

Northern Bank Quarterly Economic Overview QEO July 2010



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Economic Commentary and Outlook: Summer 2010

Global Recovery: cautious optimism but risks rise.

In early July the International Monetary Fund adjusted its forecast for global growth upwards for 2010, but at the same time emphasised that downside risks have increased. While the global recovery got off to a strong start in 2010, new headaches appeared in Quarter 2. In the first instance, the debt crisis in the Euro area created new uncertainty and led to sharp declines in equities and credit bonds, which has provided a new and unexpected headwind to the global economy. Secondly, job creation in the United States has disappointed and finally, Chinese growth appears to be slowing earlier than expected due to government tightening of economic policy.

While a slowdown in the global economy was expected in the second half of 2010, it now looks like the loss of momentum could become stronger than anticipated. The strength of the labour market and potential pent up demand will determine whether the global economy can stay on a recovery track when current support from government stimulus and the inventory cycle disappear.

Fiscal policies such as tax support and government spending which provided a decent level of economic support during 2009 and 2010 are now fading, although it is important to note that low interest rates continue to support disposable incomes and corporate earnings.

Risky assets, such as equities and corporate bonds, were also a cause for concern in the last quarter. Stock markets unexpectedly turned into a headwind at the end of Q2 as investors moved away from risky assets, however markets have since recovered.

Latest global developments have raised fears of a 'double-dip' in financial markets. While downside risks have increased and growth is bound to slow, we believe it is too early to call for a double-dip scenario. Our current forecasts, however, are based on the expectation that global job gains pick up soon and equity and credit markets stabilise and recover. If these factors fail to come through in the coming months we will have to re-evaluate the outlook.

United Kingdom

The UK has had a turbulent Quarter 2 with a change of government and two budgets within three months. The new government's plans to tackle the deficit by cutting spending has had a mixed response. The reaction from markets has been favourable with the interest on ten year government gilts falling from 3.8% prior to the election to roughly 3.32% in early July.

However fears are mounting that significant cuts in public sector jobs and services will have a negative impact upon overall demand and confidence - thereby stifling economic growth that had been forecast for the second half of the year.

The preliminary estimate for UK GDP growth in Q2 suggests that the economy grew by a surprising 1.1 per cent in the three months ending in June. This rate of growth was much higher than forecasters had predicted. There is clearly a risk that this relatively high growth rate will not be maintained through the rest of this year due to the fiscal consolidation imposed by the new government combined with weak demand from the Euro area following the sovereign debt problems in Southern Europe.

As with many recoveries there are some mixed signals emerging, while manufacturing output rose 4.3 per cent year on year in May, the recovery in the UK's housing market appears to be running out of steam with prices reported to have dropped in April, May and June according to the Halifax house price index (although UK house prices are still 7.5% higher than in April 2009).

Northern Ireland

With a limited local export base, the road to recovery for Northern Ireland will be slow and is not expected to be smooth. Output growth within Northern Ireland has been revised downwards from the last report. We look for a tepid recovery in Northern Ireland with GVA growth of 0.8% this year and 2.0% in 2011. The lower than average growth is the result of subdued consumer confidence, the imminent public spending cuts and greater fragility in the Euro area.

The withdrawal of government fiscal support, the temporary rise in prices and the looming UK general election have all taken their toll on local household confidence. The Northern Bank Consumer Confidence Index fell by 2 points in the latest quarter.

During Quarter 2, local employment levels increased by 2,000 but unemployment rose by 6,000. The ILO unemployment rate was 7.0 % in the period March-May, an increase of 0.6 percentage points over the quarter, but still low relative to international counterparts.

Some good news came by way of new car registrations which were recently reported to have held up well in Quarter 1, with an increase of 23.2 per cent on the equivalent period one year earlier; although registrations were still down 12.3 per cent when compared with the ten year historical average for this time of the year.

Overall, downside risks to growth have risen in Quarter 2 as early fiscal tightening will clearly take its toll on an economy which is overly dependent on the public purse. In addition the recent financial headwinds facing the global economy will impact upon both business and household confidence.

Economic summary – Northern Ireland	2008	2009	2010
GVA growth (%) (yoy)	0.13%	-4.4%	0.8 % <i>(forecast)</i>
Employment (Mar-May)	798,000	744,000	776,000
Employment growth (%) (yoy)	0.6	-6.8	4.3
Unemployment:			
<i>ILO</i>	34,000 4.1%	50,000 6.4%	59,000 7.0%
<i>Claimant count</i>	25,700 3.0%	49,500 5.5%	56,100 6.3%
Consumer prices (UK) (CPI annual average) (%) (yoy)	3.4%	2.1%	3.2% (June)
Bank of England official bank rate	5.0%	0.5%	0.5%

1. Labour Market Statistics

Overview: The recent developments in the Northern Ireland labour market shows mixed signals as both employment and unemployment have risen due to an expansion in the labour market participation. In the longer term public sector job shedding will intensify the pressure.

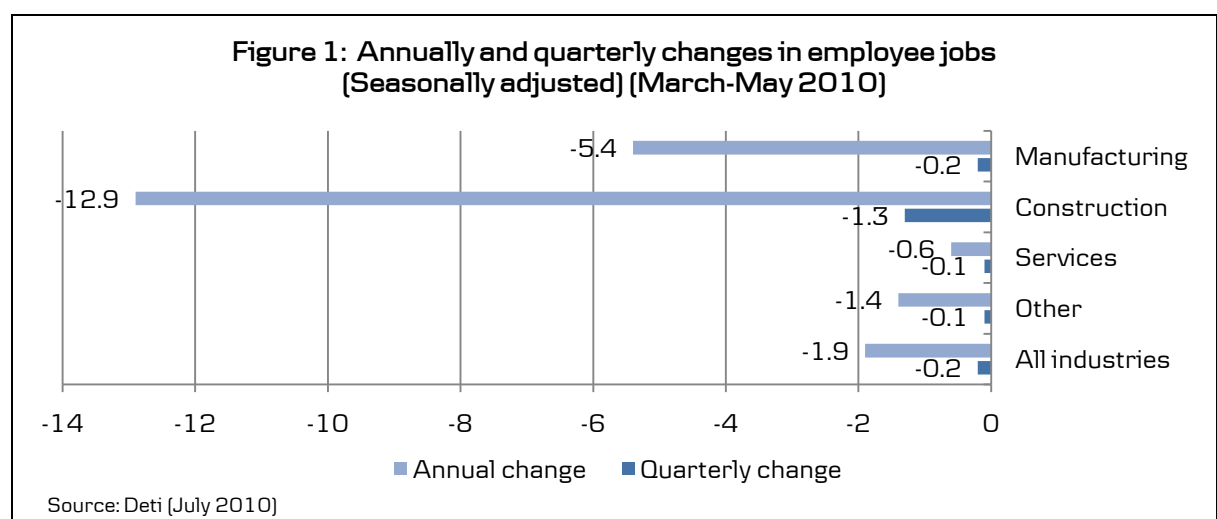
The Labour Force Survey (LFS) published by the Department of Enterprise Trade and Investment (DETI) in July showed that from March to May 2010 there was a rise (+2,000) in local employment levels. The unemployment rate increased by 0.6 percentage points in the three months period and the number of people claiming unemployment benefits in the month of June rose by 200.

Internationally, there is evidence that global unemployment stemming from this recession is peaking earlier than expected, and while this could be the case for the local economy, public sector job shedding after 2011 is expected to feature heavily in the medium term.

a. Employment

The DETI report shows that the number of persons in employment in the period March to May 2010 was estimated to be 776,000. This represented a marginal increase of 2,000 over the quarter and 32,000 over the year.

The seasonally adjusted quarterly change in employee jobs consisted of decreases in the Services sector (-0.1%) Construction sector (-1.3%) and Manufacturing sector (-0.2%). Over the year the change in employee jobs consisted of a 5.4% contraction in manufacturing and a 12.9% contraction in construction. (See Figure 1 below).



b. Vacancies:

The level of unfilled vacancies reported to the Department of Enterprise, Trade and Investment in the period ending May 7th 2010 stood at 6,220, an increase of 4 percent relative to May last year, when vacancies stood at 5,957.

c. Labour Market Inactivity (seasonally adjusted)

The number of economically inactive persons in the period March to May 2010 was estimated at 557,000. The Northern Ireland inactivity level decreased by 25,000 over the year and 5,000 over the quarter. The *working-age* economic inactivity rate for Northern Ireland stands at 26.4 % significantly higher than the UK average rate (21.3 %) and the highest of the twelve UK regions.

Unemployment

Claimant Count June 2010

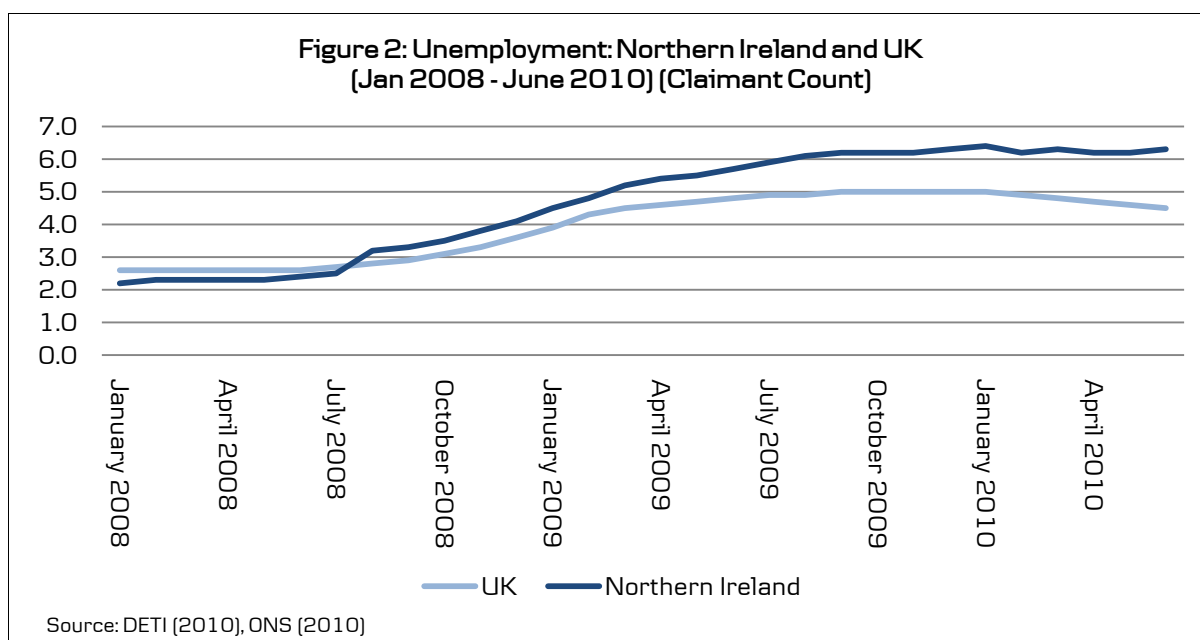
The Department of Enterprise Trade and Investment has reported that the local seasonally adjusted claimant count increased by only 600 over the month to June 2010 to 56,100 (6.3 % of the workforce). The claimant count unemployment level has increased by 6,700 over the year.

In the UK, claimant count unemployment fell by 20,800 between May and June 2010 to reach 1.46 million and fell by 100,100 over the year. The claimant count unemployment rate in June stood at 4.5 % down 0.3 percentage points from a year earlier.

Table 1: Unemployment in Northern Ireland and UK (Claimant count) (Seasonally adjusted)					
	Level (June 2010)	Monthly change (number)	Annual change (number)	Unemployment rate [%] (June 2010)	Unemployment rate [%] (June 2009)
Northern Ireland	56,100	600	6,700	6.3%	5.5%
UK	1,460,000	-20,800	-100,100	4.5%	4.8%

Source: DETI: Labour market statistics, July 2010

See Figure 2 below for trends in monthly claimant count levels for Northern Ireland and the UK over the past two years.



ILO Unemployment

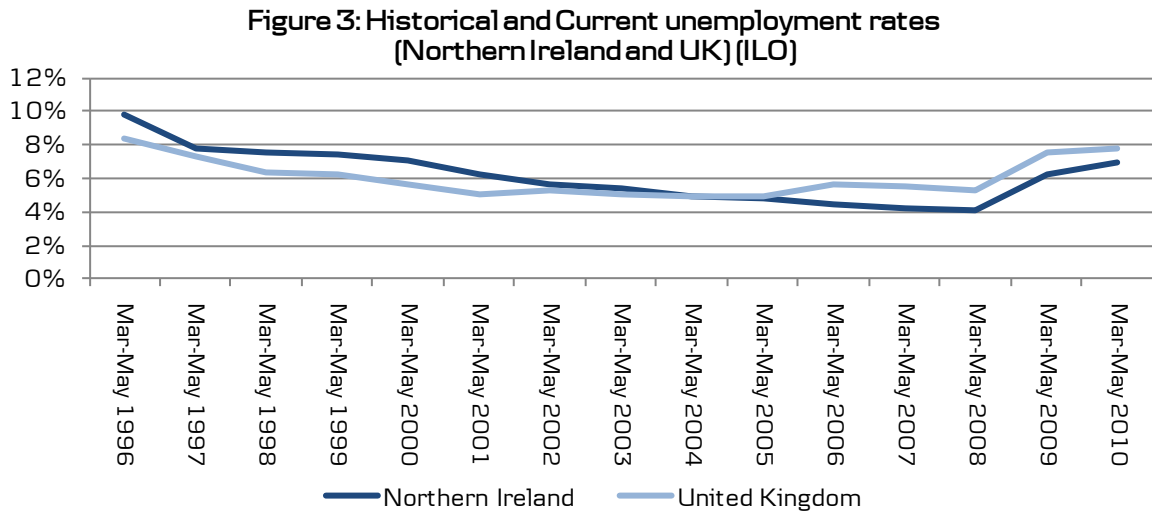
The International Labour Organisation (ILO) seasonally adjusted unemployment rate for Northern Ireland was 7.0 % for the period March to May 2010, equivalent to 59,000 persons. The latest data represents a rise of 0.6 percentage points over the quarter and +0.6 percentage points over the year (see Table 2).

**Table 2. ILO Unemployment March to May 2010
(Aged 16 or Over) (Seasonally Adjusted)**

	March to May 2010 (%)	March to May 2009 (%)	Annual Change in ILO Unemployment	
			% points	Number
Northern Ireland	7.0%	6.4%	0.6	rise of 8000
United Kingdom	7.8%	7.5%	0.3	rise of 92,000

Sources: NISRA (2010); ONS (July 2010)

See Figure 3 below for the long-term trend for quarterly unemployment rates for Northern Ireland and the UK.



Unemployment: International Comparisons

The NI ILO unemployment rate of 7.0 % compares favourably to the UK rate of 7.8 %, the European Union average rate of 10% (June) and the Republic of Ireland rate which was 13.3 %.

d. Redundancies

The Department of Enterprise, Trade and Investment (DETI) was notified of 224 *proposed* redundancies over the period mid-June to mid-July 2010. This compared to 81 proposed redundancies notified in the previous period. There were 135 *confirmed* redundancies in June¹. There were 2,994 confirmed redundancies over the 12 month period to June 2010, a decrease of 36 % from the previous year (4,697). When examined at the District Council level, the majority of redundancies (33.0 %) over the last year occurred in Belfast. (See Table 3 below for breakdown of redundancies by Industrial Sector).

¹ N.B. The official figures underestimate the true level of redundancies as only companies employing 20 or more staff are obliged to notify the DETI.

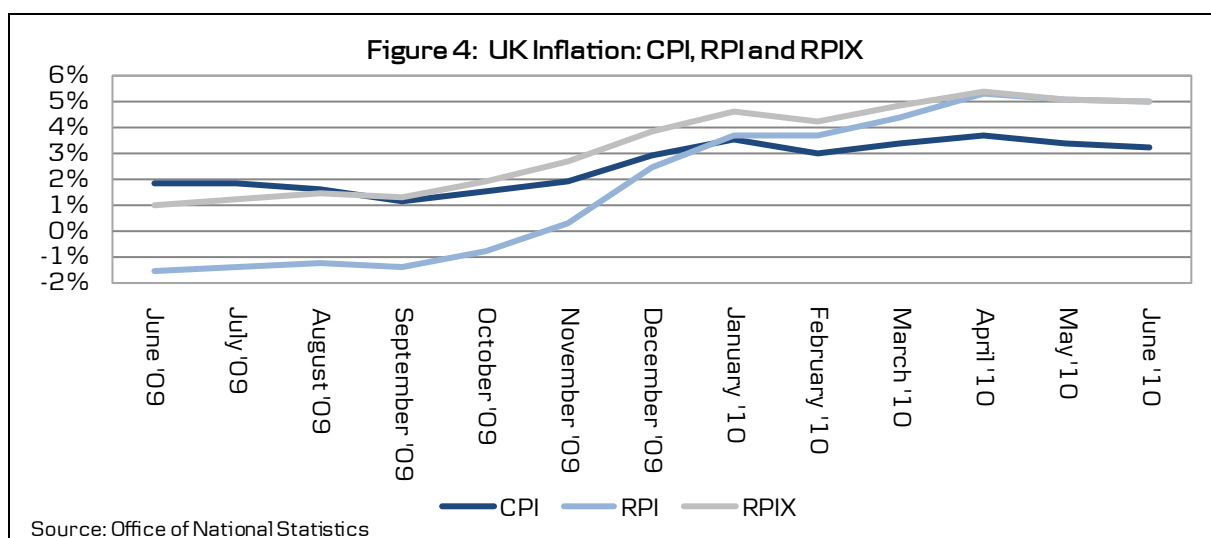
Table 3: Confirmed redundancies by industrial sector (Northern Ireland)	2009		2010 (Jan-Jun)	
	Number	%	Number	%
Agriculture, Forestry and Fishing	-	0%	-	0%
Mining and Quarrying	-	0%	7	1%
Manufacturing	2,592	56%	305	30%
Electricity, Gas, Steam	30	1%	-	0%
Water, sewerage	168	4%	77	8%
Construction	211	5%	92	9%
Wholesale and Retail	276	6%	209	21%
Transport	131	3%	137	13%
Hospitality (Accommodation and Food)	87	2%	33	3%
Information and Communication	651	14%	35	3%
Financials and Insurance	262	6%	86	8%
Real Estate	-	0%	-	0%
Professional Scientific and technical activities	45	1%	-	0%
Administration and Support Services	56	1%	15	1%
Public Administration	-	0%	17	2%
Education	-	0%	-	0%
Health and Social Work	83	2%	6	1%
Total	4,592	100%	1,019	100%

Source: DETI (2010)

2. Inflation:

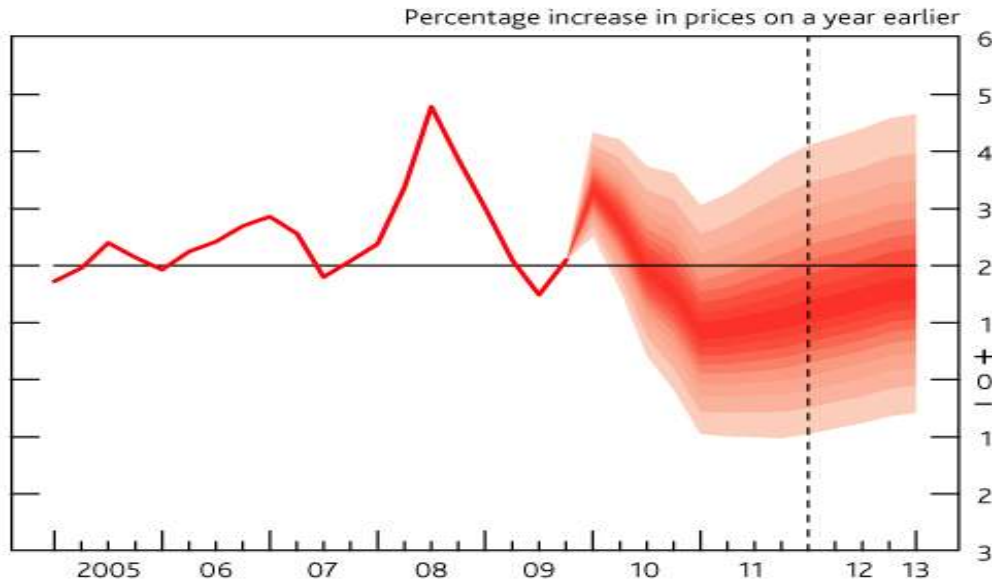
a. UK Consumer Price Index, June 2010

In Quarter 2 we have seen the annual CPI inflation rate remain well above the 2% target - averaging 3.4 per cent over April to June. The elevated rate has been raised by the restoration of the standard rate of VAT to 17.5%, higher oil prices and the past depreciation of sterling. In June the CPI rose by 3.2 per cent on the year, down from 3.4 per cent in May. Over the same period, the all items retail price index (RPI) fell by 0.1 percentage points to 5.0. The all items RPIX (the RPI excluding mortgage interest payments index) also fell by 0.1 percentage points - down from 5.1 per cent in May to 5.0 (See Figure 4).



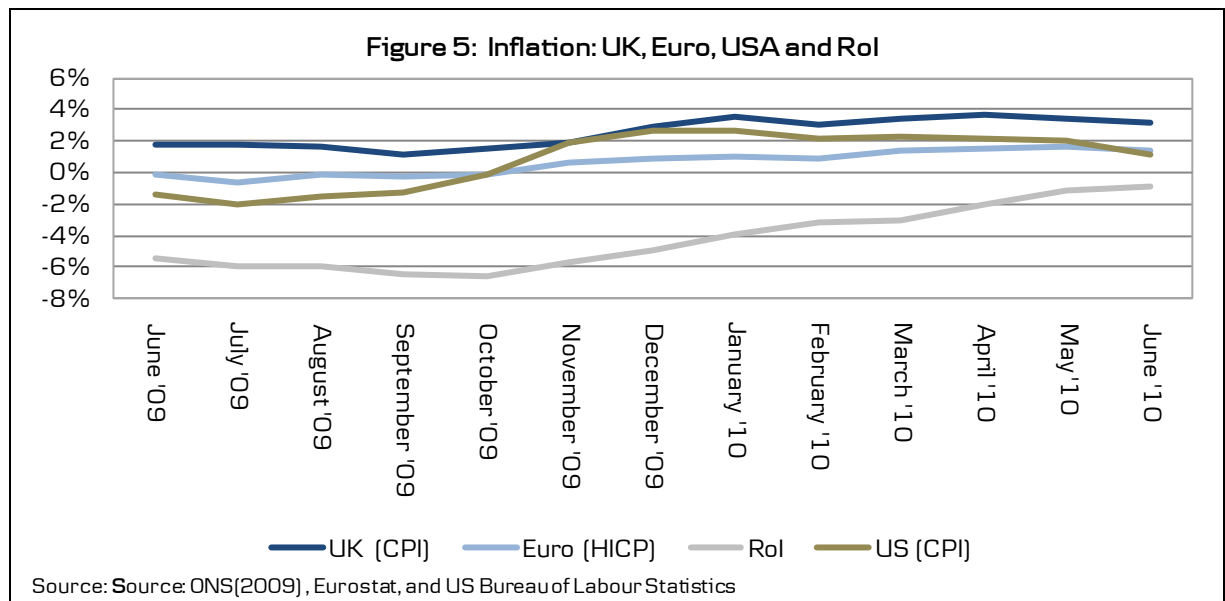
b. BoE Inflation Outlook:

Quarter 2 2010 has seen the Bank of England caught between the risks of rising inflation and weak economic growth. Persistently high inflation in the UK has been evident since December 2009 but the Bank’s Monetary Policy Committee highlighted in its May report that as the temporary effects on inflation wane, downward pressure from the persistent margin of spare capacity is likely to cause inflation to fall below the target for much of the forecast period. However, the pace and extent of that moderation in inflation are highly uncertain.



Source: Bank of England, Inflation Report Feb 2010

In general, inflation rates outside the UK have been significantly lower than UK levels. The Euro area average inflation rate, the Harmonised Index of Consumer Prices (HICP), was 1.4 per cent in June 2010 and the CPI rate for the United States in the same month was 1.1 per cent (see Figure 5).



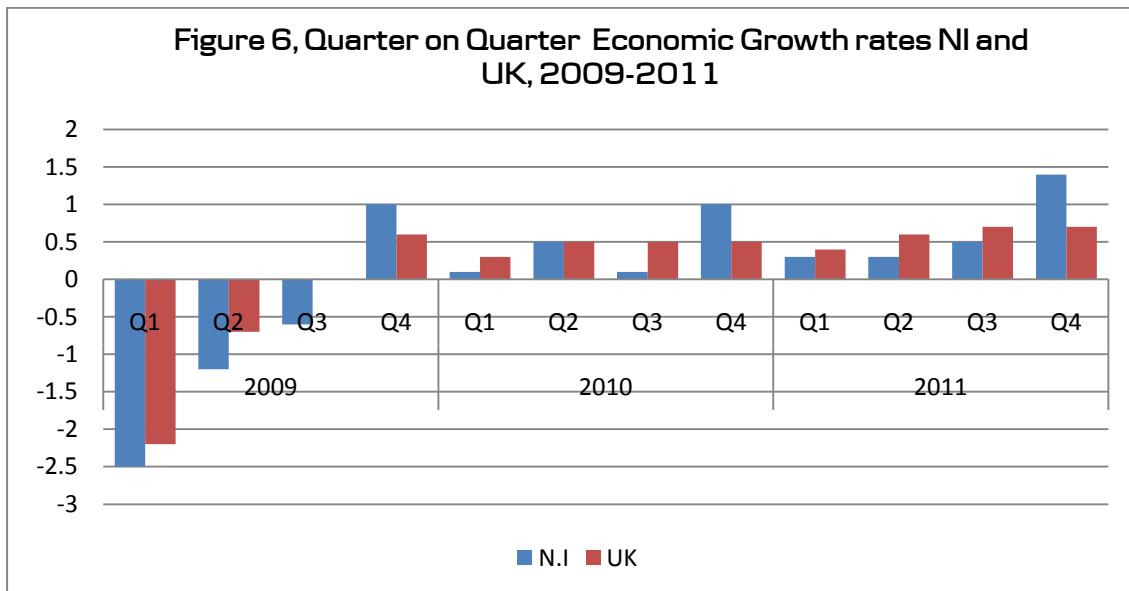
3. Economic Activity

a. UK Gross Domestic Product (GDP)

First estimates of UK GDP growth suggest that the UK economy grew by 1.1 percent in Quarter 2 this year after an increase of 0.3 percent in Quarter 1. This first estimate, which may be revised at a later date, is much higher than many forecasters had predicted. For example, the *National Institute of Economic and Social Research* (NIESR) had forecast 0.7 percent, *Northern Bank* had forecast 0.5 percent, and indeed the government's newly created *Office for Budget Responsibility* (OBR) had forecast 0.6 percent.

b. Northern Ireland Gross Value Added (GVA)²

Estimates from *Oxford Economics* (July 2010) suggest that in Northern Ireland GVA contracted by 4.4 per cent (year on year) in 2009. Although the local economy came out of recession in Q4 2009 the recovery has since remained extremely weak with growth over the three months to June estimated to be only 0.5 percent. Annual growth is now expected to amount to only 0.8 percent in 2010 (revised down from the previous estimate of 1.0%) and even this revised estimate carries significant downside risk.



Source: Northern Bank/ Oxford Economics Qly Sectoral Report, July 2010

² GDP data is not available for Northern Ireland so Gross Value Added (GVA) data is used instead. GVA + taxes on products - subsidies on products = GDP

4. Demand Indicators:

a. Savings Ratio /Household Expenditure

The Office of National Statistics has reported that the UK saving ratio in 2010 quarter one was 6.9 per cent compared with 7.2 per cent in quarter four 2009. This fall was driven by higher household expenditure in the first three months of the year. Real household disposable income rose by 0.4 per cent in Quarter 1, following a 1.0 per cent fall in 2009 quarter four.

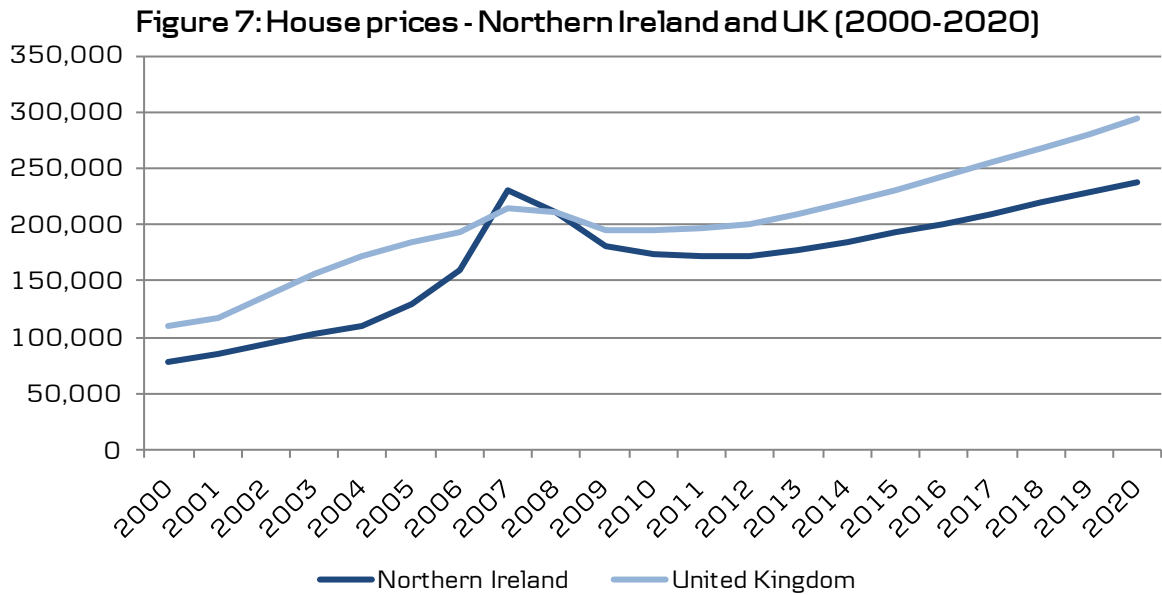
b. House Prices Quarter 1 2010

University of Ulster, Quarterly House Price Index, Quarter 1, 2010

Northern Ireland's average house price was reported to have experienced an increase during Quarter 1 2010, although the regional variation was extremely wide with *Belfast* and *North Down* driving the overall price growth but *Mid-Ulster* and the *West* still experiencing price deflation.

The average house price was reported to be £169,497 compared to an overall average of £161,429 for the final quarter of 2009. The price adjustment since the 2007 peak is now approximately 36 per cent. The University of Ulster's most recent quarterly house price report shows evidence that the strongly negative figures over the past two years may have been stabilised and indeed reversed with a modest increase in price levels. Over the year, the survey shows weighted price growth of 4.9% with a comparable rate of price growth over the quarter of 4.4%.

Forecasting data from *Oxford Economics* shows that 2010 and 2011 should see local house prices stabilise. House price growth in the next couple of years is unlikely. (See Figure 7 below).



c. New Car Registrations Q1 2010

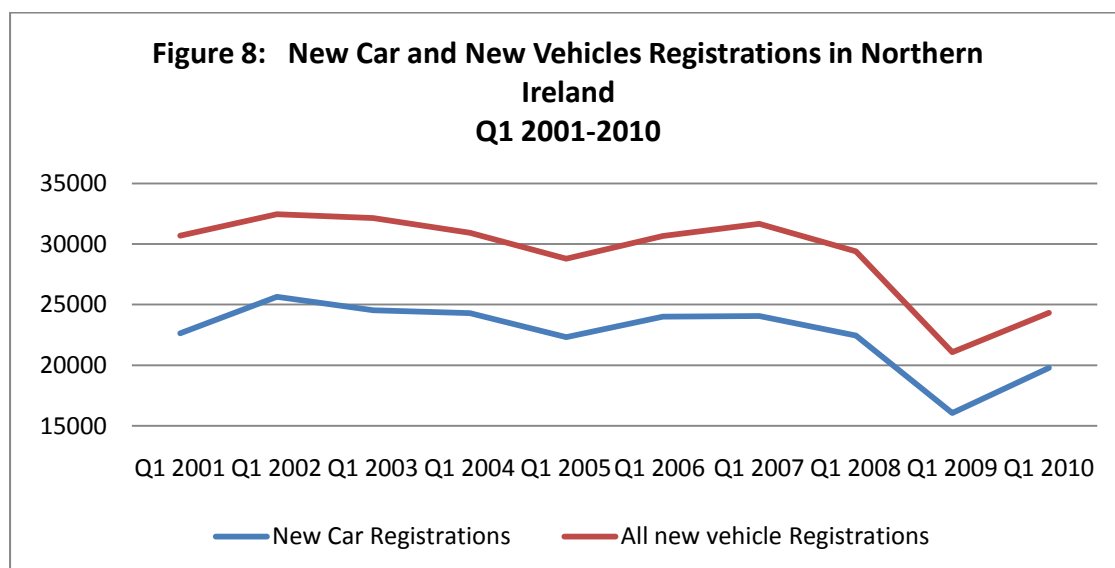
Data for Quarter 1 2010 new vehicle registrations in Northern Ireland was published by the Department of Regional Development on June 24th. The data shows that during Q1 2010, a total of 24,325 new vehicles were registered for the first time in Northern Ireland compared to 21,069 the same period a year before, an increase of 15.5%. Improved consumer confidence relative to one year earlier and the car scrappage scheme (which ended in March) are expected to have positively affected vehicle registrations.

From the total of new registered vehicles, new cars accounted for 19,769, an increase of 23.2% on the same period one year earlier and up 108% on the previous quarter's figure of 9,515. (Quarter 4 is traditionally the weakest season for car sales as customers delay purchasing until the next year's registration number is available).

Although the latest figures show an improvement between this quarter and the same period in 2009, the numbers of both 'new car' and 'all vehicle' registrations remain below the ten year historical average for quarter one by 12.3% and 16.7% respectively. (See Table 4 and Figure 8 below).

	Q1 2009 (Number)	Q1 2010 (Number)	Annual Change [%]
New cars	16,072	19,769	23.2
All vehicles	21,069	24,325	15.5

Source: DVLNI (June 2010)



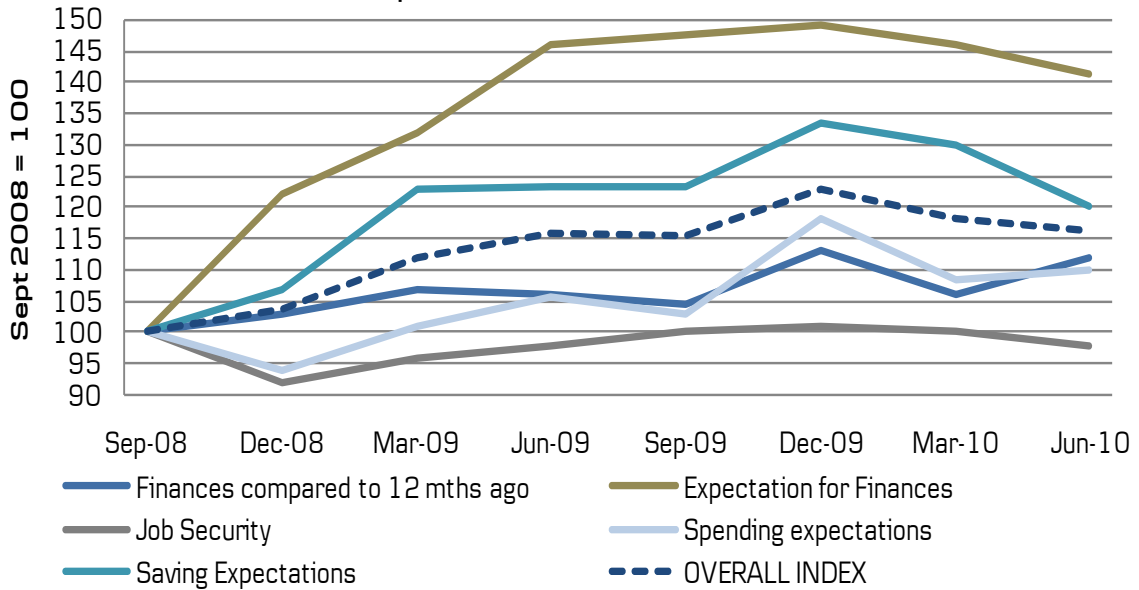
Source: DVLNI (June 2010)

d. Consumer Confidence, July 2010

Local consumer confidence, dipped again in the second quarter of 2010 suggesting that weak economic recovery combined with the much publicised austerity measures have taken their toll upon household confidence. The latest Northern Bank ‘Consumer Confidence Index for Northern Ireland’ which entails interviewing 1,000 people across Northern Ireland showed a decline in confidence levels over the quarter and no change when compared to recorded levels one year ago. The overall index dropped 2 points from 118 in Quarter 1 2010 to 116 in Quarter 2 this year (with 100 representing the low point at the peak of the financial crisis).

The overall index was pulled down by expectations for savings and finances over the next 12 months. High inflation rates combined with low or no pay increases seems to have squeezed disposable incomes. There was also a small decline in confidence around job security.

Figure 9 Northern Bank: Local Consumer Confidence, September 2008 to June 2010



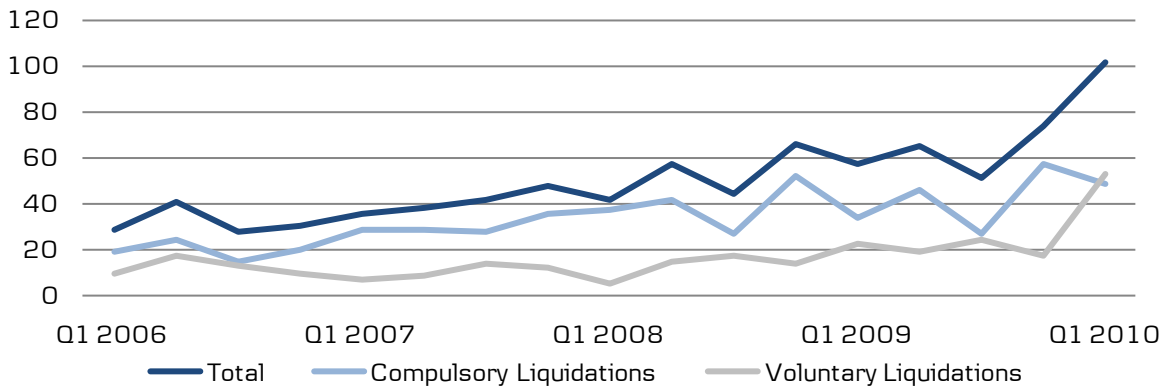
Source: Northern Bank, July 2010

5. Business Environment

a. Company Liquidations Quarterly Analysis, Quarter 1 2010

Provisional data from the Insolvency Services (DETI) shows increased levels of company liquidations. The first quarter of 2010 saw 102 company liquidations in Northern Ireland, up 37.8 per cent from the previous quarter and up 78.9 per cent compared to the same period one year earlier (when company liquidations totalled 57). (See Figure 10 below)

Figure 10 Number of Company Liquidations (Northern Ireland) (2006-2010)



Source: DETI & Companies House

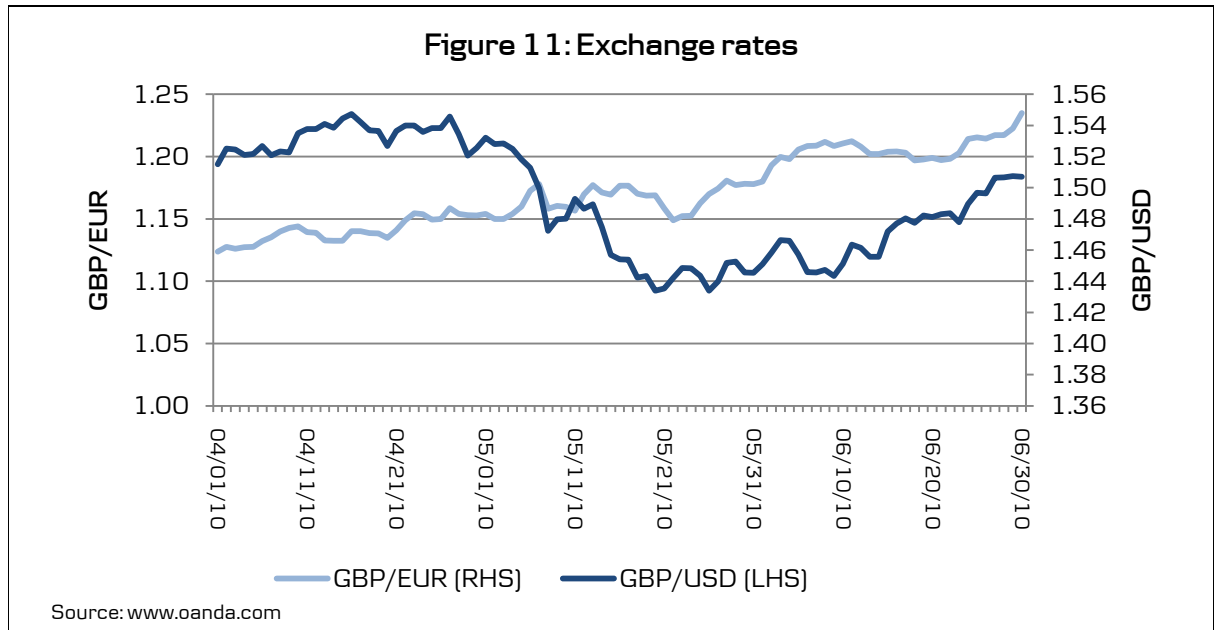
b. Bank of England: Agent's summary of business conditions (May 2010)

The Bank of England's latest summary of business conditions in Great Britain and Northern Ireland is summarised below.

- The pace of **consumer spending** growth, which had been slowing since the end of 2009, appeared to have stabilised.
- The number of **homes for sale** had risen, prompting a further correction in the imbalance between demand and supply in the housing market.
- **Investment intentions** had stabilised in recent months, and there were occasional reports of businesses planning to invest more in the year ahead.
- **Exports** continued to increase gently, although the pace of recovery had been constrained by weak growth in the United Kingdom's main trading partners.
- Both **business services** turnover and **manufacturing** output had continued to recover gradually.
- Output in **the construction sector** had begun to stabilise.
- **Credit conditions** remained tight, although there were further reports of a marginal improvement in the availability of bank credit.
- **Employment intentions** remained stable, but there were a few signs of selective plans for increased hiring during 2010.
- **Pay growth** remained muted, although there had been a slight increase in pay awards relative to late 2009. In most cases, those awards were aimed at rewarding performance, recognizing employees' loyalty and boosting morale.
- Overall, **materials costs** continued to rise, in some cases sharply. Higher steel, plastic, timber and fuel prices were regularly cited as putting upward pressure on businesses' costs.

c. Exchange rates, Sterling Quarter 2 2010:

Sterling moved as high as 1.2391 (80.7p) against the euro during Quarter 2 and on average traded at 1.17064 (85.4p) during the three month period April to June (see Figure 11). The sterling gain over the last quarter is largely attributable to the sovereign debt crisis in Europe which worked to weaken the euro against a number of major currencies.



d. Interest Rate Environment

On July 8th 2010, the Bank of England voted to maintain the Bank Rate at 0.5 per cent and also maintain the stock of asset purchases financed by the issuance of central bank reserves at £200 billion. Our expectation is that the base rate will not deviate from 0.5% for the rest of this year.

The London Interbank Offered Rate (LIBOR), which is the rate of interest at which banks borrow funds from each other, has risen marginally over Quarter 2 - with 3 month LIBOR sitting on average at 0.66 between April and June 2010.

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