Group Economics

Ulster Bank

# Stormont to raise rates before the Bank of England

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2015 will go down in the economic annals as a good year for the Northern Ireland consumer. Falling food and energy prices, coupled with a return of pay rises, have boosted disposable incomes. At the same time, employment growth has continued, with over 90 percent of the jobs that were lost during the downturn having now been recovered.

It is a somewhat different picture though when it comes to economic output, with Northern Ireland still some way off recouping what it lost in the downturn. Indeed, Northern Ireland's economic recovery has been the weakest on record. Since 2010, local commentators have consistently overpromised in their forecasts for economic growth.

The Northern Ireland economy has failed to record an annual growth rate of at least 1% since the recovery began. Following 0% growth in 2010, Northern Ireland's annual growth rates in the three subsequent years were: 0.5% (2011), 0.9% (2012), 0.7% (2013) and 0.8% (2014).

2015 and 2016 should be better, with the low / no inflation, coupled with a return of pay rises, providing a much-needed boost to economic growth. Consumer spending, stemming from real wage-growth will account for a greater share of growth, whilst the corporate sector should see its contribution moderate.

The local economy is estimated to have grown by 1.5% - 2% in 2015 (UK +2.3%). Assuming this growth rate, the Northern Ireland economy will have recouped less than half the output lost during the downturn. For perspective, the Republic of Ireland economy returned to its pre-crisis levels in 2015 with its second successive year of more than 5% growth.

The Northern Ireland economy is expected to lag behind its nearest neighbour and the UK in 2016, with expansion likely to be close to but above 1%. This compares with growth of 2% in the UK and 4.5% for the RoI.

In terms of the labour market, falling real wages have blighted Northern Ireland's recovery in recent years. However last year saw wage increases return with a vengeance, with the first real terms increase since 2009. Indeed, Northern Ireland recorded the fastest rate of wage growth in 2015 of all the UK regions. Northern Ireland's 5.4% annual rise in pay last year (UK +1.9%) represented the biggest rise in 11 years and the first real terms increase since 2009.

The local claimant count unemployment register has been falling for three years. Last year saw the numbers claiming unemployment benefit fall by close to 12,000, taking the claimant count to its lowest level since January 2009 and 25,600 below (-40%) its post-recession peak.

The pace of decline should ease in 2016. The headline ILO unemployment rate briefly dipped below 6% in Q4 2014 for the first time in six years. However, it returned back above this level in Q1 2015 with the unemployment rate averaging 6.2% in 2015. The UK and NI unemployment rates are set to diverge in 2016 with the former expected to go sub-5% later this year while Northern Ireland moves towards 7%. Meanwhile the Republic of Ireland's unemployment rate returned to single-digits last year for the first time since January 2009 and should average around 8.4% in 2016.

Employment growth remained strong in 2015 although the pace of growth slowed towards the end of the year. The drivers of growth are expected to change in 2016 too. In the 12 months to Q3 2015, manufacturing accounted for more job gains than any other sector. However, manufacturing output has been contracting sharply in the second half of last year. Indeed, output fell at its sharpest rate since Q2 2009 in Q3 last year.

Local manufacturing is feeling the chill from the slowdown in global trade / manufacturing activity. In 2016 Northern Ireland manufacturing is expected to lose more jobs than it creates. JTI and Michelin have already announced their plans to close with redundancies to commence this year. In 2015, manufacturers were battling an unfavourable exchange rate, however, over the last two months, sterling has weakened considerably, with the euro back above 77 pence. While talk of Brexit continues to weigh on sterling sentiment, the recent sterling weakness may prove to be short-lived.

Divergence in monetary policy intentions by the Federal Reserve, the ECB and the Bank of England should be a big driver of currency moves in 2016. The Fed raised interest rates last month for the first time in almost 9 years. Meanwhile the ECB is expected to embark upon more monetary policy stimulus. The UK falls somewhere in between. Another year of no change is very much on the cards.

Indeed, it is likely that Stormont will raise domestic rates before the Bank of England moves interest rates upwards. Post the NI Assembly election, such are the state of the public finances that we should see a number of difficult revenue-raising decisions taken in other areas too, such as university tuition fees.

The consumer environment we are currently in could be described as a cost-of-living sweet spot, and after the election would be politically the most conducive time to close the revenue gap between Northern Ireland and the rest of GB.

This is an 'opportunity' that the UK Chancellor won't miss. He will put away his public expenditure axe and his weapon of choice will change to revenue raising. He will understand that there is no 'better' time to raise revenue than immediately after an election and whilst inflation is effectively bumping along at record lows.

In 2016 – the Chinese Year of the Monkey - Northern Ireland's productivity challenge will be greater than ever before. Global factors will also loom large, with the global economy weighed down by BRICS - i.e. difficulties in the developing economies of Brazil, Russia, India, China and South Africa. Indeed, whilst countries generally go into recession after staging the Olympics, Brazil wins the gold medal for experiencing one before Rio hosts the games.

Northern Ireland is a £34.5billion economy of 1.8m people and is vulnerable to external influences, both economic and political. And there will be plenty of these in 2016, notably a China slowdown / crisis, Eurozone economic uncertainty, and uncertainty in relation to a potential Brexit. 2016 should not be short of drama.

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