Group Economics

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The NICE and not-so-NICE of the 'new normal'

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Following the downturns across the world, and subsequent weak recoveries, there has been much discussion about the *'new normal'*. One of those to coin the phrase was Bill Gross, founder of PIMCO, the world's largest bond fund. Back in 2009, Gross suggested that investors would need to question many of their long-held beliefs; they would have to get used to a *'new normal',* characterised by heightened volatility within financial markets, sluggish growth, more regulation, persistently high unemployment, and sovereign debt issues.

Northern Ireland, like economies elsewhere, will have to get used to its own *'new normal'* (not all of it bad). The *'old normal'* that prevailed before the downturn was characterised by what Sir Mervyn King described as the 'NICE' era – Non Inflationary Continuous Expansion. For Northern Ireland, the NICE era meant simultaneous booms in: public expenditure (including welfare benefits); employment; and property; and in relation to the positive overspill from the Celtic Tiger's rampant growth. It also meant a mistaken belief that Northern Ireland was recession-proof and that economic growth, employment and house prices could only go up.

Fast forward five years and one would be forgiven for thinking that the *'new normal'* is the polar opposite; one of continuous declines in employment and output. Private sector output has fallen by over 17% since Q2 2007 and is back to levels last seen in early 2003. Had the growth rates that occurred in the old normal continued, Northern Ireland's private sector output would be 45% higher than what the latest figures for Q2 2012 suggest it is. If we had half the pre-recession economic growth rate, it would be 2022 before we clawed all of this lost output back.

Meanwhile, in the labour market, 40,000 people have been added to the dole queue over the last four-and-a-half years, with almost 55,000 jobs lost in the last four years. Recouping these by the end of this decade will be a tall order, particularly in the absence of new policy levers; a 12.5% corporation tax rate being the most obvious one.

In 2007, Northern Ireland was arguably at full-employment; anyone who wanted to work did. Looking ahead the number of jobs requiring basic or no qualifications will continue to fall, and skills are the passport to employment opportunities at home and abroad. Those with well-developed and varied skills sets will prosper - in the new normal of the labour market, the idea of a job for life has gone. To stay competitive, people will have to constantly refresh their skills sets. In the same way that we see upgrades of Windows (7, 8, etc), individuals will have to roll-out upgraded versions of themselves.

In understanding the *'new normal'*, it is important to recognise that much of the growth between 2003 and 2007 was abnormal and painted a veneer of false prosperity over an unsustainable growth model. The drivers of growth were boosted by unsustainable increases in credit, debt, public expenditure and having Europe's fastest growing economy – the Republic of Ireland – on our doorstep. These were freak conditions. As Herbert Stein, a former economic adviser to two US Presidents, said: *'If something cannot go on for ever, it will stop'.*

Equally, it is important to recognise that many aspects of current economic conditions are not part of the *'new normal'* and Herbert Stein's Law also works in both directions. Private sector output, employment and house prices cannot and will not keep falling indefinitely. The house building sector is currently building fewer houses relative to population than at any time since the 1950s. Mortgage activity for home movers has recently hit its lowest level since 1974. Construction and Business Services and Finance activity is some 40% and 51% below their respective pre-recession peaks. These trends cannot continue and, in time, levels of output in these areas must rise.

But in many respects, it will be a long and slow process before the *'new normal'* emerges, as it will take time for businesses, households and individuals to digest the debt accumulated during the old abnormal. Interest rates also remain at record lows and it will be some time before they return to 'normal' levels (probably around 5% or higher).

As parts of the local economy await the *'new normal'* a number of trends that many will see as welcome are becoming clear. We have witnessed the re-emergence of: the frugal consumer, greater regulation, and tighter control over the access and availability of credit. The return of a new savings culture can also be viewed as a much-needed return to an old normal. Similarly, public spending was often taken for granted and we now see more enthusiasm for efficiency.

The new normal also means a greater focus on the skills that our economy requires to be more competitive, and a greater focus by businesses on exporting, and a greater focus generally on entrepreneurship. The new normal for Northern Ireland is also a burgeoning tourism industry. We have gotten used to record highs and lows of the negative variety in our economy, but, when it comes to tourism, record highs of the positive kind are the current 'norm', and a 'NICE' decade of tourism growth lies ahead.

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