Group Economics

Ulster Bank

UK economic recovery quickens as rate rises draw nearer

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The single most important influence on the Northern Ireland economy concerns the performance and prospects of the UK economy (GB). Not only is Great Britain our largest trading partner, it is also the largest source of investment and visitor numbers. While Northern Ireland's recent recession was deeper and longer than that of the UK economy, and the recovery has been much weaker, the local economy traditionally follows the same economic cycle as the UK. This is due to the fact that Northern Ireland follows the same fiscal and monetary policy arrangements as the rest of the UK. In addition, given that Northern Ireland shares a common currency with the UK, the price of imports, the competitiveness of exports and the rate of inflation are all linked to the fortunes of sterling.

Therefore while Northern Ireland is exposed to other external influences, alongside its own economic micro climate (for instance the local housing market), the performance of the wider UK economy is the most significant factor that can move the needle on Northern Ireland's economic dial. For this reason, local businesses and households alike should be taking a keen interest on the strength of the UK's economic recovery.

The incoming economic news on this front is all pretty encouraging. According to the Bank of England's latest forecasts, the UK economy is expected to grow by 3.4% in 2014, double the rate posted last year. Furthermore, the UK is expected to be the fastest growing economy in the G7 in 2014. However, it should be remembered that the UK recovery to date, as far as output is concerned, has been the weakest recovery in recent history. Indeed, the UK will only regain its pre-crisis level of output later this year. The recovery remains largely dependent on consumer spending with export growth yet to ignite. It is encouraging though that business investment has been increasing for the last five quarters, albeit it still remains some 8% below 2007's peak.

The UK's unemployment rate dropped to 6.8% in Q1 2014 - a five-year low. Meanwhile the UK's spectacular employment recovery, which is largely due to a surge in self-employment, continues. The rate of employment growth accelerated in Q1 with an additional 283,000 individuals engaged in work in some shape or form. This represented the biggest quarterly increase since records began. Self-employment accounted for two-thirds of this rise and propelled the UK employment figures to a record high. Some 700,000 more people are in work in the UK today than there were a year ago.

Overall, the labour market figures are encouraging as far as rising employment and falling unemployment is concerned. However, the recovery in real earnings *(inflation adjusted)* remains in its infancy. Following a sustained period of above target inflation, which severely eroded households' disposable income, the annual rate of consumer price inflation has finally fallen below the MPC's 2% target since the start of the year. Average earnings are expected to outpace inflation later this year as consumers begin to claw back their lost purchasing power. It should be noted that since the credit crunch officially began back in August 2007, the cumulative rise in consumer price inflation has been over 22%. This is more than double the cumulative rise in average earnings.

Meanwhile UK house prices are already 5% above their pre-crisis peak - though this is largely due to London and the South East. London house prices are 27% higher than they were six years. The Bank of England Governor, Mark Carney, has highlighted that the housing market is the biggest single risk to the UK economy. Northern Ireland will be hoping that region specific measures will be applied to address this problem rather than a blunt UK wide instrument that could harm the local housing market recovery.

The ongoing improvement in the UK economy has been accompanied by a 10% appreciation in sterling since last summer. This again is a mixed blessing. Imports will become cheaper and exports will lose some of their price competitiveness. For an economy that wants to rebalance away from consumer spending towards exports, this exchange rate is not ideal. Although those of us holidaying abroad this summer will welcome the additional purchasing power that a stronger pound buys.

Sterling has also strengthened due to rising interest rate expectations. Despite the economic recovery, the Bank of England's Bank Rate remains at its 320-year low of 0.5%. Inevitably, in time, the UK economic recovery will lead to a return to more 'normal' interest rates with rises expected next year, potentially ahead of the next General Election.

Political uncertainty will be a feature until the 2015 General Election take place. However, whoever wins will have to continue to work towards a meaningful recovery in the public finances. Therefore public expenditure cuts, tax rises and interest rate rises will all form part of the UK's wider economic recovery and this will impact on the local economy's recovery too.

Richard Ramsey,
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