

UUEPC OUTLOOK WINTER 2024



Stuck in second gear

The current cycle of monetary tightening appears to have peaked, but there remains a significant divergence in expectations about the pace of interest rate reductions between the Bank of England and the wider financial markets. The markets are now anticipating base rates in the region of 4.0% to 4.25% by years end, but Andrew Bailey, the Bank of England Governor, is sticking to his “higher for longer” mantra, implying perhaps only two quarter-point reductions this year. For our part, the UUEPC is striking a middle ground with three quarter-point reductions over the course of the year.

Of course all this is data dependent. It takes approximately 18-24 months for the full impact of interest rate rises to fully transfer through to the economy and therefore many of the more recent rises have still to take effect. As a result, with an economy already in very low growth mode, the risk of a technical recession remains high, but in that scenario one would expect the Bank to reduce interest rates more quickly.

Either way, it is essential that both the UK Government (Conservative or Labour) and any returning Executive focus on economic policies to take us out of this current low growth gear.

Key forecasts

Northern Ireland (NI)

	2023	2024	2025	2026	2027	2028
GVA ⁽¹⁾ growth rate	0.9%	0.8%	1.1%	1.8%	2.0%	1.7%
ILO Unemployment rate ⁽²⁾	2.3%	2.4%	2.4%	2.2%	2.2%	2.2%
Jobs growth	1.7%	0.1%	0.4%	0.6%	1.0%	1.0%

United Kingdom (UK)

	2023	2024	2025	2026	2027	2028
GVA ⁽¹⁾ growth rate	0.7%	0.7%	1.4%	2.0%	2.0%	1.8%
ILO Unemployment rate ⁽³⁾	4.2%	4.6%	4.6%	4.4%	4.2%	4.1%

Macro-economic variables

	2023	2024	2025	2026	2027	2028
Interest Rates ⁽⁴⁾ (end of year)	5.25%	4.5%	4.0%	3.5%	3.5%	3.5%
Inflation ⁽⁵⁾ (Q4 forecast)	4.1%	3.4%	2.2%	1.9%	-	-

Source: UUEPC, OBR

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). UK GVA growth forecasts are sourced from OBR.

Note 2: 16-64 ILO unemployment rate

Note 3: OBR unemployment rate (16+)

Note 4: Bank of England Base Rate

Note 5: Bank of England mean CPI inflation

Job Creation in Northern Ireland Firms

Job creation is a key policy aim of government, but to date little is understood about the extent of job creation within firms and how often firms are in job creation mode. To increase this understanding, [UUEPC's recent report](#) analysed job creation, retention, and loss within the nearly 68k employer firms (public [1] and private sector) born in NI between 2007 and 2021.

The median size of all firms at birth was 1 employee (and a mean size of 4.5 employees), confirming that most firms typically start very small [2]. Despite their small start size, these firms created just under half a million gross jobs between 2007 and 2021, the majority of which (301k jobs) were created in the year of birth, whilst a further 192k jobs were created through expansion.

By 2021, just under 38k of these firms had ceased trading, resulting in the loss of 114k jobs. Those that survived but contracted in size resulted in a further loss of 125k jobs, leaving a net job creation of 253k over the 14 year period.

This impact should not be underestimated. To put in context, total employment in NI has increased from approximately 790k in 2007 to its current level of 880k [3], an increase of 'only' 90k. This shows that the existing business stock is more likely to contract in terms of employment than expand over time, and therefore maintaining and growing the size of the labour market is dependent on continuous entrepreneurial activity.

It is important to recognise that over this period, total employment has been impacted by both the financial crisis in 2008 and then the pandemic. It took the labour market 4 years to fully recover from the financial crisis and 3 years to recover from the pandemic. These shocks may be viewed as atypical and in their absence the labour market would be much larger, but economies are always subject to economic shocks and new business starts are critical in the economic recovery process.

Private sector job creation

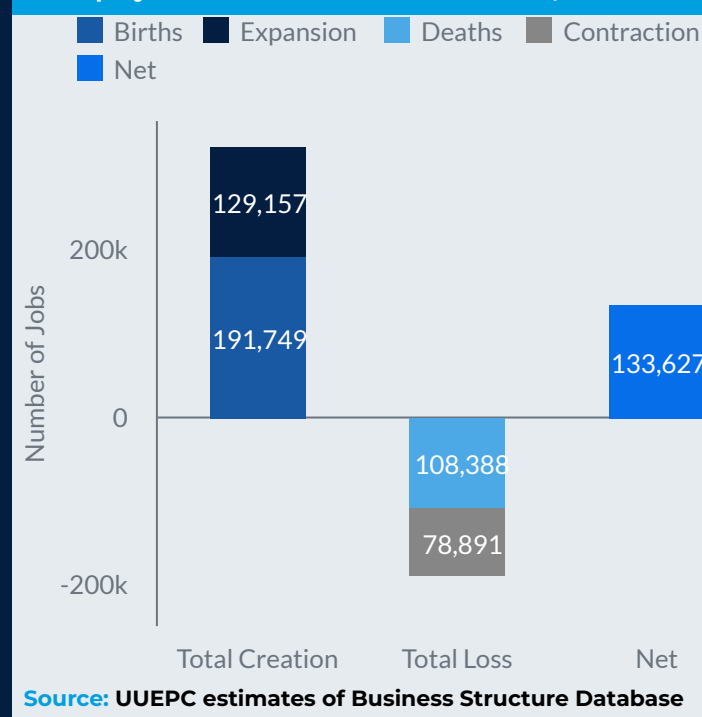
Focusing on the private sector specifically, new starts created almost 192k jobs in their first year and those surviving created a further 129k jobs in subsequent years, resulting in gross job creation of almost 321k between 2007 and 2021. Separately, a total of 187k jobs were lost during the period, due to businesses that ceased trading and through contraction, resulting in net private sector job creation of 134k (Chart 1).

[1] Public sector firms are identified by Standard Industrial Classification Code (SIC) ie. Education, Health and Public Admin.

[2] Public sector firms are the outlier with mean size at birth of 36.6 employees.

[3] UUEPC, LMI Portal

Chart 1: Components of Gross Job Creation and Loss in Employer Births in the NI Private Sector, 2007-21



Trends in job creation

Consistent with previous research, the analysis shows that most jobs were created in the year of birth and any subsequent job creation episodes were more likely in the early years of firms' existence. This underlines the importance to policy makers of a steady stream of new business starts in the overall job creation process.

Furthermore, the results suggest that policy interventions for growth should take the age and size of firms into consideration rather than necessarily just focusing on smaller firms. Of particular importance, the very smallest were least likely to create more jobs over their business lifecycle. However, firms which started with an average of 4 or more employees, typically had more repeat episodes of job creation and created more jobs over their lifetime. These larger start ups would therefore be the most likely target group for effective high growth interventions to assist with a faster scale up.

In general, there were few common trends that emerged in terms of employment growth and the most frequent observation was zero change in employees from one year to the next. Typically, most firms start small and stay small, so from a policy perspective it would be important to understand if these businesses experience other blockages to growth. This could range from the growth mindset of the owner (and if this cohort could be encouraged to grow in the right circumstances) through to other practical barriers such as access to finance.

Attracting large FDI projects will always capture the media headlines, but supporting an entrepreneurial, business start up economy is critical to job creation.

Low Productivity and Falling Capital Investment

Low productivity growth since the Global Financial Crisis is one of the primary economic challenges of our time. It explains why, after over a decade of government spending constraints alongside a rising tax burden, the public finances are still very strained. A lack of economic growth has restricted tax revenue growth and hence the Government's ability to invest in public services and reduce taxes on businesses and households.

This problem is far from unique to Northern Ireland (NI) but is a significant issue here. Between 1998 and 2008 average annual productivity growth in NI was 1.3%, but this fell to only 0.6% between 2008 and 2019 [4]. Although productivity improved in 2020 and 2021, this is largely attributed to the rebound effects from the pandemic and are regarded as temporary. Economists have struggled to provide satisfactory explanations for this long-term drop (to the extent that it is often referred to as the 'Productivity Puzzle'), however it is generally recognised that investment is a key driver of productivity growth.

In an effort to increase our understanding of recent capital investment trends in NI, analysis was undertaken of new experimental ONS data on regional Gross Fixed Capital Formation (GFCF) [5]. Fixed capital refers to assets that are repeatedly used in the production process for more than one year. It includes both tangible/ physical assets such as machinery, buildings and roads, as well as intangible assets such as computer software and Research & Development activity. Intangible assets are particularly important for nurturing and generating innovation activity.

This latest data shows that the trends in productivity growth outlined above are mirrored in the GFCF spending trends. Between 1998 and 2008, the level of GFCF grew at an annual average rate of 4%, but between 2008 and 2020, it contracted at an annual average rate of 3% [6]. Total NI GFCF contracted by 44% in real terms between 2008 and 2014 before increasing in the 3 years to 2017, but then fell again by 10% between 2017 and 2020 (Chart 2).

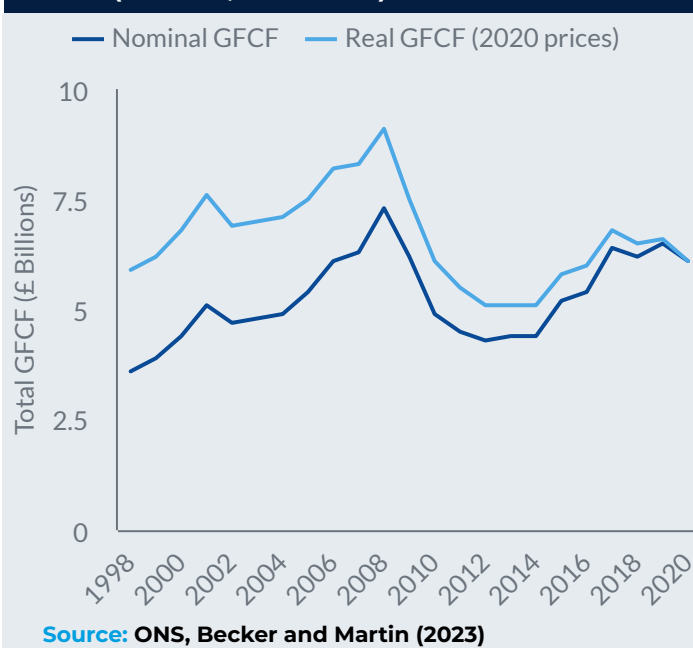
The recent contraction in the 2017 to 2020 period is even greater when measured in terms of GFCF per job (a reduction of 13%). This reflects an economy that has achieved its limited economic growth through an increase in labour rather than an improvement in productivity. In effect organisations have chosen to employ more staff rather than increase capital investment.

[4] Productivity estimates calculated as output per hour using chained volume measure

[5] ONS (2022): Experimental regional gross fixed capital formation (GFCF) estimates by asset type: 1997 to 2020, with updated Building Structures data sourced from ONS (2023): Experimental regional gross fixed capital formation (GFCF) estimates by asset type, UK: 1997 to 2022.

[6] Price deflators sourced from M. Becker, J. Martin (2023) New insights on regional capital investment in the UK, 1997 to 2019. Productivity Insights Paper No. 016, The Productivity Institute

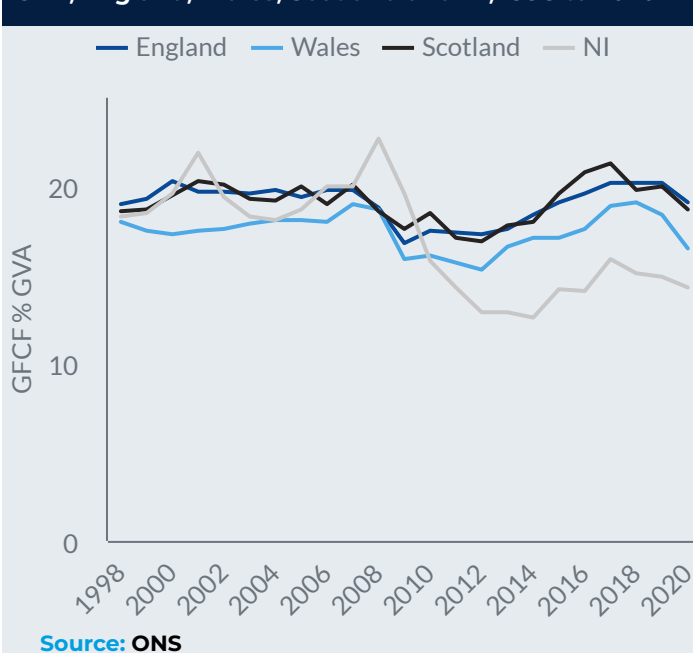
Chart 2: Total Gross Fixed Capital Formation in NI 1998 to 2020 (Nominal, Real Prices)



NI investing significantly less than other UK nations

In addition to an absolute decline in total GFCF, NI has also experienced a significant fall in the level of investment intensity (i.e. Total GFCF as a percentage of GVA). Pre-2008, NI GFCF as a percentage of GVA averaged 20%, but this has fallen to 15% in the post-financial crisis period. Investment intensity has also been volatile in the other home nations but has held up more strongly in England and Scotland (Chart 3). By way of contrast, post-2008 average GFCF as a percent of GVA is 23% in Germany, 25% in France and 21% in the US.

Chart 3: Gross Fixed Capital Formation percentage of GVA, England, Wales, Scotland and NI, 1998 to 2020



Shifting composition of investment

The new ONS data also allows analysis by investment type [7]. Non-residential investment increased by £3.4 bn between 1998 and 2008 but declined by £2.9 bn over the period 2008 to 2013 (Chart 4). Although there was a strong recovery from 2015 to 2017, the downward trend resumed and by 2020 was still £2.2bn lower than in 2008.

These changes were primarily driven by volatility in 'building and structures' investment, which increased very significantly in the 'boom' years prior to the financial crisis and then collapsed in the subsequent years. However, investment also fell in transport, ICT and other tangible assets during this time.

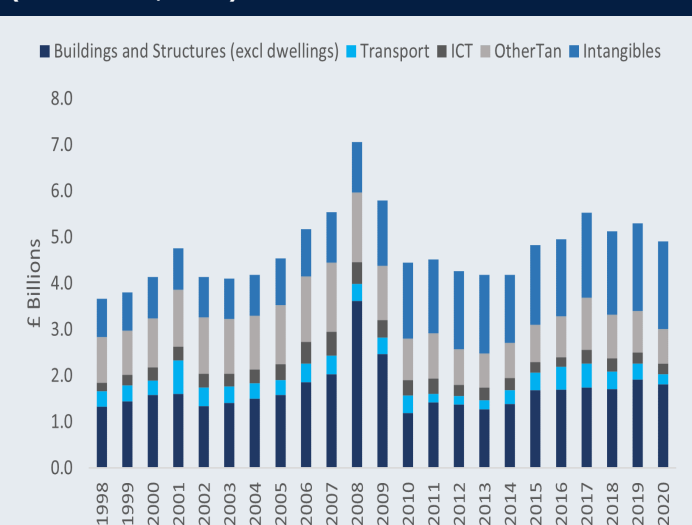
One positive story from the NI data is the strong growth in intangibles investment (e.g. software and R&D), which grew by 129% over the period 1998 to 2020, faster than any other UK nation. As noted above, this is important because investment in intangible assets is often more closely associated with productivity improvements [8].

Intangibles investment increased from 2.9% of GVA in 1998 to 4.4% in 2012 but has since plateaued. This growth has taken NI to the 'middle of the pack' in UK regional terms (Chart 5), but significant continued growth is required to achieve the levels observed in the South East and East of England at 6% and 7.8% of GVA respectively.

One potential avenue of further research to inform policy development would be to identify the extent to which intangibles investment growth has been either dominated by a small number of high performing firms or has been more broadly distributed across all firms. This would significantly influence the nature of policy intervention.

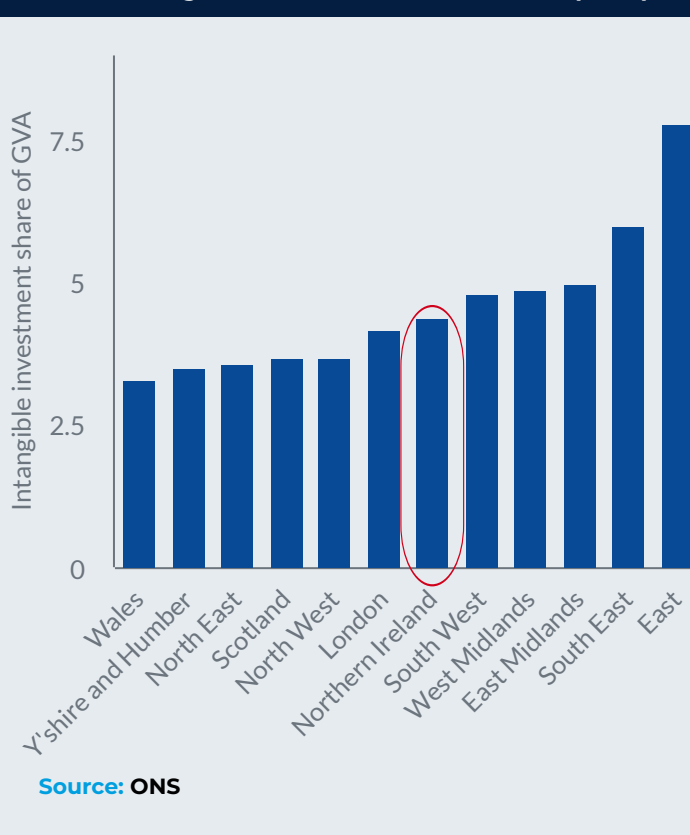
Separately, reflecting the shift to a more service-oriented economy with less reliance on heavy machinery, investment in 'other tangibles' (e.g. machinery and equipment) has fallen by 24% in real terms over the period 1998 to 2020. Put another way, for each £1 invested in 'other tangibles', the amount invested in intangibles has risen from £0.83 to £2.52 over the 22-year period.

Chart 4: NI GFCF by Asset Type, Excluding Dwellings (Real Prices, 2020)



Source: ONS, Becker and Martin (2023)

Chart 5: Intangible Investment Share of GVA (2020)



Source: ONS

Investment must be a policy priority for any returning Executive

This brief analysis would suggest that investment in the post-2008 era has only been sufficient to support very modest productivity growth. It can be no coincidence that productivity growth collapsed in NI at the same time as GFCF spending fell significantly. Therefore, one can only conclude that a return to strong productivity growth requires both businesses and Government to increase their capital investment expenditure.

To encourage private sector investment, the Chancellor of the Exchequer chose to make full expensing permanent in his recent Autumn Statement but there are also measures a NI Executive/ NICS could take. For example, increase direct public investment in areas such as water and wastewater infrastructure and public transport. In addition, barriers to private sector investment could be removed through lower cost policy changes such as the reform of our planning system, as highlighted in a recent NI Audit Office report [9].

GFCF will be the subject of further UUEPC research in 2024.

[7] Investment in housebuilding has been excluded to focus on business and government investment. Housebuilding will be considered in a more detailed report to be published by UUEPC later in the year.

[8] M. Becker, J. Martin (2023) New insights on regional capital investment in the UK, 1997 to 2019. Productivity Insights Paper No. 016, The Productivity Institute.

[9] Northern Ireland Audit Office (2022): Planning in Northern Ireland

Sectoral Forecasts

Manufacturing

The manufacturing sector has faced its share of challenges over the last few years with increasing energy costs and disruptions to supply chains from the NI Protocol/ Windsor Framework. Although the sector seems to have largely worked through those problems, the latest PMI data from Ulster Bank alongside the Index of Production data from NISRA both suggest that the wider global economic slowdown has had an impact on the sector in the second half of the year.

This is being driven by a fall in export orders highlighting the global nature of the challenge faced which local manufacturers are responding to by reducing their prices. This is affordable in the short term due to the falling cost of energy from recent highs, but energy prices remain much higher than prior to the war in Ukraine, raising longer term competitiveness issues. Despite these conditions, the sector still reports that filling vacancies remains a challenge albeit less acute than 12 months ago, pointing to a more resilient labour market despite the economic challenges.

Construction

The construction sector also experienced the challenging economic headwinds in the latter half of the year. Overall activity was stronger in 2023 than in 2022 but activity levels are now trending down. Most growth has been driven by 'Repair & Maintenance' (e.g. house conversions, extensions and improvements), but higher interest rates has reduced demand for domestic new builds. It is only a lack of supply that is providing a floor for prices.

Infrastructure spending has held up reasonably well, but public sector infrastructure investment has been trending down. Given the ongoing funding pressures on the public purse, government capital spending is likely to remain subdued, particularly in terms of new projects. Private sector activity in 'Other Work' such as commercial and industrial buildings rebounded quickly following the pandemic but has started to slow in recent quarters.

Overall public and private sector investment is critical to longer term productivity growth and as challenging as public sector budgets are likely to remain, this must remain a priority.

Private sector services

Overall private sector services remain the strongest component of the economy, however given the breadth of the sector, not all areas are performing equally. Retail continues to face multiple challenges including the long term internet threat alongside reduced footfall in urban centres which remains below pre pandemic levels. This is reflected in our lower retail employment forecast, but the pace of job losses is likely to be relatively slow and managed through natural wastage rather than mass redundancies.

Hospitality has performed more strongly than Retail, but the change in footfall patterns is impacting some hospitality locations more than others. Separately, the large number of migrants/ asylum seekers has provided a welcome revenue boost to some businesses in the accommodation sector. Closely linked to hospitality, the

Arts & Entertainment sector has largely recovered from the pandemic and enjoyed something of a boon as excess savings were spent. However, with higher interest rates and cost of living pressures, leisure spending could become more constrained.

The major growth areas remain in Professional and Administrative Services and to a lesser extent ICT. These sectors were the most resilient to the impact of the pandemic and continue to show strong growth even as broader economic growth slows.

Public sector services

The public sector position remains largely unchanged from the previous outlook. Real wages are constrained causing significant industrial unrest which in turn has a negative economic impact on the private sector.

Solutions to this problem are difficult to identify because without a sustained period of higher economic growth or increased revenue raising locally, government funding will remain under pressure. At time of writing the Northern Ireland Office has proposed a funding package to encourage the DUP back into power sharing. If an Executive is restored, it is likely that much of this additional funding will be used to alleviate immediate pressures, however this will not resolve any of the longer term structural issues facing the Northern Ireland public sector. It is essential, if similar funding problems are to be avoided in another 4 or 5 years, a significant portion of the current proposed package must be set aside to fund the reform of public sector service delivery.

The longer term employment outlook for the public sector reflects the greatest need arising in the Health sector, particularly in terms of an aging population.

Sectoral Employment Actual and Forecast (000's)				
Industry:	2012-19 (Recovery)	2020-22 (Pandemic)	2023-33 (Baseline)	2023-33 (Upper)[10]
Agriculture	-4.9	-5.6	0.0	0.2
Mining	0.1	0.0	0.0	0.0
Manufacturing	18.2	1.3	3.4	5.5
Elect' & gas	0.8	0.2	0.9	2.0
Water supply & waste	1.6	0.2	0.5	1.1
Construction	7.5	-4.4	5.9	7.1
Wholesale & retail	7.0	-2.3	-3.8	1.0
Transport & storage	5.5	0.8	4.1	5.9
Restaurants and hotels	9.0	2.2	5.1	7.1
Info' & comm'	6.6	1.1	6.2	9.9
Finance & insurance	0.0	-0.4	1.5	3.3
Real estate	0.4	-0.7	0.0	0.6
Prof' scientific & technical	11.0	4.1	7.1	10.3
Admin' & support services	14.6	6.0	1.9	3.2
Public admin & defence	-6.1	2.7	0.5	2.1
Education	4.8	5.5	0.2	1.0
Health & social work	13.7	-4.5	7.3	11.9
Arts & entertainment	2.2	-0.1	0.4	2.4
Other service activities	9.8	1.1	0.9	3.2
Total	101.8	7.1	41.9	77.6

[10] Upper scenario incorporates a higher aspirational employment rate.

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
@ g.hetherington@ulster.ac.uk

Principal Economist: Mark Magill
@ md.magill@ulster.ac.uk

Principal Economist: Dr Eoin Magennis
@ e.magennis@ulster.ac.uk

Principal Economist: Dr Karen Bonner
@ ka.bonner@ulster.ac.uk

Principal Economist: Dr Myles Patton
@ m.patton@ulster.ac.uk

Senior Economist: Marguerite Shannon
@ m.mcpeake@ulster.ac.uk

Senior Economist: Gillian Martin
@ g.mcausland@ulster.ac.uk

Senior Economist: Anastasia Desmond
@ a.desmond@ulster.ac.uk

Assistant Economist: Sarah Perry
@ s.perry@ulster.ac.uk

Assistant Economist: Todd Gowdy
@ t.gowdy@ulster.ac.uk

Centre Co ordinator: Danielle McKee
@ d.mckee@ulster.ac.uk

Website: www.ulster.ac.uk/epc

@ economicpolicycentre@ulster.ac.uk

@UlsterUniEPC

@Ulster University Economic Policy Centre

