Ulster University
Economic Policy Centre

Outlook
Spring 2016

A finely balanced recovery

Current conditions in the local economy are relatively positive but there is an over-reliance on consumer spending which is unsustainable in the longer term. There are also significant global risks which have the potential to impact growth locally, nationally and internationally. It is against this uncertain backdrop that the UUEPC has developed its latest Spring 2016 Economic Outlook.

UK Treasury sentiment has shifted over the last 12 months. In early 2015 '*the austerity plan is working*' mantra was at the forefront of policy, then following the general election, both the Summer 2015 Budget and subsequent 2015 Autumn Statement were more generous than anticipated (discussed in more detail in this edition). This points to a marginally more optimistic outlook but one that recognises growing global uncertainty.

Locally, the high profile job losses announced in the manufacturing sector in 2015 and early 2016 have contrasted with several new investment announcements. This is a reminder of the volatile nature of global investment patterns and looking forward, the UUEPC forecasting model continues to suggest a relatively modest rate of growth.

Key Forecasts

Northern Ireland

	2015	2016	2017	2018	2019	2020
GVA growth rate [1]	1.9%	1.6%	1.3%	1.8%	1.7%	1.7%
Unemployment rate [2]	3.6%	3.3%	3.7%	4.0%	4.2%	4.2%
Employment growth rate	1.7%	1.2%	-0.3%	-0.4%	-0.2%	0.4%
House price growth	7.6%	6.9%	5.4%	2.8%	3.0%	3.2%

United Kingdom and global forecasts

	2015	2016	2017	2018	2019	2020
GVA growth rate [1]	2.2%	2.2%	2.0%	1.9%	1.9%	1.8%
Unemployment rate [2]	1.8%	1.7%	1.8%	2.1%	2.2%	2.3%
Interest rates [3]	0.5%	0.6%	2.0%	2.5%	2.5%	2.5%
Inflation [4]	0.1%	0.8%	1.0%	1.7%	1.8%	2.4%
House price growth	5.3%	8.2%	4.4%	2.8%	3.0%	3.2%
World Trade [5]	3.5%	4.1%	5.2%	4.9%	4.7%	4.5%

Source: CBR-UUEPC

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
Note 3: Bank of England base rates
Note 4: UK Consumer Prices Index (CPI)
Note 5: World trade data sourced to Oxford Economics

In this edition

- **A finely balanced recovery** – recent economic growth has been fuelled by stronger than anticipated domestic demand, largely as a result of lower oil prices, but domestic spending cannot be relied upon indefinitely. With international risks being reported on a regular basis, coupled with the uncertainty of 'Brexit', the main driver of future economic growth is far from apparent. This edition discusses a range of factors impacting local economic growth over the next 12 months.

- **The impact of corporation tax devolution** – with a 'date and rate' set for the devolution of corporation tax, the business community is looking forward to a period of increased levels of investment. However, there will also be a cost implication to the NI Block Grant to reflect the lower level of tax receipts. This edition examines the impact on corporation tax receipts in both the UK and Republic of Ireland (RoI) in the period following rate reductions, with results which may surprise.

- **The changing pace of austerity** – although several Government Departments have already made significant cost savings and difficult spending decisions still remain, the level of austerity the Executive now faces is less severe than was being anticipated in early 2015. This edition discusses the changing pace of austerity over the last twelve months.

A finely balanced recovery

The publication of the "Fresh Start Agreement" brought 2015 to a successful conclusion and the threat of institutional collapse was avoided. Importantly for the business community, the Agreement came with a firm commitment on the devolution of corporation tax. It was also encouraging that the global reporting of the Agreement included coverage of this shift in tax policy.

Setting aside the local cynicism, the "Fresh Start Agreement" is a potential watershed moment for Northern Ireland (NI). Analysing the numbers and reading the tone of Ministers' speeches, there now seems a greater realisation that NI must look internally for solutions to its challenges rather than relying on others to fund our way of life. The history and cause of NI's economic challenges are well documented, but a regional benchmarking analysis undertaken by the UUEPC (to be published shortly), suggests similar economic problems exist in other areas of the UK, even though the cause may be different. It must be recognised that policy makers in Westminster are more likely to focus on funding solutions to economic challenges across all regions in the UK, irrespective of the cause.

The winds of change are blowing strongly in 2016. The Assembly elections will be held in May, a new Programme for Government will be developed and a new Department of the Economy will be established combining both economic and skills development.

The year ahead is also a potential game-changer in the UK, with the referendum on EU membership set for 23 June 2016. A vote to leave would most likely have a bigger impact on NI because of its land border with the Republic of Ireland (RoI) as well as the relatively large size of the local agriculture sector. Supporters of UK exit suggest that the current programmes in place to support agriculture (such as the CAP) could be maintained and funded directly through Westminster rather than Brussels. This is certainly a possibility, but the Government has given no guarantees that this will happen.

Furthermore, given the level of north-south and east-west trade, the decision will also have implications for the RoI (and it is a decision over which it will have no say).

China, oil and financial market volatility

The performance of the Chinese economy is leading many economic news headlines, particularly the significant levels of volatility on the financial markets. Whilst the swings on international markets demonstrates investor caution, the headline economic data is less striking with moderate job growth still being reported in the US, Eurozone, India and Japan.

In January 2016 Oxford Economics stated: "*In spite of the strong global market response to the rout on China's equity market, we do not expect the equity slump to have a major impact on China's real economy. Nor do we think that the rout reflects signs of a sudden worsening of growth dynamics. Indeed, we think that global markets have overreacted.*" This suggests growth is continuing even if the financial indicators are suggesting something more alarming.

The economic headlines have also been dominated by the collapse in the price of oil over the last 18 months. Whilst this has been a very welcome development for net oil importers (such as the UK and RoI), it is also creating economic stress in other areas of the global economy. In particular, a number of emerging market economies are dependent on oil exports, such as Brazil and Russia, and there is also risk in some parts of the financial sector which may have high levels of exposure to the oil industry.

Taken together, the local, national and international factors highlighted above all point to 2016 being one of major change.

Domestic strength welcome in a world of uncertainty

The domestic economy has had a strong 2015, driven by a number of positive factors including: rising wages, rising employment and falling prices (closely linked to the lower oil price). In addition, continued increases in property prices coupled with deferred purchases from the first half of the decade creating pent-up demand have combined to encourage greater levels of consumer spending.

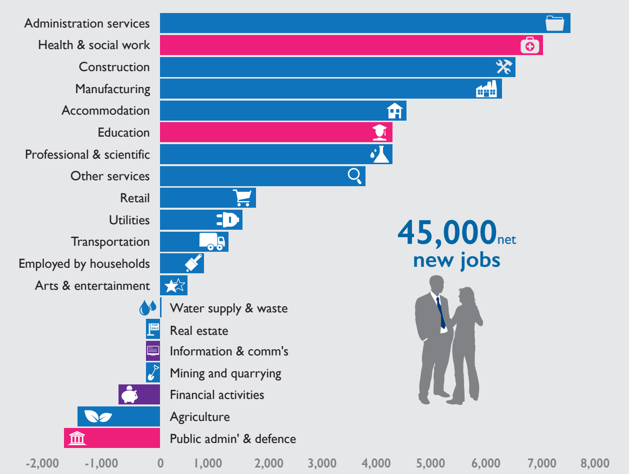
This is in stark contrast to the harsh reality of the global economic environment and the associated job losses announced by JTI, Michelin and Bombardier (amongst others) over the last 12 months. These announcements are a significant loss to the local economy and it is important to understand the factors driving the closure decisions to identify potential policy solutions. Management at Michelin indicated energy prices as one factor in the decision to close the plant. To that end, a three month special commission on energy pricing has been commissioned by DETI (with the UUEPC providing research support) to identify the extent to which locally controlled policy options could reduce the price differential with the rest of the UK.

Mixed fortunes at the sectoral level

Overall local employment levels have been increasing since 2012, with approximately 45,000 net new jobs created in the period to the end of 2015. At the sectoral level, the official data points to job growth and losses in some surprising areas (see Chart 1).

Despite the austerity headlines, employment levels in both health and education have continued to rise and have accounted for approximately 25% of the total net jobs created in the economy. In contrast, despite a number of high profile foreign direct investment (FDI) announcements, sectors such as ICT and Finance have shed jobs since the start of the recovery. Moving forward, a reversal in this trend is likely as those FDI job announcements start to materialise and pressure on Government spending restricts continued public sector employment growth.

CHART 1: SECTORAL CHANGE IN EMPLOYMENT, NI (2012-15)



Source: UUEPC & ONS

The economic growth and employment trajectory

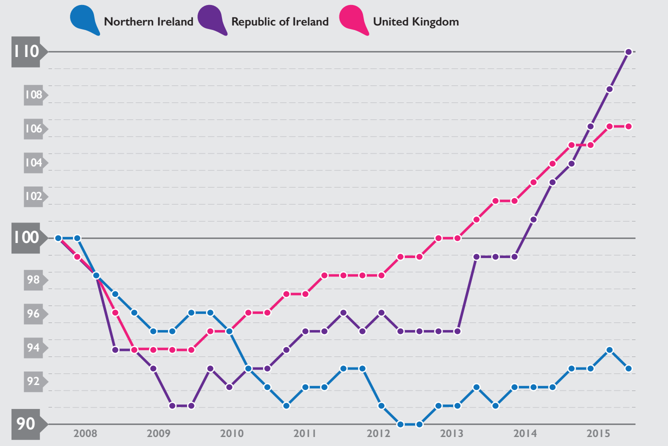
Gross Value Added (GVA) and employment levels are two primary measures of economic performance. NI does not measure quarterly GVA, but DETI produce the NI Composite Economic Index which measures local economic activity and is a reasonable proxy.

As the recession took hold in 2008, local economic performance was significantly impacted and the economy contracted by approximately 10% over the following four year period. This was more severe than in the UK as a whole, where GDP fell by just less than 6% over a two year period. In the RoI, the economy contracted much more quickly, falling by over 9% but the recovery started in 2010, two years earlier than in NI (see chart 2).

In terms of recovery, the UK has enjoyed relatively consistent annual growth (approx. 2.0% p.a. since 2010), this is not stellar but is amongst the strongest in the G7. Growth in the RoI was relatively slow initially, however the pace has quickened significantly in the last two years (averaging 5.7% p.a. from the start of 2013). This is in stark contrast to NI economic performance, which has been the slowest to emerge from recovery and been characterised by low growth (only 1.2% p.a. from the start of 2013).

The employment picture follows a different trend (see Chart 3). It is striking that the very strong GVA growth experienced in the RoI is not reflected in job growth, and employment levels in both NI and RoI remain below that reached in 2008. Encouragingly unemployment in NI peaked at only 5.6% in 2013 and has since fallen back to 3.2%. This is benign by historical standards particularly given the severity of the recession.

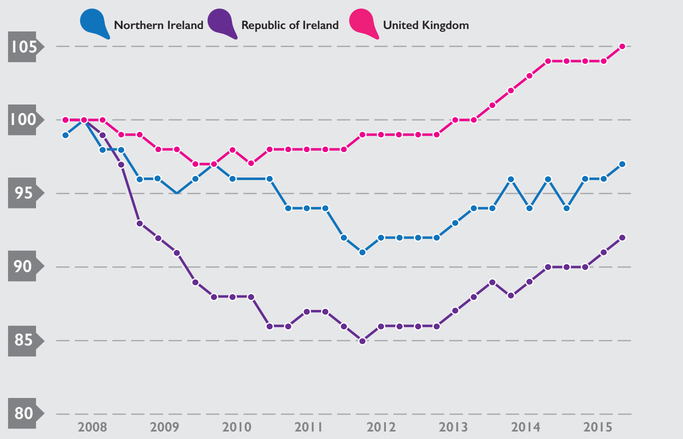
CHART 2: QUARTERLY ECONOMIC GROWTH (1)
NI, ROI AND UK (2008-15) (2008 Q1 =100)



(1): NI = NI Composite Economic Index, UK = GDP, ROI = GDP

Source: DETI Analysis

CHART 3: QUARTERLY EMPLOYMENT GROWTH, NI, ROI AND UK (2008-15) (2008 Q1 = 100)



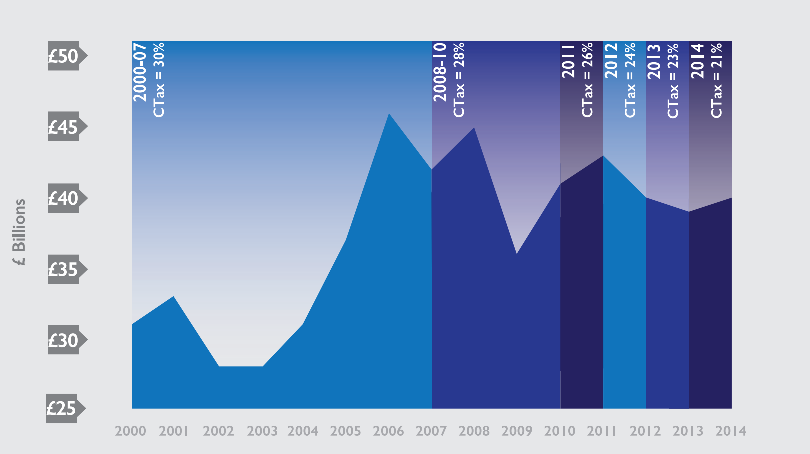
Source: ONS (UK and NI) & CSO (ROI)

The impact of corporation tax devolution

As widely reported, the 'date and rate' for the devolution and reduction of corporation tax has now been set for 2018. Importantly, the economic impact of the proposed reduction has not been included in this UUEPC Economic Outlook because the method of paying for the tax cut has yet to be determined. Previous UUEPC research for DETI estimated the move could create approximately 32,000 additional jobs by 2030 and the cost to the NI Block Grant (reported at over £200 million) would be funded through a reduction in public sector spending. However, if the cost was to be met through an increase in other taxes (e.g. the abolition of industrial de-rating or the introduction of domestic water charges), then the profile of economic growth would be different. When the means of meeting the cost are agreed, the UUEPC baseline forecasts will be uplifted.

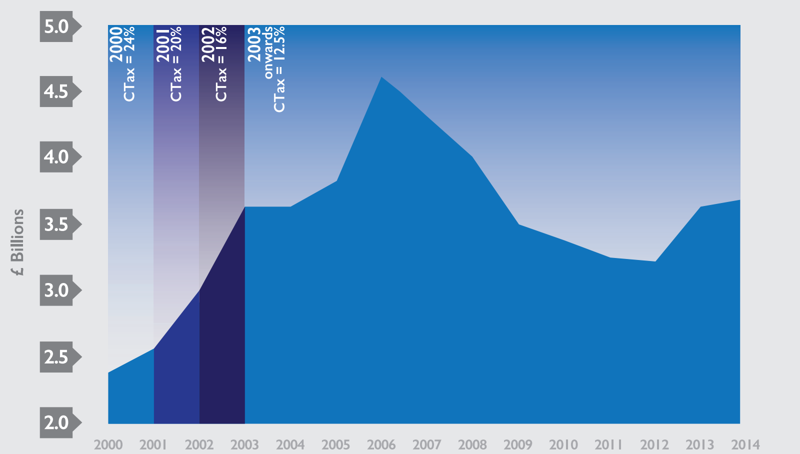
It is often suggested by proponents of business tax reductions that such moves have the potential to increase rather than reduce tax receipts. In that regard, it is worth analysing the impact of corporation tax receipts in the RoI and the UK following previous rate reductions (see Charts 4 and 5).

CHART 4: UK CORPORATION TAX RECEIPTS (2000-2014)



Source: OECD

CHART 5: ROI CORPORATION TAX RECEIPTS (2000-2014)



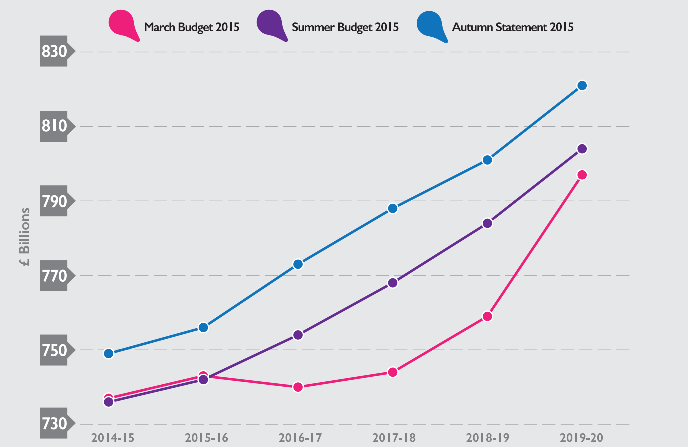
Source: OECD

The UK Government has reduced corporation tax from 30% to 21% since 2008 and in that time period, overall revenues have been volatile but fallen only very marginally given the scale of the tax rate reduction. In the RoI, corporation tax rates were reduced from 24% to 12.5% between 2000 and 2003 and tax revenues continued to rise strongly up to 2006.

This indicates that the most important driver for the level of tax receipts is the prevailing economic climate and therefore it is very difficult to separately determine the cost to the Exchequer of a corporation tax rate reduction. Furthermore, any job creation associated with a rate reduction also has positive implications on income tax, VAT and welfare payments.

Looking forward, it is important to recognise that global economic conditions are less favourable than when either the RoI or the UK reduced its rates. This could have a bigger impact on tax receipts than any change in the rate itself, but if NI was to mirror the experience of either the UK or RoI, the 'cost' of the rate reduction would be more modest than currently being reported.

CHART 6: UK TOTAL MANAGED EXPENDITURE PROJECTIONS



Source: OBR Economic and Fiscal Outlook

The changing pace of austerity

Austerity has been part of the policy narrative for over six years and during that time there has been significant debate about the pace the Chancellor should set for reducing the budget deficit and 'balancing the books'.

The UUEPC Spring 2015 Outlook noted the UK Treasury's aim to reduce Government spending by a further £30bn in the initial years of the 2015-2020 Parliament and to eliminate the deficit by 2019. Although the UUEPC indicated that achieving the level of savings being proposed would be very ambitious and likely to be revised after the General Election, the Spring 2015 forecast was based on the Government spending plans at that time.

Over the following six-month period, the Chancellor has delivered two significant spending announcements, a post-election Summer 2015 Budget and the Autumn Statement 2015. In both announcements, the Chancellor substantially re-profiled public expenditure from his March 2015 Budget (see Chart 6). The Autumn Statement 2015 committed an additional £155bn of public spending over the period 2015-16 to 2019-20 than forecasted in March 2015.

The OBR forecast that the proposed changes in spending has now pushed back the expected date of a balanced budget from 2018/19 to 2020/21. It will be interesting to see the direction taken by the Chancellor in his March 2016 Budget as he has signalled fiscal restraint in recent interviews.

Implications for NI

The broad NI budget allocation can be determined from the UK Budget by means of the Barnett Formula settlement (see Table 1).

Table 1: 2015 Spending Review – Northern Ireland Outcome (Cash terms)

£m	2016-17	2017-18	2018-19	2019-20	% change 2016-20
Operating Spend (1)	9,745	9,821	9,828	9,854	1%
Capital Spending (2)	1,010	1,036	1,073	1,126	11%

Source: NI Budget 2016/17

Note 1: Non-Ring Fenced Resource DEL
Note 2: Capital DEL (excludes Financial Transactions Capital)

The operating spend profile is broadly flat in cash terms, and will therefore decline in real terms. As a result, managing the level of inflation in public services and in particular pay will be critical. Although the overall reduction in spend is smaller than originally anticipated, the significant protections for both health and education will require more significant reductions to be made to other Departmental budgets. This will be a key challenge for the new Programme for Government.

On a more positive note, the funding available for infrastructure spending is set to increase by 11% to over £1.1bn by 2020.

Sectoral Outlook

Manufacturing

The most recent data shows manufacturing employment growing strongly and since the trough of the recession in 2012, the sector has created approximately 6,300 additional jobs (equivalent to 8% growth). This is in contrast to the performance of the manufacturing sector across the rest of the UK which has only grown by 3% in the same period.

The outlook remains positive but growth will be lower reflecting the difficult international trading environment and the recent announcements at JTI, Michelin and Bombardier (with the impact being most significantly felt in 2017 and 2018).

Construction

The construction sector experienced relatively strong growth in 2014 and 2015 after six consecutive years of job losses. There are a number of factors driving this growth including a strengthening local housing market (in January 2016 the National House Building Council (NHBC) indicated a 30% rise in new home registrations). In addition, local firms are continuing to enjoy success in developing export markets.

The outlook is positive but the pace of growth is likely to be lower than in the last two years. The devolution of corporation tax should create demand in the commercial property sector and following the UK 2015 Spending Review, the NI Executive capital budget (i.e. Capital DEL) is forecast to increase by 11% by 2019-20. This should be good news for local public infrastructure and capital projects.

Private sector services

The service sector remains the most important component of the overall private sector in NI and has been responsible for approximately half of all job growth since 2012 (23k of the 45k net new jobs created). The PMI indices remain strong, which is encouraging for short term growth prospects and positive inward investment announcements are continuing. However, job reductions in higher value added service sectors such as ICT and financial services are disappointing.

The UUEPC forecasts suggest that private sector services will generate the majority of the total jobs created. In the first instance, there is an expectation that recent inward investment announcements should become apparent in the job figures over the next few years and it is forecast that both ICT and professional services should be major beneficiaries in a lower corporation tax environment.

Public sector services

Employment levels across the public sector have increased since 2012, but this growth has been confined to health and education (and this includes private sector provision in these areas). Public administration has seen a small reduction by approximately 1,800. Given the NI Executive's commitment to largely protect both health and education, the forecast employment reductions are likely to be small.

The overall outlook for the public sector is less severe than previously anticipated and whilst changing demographics will continue to increase demand for public services, cost control will remain key in determining future employment levels.

Sectoral employment actual and forecast

Industry:	2008-12 (Recession)	2012-15 (Recovery)	2015 –25 (Forecast)
Agriculture	800	-1,500	200
Mining and quarrying	300	-300	100
Manufacturing	-11,500	6,300	4,000
Utilities	300	1,500	0
Water supply & waste	0	0	0
Construction	-26,500	6,500	4,400
Retail	-13,300	1,800	1,900
Transportation	-500	1,300	3,300
Accommodation	-800	4,500	3,900
Information & Comm's	-1,000	-300	4,400
Financial activities	-1,500	-800	-100
Real estate	-300	-300	900
Professional & scientific	-300	4,300	8,500
Administration services	-3,300	7,500	8,100
Public Admin' & defence	-4,000	-1,800	-6,500
Education	-1,300	4,300	-1,500
Health & social work	2,800	7,000	3,400
Arts and entertainment	-300	500	4,000
Other services	-300	3,800	1,000
Employed by households	0	800	0
Total	**-60,500**	**45,100**	**40,200**

Headline sectoral GVA forecasts (% p.a.)

	2015	2016	2017	2018	2019	2020
Production and Manufacturing	1.0%	1.6%	0.9%	1.6%	2.4%	2.6%
Construction	7.3%	2.4%	2.9%	2.7%	2.2%	2.0%
Public sector services	-0.4%	0.1%	0.9%	1.7%	0.9%	1.0%
Private sector services	3.1%	2.4%	1.5%	1.9%	1.8%	1.7%
Total	**1.9%**	**1.6%**	**1.3%**	**1.8%**	**1.7%**	**1.7%**

Outlining the research agenda

The UUEPC research agenda is focused on the strategic economic priorities of the NI economy and in consultation with our sponsors, the Centre is taking forward the following projects:

- **UUEPC NI macro-economic model** – the team are continuing to develop the macro-economic forecasting model in partnership with the Judge Business School, University of Cambridge. The model will provide the framework and empirical test bed to measure the impact of a wide range of policy options as well as underpinning the economic forecasts presented in this report.

- **UUEPC Local Government economic model** – following the devolution of many economic development powers to local government, the UUEPC is enhancing its NI macro-economic model to provide local government forecasts. This should assist the new councils to identify appropriate economic development policies for their individual areas.

- **Cost of Division: A benchmark of performance and expenditure** – this research sets out a comparison of the costs of public sector services in NI, other UK regions and RoI. The analysis provides a basis to identify the additional costs associated with division but a wide range of other factors have also been identified which contribute to cost differentials.

- **Further development of the NI Skills Barometer** – following the successful launch of the Skills Barometer in November 2015, the UUEPC skills team are working with the Department for Employment and Learning (DEL) to identify ways in which the Barometer could be improved further and the information made more accessible to all relevant stakeholders.

- **Further Education – Successful outcomes analysis** – this econometric analysis study, undertaken for DEL, will review data covering a wide range of characteristics of FE students to understand the factors contributing to those achieving a successful outcome.

- **Economic Advisory Group (EAG) NI Competitiveness Scorecard** – UUEPC is updating the competitiveness scorecard for Northern Ireland in order to inform Government policy on economic development matters.

New sponsors

UUEPC is pleased to have signed a new sponsorship agreement with Derry City & Strabane District Council. We look forward to having a mutually beneficial research relationship with the Council at this time of significant change across the local government sector.

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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 Centre'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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