

Northern Ireland Economic Outlook

April 2014

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Northern Ireland (NI) economic growth is estimated as 1.9% in 2014 and 2.0% in 2015.

UK economic growth is estimated as 2.6% in 2014 and 2.4% in 2015.

Republic of Ireland (RoI) economic growth is estimated as 2.1% in 2014 and 1.8% in 2015.

- We anticipate GDP growth in Northern Ireland (NI) of 1.9% in 2014 - the best performance since the banking crisis began in 2007-8. However, NI will be the slowest growing of the 12 UK regions during 2014.
- The UK economy grew by 0.8% in Q1 2014, the fifth consecutive quarter of GDP growth and the longest positive run since the financial crisis. This was slightly up on the 0.7% recorded for Q4 2013 and the overall UK economy remains still 0.6% smaller than the peak of Q1 2008.
- Some uncertainties remain in the global oil and commodities markets, but inflation is likely to continue to remain within the Bank of England's 2% target.
- Increased interest rates cannot be ruled out this year but they are more likely to occur in 2015. Regardless of timing, this unprecedented era of low interest rates is moving inexorably towards a close.
- Budget 2014 brought a small addition to the Executive's funding block (£21 million) but confirmed that austerity will continue until the end of the decade, with further public spending restraint inevitably challenging because some of the new job creation in 2013 came from the public sector.
- While the trend towards growth and expansion is well defined, falling unemployment and job announcements are evidence of recovery rather than real growth and the NI economy has a way to go before it returns to pre-recession levels.
- The structural challenges facing the NI economy remain. Relatively few businesses export, management skills must become more strategic and a faster rate of innovation is necessary to drive up productivity, exports and international competitiveness

- By implication this also challenges the Executive to consider whether its policies are sufficient to stimulate inward investment, encourage international competitiveness amongst indigenous companies and support a dynamic micro business sector.

GDP Growth (%)	2012	2013	2014	2015
Northern Ireland*	-0.3	1.1	1.9	2.0
United Kingdom	0.2	1.8	2.6	2.4
Republic of Ireland	0.4	0.1	2.1	1.8

Note: *NI output growth measured by Gross Value Added (GVA)

Source: Office for National Statistics (ONS), Central Statistics Office (RoI), PwC (NI, RoI and UK 2013-2014)

Other indicators	2012	2013	2014	2015
UK inflation (annual average)	2.8%	2.6%	1.8%	1.9%
UK interest base rate (Q4)	0.5%	0.5%	0.5%	1.0%
NI claimant count (Mar)	61,700	64,500	57,000	55,000

Source: ONS, PwC (inflation 2013-2014, interest rate 2013-2014, claimant count 2014), Nomis
Key: Shaded boxes represent forecasts.

1. Confidence

Business confidence continues to improve...

The Ulster Bank Purchasing Managers' Output Index (PMI) for March 2014 hit 56.6, which marks a 9-month period of continuous improvement in NI business activity (a PMI score of above 50 represents an increase in the business activity in comparison with the previous month).

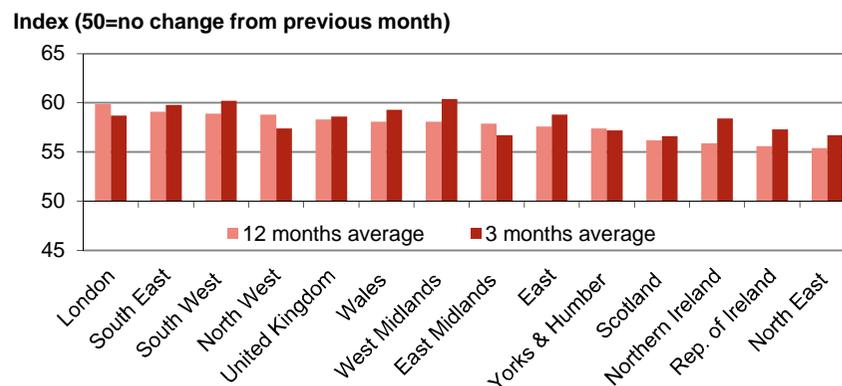
NI's services, manufacturing and construction sectors all showed increased activity in March relative to previous months. The impact of last month's business confidence growth brings the 12 month average to 55.9. With the March 2013 score reaching 48.9, it is evident that the NI business sector has enjoyed steady improvement, although the 12-month average is the second lowest of the 12 UK regions.

Consumer confidence on the rise...

In the first quarter of 2014, the Danske Bank Consumer Confidence Index reached 132, the highest level since September 2008, when the survey started. This represents increases of 9 points as compared to Q4 2013 and 22 points on the same period in 2013.

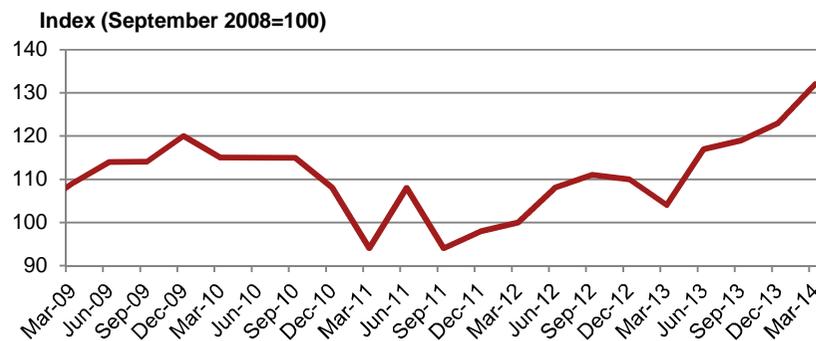
With the exception of job security, which has remained flat since the start of 2013, the other 3 elements of the survey - financial position; spending expectations; and savings expectations - have seen improvements. The Index results are consistent with the general sense of optimism now marking the NI economy, but the Danske Bank Q4 2013 publication indicated a contrast between low income or unemployed households and the rest: only 7% of the lower income households claim to be better off than last year, compared with 21% of higher income households.

Figure 1: PMI Output Index by region, 12 and 3 month average to March 2014



Source: Ulster Bank Purchasing Managers' Index (PMI)

Figure 2: NI Consumer Confidence Index, 2008-2014



Source: Danske Bank Consumer Confidence Index

2. Housing market

Average property price in NI is £115,085...

The NISRA/Land and Property Services (LPS) Northern Ireland Property Price Index for Q4 2013 shows that the number of property sales increased to 4,827 in Q4 2013. That compares with Q4 2012, when there were 3,783 sales. At the peak in Q3 2006, there were almost 11,000 property transactions. The average house price is now £115,085, a marginal fall on the Q3 2013 figure of £115,719, but around £3,000 more than the average in Q4 2012.

Housing affordability in NI continues to be better than the UK average...

Housing continues to be more affordable in NI compared to the UK average, according to the latest Lloyds Housing and Mortgage Affordability Index. It shows that in Q1 2014, NI had a housing affordability ratio of 3.64 which is below the UK ratio of 4.77.

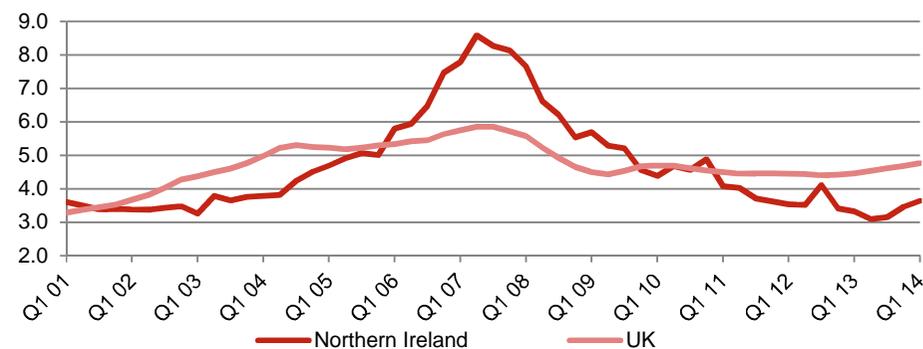
A report from the University of Ulster in December 2013 examined affordability in the NI housing market and used two inter-related measures of affordability, the first is an *affordability index* and the second an *access to deposit gap*.¹ Based on these measures the report suggested that across NI, most areas have seen an improvement in affordability with Armagh/Craigavon and Fermanagh/Omagh having the greatest gains. On the other hand Ards/North Down and the

¹ The access deposit gap measures the level of deposit required using the first quartile (25th percentile) house price and income adjusted to reflect overall net (disposable) income after tax deductions and national insurance. This measure also assumes a savings rate to determine the length of time it would take to amass the necessary deposit.

Magherafelt/Cookstown/Dungannon region are the areas that have seen the largest reduction in affordability.

In contrast to NI's relatively strong performance in terms of affordability, the region is reported to have the highest level of negative equity in respect of mortgages issued since 2005; at 41% compared to a UK average of just 8%.²

Figure 3: House price affordability (average house price/average earnings ratio), 2000-2014



Source: Lloyds Regional House Price Index

² HML 1 March 2014, "BBC Negative equity report", accessed from HML website: <http://www.hml.co.uk/latest-thinking/2014/03/bbc-negative-equity-report/>

3. Labour market

Claimant count decreased by 7,500 over the past year...

The March 2014 NI claimant count was 57,000, a decline of 7,500 since March 2013. This takes the current NI claimant count to 6.3%, compared to the UK average of 3.4%.

According to the Labour Force Survey definition, unemployment in NI has fallen by 4,200 over the past year, a fall of 0.7% to 7.7%. This compares to the UK average which fell by 1% to 6.9% over the same period. Economic inactivity remains considerably higher in NI, at 26.3%, as compared to the UK average of 21.9%, with the NI rate remaining the highest of all the 12 UK regions.

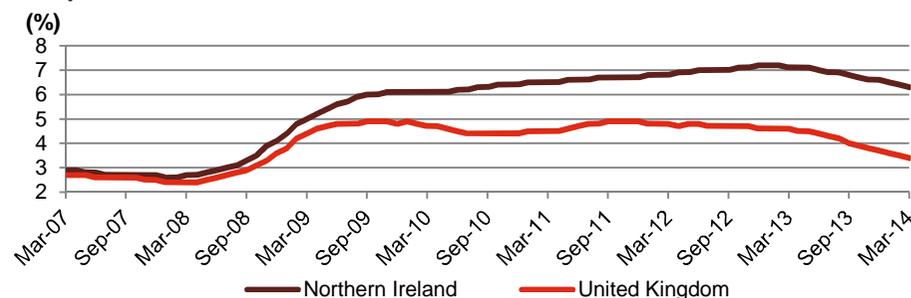
There were 2,011 redundancies in 2013 a decrease from the 3,353 total recorded in 2012. This new level is similar to 2011, when there were 1,808 redundancies and 2010, which saw 2,096 redundancies. There were 158 redundancies in March 2014, but further job losses are expected. The collapse of KPL Contracts means a loss of 200 jobs, with a further 300 jobs to go at the Driver and Vehicle Agency (DVA) in Coleraine as vehicle licencing is centralised in Swansea.

On the other hand, 1,000 contact centre jobs are promised by Concentrix, 486 from EY and 100 by Ryobi Aluminium Casting in Carrickfergus and 250 customer service jobs will be brought to NI by EE: Mobile over the next months. These provide some indication of reshoring³, which appears to be accelerating in the UK. PwC estimates that reshoring could add 100,000-200,000 additional jobs in the UK over the next decade, with the reshoring phenomenon potentially having a positive long term impact on the NI job market and thus boosting regional output.

³ The transfer of a business operation back to the country of origin i.e. the reversal of offshoring.

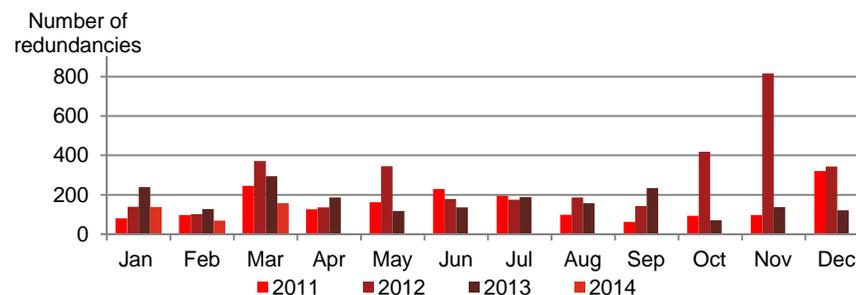
The steady fall in unemployment is welcome and further reinforces the wider data supporting the strength of recovery. Nevertheless, unemployment is not falling as quickly as in other UK regions and there is a mountain to climb to bring unemployment back to the June 2007 level of 2.6%, when it last broadly reflected the UK average.

Figure 4: Claimant count unemployment rates, 2007-2014



Source: ONS Labour Force Survey, 16+

Figure 5: Number of redundancies, 2011-2014



Source: DETI District Council Area Statistics

4. *Future prospects*

Global Economy

PwC forecasts global GDP growth of 3.5% in 2014 and 3.7% in 2015, with annual growth of 3.7% during 2016-20. Growth has returned to the Eurozone, albeit with a forecast of only 1% in 2014 and 1.3% in 2015. There is still a contrast between economies in the northern Eurozone and those in the south (e.g. Spain and Italy), as high unemployment rates and indebtedness continue to dampen domestic demand in southern economies. The Eurozone has some vulnerability to the current Ukrainian crisis in terms of the impact of uncertainty, higher energy prices and reduction of trade through sanctions. In contrast, growth in the US looks set to continue and we anticipate growth of 3% in both 2014 and 2015.

Local Economy

In the short term, NI economic indicators are improving, but the lag behind the UK in most key economic measures is likely to continue. On a positive note, there is evidence of emerging local industries, such as film, tourism, advanced manufacturing, pharmaceutical and business services; further devolution of fiscal powers could provide NI with a platform to shape the longer term prospects.⁴

The 2014 Budget announced the creation of NI's first enterprise zone (EZ) in Coleraine and this is a positive development. Other UK regions have already benefitted from EZs and the key test will be whether the establishment of a pilot EZ will attract new investment to the region. However, the incentives available are likely to be most attractive to highly capital intensive sectors.

The latest estimate from the Department of Finance and Personnel is that public spending in NI exceeded the level of regional tax receipts by £9.6bn in 2011-12, a

similar level of fiscal deficit to that of 2010-11. All UK regions outside of London and the South East also run deficits but none as large in per capita terms. Whilst there is no formal requirement on Stormont to balance its books, this situation does leave the Executive exposed in its dealings with HM Treasury on a wide range of issues such as domestic water charges, welfare reform, tuition fees and Corporation Tax.

Northern Ireland continues to have an exceptionally high rate of fuel poverty - 42% in 2011 compared to 15% in England, 25% in Scotland and 29% in Wales. This, and a 10% drop in real income compared to pre banking-crisis levels⁵, has meant that the rise in food and energy costs has hit Northern Ireland harder than other regions.

Inflation

We estimate that UK inflation will fall to below the Bank of England's 2% target, to around 1.8% in 2014 and 1.9% in 2015. However, price shocks in an open economy like the UK are largely imported, so the supply and demand of global commodities like food and fuel are likely to be prime drivers of domestic inflation.

Interest rates

The previous explicit forward guidance policy which dictated that the base rate would not rise until UK unemployment falls below 7% has now been superseded by "fuzzy guidance", with the Bank looking to a wider range of indicators to determine the volume of spare capacity in the UK economy. As part of Budget 2014 data, the Office for Budget Responsibility reduced its estimate of the volume of spare capacity in the UK.

⁴ Ironically, the current impasse regarding the implementation of welfare reform in NI could lead to powers relating to social security being "undeveloped".

⁵ Joseph Rowntree Foundation, March 2014, "Monitoring Poverty and Social Exclusion in Northern Ireland 2014"

5. Sector dashboards

Employment*				
Sector	Dec 11	Dec 13	Change	Key Issues
Public sector	214,320	216,550	1.0%	<ul style="list-style-type: none"> Budget 2014 defined challenging fiscal environment. The UK government plans to cap welfare spending. The current hiatus in implementation of GB-origin welfare reform policy is implying a growing “penalty” on the NI funding block, with the First and Finance Ministers forecasting that this could reach £1bn. Small increase in Executive’s borrowing power for 2014/15 and 2015/16 but the region lags behind Scotland and Wales in not having had a wider debate on devolving fiscal powers.
Construction	31,650	30,150	-4.7%	<ul style="list-style-type: none"> Activity beginning to expand again in the sector, albeit from a low base. Executive’s longer term capital spend plans depend critically on extent of “alternative” (i.e. public-private) financing.
Tourism and Leisure	53,710	54,370	1.2%	<ul style="list-style-type: none"> Strong growth during 2013. Cost competitiveness challenges relative to much lower rate of VAT and air tax in RoI.
Food processing	17,680	18,000	1.8%	<ul style="list-style-type: none"> Sensitive to exchange rate fluctuations especially regarding competition in the RoI market or producers. Very ambitious targets in the action plan for agri-food; <i>Going for Growth: Investing in Success</i>.
Financial and Business services**	49,260	51,900	5.4%	<ul style="list-style-type: none"> Continued employment decline alongside branch network reduction in banking and uncertainty surrounding Ulster Bank and its position in RoI. The “access to finance” debate continues. Increased investment and employment in business services
Retail	117,630	117,520	-0.1%	<ul style="list-style-type: none"> Performing less well than GB in terms of footfall and extent of vacant premises. Planning system has now turned decisively against out of town centres.
Manufacturing***	55,420	56,500	1.9%	<ul style="list-style-type: none"> Almost the highest energy prices in Europe. Most exports and R&D can be attributed to the handful of large firms.
All other sectors	156,690	166,920	6.5%	
Total	696,360	711,910	2.2%	

Note: *: Employees only (i.e. excludes self-employed), **: F&BS refers to SIC codes 64-66, 69, 70, 81, and 82, ***: Excludes food processing.

Source: Quarterly Employment Survey.

6. Outlook analysis – NI aerospace and defence: Can the sector really take off?

Current position

One recurrent theme in recent PwC analysis of the Northern Ireland economy has been the relatively strong performance of manufacturing in NI. The long term trend decline in total employment in manufacturing, once perceived as inevitable, has been reversed in recent years.

Our focus in this Outlook analysis is on one significant sub-sector within NI manufacturing; aerospace and defence. We concentrate on aerospace but the related activity of missiles (Thales) dominates the defence sub-sector where there are also 75 companies in areas such as access control, personal protection, cyber security, covert technology and security training. Invest Northern Ireland indicate that there 13 NI companies in the space sector.

Table 1: Key data relating to NI aerospace and defence

Annual sales output	£1bn
Gross value added	c. £320m*
Direct employment	8,000
Indirect employment, i.e. multiplier effect	9,600
Presence of firms in the Top 100 global aerospace and defence suppliers**	Bombardier 16 th Thales 18 th B/E Aerospace 44 th Magellan Aerospace 80 th
NI's share of world market	0.75%
UK's share of world market (UK industry sales)	17% (£24bn)
NI sectoral R&D 2011	£34m
UK sectoral R&D 2011	£2bn

Note:* Estimated using the relationship between GVA and turnover at the UK level.⁶

** : PwC data published in *Flight International* 24-30 September 2013.

Source: ADS Northern Ireland 2014 and *Flight International* 24-30 September 2013, “Top 100 Special Report”.

As Table 1 indicates, this sub-sector has become significant within the NI, UK and, indeed, global economies. It is also a sub-sector with above average outcomes in terms of rates of productivity and exports, meaning that it ticks all the right boxes in terms of the targets within the Executive's *Economic Strategy and Programme for Government*. NI is part of the UK aerospace sector which is second only to the US at the global level. This sector has been present in NI for about 100 years.

PwC's *Top 100 Aerospace Company* report in September 2013 showed that Northern Ireland companies perform well in the global league table. Measured by annual sales, Bombardier ranks 16th, followed by Thales at number 18, with B/E Aerospace and Magellan Aerospace ranked 44th and 80th, respectively. Understandably therefore, the Executive has endorsed a strategy to double the sales output of this sub-sector over the next 10 years, which would drive growth in employment from 8,000 to 12,000.⁷

Part of the justification for such stretching growth targets is that this sub-sector is expected to expand considerably at the global level. One estimate envisages global demand for passenger aircraft of \$3.7trillion by 2030, i.e. 27,000 aircraft.⁸

⁶ House of Commons Library 3 April 2014, “The aerospace industry”, Note, SN/EP/00928.

⁷ ADS Northern Ireland 2014, Northern Ireland Partnering for Growth- Together Growing the Northern Ireland Defence, Security and Space Industries.

⁸ HM Government 2013, Lifting Off- Implementing the Strategic Vision for UK Aerospace.

Alongside this, aerospace and defence has been identified as one sub-sector where NI already has some competitive advantage and a network of successful and inter-dependent businesses has begun to develop. The MATRIX study of NI innovation policy in 2008 argued that advanced manufacturing, including transport equipment, was one of five strong industrial clusters which NI should seek to grow further.

There is, however, no room for complacency and in the remainder of this Outlook Analysis we consider some of the outstanding challenges so that NI aerospace and defence can achieve its full potential:

Tackling high energy costs

NI manufacturing in general faces much higher energy costs than the UK average or much of the rest of Europe. One solution, as has recently been proposed by Bombardier, is to generate power on the site.⁹ However, this is only likely to be a viable option for the largest firms.¹⁰

Growing the supply chain

As Table 1 indicates, NI benefits from the presence within the region of four of the Top 100 global firms. Around 50 firms are involved in sub-supply work. Bangor based Denroy, for example, makes components for the Typhoon Eurofighter jet whilst Belfast based Marlborough Engineering has successfully passed through the project test phase of work for the Brazilian Embraer as it develops a new military aircraft.

Among the companies supplying parts for Boeing are Bombardier, Magherafelt firm Moyola Precision Engineering, Maydown Precision Engineering in Eglinton

⁹ Use of solar power, waste and biogas. See Belfast Telegraph 6 February 2014, “Bombardier- Durkan gives green light to the North’s largest scheme to convert solar radiation to electricity”.

¹⁰ There is also an unintended negative consequence for the other purchasers of energy who remain dependent on the traditional grid and suppliers as they now have to assume a bigger share of covering the fixed costs of the system- a problem of stranded costs.

and JW Kane Precision Engineering in Portadown, with all three companies also supplying components for Airbus. In 2012, John Huddleston Engineering of Greyabbey was bought over by Canadian firm Magellan, which was in 80th place in the PwC’s *Top 100 Aerospace Company* survey.

The Northern Ireland Centre for Competitiveness, along with the industry association ADS is heading up a drive to boost the NI supply chain. One challenge is if the big aerospace manufacturers, the “primes”, begin to devolve responsibility for organising their supply work to intermediary firms, so called “Tier 1 Integrators”. So far, NI has no obvious Tier 1 Integrators and this creates a risk that NI suppliers could be by-passed.

Ensuring adequate skills

Aerospace and defence has a critical interest in Executive efforts to increase the supply of STEM¹¹ skills be that at the graduate or apprenticeship level; in 2013 30% of UK aerospace firms reported vacancies. The UK-wide sector faces a continuing challenge to ensure adequate recruitment, and retention, of appropriately trained graduates and, indeed, to begin to think of alternatives to graduate recruitment.¹²

In summary therefore, in a world where aerospace and defence shows little sign of diminishing in importance and growth, being a key player in global supply chains can deliver high levels of employment, GVA, R&D and international competitiveness. Northern Ireland has attained a significant position in the global manufacturing supply chain and capitalising on this position with further growth will pay significant dividends.

¹¹ Science, Technology, Engineering and Mathematics.

¹² Notably, in terms of stronger emphasis on apprenticeships especially at a higher skills level (i.e. Level 3 and above). For the skills challenge generally, see PwC, “Creating an environment where employees can thrive”, in *Flight International* 24-30 September 2013.

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