Group Economics

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Diverging economic picture set to continue in 2017

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Divergence has been a key theme of the Northern Ireland economy during recent years, with our economic performance consistently diverging from – i.e. falling further behind - the rest of the UK. But divergence has recently become more prominent in others areas too, including between the first and second half of 2016, the performance between sectors, within the labour market, and in terms of our domestic and export performance. And this is a theme that is set to become even more prominent in 2017.

During the first half of 2016, the Northern Ireland economy performed well, with economic and employment growth continuing. Northern Ireland's Composite Economic Index (a proxy for GDP growth), revealed a notable pick-up in the annual economic growth rate from 0.9 percent in Q1 2016 to 1.6 percent in Q2. However, this conceals diverging growth rates for the public and private sectors. The latter posted a robust 2.9 percent year-on-year expansion in Q2, whereas the public sector reported a hefty rate of decline (-2.6 percent). Meanwhile, the services sector expanded at its fastest rate in 10 years in Q2 (+4 percent year-on-year) with strong growth recorded in consumer sensitive sectors. Despite three years of a recovery, however, Northern Ireland's private sector has recouped just 55 percent of the output lost during the downturn. Private sector output in Q2 2016 was at the same level it was 11-years ago.

Overall, the second half of 2016 has been weaker than the first half. This is borne out in the PMI surveys, which suggest that both economic and employment growth dropped down into a low gear. Following stagnation in September, however, Northern Ireland's private sector returned to growth in Q4. But, the pace of growth was still weaker than the beginning of the year.

Perhaps the most significant aspect of the most recent PMI surveys concerned new orders, which are growing at a much weaker rate than export orders. Indeed, the latter posted a record high in Q4. Pharmaceuticals is one notable growth area, benefiting from sterling weakness versus the dollar. But the different growth rates between overall orders and export orders implies that domestic orders (outside of retail) remain pretty subdued.

The converse however seems to be the case within the construction sector. Given Belfast's crane cluttered skyline, it would appear that business conditions within the local construction market are relatively buoyant. However, despite this, and perhaps surprisingly, the PMI points to rapid rates of contraction in construction output orders and employment. This is largely due to subdued demand within a major external market – i.e. GB. But it is our view that the construction recovery should continue to build.

In terms of the EU referendum vote, it has proved to be a mixed blessing for firms. On the one hand, sterling's weakness against the euro has boosted export price competitiveness and helped to deliver a record year for the tourism industry. Meanwhile some PMI survey respondents say that increased uncertainty following the vote has negatively affected orders. The outlook for foreign direct investment also looks highly uncertain due to BRUMP – Brexit and Trump. The latter's election suggests that protectionism will be a key theme in the US for the next few years.

A weak pound may be have been positive for exporters (and cross-border retailers) but it is bad news for importers. Input cost inflation is accelerating, and manufacturers and retailers are bearing the brunt of this. This will feed through into significant rises in consumer prices in 2017. So whilst 2016 will likely prove to have seen a bumper Christmas for local retailers, the outlook for retail during 2017 is much less merry, as consumers look set to feel a squeeze. For instance, the latest figures show that the price of petrol and diesel in the UK has risen to its highest since July 2015, following a three-pence-a-litre increase last month alone. And over the next two weeks, the RAC expects the price of unleaded to rise further to 118p, with diesel going up to 121p a litre.

Car sales will also likely experience another year of little or no growth in 2017, following stagnation in 2016. However, it is worth noting a divergence that is taking place beneath the bonnet. The headline figures conceal contrasting fortunes between premium and non-premium brands. While sales of non-premium cars have fallen by 2 percent, the premium end of the market – which includes the likes of Audi, BMW, Volvo and Porsche – posted a healthy rise of almost 13 percent. Sales of premium brand cars in Northern Ireland are now 12 percent above 2007 levels.

In relation to the labour market, the headlines in the latest labour statistics make for pleasant reading. Unemployment is continuing to fall with the headline rate hitting 5.6 percent in Q3 2016 - close to an eight-year low. Meanwhile fresh record highs and lows were established for the employment and economic inactivity rates respectively. However, these headlines conceal a significant divergence with respect to gender. Male unemployment has risen significantly from 6 percent in Q4 2015 to 7.3 percent for Q3 2016. Meanwhile the corresponding rate amongst females has plummeted from 5.7 percent in Q1 2016 to 3.7 percent in Q3 2016. This gender story partly reflects the contrasting fortunes between the male dominated manufacturing sector and the retail and hospitality sectors that have high concentrations of female workers. In 2017, Northern Ireland's unemployment rate is expected to move back towards 6.5 percent.

Overall, it is encouraging that the private sector remains in growth mode. What is concerning though is that the rate of employment and output growth remains relatively weak. Furthermore, the largest contributor to growth remains the retail sector. The retail and hospitality sectors should continue to benefit from cross-border trade in 2017 due to sterling weakness. However, given that inflation pressures are intensifying, these will increasingly come to the fore in 2017 with rising consumer prices, and will ultimately act as a major brake on growth. Furthermore, a range of benefits have been frozen until 2020 which, coupled with inflation in excess of 2½ percent, will see real incomes fall. Northern Ireland consumers will say farewell to the consumer sweet spot that they have enjoyed for two years – even if interest rates remain on hold in 2017.

One of the other significant challenges for the local economy concerns changes happening within large firms here, with some major employers closing, others scaling back their operations or making redundancies, and others seeing their operations consolidated following mergers with rivals. In this economic context, it is essential that the economy is the number one priority of the policy-makers. However, with significant issues distracting governments locally and nationally - most notably Brexit – this is unlikely to be the case in 2017.

Overall, following growth of around 1.5 percent in 2016, the Northern Ireland economy will do well to avoid recession in 2017. Economic growth is expected to be a marginal 0.5 percent at best. However, it is not all bad news, as some sectors of the economy - for instance the likes of pharmaceuticals and tourism - look set to continue to thrive. And of course there will be good companies who will continue to buck the overall trends do well despite the challenging environment. We just need more of them.

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