

Output down, inflation up, Eurozone in despair – November 2011

Contact: Richard Ramsey
Chief Economist, Northern Ireland
02890 276354 or 07881 930955

Richard.ramsey@ulsterbankcm.com

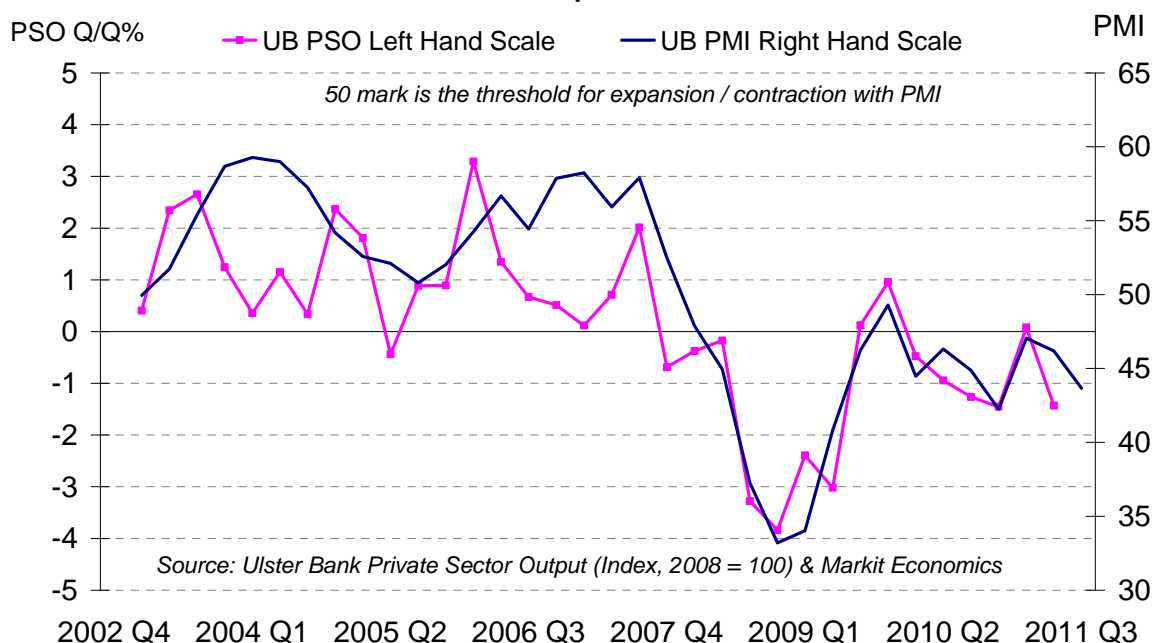
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Northern Ireland Private Sector Output Still Contracting in Q2 & Q3

Last month saw the release of the latest official Northern Ireland output figures for private sector services, construction and production (*mostly manufacturing*) industries for Q2 2011. These separate surveys are produced by the Department of Finance & Personnel. In the absence of quarterly GDP figures, which are not available for Northern Ireland, the three aforementioned surveys can be compiled into a single composite index to provide a useful estimate for local private sector output. This composite index excludes agriculture and the public sector. Using this composite indicator, private sector output has fallen in 12 of the last 15 quarters up to Q2 2011 with a decline of 1.4% in the latest quarter. As a result, private sector output is now almost 17% below its Q3 2007 peak. Furthermore, output is now at 2003 levels. It is noted that the private sector composite index is strongly correlated with the more timely Purchasing Managers or PMI Index. The latter signalled further contraction (43.7) in Q3 which suggests another fall in the composite private sector output index in due course.

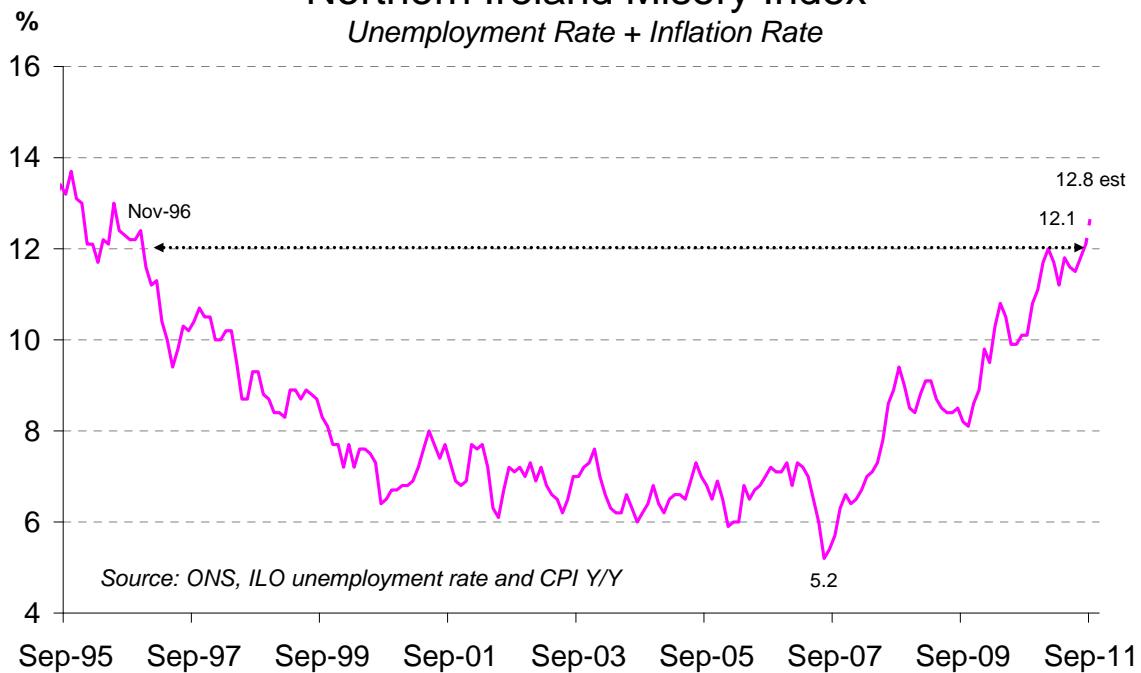
NI Private Sector Output Index Versus NI PMI



What's Up?

The 'Misery Index' – The misery index, invented by Arthur Okun, is simply the sum of a country's inflation and unemployment rates. The UK's misery index hit 12.6 in August (*annual CPI of 4.5% plus ILO unemployment rate in 3 months to August of 8.1%*) which represents its highest level since February 1994. Given that CPI inflation jumped to 5.2% in September, an annual rate that has never been higher, the UK's misery index will rise well above the 13 mark when the unemployment figures for the 3 months to September are released. Meanwhile, the equivalent misery index for NI is currently 12.1 (*ILO unemployment rate of 7.6% & CPI inflation of 4.5%*). The latter represented the highest reading since November 1996. As with the UK, NI's misery index will push towards 13 in September. NI's current misery index reading is more than twice the record low posted in July 2007. Back then, the local economy enjoyed record low unemployment of 3.3% and annual CPI inflation of just 1.9%. The misery index is further evidence of the ongoing human recession and explains why consumer confidence and spending are extremely subdued.

Northern Ireland Misery Index Unemployment Rate + Inflation Rate

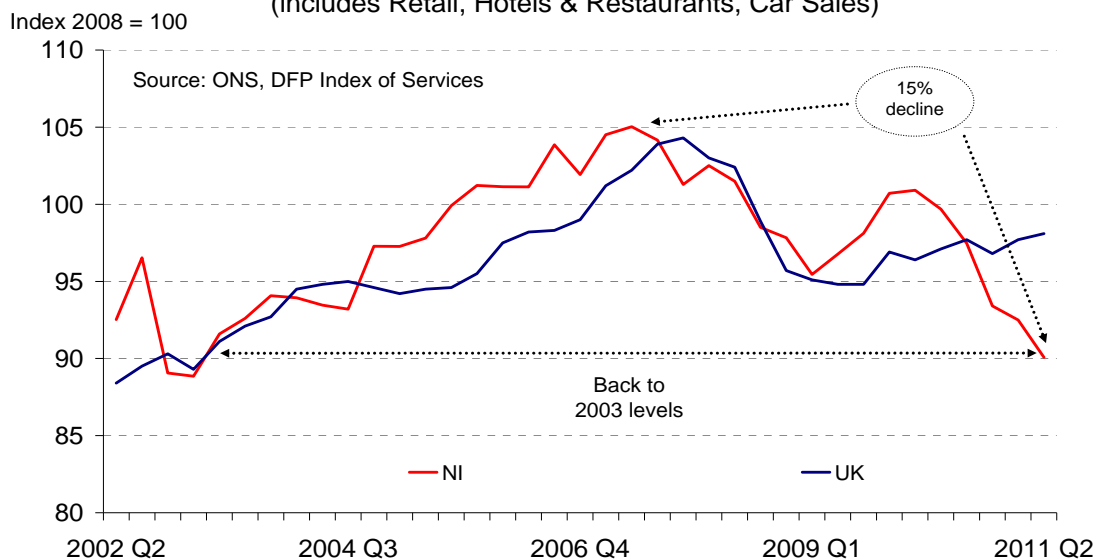


What's Down?

Consumer Spending – The cumulative impact of inflation is increasingly taking its toll on consumer sensitive sectors. Since the credit crunch officially began, the cumulative rise in the UK all items CPI has increased by 15.5%. Meanwhile, food & non-alcoholic beverages prices have risen by a whopping 28% over the same period. During this period, UK average earnings (*excluding bonuses*) have risen by just 8.8%. The net result is incomes (*before tax rises and benefits cuts are considered*) are being severely squeezed. Clearly, the annual earnings increases for NI would be below the equivalent rises in the UK. Therefore the deterioration in living standards is more rapid in NI than elsewhere. This is evident when looking at consumer spending. According to the latest Index of Services survey, output within the *Wholesale, Retail, Repair, Accommodation & Food Service* (amalgamates the *Distribution and Hotels & Restaurants* sectors), has fallen for the last five consecutive quarters to Q2 2011, with a cumulative decrease of almost 11%. This compares with a rise of 1.8% for the UK. Clearly, this period partly reflects the fact that the influx of shoppers from the Republic of Ireland has eased substantially. To date, NI's *Wholesale, Retail, Repair, Accommodation & Food Service* sector has experienced a peak to trough decline of 15% since Q2 2007. By comparison, output within the corresponding sector for the UK is only 4% off Q2 2007 levels.

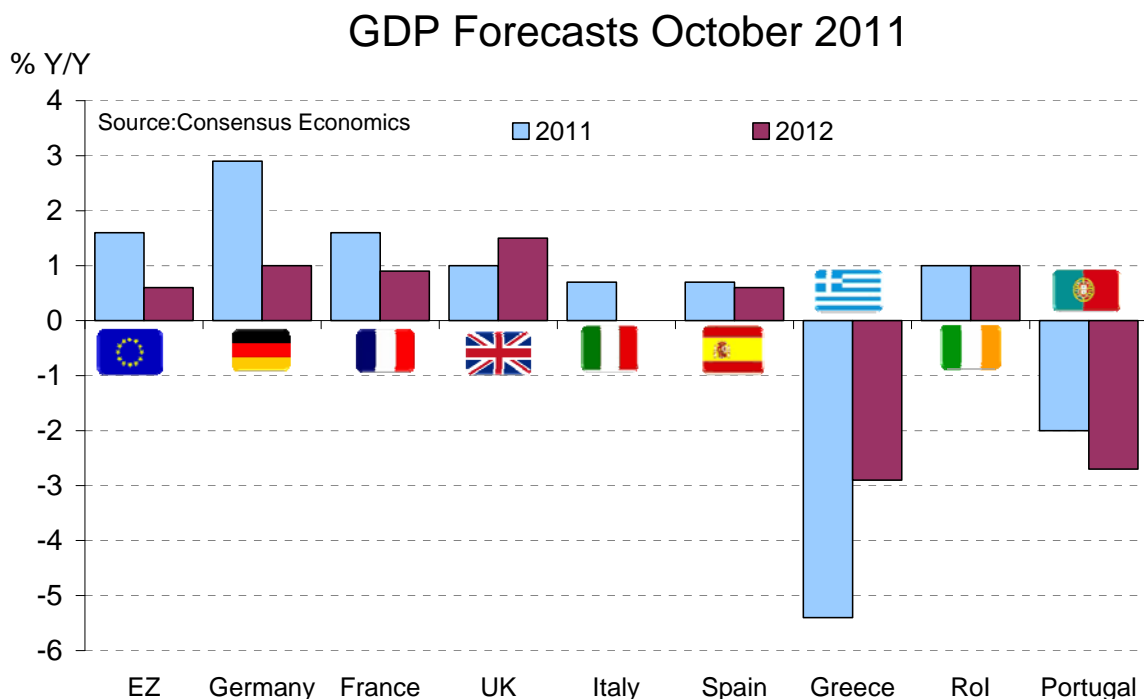
NI Distribution, Accommodation & Food Services Output

(includes Retail, Hotels & Restaurants, Car Sales)



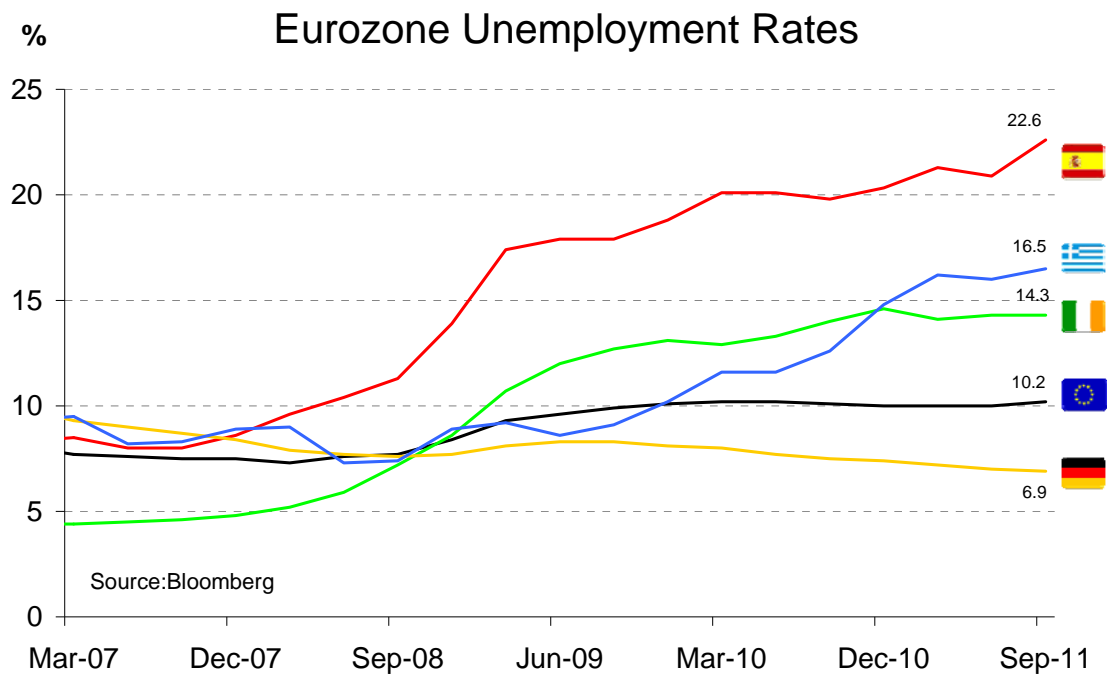
Eurozone growth forecasts slashed

The recent high frequency economic indicators (*e.g. PMIs*) have pointed to a significant slowdown in eurozone economic growth. As a result, forecasts for economic growth for 2012 have been scaled back significantly. The latest consensus forecasts (*analysts' average*) for October pre-date the recent bout of financial market turmoil, triggered by Greece, in late October / early November. The eurozone growth rate is expected to slow from 1.6% this year to just 0.6% next year with Germany anticipated to experience the sharpest slowdown - 2.9% this year to 1% in 2012. Both Greece and Portugal are expected to contract by 2.9% and 2.7% respectively in 2012. However, the risks to these forecasts now lie to the downside. In recent months Italy has been caught in the cross-hairs of financial markets due to its huge national debt burden. The cost of 10-Yr Italian government debt has recently soared to 6.3%, which is above the perceived bailout danger level of 6%. With the Italian economy forecast to stagnate at 0% next year the concern is that Italy cannot grow itself out of public finance difficulties.



Eurozone unemployment hits record high

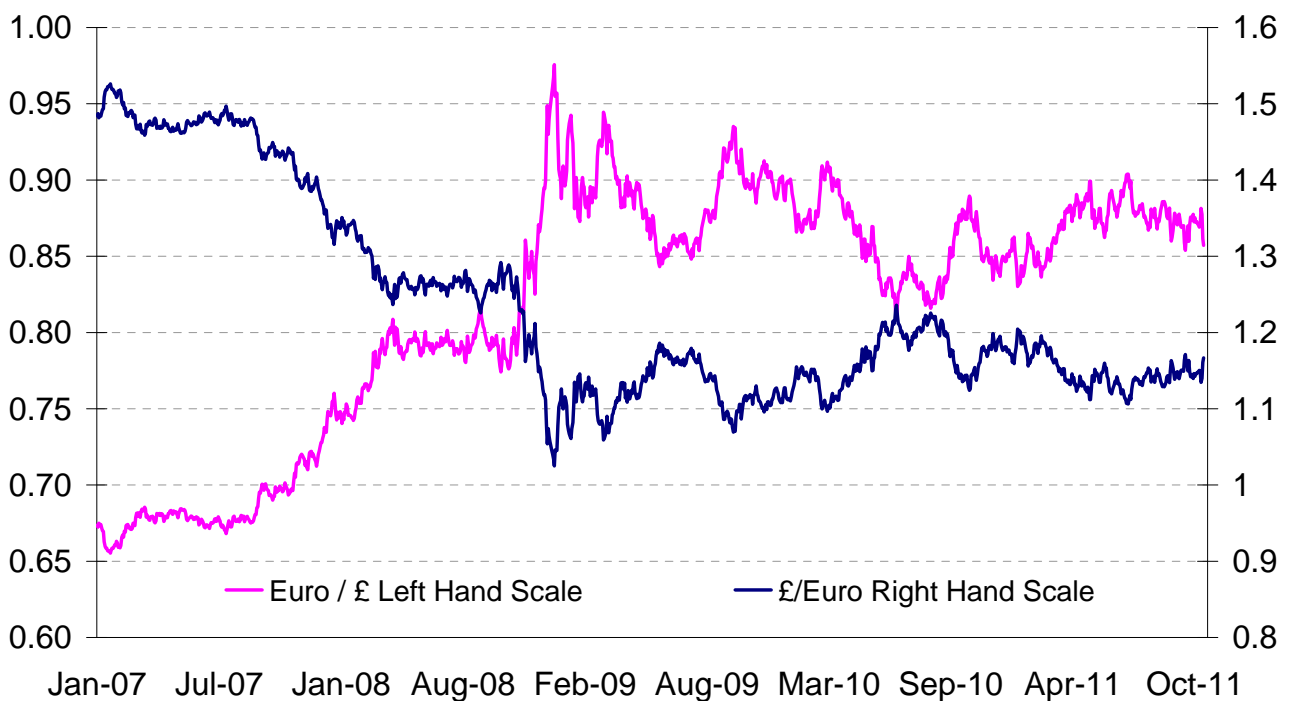
It is not just slower growth that is giving eurozone policy makers cause for concern, unemployment is also on the rise. The level of unemployment rose to 16.2m in September, 188,000 higher than in August and the highest since comparable records began in the late 1990s. The September increase marked the sharpest rise in two years. With growth set to slow markedly in the eurozone next year, unemployment, which is a lagging indicator of economic performance, is destined to push higher. The eurozone unemployment rate is currently at 10.2% which compares with a UK rate of 8.1%. Within the eurozone, however, there is significant divergence in unemployment rates. Germany is the only eurozone economy that has seen its unemployment rate fall since the credit crunch began. Furthermore, its unemployment rate hit is now at a record low of 6.9%. Meanwhile at the other extreme, Spain has seen its unemployment rate hit a record high of 22.6%. This is a major concern given the austerity that still faces the Spanish economy and GDP growth of 0% in Q3.



Euro summit bubble pops

They say a week is a long time in politics. At the time of writing, five days has certainly proved to be a very long time in the politics of the eurozone. After the post-euro Summit euphoria on 27 October, which sparked a return of risk appetite and a surge in the euro, the Greek prime minister threw a spanner in the works on 31 October by calling for a referendum on the latest bailout package. The move, which was unexpected, raises the prospect of a disorderly Greek default. With the referendum due to take place in January, Greece has just introduced another two months of uncertainty which the recent summit tried to remove. This development sent equities sharply lower, after a bumper October, with the return of risk aversion leading to a major sell off of the single currency. All of the single currency's post euro summit gains have been wiped out. The $\text{€}/\text{\$}$ currency pair fell from Thursday's post-summit high of $\text{\$}1.42$ to $\text{\$}1.37$ on 1 November. Meanwhile, the $\text{€}/\text{£}$ currency pair dipped below 86p ($\text{£}=\text{€}1.16$) on 1 November. This compares with a post-euro summit high of 88.3p ($\text{£}=\text{€}1.13$).

Sterling / Euro Exchange Rate



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