourism.
- **Sub-Regional Growth and Prosperity across Northern Ireland** – this research examines the relative economic performance of NI sub-regions, reviews internationally published literature on balanced economic growth, local commuting patterns and Invest NI support to client companies.
- **Corporation Tax** – the UUEPC continues to work with the Department for the Economy and Department of Finance on a number of policy areas linked to the devolution of Corporation Tax.

The UUEPC is also consulting with sponsors to identify the appropriate publication schedule for a range of other ongoing research including the update to the **Northern Ireland Skills Barometer** and the economic impact of the **National Living Wage**.

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About UUEPC

UUEPC is an independent economic research centre focused on producing evidence based research to inform policy development and implementation. It engages with all organisations that have an interest in enhancing the Northern Ireland economy. The UUEPC's work is relevant to Government, business and the wider public with the aim of engaging those who may previously have been disengaged from economic debate.

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