Ulster Bank

There is no pain-free prescription for the NI economy

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Appears in Belfast Telegraph Business Month published 5th December 2011

An old saying is that when the United States sneezes the world catches a cold. This used to hold true but the emergence of the new economic superpower that is China has reduced the importance of the US economy as a driver of global economic growth, and a key concern will be whether China sneezes and the rest of the world catches cold, or indeed something more serious. But for now, the spotlight is firmly fixed on the Eurozone. The latest consensus forecasts anticipate growth for the eurozone of just 0.4% in 2012 with some of its economies: Greece, Portugal and worryingly Italy expected to experience outright contraction. Indeed, some analysts are forecasting the recession in Greece to last until 2015. It began in 2008!

The situation in the eurozone is certainly more serious than a cold, with the sovereign debt crisis spreading its flu-like symptoms throughout global financial markets. To date, European policy-makers have struggled to stabilise the patient and the best case scenario is a long, slow and painful recovery. The key question is will Northern Ireland catch a cold from the eurozone too?

Northern Ireland (NI) is unique in that it is the only part of the UK to share a land-border with the Eurozone – the Republic of Ireland (RoI). Throughout most of the last decade, NI enjoyed the positive economic spillovers, *or 'Southern Comfort'* from its proximity to the fastest growing economy in eurozone. Prior to the downturn exports to the RoI were as large as all other sales to Asia and the rest of the EU combined. As for tourism, the RoI is our second most important market and visitors from the South contributed to a record year for the industry in 2007.

Since then, however, the trade, tourism and investment linkages have turned into negatives. Proximity, and the financial and economic inter-linkages with one of the eurozone's so-called 'PIGS' (*Portugal, Ireland, Greece & Spain*), led to NI contracting a *'swine-flu'.* As a result, NI is now experiencing the economic chill from its closest neighbour and a lengthy period of *'Southern Discomfort'.* It is important to note, however, that the local economy was already shivering as it had already contracted its own property-induced flu. Since then, the local economy has stabilised but it has been unable to shake off a heavy economic cold.

With the Eurozone likely to enter recession and the ongoing sovereign debt woes, these factors will simply delay NI's recovery. The local economy will be pulling a *'sickie'* for some time yet. Over the last year, the only part of the NI showing any meaningful recovery has been manufacturing. This has been due to the fact that export markets, outside of the RoI, have been relatively buoyant. However, the rapid economic slowdown is going to close, but not shut, that door. This will limit the economic uplift from an export-led recovery. Meanwhile, the domestic economy within NI remains pretty much flat on its back. NI will also not be immune to the rising funding costs within the wholesale money markets. This makes the cost of financing the recovery more costly than it otherwise would have been.

The two most important factors behind a NI economic recovery are the strength of the recoveries in the UK and the RoI. In recent weeks, the economic outlook for both these economies has deteriorated markedly with growth forecasts being scaled back. These two economies are essentially the two tow trucks for NI's economic recovery. But with economic growth slowing to a pedestrian rate, if not a standstill, these trucks have temporarily run out of fuel largely due to the economic and financial market deterioration within the Eurozone. Therefore the biggest impact of the Eurozone downturn on the local economy stems from the indirect impact on the economic growth and public finances prospects of the UK and RoI tow trucks.

Last week the Chancellor provided us with a sobering assessment of the health of the UK economy and its public finances. Put simply, the prognosis is far from good with more tax rises and deeper public expenditure cuts for longer than was previously thought. For a public expenditure driven economy such as NI the next two parliaments of fiscal pain will hurt. Meanwhile, this week our nearest neighbour – the RoI – will receive yet another austerity budget. As we saw recently with the *'Enda the road for the A5'* the economic and financial impact of this will be felt here too.

Whilst we will not be leaping out of the sick bed anytime soon it is important to remember that like all colds or flus, we will recover from this one. The question is when and with what prescription? Locally, NI must take its own medicine, but much will depend on what is administered at a eurozone level. In the meantime, while we are laid up it is perhaps worthwhile bringing forward, rather than pushing back, some of that surgery *(public sector reform)* we have talked about.

Richard Ramsey,
5th December 2011