Ulster Bank

Global conditions for a rate hike are still not alright said Fed

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Last week, all eyes and ears were on the US Federal Reserve's Chair Janet Yellen as markets braced themselves for the first interest rate hike in almost a decade. In a rate decision that was broadly seen by economists as something of a 'coin toss', the Fed's policy-setting committee chose to keep rates on hold at almost 0%. This means that the Fed has yet to increase interest rates from their record lows of 2009.

It is clear that the US central bank is becoming increasingly concerned about global economic and financial market risks – and it is not alone.

Last week, the Bank of England Governor, Mark Carney, acknowledged that risks to the health of the global economy have intensified as China's economy faltered. Nevertheless, Mark Carney still expects the case for beginning interest rate hikes to come into sharper focus at the turn of the year.

The Governor's view, however, is not shared by his Chief Economist and MPC colleague, Andy Haldane. Rarely does a speech in Portadown catch the attention of financial markets, but Haldane's did on Friday when he addressed an audience of local business people. He said that "the case for raising UK rates in the current environment is, for me, some way from being made". Indeed, according to Haldane, given the downside risks to growth, there is every chance that the next interest rate move could be a cut instead of an increase.

Outside the roller-coaster ride in equity markets last month, there has been a steady stream of evidence signalling that a global economic slowdown is in train. The vast majority of manufacturing PMIs around the world indicated weaker growth in August relative to July. Furthermore, 11 manufacturing PMIs (including those of China, Russia, Brazil, France and Canada) signalled contraction in August.

Over the last month it was revealed that Canada had joined Russia and Brazil in recession between April and June. Meanwhile the US economy's trade with the Rest of the World contracted in the first seven months of the year. This is not surprising when you consider that global trade is now growing at its slowest rate since 2009.

So how is Northern Ireland faring?

Clearly, Northern Ireland cannot insulate itself from global economic developments. Whilst trade with China is relatively small, it is the wider global economic slowdown that is more concerning. Northern Ireland firms, particularly our manufacturing businesses, are exposed to markets that are very reliant on China. For instance, Northern Ireland companies that supply equipment to the quarrying sector benefited from the commodity boom that was driven by China.

Last week's Northern Ireland manufacturing output figures showed that overall, the sector was performing better than the UK as a whole. Despite a quarterly decline of over 2%, output was up

1.6% on the same quarter a year ago. The equivalent growth rate for the UK manufacturing sector was just 0.6%.

The quarterly decline in Q2 was due to an unusually large increase in Q1, stemming from the Transport Equipment sector (which includes aerospace). This sub-sector posted a quarterly rise in output of almost 14% in Q2. Given the outsized gain in manufacturing output in Q1 (+3.8% q/q) a decline in Q2 was inevitable. What is important is that the underlying trend, stripping out Q1, showed strong growth (+1.6%) between Q4 2014 and Q2 2015.

Manufacturing output has increased by 20% since it troughed in 2009. Output in Q2 is just 3% below the levels that prevailed at the peak before the last global downturn. However, some sectors are experiencing much higher levels of output now than before the last global downturn. In particular, Transport Equipment (which includes Wrightbus and Bombardier) output recently hit a record high, with output more than doubling relative to its trough in 2009. In Q2, output was one-third above its pre-downturn peak seven years ago. The Chemicals & Pharmaceutical Products sector (which includes Randox, Norbrook and Almac) has posted declines in output in recent quarters. However, output is still 27% above the levels that prevailed even years ago.

There are only two sectors within Northern Ireland's manufacturing sector that are experiencing lower levels of output in Q2 2015 than during the trough of the global economic downturn. These are the Food, Drink & Tobacco (FDT) sector and Wood & Paper Products. According to last week's figures, FDT output amongst NI firms was 18% lower in Q2 2015 than six years ago. Conditions for this sector are much less favourable today than six years ago. The Euro / Sterling exchange rate for one has moved from 91.5p in Q3 2009 to 72.3p today. The collapse in milk prices, alongside Russian sanctions on EU food imports, has also hit the dairy sector.

Looking ahead, the second half of 2015 is likely to see more subdued manufacturing activity amongst Northern Ireland firms. The Ulster Bank PMI indicated a notable slowdown in manufacturing output and new orders growth in August. Over the next two weeks, financial markets will be closely watching the manufacturing PMIs for September, which are expected to show a further slowdown in activity. Northern Ireland is expected to follow the same trend.

Overall, mounting pessimism concerning global growth is drawing more and more comparisons with 2009. From a Northern Ireland-perspective, the economy was more insulated to a global downturn six years ago than it is now. Public expenditure growth and a deferral of austerity shielded Northern Ireland more than elsewhere. Back then the economy enjoyed political stability with the economy set as the number one priority. Comparisons between then and now couldn't be starker on all of these fronts. Furthermore, households and corporates benefited from the Bank of England slashing interest rates to 0.5%. Linked to this exporters benefited from the sharp depreciation in sterling. This time around, however, Northern Ireland faces more headwinds than tailwinds. Northern Ireland would love to be in China's position of being able to slash interest rates and unleash a fiscal stimulus. However, the UK played these cards already in 2009.

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