

2012 – The Year of the dragon or will the year of the snake come early?

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At this time of year, economists reflect on the year that has passed and provide insight into what to expect ahead. Looking in the rear view mirror and at the road in front is far from pretty. 2011 started off badly, deteriorated mid-year and tailed off towards the end. Indeed, my own economic outlook this time last year proved to be overly optimistic for the fourth year in succession. Against this background, expectations for the year ahead are extremely, low but may still prove to be overly optimistic. Having become immune to surprises, we should expect the unexpected and more volatility in the year ahead.

Economic growth forecasts for 2012 have been slashed. The UK is expected to grow this year at 0.7%, one third of the growth rate anticipated 12 months ago. This is also one third of the growth rate (2.1%) forecast for the US economy, but still sluggish by its standards.

Meanwhile, the biggest downgrades in economic growth are centred on the eurozone. In January 2011, financial markets were nervous that Spain might require a financial bailout. The focus, however, shifted to Italy which wasn't even on the radar this time last year. The eurozone is expected to contract by 0.1% in 2012 which compares with the 1.6% growth rate expected just 6 months ago. Rating downgrades will remain a feature for sovereigns and financial institutions alike. France is expected to lose its coveted AAA credit rating for the first time since 1975. Indeed, this downgrade may already be in the post.

A year ago I highlighted that talk of the demise of the euro was overdone and that the EU authorities would 'throw the kitchen sink' at addressing their problems. Clearly, this did not happen and markets lack confidence that there will be an adequate policy response in 2012. Rather than the demise of the euro, the talk this year will be on how the eurozone changes – in terms of possible eurozone exits and further fiscal integration. Against this backdrop, we have a bias for euro weakness against sterling. UK holiday-makers in the eurozone next summer should experience their best exchange rate since 2008 with the pound expected to be worth around €1.22 (€=0.82p) if not more.

From a local viewpoint, we will be closely watching the issue of corporation tax from two perspectives. First, whether the Republic of Ireland manages to hold onto its 12.5% corporation tax rate and second, whether Northern Ireland can secure such a rate if corporation tax powers are devolved. Clarity on both issues should emerge later this year. On this front, let's hope for Northern Ireland's sake that the London Olympics don't provide a good opportunity to bury bad news.

This summer will also reveal the findings from a Chancellor-commissioned report into regional public sector pay. Both of these fiscal issues will have a significant bearing on rebalancing the local economy. Before then we will get a Spring UK Budget which will provide more detail on the additional spending cuts (2015/16 & 2016/17) announced in the Autumn Budget Statement. Against this context, Northern Ireland faces the unenviable position of being the UK region that has experienced the deepest recession and is also the most exposed to public expenditure. It is also the UK region most exposed to the Republic of Ireland. With both the latter and the UK set to grow by one percent or less this year, the local economy will do well if it avoids negative growth.

Outside of Europe, 2012 could prove a significant year for China. In the Chinese calendar this is the year of the dragon. However, it remains to be seen whether China will still be firing on all cylinders. Opinion is divided over whether the booming Chinese economy will experience a soft or hard landing. I am sitting on the fence and expect it to experience something in between! 2013 is ominously the year of the snake. So far, China's

economic development has been all ladders and no snakes. However, the economic board game being played by most other economies is *'Snakes and No Ladders'*. The one positive from a slowdown in China would be an easing in global commodity price inflation.

UK CPI inflation should fall dramatically this year, with the Bank of England more concerned with inflation being too low in two years time than too high. Therefore, in order to hit its 2% target within 2 years, we anticipate more monetary policy action next month in the form of another £50bn injection of quantitative easing (QE) as interest rates remain on hold. However, it's the level of prices rather than the rate of increase that is the problem. In Northern Ireland, the severe income squeeze set to continue, with the impact increasingly felt on the high street and consumer sensitive sectors.

2012 will be another year of further restructuring for businesses and the start of reform within the public sector. Northern Ireland's relative economic prosperity vis-à-vis the UK average is now back at levels last seen in 1992. This underscores the need for game-changing reforms and policies (*e.g. lower corporation tax*) to aid our escape from our longstanding SQSS condition – *'Status Quo Stockholm Syndrome'*.

Richard Ramsey,
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