Ulster University

Economic Policy Centre

Outlook - Winter 2018

Global trade winds, local headwinds

The critical role of the consumer and the squeeze in real incomes formed the basis of the previous UUEPC economic outlook and these issues continue to constrain economic growth, but they have been somewhat offset by a boost in hospitality and manufacturing as a result of the depreciation in Sterling and stronger global growth.

Fortunately, we are now in a period where the three engines of global growth (the US, China and Europe) are all increasing growth at the same time. Furthermore, 2018 has started on a positive note with the UK and EU poised to begin negotiations on post-Brexit trade and transition/ implementation arrangements.

The medium term outlook for Northern Ireland is likely to see a continuation of below trend growth for the remainder of the decade, but avoiding recession. The global economy is growing more strongly than many anticipated but the local challenges of low earnings growth, public and private sector debt and Brexit uncertainty weigh on growth.

Key Forecasts

Northern Ireland (NI)

	2017	2018	2019	2020	2021
GVA[1] growth rate	1.4%	1.2%	1.1%	1.2%	1.5%
Unemployment rate[2]	5.0%	4.5%	4.6%	5.0%	5.2%
Employment level '000s	874	882	883	881	879
House price growth	4.4%	3.8%	3.6%	3.8%	4.0%

United Kingdom (UK)

	2017	2018	2019	2020	2021
GVA[1] growth rate	1.8%	1.5%	1.2%	1.3%	1.7%
Unemployment rate[2]	4.3%	3.9%	4.1%	4.7%	5.2%
House price growth	4.2%	2.2%	2.5%	3.3%	3.5%

Macro-economic variables

	2017	2018	2019	2020	2021
Interest Rates[3] (end of year)	0.50%	1.00%	1.25%	1.75%	2.00%
Inflation[4] (annual average)	2.7%	2.5%	2.0%	1.8%	1.6%

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: The UUEPC now uses the ILO measure of unemployment
Note 3: Bank of England base rates
Note 4: UK Consumer Prices Index (CPI)

In this edition

- **Greater certainty starting to emerge –** the magic words from the EU that "sufficient progress" has been made in phase 1 of the Brexit talks paves the way for detailed discussions on both trade and transition arrangements. This reduces the likelihood of a 'no deal' Brexit and the process of creating greater certainty has started.

- **Migrants in Northern Ireland –** the Brexit debate was dominated by the role of migrants, but little research work has been published on the labour market profile of the migrant population in Northern Ireland. This edition provides some further insight.

- **Unemployment and inactivity –** the unemployment rate is at historic low levels and is forecast to fall further even as job growth slows significantly. This points to a tightening of the labour market but has also resulted in a significant number of people transferring from unemployed to economically inactive. This takes them further away from the labour market and reduces the likelihood of a return to employment.

- **Automation –** with the potential for lower value added tasks to be automated over the next 10 to 15 years, the productivity problem could be partially addressed by technological investments. However this raises a different set of challenges for both policy makers and businesses, which are discussed in this edition.

Greater certainty starting to emerge

The phase 1 progress report agreed by the UK and the EU came as a relief to everyone and was immediately hailed as a victory for both sides, by both sides. The agreement increases the prospects of a reasonable final deal and whilst there are many twists and turns ahead, the path to greater clarity on the UK's post-Brexit future is starting to emerge.

The current forecast remains similar to our previous outlooks and the reduction in growth is caused primarily by the long standing issue of over-reliance on consumer spending. Low real wage growth and increasing levels of consumer debt will limit the extent to which consumer spending can continue to drive economic growth. However, this should be partially offset by increased manufacturing activity assisted by the depreciation in Sterling. Locally, the more competitive exchange rate is also helping retailers and the hospitality sector.

The UUEPC continues to develop upper and lower employment forecast scenarios to reflect the wide range of outcomes still possible. Taking an optimistic view and consistent with the long term objective of convergence with UK average economic performance, employment levels could increase by almost 100k by 2027 (or approx. 10k additional jobs p.a. compared to an average of 14k jobs p.a. created since 2012). Conversely, a fall in business and consumer confidence could see a squeeze in real incomes and a drop in employment levels of over 11k over the next ten years. However, the most likely outcome, our central estimate, is 34k jobs created over the ten-year forecast period.

TABLE 1: Sectoral employment forecast 2017-27 across scenarios

	Lower case (Pessimistic)	Central estimate (Expected)	Upper case (Optimistic)
Production and Manufacturing	-13,600	300	4,600
Construction	1,900	3,500	7,100
Public sector services	1,100	1,800	13,800
Private sector services	-1,000	28,400	70,500
Total	-11,500	34,000	96,000

Note: Totals may not sum due to rounding

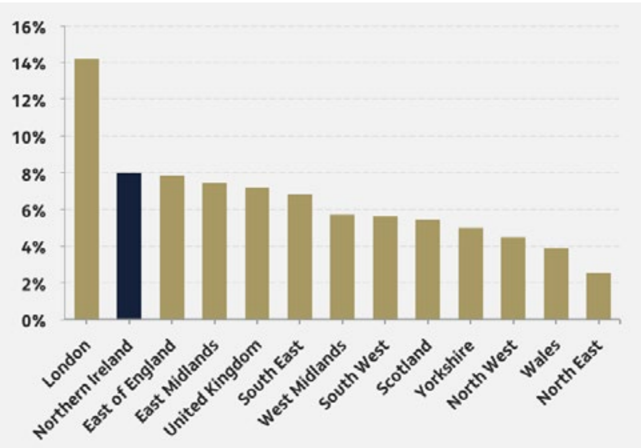
Migrants in Northern Ireland

As the UK and EU negotiate the terms of their future trading relationship, understanding the role of migrants in the economy is more important than ever. Foreign born workers made up 17.4% of the overall labour market in the UK in 2016, compared to 10.2% in Northern Ireland and up from just 4.7% in 2004. Therefore migrant labour is playing an increasingly important role in the local economy.

Country of origin is important in Northern Ireland

In a Brexit context, the country of origin of foreign-born workers is also relevant. Northern Ireland is very reliant on the European Economic Area (EEA) as a source of labour. EEA born workers represent 8% of total employment in Northern Ireland, ranking second only to London (see Chart 1).

CHART 1: EEA-born nationals (exc UK) as % of total employment (2016)

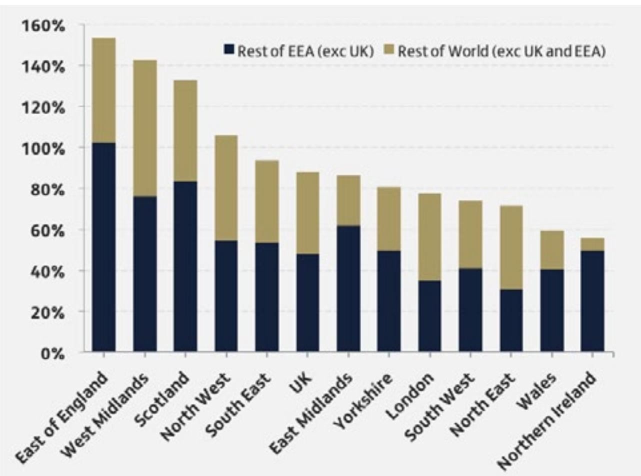


Source: Annual Population Survey

Migrants taking most of the new jobs created

Foreign-born workers accounted for most (55% or 50,000 jobs) of all employment growth in Northern Ireland over the 2004-16 time period. However, that was the lowest proportion across all 12 UK regions (see Chart 2). Migrants have therefore had a very important role in the employment growth story across the UK.

CHART 2: Non-UK born job growth as % of total employment growth (2004-16)



Source: Annual Population Survey

Migrants taking the jobs locals do not want

Migrants also seem to be taking the jobs that Northern Ireland workers do not want. Approximately 83% of the increase in 'low skilled'[1] jobs, between 2004 and 2016, were taken by migrant labour. Conversely, migrants accounted for only 13% of the increase in 'high-skilled'[2] employment over the same period.

If future UK migration policy reduces the supply of overseas workers, local firms will need to consider other options. This may include attracting more local workers, possibly through higher wages, but given unemployment is currently at very low levels, encouraging the 'harder to reach' economically inactive groups back into employment may be needed.

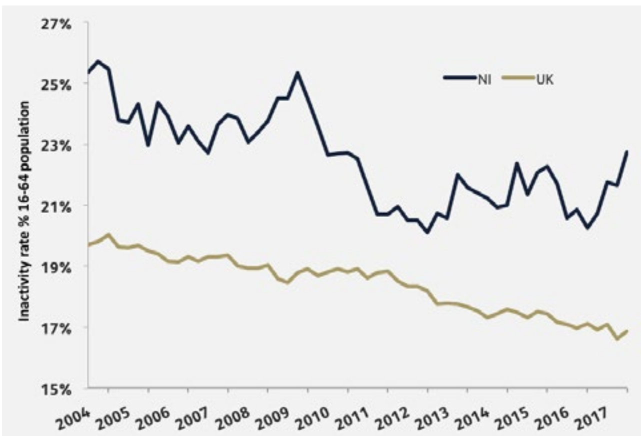
Another option is to consider increased automation to reduce the need for labour. As most migrant jobs are lower skilled, these roles may be easier to replace with capital than higher skilled roles. Both economic inactivity and automation are considered below.

Economic inactivity

Unemployment is at a lower rate now than at any point in the last decade suggesting a tight labour market, however a significant level of economic inactivity is also prevalent in the local economy. Northern Ireland has consistently underperformed the rest of the UK in this area, with the highest working age economic inactivity rate of all UK regions in 92 of the past 102 quarters (i.e. almost 23 of the last 25 years).

Furthermore, over the last year Northern Ireland's economic inactivity rate (excluding students) has increased to 22.7% compared to 16.9% in the UK (see Chart 3).

CHART 3: Economic inactivity (exc students), 2004-2017



Source: ONS Labour Force Survey

[1] Low skilled – major occupation groups 5 to 9 (SOC2010)
[2] High skilled – major occupation groups 1 to 4 (SOC 2010)

The latest quarterly data (Q3 2017) shows long-term sickness has increased by 15,000 from the same period in 2016, which is broadly equivalent to the fall in unemployment recorded over the same period. Given employment growth has also fallen over the last year, this points to a significant flow of people from unemployment to long-term sickness. This is consistent with previous UUEPC research[3].

There may be valid reasons for Northern Ireland's higher rate of long term sickness, but achieving the average UK rate would result in 58,550 fewer people in this category.

From a policy perspective, the current flow from unemployment to long-term sickness suggests that the existing unemployment programmes have not been effective for a significant number of people. As a start, stemming this flow is essential if Northern Ireland is to improve its economic performance.

Automation

The replacement of workers (labour) with machines (capital), is often viewed in very binary terms, it is either potentially catastrophic or it is the route to sustained economic growth. Employees are naturally concerned about losing their jobs, but similarly, automation holds out the potential for higher quality goods and services and generates new jobs in the development and operation of these new technologies. Therefore, it is understandable that automation polarises opinion.

Historical perspectives

Fears about automation are not new. In 1821, the economist David Ricardo argued that technological progress would create mass unemployment and in the 1930's Keynes forecast that technological progress would increase living standards and that the reduced demand for labour would require employees to work for only fifteen hours per week. Ironically, Keynes's main concern was how society would fill the additional leisure time.

With the benefit of hindsight, these concerns were misplaced. The new technologies created jobs in new industries and have significantly increased standards of living.

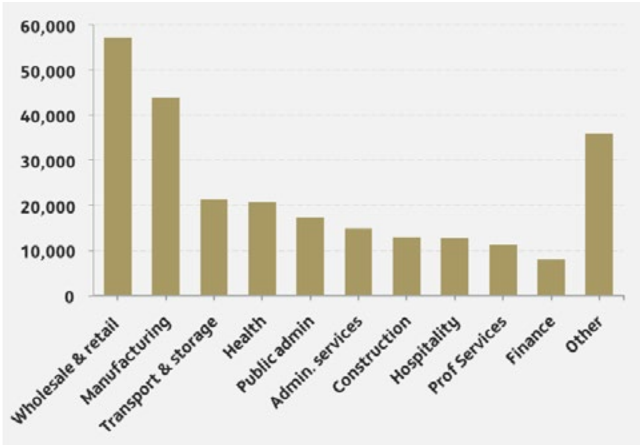
The impact on the NI economy – jobs impacted does not mean jobs lost

A review of previous research shows a range of estimates in terms of the number of jobs impacted. Encouragingly, the research also suggests that automation is likely to create at least as many jobs as are lost.

Based on PwC UK research[4], the UUEPC, in partnership with Catalyst Inc., recently published research on the impact of automation in Northern Ireland. This reflected the specific composition of the local labour market and found sectors such as retail, manufacturing and logistics (transport and storage) are likely to be impacted most (see Chart 4).

Importantly, jobs impacted does not mean jobs lost. Individual tasks associated with a specific job could be automated rather than the entire job itself being replaced. Typically, this should provide the employee with more time for higher value added activities and therefore is less likely to cause mass redundancies as technology is embraced.

CHART 4: NI Jobs potentially impacted by automation by 2030



Source: PwC & UUEPC analysis

Policy implications

At the macro level, automation has been good for society but at the micro level it can cause significant challenges for some groups in society. As a result an education and skills framework is needed which prepares young people for the future skills needs of the economy but also upskills those in employment as their jobs evolve.

In addition, consideration should be given to identifying the skills profile of the human resource that will become available as a result of automation and appropriate ways to make use of that resource identified.

[3] Magill, M. and McPeake, M. (2016) An anatomy of economic inactivity in Northern Ireland. Ulster University Economic Policy Centre working paper. https://www.ulster.ac.uk/__data/assets/pdf_file/0004/181435/UUEPC-Inactivity-Discussion-Paper-Final-Report.pdf

[4] PwC (2017), Will robots steal our jobs? The potential impact of automation on the UK and other major economies

Sectoral Outlook

Manufacturing

The manufacturing sector continues to see increasing levels of employment. As at September 2017 (the latest available quarterly data), approximately 95k people were employed in the sector, up from 88k in September 2016. The job losses announced in the last year have been well reported but it is not yet clear the extent to which those redundancies have been fully implemented. Future data releases will provide further clarity.

The PMI data for the sector remains reasonably strong locally, and increased global growth coupled with the depreciation in Sterling is creating conditions for continued growth in exports.

The Brexit issue is of particular importance to the agri-food sector in Northern Ireland given the level of north-south trade and the integrated nature of supply chains on the island. In this regard, 2018 will be a critical year in determining the long term future trading relationship.

Construction

The construction sector in Northern Ireland had a reasonably strong 2017 by recent standards, growing in employment terms by approximately 5%. Activity in the housing sector increased by almost 15% between Q3 2017 and the same quarter in 2016. Infrastructure activity is more volatile and increased only 1.9% over the same period, as a result of lower public sector infrastructure activity. Other investment in areas such as factories, schools, offices and hotels also increased strongly with activity up almost 15%.

The outlook for the sector is mixed. Both residential and private sector investment activity should remain steady but approval for public sector infrastructure spending is reliant on political leadership.

Private sector services

Private sector services has been the engine of employment growth since the recovery started in 2012, but the sector experienced a slow down in employment growth in 2017. This is quite a turnaround from the 24k jobs created in 2016 alone.

The retail sector is the largest employer in the economy, with 139k employed, but has failed to reach the heights of 151k achieved in 2008. The switch to on-line shopping is one reason and the strong employment growth in the Transport & Storage sector in 2016 appeared to support that view, however even Transport & Storage experienced a decline in 2017.

Financial services is also struggling to create employment as businesses change their operating models to reflect shifting preferences to digital channels. This creates other employment opportunities but requires a different skillset.

Taking a 10 year view, the highest levels of employment growth are likely to be experienced in Hospitality, ICT, Professional Services and Administration Services. This is consistent with previous forecasts.

Public services

Employment levels across the public sector dominated areas have been broadly flat. The health sector has seen employment increase the most over the last five years and will also continue to grow in future as its budget is protected. The education sector has increased only very modestly and other areas of the public sector have seen net reductions in employment.

Forecasting public sector employment is an exercise in forecasting future public policy, but these forecasts are based on the assumption of continued fiscal restraint at the UK level, which in turn impacts the block grant. However, political pressure could result in a change in policy in the medium term.

Sectoral employment actual and forecast (000's)

Industry:	2008-12 (Recession)	2012-17 (Recovery)	2017-27 (Forecast)
Agriculture	0.8	-2.0	-2.2
Mining and quarrying	0.3	-0.3	0.0
Manufacturing	-11.5	15.5	1.6
Utilities	0.3	1.3	0.4
Water supply & waste	0.0	0.8	0.5
Construction	-26.3	4.3	3.5
Retail	-13.3	1.3	0.1
Transport & Storage	-0.5	2.5	2.6
Hospitality	-0.8	9.8	6.6
ICT	-1.0	3.3	4.0
Financial Services	-1.5	-1.3	0.4
Real Estate	-0.3	-1.5	0.3
Professional & scientific	-0.3	6.5	6.8
Administration services	-3.8	15.0	6.4
Public admin & defence	-4.0	-5.0	-2.7
Education	-2.0	2.0	0.4
Health & social work	2.8	6.8	4.1
Arts & entertainment	0.0	2.5	1.1
Other services	-0.3	8.5	0.1
Total	-61.3	69.8	34.0

Outlining the research agenda

The UUEPC research agenda is focused on the strategic economic priorities of the Northern Ireland economy. The UUEPC has been involved in a wide range of projects set out below.

Economic modelling and forecasting

- **UUEPC UK and NI macro-economic model** – the team continues to develop the macro-economic forecasting model in partnership with the Judge Business School, University of Cambridge.
- **UUEPC Local Government economic model** – the UUEPC is also developing its Northern Ireland local government economic model, to provide bespoke forecasts to individual councils.

Core research

- **Knowledge Economy Report 2017** – the UUEPC develops and produces the Knowledge Economy Report for its sponsor, Catalyst Inc. The latest report published in January 2018 provides a detailed overview of activity in the sector.
- **Review of Vacant Property Rates Relief** – the Rates Rethink Consultation included proposals to change the current level of rates relief and this research is focused on considering the potential impact of those changes.
- **Economic Footprint of Belfast Port** – Belfast Port and the harbour estate has a very significant role in the economic life of Northern Ireland. This project seeks to quantify the scale of that contribution.
- **A review of Northern Ireland Industrial Strategy targets** – following the publication of the Northern Ireland Industrial Strategy, the UUEPC provided detailed analysis to inform further development of the targets.
- **Corporation Tax** – the UUEPC continues to work with the Department for the Economy and Department of Finance on a number of Corporation Tax research projects to inform their thinking and negotiations with HM Treasury.

The UUEPC will be starting research to identify skills demand on a sub-regional basis. This is an extension to the Centre's **Northern Ireland Skills Barometer** research.

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.

Contact Us

Director: Gareth Hetherington
E g.hetherington@ulster.ac.uk
T 028 9036 8036

Deputy Director: Richard Johnston
E richard.johnston@ulster.ac.uk
T 028 9036 8041

Senior Economist: Mark Magill
E md.magill@ulster.ac.uk
T 028 9036 6245

Senior Economist: Dr. Esmond Birnie
E esmond.birnie@ulster.ac.uk
T 028 9036 6243

Senior Economist: Dr. Eoin Magennis
E e.magennis@ulster.ac.uk
T 028 9036 6219

Economist: Jordan Buchanan
E j.buchanan@ulster.ac.uk
T 028 9036 8362

Economist: Laura Heery
E l.heery@ulster.ac.uk
T 028 9036 6345

Economist: Marguerite McPeake
E m.mcpeake@ulster.ac.uk
T 028 9036 6266

Economist: Andrew Park
E a.park@ulster.ac.uk
T 028 9036 8917

W ulster.ac.uk/epc
E economicpolicycentre@ulster.ac.uk
T 028 9036 6561
T @UlsterUniEPC