Executive summary
Cracks appearing globally, and NI concerns growing, but ROI still firmly in growth phase

Encouragingly, job creation has continued throughout 2018 with more people now employed on the island than at the peak of the last boom. Despite growing concerns over global economic conditions, and the UK in particular, the most common conversations we are having with clients relate to finding, hiring and retaining staff.

With March 2019 fast approaching, Brexit is foremost in businesses’ minds, but being able to respond rapidly to the outcome when it is decided remains the most common challenge.

Michael Hall
Head of Markets, EY Ireland

Synchronous growth was the term used in early 2018 to refer to the unusual conditions prevailing at that time in which all of the world’s major economies were enjoying growth. Sadly, less than a year later, cracks are already beginning to appear. Global trade wars, Brexit, vulnerabilities in emerging markets and closer to home in Italy, have led to a growing nervousness about the economic outlook.

The Republic of Ireland (ROI) is so far unaffected by the increasing global anxiety, with growth forecasts again revised upwards and the labour market continuing to expand rapidly. However, as a very open economy, the growing global concerns should not be ignored. Northern Ireland (NI), in contrast, is growing only modestly. The impressive level of job creation remains noteworthy in NI and is currently a more useful comparator for growth in both countries than GDP. Indeed, due to the level of job creation in NI, our forecasts have been revised upwards for 2018 and we now project NI to have enjoyed growth similar to the United Kingdom (UK) rate.

After a period of muted pay inflation, wage increases are accelerating in ROI. With inflation remaining low, this expansion in real incomes represents a ‘sweet spot’ for the domestic economy, though it is also increasing business costs. This pattern of real wage increases is not the case for the UK and NI, in which pay rises are only just above the rate of inflation.

A change in consumer behaviour is perhaps the greatest threat to the UK outlook. Household savings are at historically low levels and overall UK growth is highly dependent on consumers continuing to borrow and spend. A slowdown in consumer spending could be exacerbated by Brexit, but was always going to adversely affect UK prospects at some point.

EY growth forecasts

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Source: EY Economic Eye, UK ITEM Club

*Modified domestic demand removes the impacts of IP relocation and aircraft leasing, giving a more accurate picture of the domestic economy.
Although not our central case, the possibility of a more pronounced slowdown in 2019 cannot be discounted, and needs to be incorporated into firms’ scenario planning.

Looking ahead, we expect pay pressures to accelerate in ROI, inflation to pick up and the economy to slow slightly as the labour market continues to tighten. Increased levels of inward migration will continue to create demand, but add to price pressures, which in turn present a clear risk to ROI’s competitiveness. To date, ROI is one of the top Brexit relocation countries but competition is fierce. Although price is not the top factor in relocation decisions, it plays an important part.

For NI, sluggish growth is expected to continue and we project the labour market to begin to contract in 2019 as pressures on consumers mount. However, this was expected in 2018 and firms continued to hire.

Brexit looms large but firms still lack the clarity needed to make strategic decisions. Active contingency planning is underway to ensure readiness, but early 2019 could prove to be frenetic, depending on what decision is reached. Our forecasts are based on a transition phase of two years and a Free Trade Agreement thereafter.

We continue to track the gathering global storm clouds and monitor the UK consumer market as 2019 approaches. Even in the fast growing ROI economy, preparation is required as the external data flashes warning signs.

November 2018
Headline growth forecasts

The divergence in growth forecasts has become more prominent on the island as 2018 enters its final quarter. ROI 2018 growth is projected at more than six times that of NI at 8.2% and 1.3% respectively. 2019 sees this gap narrow to 4.4% and 0.9%. Looking across a basket of indicators, the 2019 outlook remains positive for ROI and weaker for NI, with employment expected to fall as consumer pressures and Brexit fall-out take effect.

ROI

ROI growth is expected to surpass the exceptionally high 2017 figure, on the back of two strong quarters of data. However, headline GDP figures, taken in isolation, are no longer an appropriate measure of how the economy is performing. Using modified domestic demand, growth in the range of 3%-4% is forecast for 2018/2019, removing the impact of IP relocation and aircraft leasing. This represents a more accurate reflection of the domestic economy, and while it is not as high as headline GDP growth, it is extremely healthy. There is little sign yet that Brexit has started to impact negatively, outside the pockets of exporters to the UK hit by currency volatility.

Inflation has stayed surprisingly low in 2018, rising 0.9% in the year to September, held back by a weaker GBP, which has the effect of reducing the price of imports. Housing and fuel costs rose by 6.3% in the same period. This will be exacerbated further by the tightening labour market and inward migration, contributing to rising prices. We forecast inflation of 0.8% for 2018, picking up to 2.1% in 2019.

NI

Growth for NI is projected to be modest for 2019 at 0.9% as the effects of Brexit and a continued squeeze on consumers continue to bite. Considering the lack of government, it is perhaps a better outturn than might have been expected. Our forecast risks are more pronounced on the downside given the possible Brexit disruption, continued political uncertainty and tougher conditions for consumers.

The labour market continues to surprise in NI at 1.6% growth in the year to Q2, but real wages remain stagnant, constrained by high inflation.

Consumers

The consumer outlook is looking strong in ROI as population and job growth, coupled with rising real wages translate to increasing incomes and spending power. 34,000 net inward migration was recorded this year, the highest level since 2008 and this could easily climb with people who might otherwise have located to the UK.

Unemployment is at its lowest since early 2008 and effectively full employment is anticipated by 2019, on the assumption of a relatively soft Brexit.

Disposable incomes rose by 5.7% in the year to Q2. This rise in incomes and low inflation means that consumers are richer, but savings rates are high, partly due to the paying down of legacy debt and young people saving for housing. This has the effect of slowing down spending and boosting bank balance sheets, which in turn can support lending.

Inflation is being kept low by a strong euro but it is beginning to rise. It is a very positive time for domestic consumer businesses in ROI, a ‘sweet spot’ similar to that enjoyed by the UK in 2015/2016.

The contrast between ROI and NI is clear when looking at real wage data, which is virtually flat in NI, in contrast to the strong growth in ROI. Retail jobs in NI are under increasing pressure as high street retailers begin to feel the pinch of a weaker pound and falling consumer real wages, in addition to the growing challenge from online competition. Overall job growth remains robust and NI unemployment, at 4.3%, is lower than ROI, but we expect a slowdown in 2019 which will impact spending power.
Government

ROI Budget 2019 was relatively low key, particularly with respect to business and personal tax. The intention of a surplus from 2019 reflected the pressure to show restraint during such a strong boom.

The focus for this year was putting money into front line services. These measures will add to cost inflation but arguably a necessary choice is being made, addressing social issues and creating an environment that can support further growth. It is clear from the tone and content of the budget that austerity is firmly in the rear-view mirror.

Recent events are putting pressure on the confidence and supply arrangement and a general election before the end of the year is very possible.

Latest tax receipts show a 6.6% growth in the year to Q3, reflecting a strong economy and a greater choice in spending.

NI has spent 21 months and counting without a devolved government, a new record for a developed economy. Being led by UK policy means there is no local prioritisation.

The inability to make decisions on infrastructure or public services is holding back the economy and impacting future prospects. The civil service is continuing to keep services running and government policy is expected to have minimal impact on Economic Eye forecasts. The Prime Minister promised to draw a line under austerity in the UK, but it remains to be seen if this will apply to NI.

Most economists would agree that ROI should be running a budget surplus given its current growth rate and level of national debt. Sadly, the underspend on much needed infrastructure and public services over the last decade means that the capacity to reduce spending is limited and a failure to spend would lead to a rapid deterioration in ROI’s competitiveness. That being said, it is helpful to manage expectations that ROI’s rapid growth phase will not be a time for tax cuts and that public policy priorities will be focused on services and the quality of life of citizens for the foreseeable future.

It is to NI firms’ great credit that they have continued to hire more staff in the absence of an Executive and against the backdrop of uncertainty that Brexit has brought. This does not mean that a lack of devolved government is not damaging. A lack of progress on key strategic policy areas will incur significant costs in the years ahead.
**Trade**

ROI export volumes recorded an increase of 22% in the first eight months of 2018 when compared to the same period in 2017, while imports recorded a 9% increase. The weaker UK economy has started to impact, as the value of ROI exports experienced only 11% growth over the same period while imports rose by 10%. Export value to Great Britain (GB) fell by 5% in the year and imports rose by 4%.

The booming consumer sector is driving up goods imports and will continue to do so as the labour market expands, and this is reducing the overall boost to GDP. Imports are expected to be impacted by intangible assets, such as offshoring of IP, as will investment in 2018. Euro-GBP exchange rates have been relatively stable since January, the euro currently worth £0.88 as of late October, with GBP hitting an eight year low in August 2017.

Tourism is a welcome star performer in NI, with overall tourist expenditure up 6% in the year to March, bolstered by the weaker GBP. Imports should weaken on the back of currency and put pressure on consumers - but there is no regionally published data for imports in the UK. However, figures published in August for NI show that 27% goods exports and 23% imports were attributed to ROI in 2016, highlighting that the possibility of a land border or tariffs would be particularly detrimental to NI trade.

**Capital investment**

Capital investment is accelerating in ROI, with the National Development Plan committing to €116bn of infrastructure investment by 2027. Government capital investment will increase by 24% to €7.3bn in 2019. Rising costs and construction cost inflation, coupled with scarcity of building contractors may curb the volume of capital investment, but will not impact the value to the same degree.

19,000 house completions are expected for 2018* and Q2 data showed completions up 34.1% compared to Q2 last year.

Corporate investment is increasing, with some firms, mainly in the financial services sector, announcing plans to relocate to ROI post Brexit.

NI capital investment is very modest, though it has been relatively low for a sustained period. Brexit may be holding back investment and without an Executive, no major government programmes are underway.

*Source: Construction Industry Federation, July 2018*
Employment

The island steps closer to full employment

Labour market

460,000 jobs have been created across the island in the last six years and 88,000 in the last 12 months alone. At an average salary, this adds €3.3bn/£2.9bn* income to the island economy and represents a major boost to consumer industries, which is reflected in the jobs figure. Our forecast for ROI is strong for 2018 and is for a broad-based job growth of 243,000 to 2023.

After five years of job growth in NI, we project late 2018 to be a turning point and overall job numbers to contract modestly in 2019, as consumer pressures coupled with uncertainty surrounding Brexit take effect. Reported skills shortages and a remarkable level of job creation given the paltry growth figures in recent years suggest that there are, unusually, upside risks to this forecast.

Encouragingly, the sectoral growth mix remains diverse, and this is expected to continue. However, it is arguable if sectoral ‘baskets’ any longer truly reflect reality, as there is significant blurring of the lines between sectors.

There has been a notable rise in construction (+19,200) and professional services (+9,700) in both jurisdictions in the year to Q2 2018. We forecast this trend to continue, with a drop off in retail jobs in NI over the next five years.

*Average salary: ROI €38,500, NI: £25,550
Source: CSO, NISRA
Earnings

Wages remain a puzzle. There are finally signs of an acceleration in ROI average salaries at +3.3% in the year to Q2. We have revised our forecast upwards which in turn will boost consumer spending.

NI’s persistent productivity weakness, which is partly a function of the sectoral mix of jobs being created, continues to curtail overall growth in the region. Transformation of sectors and continued erosion of collective wage bargaining has shifted the balance between capital and labour.

The latest UK data suggest an acceleration above 3% in annual regular pay growth, but it remains to be seen if this is the beginning of a period of sustained wage inflation.

Real wages and disposable incomes are rising strongly in ROI but only modestly in NI. ROI wage growth is widely spread across sectors and occupational groups, with sectors such as finance, ICT and professional services recording increases upwards of 5%, reflecting the tighter labour market.

UK CPI inflation is currently running at 2.4%, while NI wage growth is expected at 2.5%, meaning only a modest increase in purchasing power.

We have revised our wage forecasts upwards across the island. This is due to the growing shortage of labour and the pressures of increasing living costs becoming a factor in firms’ decision making around attracting new staff, and retaining existing employees.

Where will firms find labour?

Full employment means migration, or those currently outside the labour market will be needed to fill job vacancies. NI is already edging towards full employment, with unemployment at 4.3% and ROI close behind at 5.4% and falling fast.

The unemployment rate in some ways is a misleading term and does not show the full picture of the labour market. ROI’s participation rate has not recovered to its peak 2007 level and remains relatively low at 62.3% (compared to 78.8% in the UK). The fall in participation is more prominent among males, currently 7.5pp lower than its peak, whereas females are just 1.2pp below peak. NI participation rates tell a similar story at 72.5%, with 51.1% of unemployed classed as long-term unemployed. This is compared with 26.0% for the UK and 33.9% for ROI.

With many people not working the amount of hours that they would like and the potential for people to be drawn into the labour market from inactivity, it would be wrong to equate low unemployment with full employment. This does not change the fact that firms will find talent attraction an even bigger challenge in the years ahead.

This is an issue that will become more prominent as public services come under increasing pressure due to demographic change. Policies to target those outside of the labour force will become more important and perhaps the volume of new jobs available and the rising salaries on offer may bring more people into the market.

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Source: EY Economic Eye, UK ITEM Club
Risk register
Brexit inertia fading fast as March deadline approaches

Following a confusing pattern of Brexit dominating headlines yet remaining muted on firms’ agendas, the third quarter of 2018 has seen the headlines and agendas begin to align. As March approaches, firms are realising that Brexit is of sufficient severity to merit time and resources, as confidence in avoiding a no-deal has faltered during the second half of the year.

Although other risks remain critical, and frequently feature more prominently at board level, given the timing, we focus our risk analysis on Brexit in this Economic Eye report.

From scenario planning to hedging
With scenario planning pointing to an equal likelihood of no-deal, customs union and free trade; firms are now focusing on hedging their bets. Strategies include structures with ownership on both sides of the border or either side of the Irish Sea. Contingency plans to deal with increased administration, such as customs paperwork, perhaps via an outsourced model are also being considered.

Currency risk remains a factor amplified by Brexit uncertainty and is influencing firms’ decision making, with many analysing and rethinking their supply chains and currency hedging strategies to protect against heightened volatility.

People, and the right people
Talent continues to dominate corporate agendas. The desired skillsets are becoming harder to source. Pay pressures and a saturated labour market mean that firms are struggling to find people. Finding the right people is even more challenging. Developing future leaders was identified as the top challenge facing CEOs in the 2018 EY Global Leadership Forecast, higher on the list than attracting talent.

Brexit has compounded this issue. With immigration a firm red-line in the UK’s negotiation strategy, unrestricted movement of people is looking increasingly unlikely.

This may offer more potential talent for firms in ROI but there is concern over housing and public service capacity to absorb increased in-flows.

The risk burden does not appear to be equally spread across regions. While the number of UK service firms attempting to recruit fell to its lowest level for 25 years, with London at 21%, NI recorded 58%, according to the British Chamber of Commerce. Despite this, the fallout from a no-deal will be evident in NI. A 9.1% reduction in GDP has been forecast by the Confederation of British Industry by 2041 if immigration was restricted. Clearly the overall population size would impact how observable such a fall would be to citizens.

Mass exodus a myth?
Dublin was the most popular relocation choice among financial services firms according to EY’s Brexit Tracker survey. However, Dublin’s rapidly rising costs means that lower-cost cities, such as Milan and Madrid are emerging as increasingly serious competitors.

The extent that Dublin could gain from Brexit relocations is unclear however, as the evidence of a UK exodus is mixed. A Reuters survey revealed that only 630 UK-based finance jobs have relocated so far and just 5,800 were anticipated in the event of a hard Brexit. This was a significant reduction from the 10,000 jobs quoted in the previous year.

Global risks starting to impact?
Looking internationally, trade war volatility is already impacting global growth and business confidence. Oxford Economics points to this as the most dominant risk since their risk survey’s inception. Despite this, business concerns surrounding cybersecurity and trade wars do not seem to be curbing hiring decisions across the island – perhaps more risk necessitates more problem solvers.
The changing economic environment brings with it new pressures and new opportunities. We observe a number of trends across our client network influenced by prevailing conditions:

**Talent not just a HR question**

The tightening labour market and accelerating salary demands are leading to new approaches to identifying, hiring and retaining talent. In addition to new recruitment approaches, firms are more actively reviewing their likely future staffing needs and exploring technology solutions that may change the nature and quantum of who they may need. The potential to automate tasks or to find new ways of identifying talent are likely to gather speed as the island moves closer to full employment. Reviewing retention packages, incentive structures and salary forecasting are increasingly common activities in boardrooms across the island.

**Refinancing and refocusing**

The direction of travel for interest rates is upwards. Although the expectation is that rates will move very slowly in the EU and UK, there is a strong case to be made that this is an extremely attractive time to restructure and refocus financial commitments.

The financing industry is reflecting on the strong growth in ROI and with many firms enjoying relatively strong demand and sales, it makes sense to review financial obligations at this time. If concerns over cracks in the global economy, and in particular the UK, prove to be the start of a phase of lower growth, then refinancing conditions may not be as favourable as they are today.

**Opportunity from new challenges**

Whether it is Brexit or rising cost pressures in the Dublin area, all challenges present opportunities for businesses and entrepreneurs. Growth in construction is one example of this new opportunity, but firms helping with staff relocation or the advisory industry around Brexit preparations are further examples of one person’s problem being another’s opportunity.

"Talent and technology will be the key resources required to meet the challenges that a rapidly evolving macro-economic environment will bring. The uncertainty that Brexit and unease over global economic prospects brings cannot be allowed to have a paralysing effect on businesses, as this would adversely impact growth across the island.

The job creation and economic growth data provide encouragement that firms are meeting the challenges, but increasingly tight labour markets may accelerate the adoption of technology and focus firms’ minds on their talent strategies for 2019 and beyond."
## ROI

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## UK

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## NI

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Source: EY Economic Eye, UK ITEM Club

Note: 2018 imports and investment are anticipated to be low in ROI due to a fall in intangible assets (relating to IP), but physical investment is projected to be growing strongly.
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