Group Economics

Ulster Bank

Economic Review & 2015 Outlook

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2013 was dubbed the 'spreadsheet recovery'. The computer said 'yes', we are technically in recovery, but the consumer said 'no', I don't feel it. 2014 saw the recovery begin to download, becoming increasingly evident in more tangible indicators such as employment, house prices, new car sales and business activity.

This economic recovery in Northern Ireland was facilitated by a marked pick-up in growth in our two most important economies – the UK and the Republic of Ireland. They are estimated to have expanded by 3% and 5% respectively in 2014, following disappointing growth rates of 1.7% (UK) and just 0.2% (RoI) the previous year.

Economic Growth

As a result, the UK and RoI recoveries acted as a tow-truck that finally pulled the Northern Ireland economy out of the ditch that was six years of contraction. The local economy is estimated to have grown by 2% in real terms in 2014. A similar rate of growth (1.5% - 2.0%) is expected in 2015, only the dynamics of this growth rate will have changed. Consumer spending, stemming from real wage-growth will account for a greater share of economic growth, whilst the corporate sector should see its contribution moderate. The UK and RoI are expected to see their growth rates slow to around 2.5% and 3.5% respectively in 2015.

Labour Market

In terms of the labour market, a lack of wage rises blighted an otherwise strong picture in both the UK and Northern Ireland last year. The local claimant count unemployment register has been falling for two years, with 2015 expected to be a third straight year of unemployment declines. The headline ILO unemployment rate has fallen to 6.3% in late 2014. A dip below 6% for the first-time in six years is anticipated later this year, with the unemployment rate expected to average around 6% in 2015. The equivalent rate in the UK should reach 5.5% in Q4. Meanwhile the Republic of Ireland's unemployment rate should return to single-digits later this year for the first time since January 2009.

Last year, Northern Ireland's rate of employment growth exceeded all expectations with the pace of job creation accelerating from 1.3% in 2013 to 2.0% for 2014. The latter represented the fastest annual pace of growth since 2005. The pace of job creation will slow in 2015 to around +1.6% y/y and again more sharply in 2016. Northern Ireland should see a return to its Q2 2008 employment peak in late 2015 / early 2016. Thereafter, a sustained period of job losses in the public sector will act as a significant drag on employment growth and limit opportunities for the younger generation.

Changes to EU State Aid rules in June last year means Invest NI will not be able to offer the levels of financial assistance to attract inward investment that was previously the case. 2015 will therefore not be the bumper year for inward investment that 2013 and 2014 were. Nevertheless, a number of the investments announced over the last two years will still bear fruit in terms of new jobs in the 12 months ahead.

As in previous years, the younger generation will remain at the back of the queue with regards to the employment recovery. Since 2012, Northern Ireland's youth unemployment rate has consistently been above 20%. The unemployment rate for the 18-24 years of age cohort is likely to remain close to 20% throughout 2015. It remains to be seen whether resources will be re-prioritised to tackle our youth unemployment problem.

Inflation
Inflation has been public enemy number one for most of the last 7 years, with consumer price rises consistently outpacing wage increases. This was particularly noticeable with food and energy / fuel prices. However, since the second half of 2014, the cost of living recovery has begun with a vengeance, and food and petrol prices have gone into reverse. The annual rate of CPI inflation has fallen from 2.6% in 2013 to around 1.5% for 2014. A huge drop in the oil price, which has still to fully feed through into fuel prices, will help to push the annual rate of CPI inflation to around 0.5% for 2015. This will represent the lowest annual rate of CPI since the series began in 1989. It also sets the bar very low to secure a real terms increase in spending from even a modest pay rise. 2015 should therefore be the first year of a meaningful wage price recovery.

When oil price falls feed through, we can expect to see petrol price to fall below the £1 per litre mark for the first time since H1 2009. Falling food and fuel prices will boost disposable incomes and will effectively act as painkillers ahead of the next 5 years of austerity.

Housing Market
In terms of the local housing market, it continues to recover from the steepest house price correction in UK history and a slump in house building. 2014 marked the first full-year of house price rises in 7 years. This trend should continue, with average prices expected to rise by 6% in 2015 following last year's growth estimate of 7%. Meanwhile, residential property transactions are set for their 4th successive year of double-digit growth.

The recent reform of stamp duty should increase activity around the £250k price threshold. Following last year's rise of 27%, the pace of growth should ease to around 15%, taking the annual number of transactions to around 23,750. This compares with 2006's 'freak peak' of 41,000, and 2005's more 'normal' levels of 29,000. A modest pick-up in house building is expected for the second successive year in 2015. However, this growth is coming from extremely low levels. For perspective, 2013 marked the lowest number of housing starts since 1978. Therefore Northern Ireland's house building recovery has a very long way to go.

Interest Rates
For many borrowers, particularly those in negative equity, monetary policy will continue to provide some much needed help. The Bank of England is not expected to raise interest rates until 2016 at the earliest. Whilst the policy-makers in Threadneedle Street sit on their hands, their central banking counterparts in the US Federal Reserve and the ECB will be more active, albeit for different reasons. The Fed is expected to raise its benchmark interest rate, its Fed Funds Rate, for the first time since June 2006 by mid-year. Unlike the US, the Eurozone is not experiencing a robust economic recovery. Economic stagnation, high unemployment and the spectre of deflation will remain key themes for the Eurozone in 2015. The ECB is expected to kick off the New Year with more stimulus in the shape of asset purchases, known more commonly as Quantitative Easing (QE).

Currencies
Diverging monetary policy intentions coupled with significantly different economic growth trajectories, particularly between the US and the Eurozone, should lead to a stronger dollar and a weaker euro in 2015. The Euro/Dollar currency pair is expected to fall from $1.23 (18/12/14) towards $1.13 by Q4 2014. This would take the currency pair to levels not seen since September 2003. Political risk surrounding the UK General Election on 7 May will weigh on sterling sentiment too. At the time of writing the pound is worth $1.565. Sterling is projected to dip below the $1.50 mark in H2 (*post a Fed rate rise)* and we target $1.49 by Q4. The last time GBP/USD was lower than $1.49 on a quarterly basis was in the depths of the global recession in Q1 2009 ($1.43). Northern Ireland exporters to the US will benefit from this but those planning a trip to Disneyland wont! Conversely, Northern Ireland will be a very price competitive destination for US tourists.

Sterling's weakness against the dollar will not be reciprocated with the euro. So, local exporters and the tourist industry will not receive the same exchange rate tailwind within the Eurozone market. Indeed, Sterling is expected to strengthen against the single currency throughout 2015 and is expected to reach €1.31 by Q4. This means a euro will be worth around 76p by the end of the year. The exchange rate is likely to be a secondary concern to weak demand within the Eurozone, with sluggish growth of around 1% anticipated. (This compares with 3% in the US.) The risks to the Eurozone lie to the downside, particularly with the negative spillovers from Russia. Local companies, particularly within the food and drink sector, have already been shut out of this market due to the economic sanctions imposed on the bear. Russia and Italy are the two largest European economies that are expected to be in recession in 2015. A severe recession in Russia, linked to the collapse in the oil price and its ongoing financial crisis, will adversely affect Western Europe too.

As a result of all of this, holidaymakers heading to the Eurozone this summer should find it cheaper than at any time since 2007. Conversely, Northern Ireland will not be a very price competitive destination for Eurozone tourists. The projected weakening in the euro should also lead to the lowest Single Farm Payment (SFP) in 8 years.

Political Risks

Political risk will be a key theme in 2015 at home and abroad. Last month's Greek presidential elections and the potential for parliamentary elections next month have put Greece back on the risk radar. More political risk will come this year with national elections in Spain, Portugal, Finland and the UK with regional elections due in France. The rise of anti-EU sentiment will be a major theme across Europe in 2015, and concerns over the entire Eurozone project are expected to resurface this year. However, unlike previous years, the focus is not so much on the periphery, but the core. In particular, concerns over the economic health and lack of reforms in France and Italy are expected to mount in 2015, with the politics of austerity centre stage.

UK politics is more unpredictable than at any point in living memory. The era of the '2-party' system appears to be over, which is a trend increasingly evident in Europe too (e.g. Spain). The UK opinion polls are pointing to a coalition or minority government in May 2015. Indeed, we may even see a three-party coalition. Financial markets are likely to get nervy with UK assets and sterling mid-year due to this political uncertainty.

Regardless of who wins the next General Election, fiscal austerity is going to move up a gear. This is both inevitable and unavoidable. The UK, and by extension Northern Ireland, will see more public expenditure cuts in the next 5 years than have been delivered over the last 5 years. To date, none of the main political parties have flagged major tax rises. However, as with, with the public expenditure cuts, these are both inevitable and unavoidable, not least to dilute the projected public expenditure cuts that are deemed to be both undeliverable and politically unpalatable. Whoever wins the next election will have the dubious honour of presiding over the UK public finances when the stock of public sector debt crosses the £1.5 trillion mark.

As in 2010, we can expect tax rises only to be announced after the election in another 'emergency Budget' in June. VAT is normally the tax weapon of choice for governments seeking to raise revenue quickly. All political parties are likely to give a VAT rate rise to 21% serious consideration.

2015 is likely to see a rise of English nationalism, which politicians are likely to have to listen to. There will be increasing attention paid to inter-regional public expenditure and revenue comparisons within the UK as a result. Northern Ireland is potentially vulnerable to this, given that it is the lowest taxed region of the UK and each man, woman and child receives more public expenditure than their counterparts in other UK regions. Additional devolutionary powers and the UK's membership of the EU will remain major political issues in 2015.

Multiparty coalitions have been a way of life in Northern Ireland. As we approach the 17th anniversary of the Good Friday Agreement, and the setting up of the Northern Ireland Assembly, securing another political deal remains an issue at the time of writing. Gaining consensus is difficult with multiparty coalitions. However, the Stormont Executive's five-party coalition up until now has kept the economy as its number one priority. Tension over this priority is likely to build in the coming year as social policy and maintaining public services are rising up the agenda. If corporation tax powers are devolved to Northern Ireland, this will quickly be followed by the question of how will it be paid for? Such a scenario will see the strains between social versus economic priorities intensify.

The Northern Ireland Executive, like government elsewhere, will be in the business of delivering unpopular policies into the foreseeable future. Populist social policies *(e.g. free prescriptions, no water charges, lower tuition fees & free public transport for the over 60s)* are now simply unaffordable and will increasingly come under scrutiny.

Global Challenges

Outside of Europe, there are plenty of risks to watch out for. In 2007/08, we had a global financial crisis. Russia is currently in the midst of its first financial crisis since 1998, which will push the Russian economy into recession. As the third largest oil producer in the world, the severity of this downturn will depend on the oil price. If prices remain around current levels of $60pb, the Russian economy will contract by around 5%. There is a risk that oil prices could fall much lower, implying an even steeper contraction.

2015 will be the year that the collateral damage from the 45% fall in oil prices becomes transparent. How exposed will the world's largest oil producer – the US – be to the oil price drop? The US economy has benefitted hugely from the shale oil boom in terms of employment. However, many shale oil drilling firms are not financially viable at current oil price levels. Many are highly indebted and there will be a wave of closures and bankruptcies. The same applies outside the US from Iran to Venezuela. Oil producers will suffer and Venezuela is likely to be the first country to default on its debt this year. There are also geopolitical concerns for oil producing countries in the Middle-East whose public finances will be hit hard by the lack of oil revenue.

The prospects for the Chinese economy will have a major bearing on global economic growth and oil demand. China's economic growth rate is expected to be sub-7% this year – its slowest rate since 2008. Almost all economies have experienced a financial / banking crisis at one time or another. To date, China has been a notable exception. However, expect concerns to mount on this front in 2015. As always, we should expect the unexpected. Last year the 45% fall in oil prices was unexpected. What will it be this year? The devolution of corporation tax powers to Northern Ireland?

Richard Ramsey
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Northern Ireland Economic Outlook 2015

By Ulster Bank Chief Economist NI, Richard Ramsey

GDP

+1.7%

Estimated growth of 2% in 2014 will be followed by growth of 1.5%-2% in 2015

Unemployment

6%

NI's unemployment rate (ILO) is expected to fall below 6% in 2015

House prices

+6%

2015 will see a 2nd successive year of house price growth, following a 7% rise in 2014

New car sales

+10%

This follows growth of around 10% in 2014

Housing starts

+10%

A modest pick-up in house building is expected in 2015

Petrol prices

<£1

Per litre

Petrol prices will likely fall below £1 per litre in 2015

Inflation

+0.6%

This would be the lowest annual rate of CPI inflation since 1989

Interest rates

0.5%

The Bank of England is expected to keep rates on hold during 2015

Oil prices

$60

Per barrel

Huge uncertainty with oil prices but huge potential to fall below $60 per barrel in 2015