Group Economics

Ulster Bank

Economic Outlook 2014

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They say a week is a long time in politics. A year has been an extremely long time in economics.

This time last year, the debate was focussed on whether the UK would suffer a 'triple-dip' recession. Now we know that, not only did the UK avoid such an outcome, but due to GDP revisions the 'double-dip', or the return to recession, didn't even occur in the first place. There were fears that the US would fall off the so-called fiscal cliff but this too didn't materialise. Meanwhile, the beleaguered Eurozone and the single currency survived another year.

For Northern Ireland, it was also an eventful year that saw a return to economic growth, strong employment growth and falling unemployment. All three of these indicators exceeded the expectations that prevailed 12 months ago. Other positive indicators pointing to a recovery included strong export growth amongst SMEs and a 10% increase in new car sales.

Economists are now trying to outdo one another in revising up their economic forecasts for the UK, Northern Ireland and Republic of Ireland in the year ahead.

The UK economy is set to see its economic growth rate almost double from 1.4% last year to an expected 2.7% for 2014. Meanwhile the Republic of Ireland is expected to see its annual rate of GDP growth accelerate to 2%, which compares with 0.2% in 2012 and a broadly flat reading last year. The improved economic trajectory within Northern Ireland's two most important trading partners will boost economic growth here too. The local economy is expected to expand by 1.5% this year, which compares with an estimated growth rate of 1% last year. Whilst this pick-up in economic growth is encouraging, it remains sluggish by historical standards. Prior to the downturn, Northern Ireland's typical growth rate was 2.5%-3% per annum.

A number of other themes are set to dominate the year ahead. 2014 will be a year of migration. The UK, along with seven other EU nations, will drop working restrictions for individuals from Romania and Bulgaria. So Northern Ireland is set to become even more cosmopolitan and we can expect to see workers from these countries appearing locally in sectors including tourism, hospitality and food processing. Meanwhile, the trend in net outward migration for Northern Ireland's 20-somethings is set to continue, given the insufficient job opportunities for our younger generation.

The younger generation has borne the brunt of the downturn, and youth unemployment will remain a key theme with close to 1 in 4 of our under 25's looking for work unable to find unemployment. Linked to this will be the underemployment of graduates. These two negative aspects will remain within an overall improving labour market.

The UK's unemployment rate may fall below the Bank of England's forward guidance threshold of 7% by the end of the year. Despite this, however, the Monetary Policy Committee is not expected to begin raising interest rates until 2015. Northern Ireland's unemployment rate will likely fall during the year, however welfare is expected to see the re-categorisation of people currently deemed unfit to work as 'unemployed', which will add to the jobless rate without job losses actually happening.

2014 will represent a year of improvement for Northern Ireland's beleaguered property market and construction industry. 2013 can be viewed as the year that Northern Ireland's housing market bottomed-out, in terms of prices. This year represents the first year that I have forecasted house price growth since joining Ulster Bank in spring 2007. I expect Northern Ireland house prices to rise by around 5% on average in 2014. However, this figure will conceal geographical variations in performance. The Greater Belfast area, where higher-waged employment is concentrated, is likely to fare better than elsewhere.

From an economy perspective, rising transactions are desired rather than rising prices. A pick-up in the pace of residential property transactions is expected as households adapt to the reality that house prices have stopped falling. However, the level of housing market activity and house building remains at historically low levels and the pace of the recovery will remain sluggish. A key housing issue that will develop further in 2014 will be the lack of finance for house builders. Watch-out for *'Help to Supply'* initiatives to rival *'Help to Buy'* schemes.

The key economic issue for 2014 will be the cost of living crisis and we can expect a ramping up of the political rhetoric on this front in the run-up to the 2015 UK General Election. Normally in economic downturns financial hardship is confined to those people out of work. However, in recent years, a growing number of households in work are finding it increasingly difficult to make ends meet. In the private sector, many people will be hoping that 2014 is the year of their first pay rise in over 3-4 years, as inflation has become and will remain public enemy number one for households. Whilst the annual rate of CPI inflation has recently fallen to a 4-year low of 2.1%, it is still set to average around 2.4% this year. Furthermore, food and energy price inflation is expected to be even higher at 3% and 5% respectively. All of these price rises will exceed any pay rises (for the majority of people) and guarantee that the squeeze on household incomes will continue.

Those consumer sensitive sectors of the economy will face another difficult year with the High Street struggling with the challenges of subdued consumer spending, value for money seeking veterans and online competition. Our local tourism industry, however, should build on the momentum from last year's World Police & Fire Games and the Derry-Londonderry UK City of Culture successes, as this year Northern Ireland will remain under the global spotlight as it hosts the Giro d'Italia.

Another aspect of the economy that has exceeded expectations since the start of the downturn has been the levels of inward investment. Indeed, we can anticipate further Invest NI announcements in the year ahead, following last autumn's successful Investment Conference. The ICT & Software, Food & Drink and pharmaceutical sectors have been strong performers throughout the downturn. This trend is expected to continue in 2014.

On the political front, risks are likely to escalate at home and abroad. In the UK, there are the local government and European Parliament elections in May and the referendum on Scottish Independence in September. In terms of the latter, Northern Ireland policy-makers will hope that the campaign to devolve corporation tax will be put back on the rails after. However, there is a risk that this will be once again parked in the station until after the 2015 General Election.

The 2014 elections will set the tone ahead of the General Election. With that in mind, the Chancellor, who has two Budgets and one Autumn Budget Statement before May 2015, is likely to be more political with any changes to spending and taxation. It should be remembered that while the economic recovery is gathering momentum, the public finances are not set to return to the black until 2018/19. Furthermore, by then, the UK will need to begin paying down its £1.7 trillion of national debt.

Outside of the UK, political risks remain in the Eurozone - France and Italy in particular. Italy struggled to exit recession and France is in danger of returning to it. Whilst concerns over the Eurozone receded in 2013, the fundamental problems with the single currency area have not gone away. Expect more problems in the Eurozone, with France, Italy and the health of the Spanish banking system likely to feature prominently. Like last year, Mario Draghi is set to become the most prominent central banker or policy-maker in 2014.

Outside of Europe, the health of the Chinese banking system also poses a significant risk. Almost all economies have experienced a financial / banking crisis at one time or another. To date, China is a notable exception. However, expect concerns to mount this year on that front.

2014 will see further steps taken along the road to recovery, but with the pound in people's pockets continuing to be worth less and less, for many people it will be a long time before it feels much like it.

Richard Ramsey,
20th December 2013