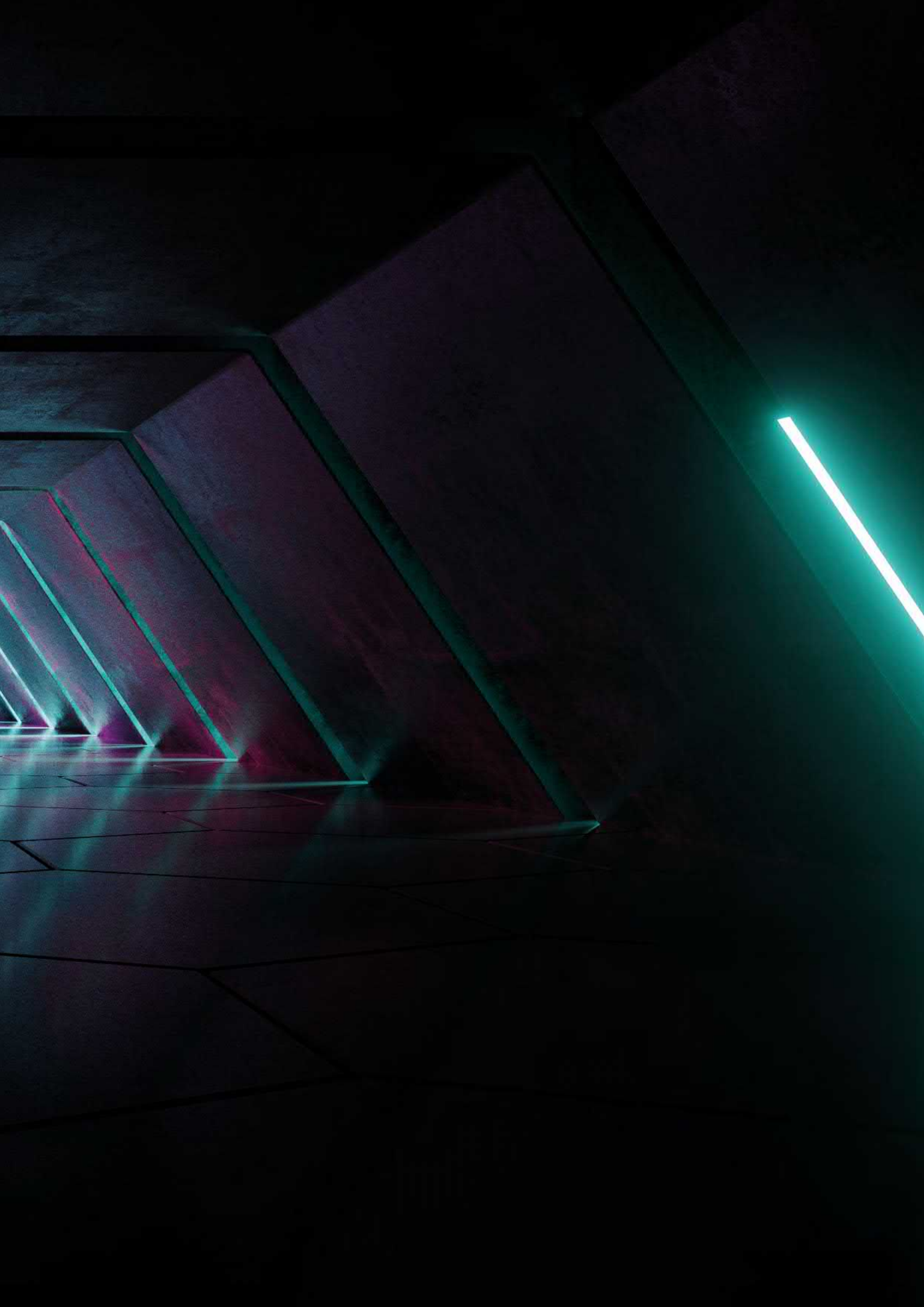


Economic Eye

Winter forecast
2019



EY DKM



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Executive summary

Busy, but watchful

It is a peculiar time for the all-island economy. On the brink of Brexit, and against a backdrop of increased anxiety over global growth, both jurisdictions continue to enjoy strong levels of job creation, and a need for more talent is the most frequent business message.

Headline growth remains exceptionally strong in the Republic of Ireland (ROI), and though more sluggish in Northern Ireland (NI), it is a long way from the predictions of catastrophe that followed the Brexit vote. Our latest Economic Eye forecasts are modestly revised from our November update, with an uptick in 2018 growth across both jurisdictions, and a very slight downward reduction in growth expectations in 2019 and 2020 for ROI. This reflects a weaker global growth outlook.

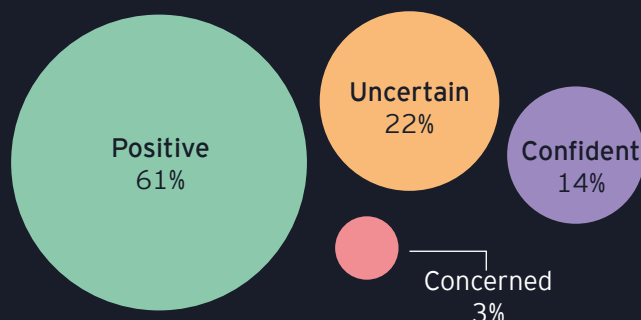
The forecasts are based on UK and EU trading conditions remaining unchanged over the forecast period due to the adoption of a transition agreement. At the time of writing, it remains impossible to say if this is indeed what will transpire at the end of March.

Firms' sentiment remains bullish

Despite the heightened level of risk, firms across the island remain positive about their own prospects. Our new survey of 600 EY leaders across the island reveals an overwhelmingly bullish outlook.

Though firms report growing unease and face a number of challenges, not least sourcing appropriate talent, the mood would be best described as 'busy but watchful'.

EY client sentiment



Source: EY 25,000 Conversations sentiment survey

Job market growth likely to slow

We expect job growth to slow across the island. In ROI, this reflects a tighter labour market and more expensive labour costs. In NI, overall weaker growth is the primary reason. Nevertheless, 211,000 more people are projected to be in work across the island in 2024 than there are today.

Brexit a concern, but far from the only one

It is the apparent paradox, of business growth set against a backdrop of great uncertainty and change, that makes it such a peculiar time for the economy. Data must be reviewed carefully to spot the 'Brexit effect', arguably because Brexit is yet to happen. In our Brexit update in this report, we contend that care must be taken to not make Brexit the answer to every question relating to underperformance, at the macro or individual firm level. Correctly diagnosing the source of problems helps to better craft solutions, whether that is in the corporate boardroom or the government policy lab.

Scenarios reveal the scale of risk

Brexit scenario analysis carried out using the Economic Eye model reveals the scale of downside risk, with NI particularly vulnerable given its lower base growth. Domestic strength provides insulation for ROI, but in the event of a fractious no-deal, the possibility of recession in NI cannot be discounted.

Constructing the future

In the first in a series of themed chapters looking at key issues for the island's economic future, Annette Hughes, Director in our EY-DKM team, takes an in-depth look at the construction sector. The need for sustained infrastructure investment across the island and an enhanced policy focus on the construction sector is considered.

Facing challenges from a position of strength

The warning signs cannot be ignored, and the possibility of a very challenging 2019 cannot be dismissed. The good news is that the island faces the forthcoming challenges from a position of relative strength, but the potential disruption from a complicated Brexit means that an agile strategy is required to facilitate a swift reaction to whatever the economic conditions will be. It will require great political skill and delicate negotiating skills to navigate a no-deal situation. Businesses across the island continue to hope such skills will not be required.

We look forward to helping our clients through the turbulent year ahead. It is worth reflecting that the 72,000 more people that are in work across the island is above our expectations from this time last year, which speaks to a resilience and flexibility that perhaps forecasting models underestimate. As inward investment continues to flow into both jurisdictions, it is clear that the island is still a good place to do business even in the face of increased levels of risk. Watchful yes, but thankfully, encouragingly busy.

February 2019



Michael Hall

Head of Markets
EY Ireland



Neil Gibson

Chief Economist
EY Ireland

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There is no doubt that the global outlook is becoming uncertain, but the continued level of job creation across the island highlights the quality of our businesses and their ingenuity to seek out opportunity, while at the same time managing and mitigating any potential risk, which will be key in 2019.

Michael Hall

Head of Markets, EY Ireland

1: Economic outlook

Global outlook revised down

China feeling trade effects

The World Bank revised down its 2019 global growth forecasts modestly in January from 3.0% to 2.9%. 'Darkening Skies' was the title of the report which reflects the increased anxiety among forecasters of an impending global slowdown.

Japanese, German and Italian GDP contracted in Q3 2018, a sooner than expected slowdown. Germany was the first of these to release Q4 data which showed a pickup, thereby avoiding a technical recession (two or more quarters of contraction). A preliminary estimate of 1.5% GDP growth was reported for 2018, the country's slowest recorded growth in five years. President of the European Central Bank (ECB), Mario Draghi has acknowledged that weaker Eurozone data has lasted longer than expected, and sees a slowdown, rather than a recession on the horizon.

The latest Chinese data showed the lowest exports in two years, but the government introduced stimulus measures including tax cuts in order to boost domestic demand. The trade surplus with the US is the largest it has ever been, but lower than expected activity is igniting fears of a slowdown. The country posted 6.6% growth for 2018, which was in line with global expectations, but the slowest since 1990 and lower than the 6.8% growth of 2017.

Global growth forecasts

	2018	2019	2020
World	3.0%	2.9%	2.8%
US	2.9%	2.5%	1.7%
Euro area	1.9%	1.6%	1.5%
Japan	0.8%	0.9%	0.7%
China	6.5%	6.2%	6.2%
Emerging markets	4.2%	4.2%	4.5%

Source: World Bank, January 2019

A return to Mercantilism?

Mercantilism was the system of trade used in the 16th-18th centuries in Europe with the belief that the amount of global wealth was static, therefore nations tried to accumulate as much wealth as possible to be self-sufficient. This was achieved through government regulation, import tariffs, maximising exports and accumulating gold and silver.

The weakness of this economic system was that not every country could run a trade surplus, and imports are necessary in order to increase economic output. Acknowledging that trade is not a zero-sum game allows countries to share scarce resources and increases incentives to innovate.

The escalation of trade war measures between the US and China, the US withdrawal from the Trans-Pacific Partnership, and the import tariffs on steel and aluminium signal a return to more protectionist policies. These policies are often referred to as 'beggar thy neighbour', as they suggest a more inward focus that cares little for the fortunes of others.

Employment is still growing in the US and wages are rising, but exporters are facing more challenging conditions. Most economists expect that the measures will damage overall economic growth, and ultimately the firms that the policies are trying to protect.

China's slower growth data has added pressure to resolve the US-China trade war, but with the US economy seemingly still booming, will the zero sum game continue, and what impact will this have on global growth?

US Government shutdown expected to curb strong performance

In the US, the longest government shutdown in history has likely negatively impacted economic growth. The US growth forecast according to the World Bank for 2019 is 2.5%, but a Bloomberg survey of economists raised the probability of a US recession to 25% in the next 12 months. An impact of the shutdown is that data releases were postponed in January, meaning that it is difficult to properly assess the health of the economy. The US Federal Reserve has emphasised its message of patience, signalling that it is willing to postpone interest rate rises if US output weakens.

Financial market volatility reflects increased risks

2018 was a disappointing year for global stock markets, both in terms of losses and the scale of swings throughout the year. It is argued that the calm experienced in the previous years was not the 'norm' but rather a result of accommodative monetary policy and an era of unprecedented low interest rates, which is slowly coming to an end.

Brexit has not caused as much market upset as expected by many, even in currency markets. This reflects the pace of developments and the lack of progress has largely been predicted and priced into the market. Stock markets are more concerned with Asian developments and fears of a Chinese slowdown.

US on different currency and interest rate path

Brexit scenarios pointing towards a softer or no Brexit have increased the value of the pound in recent months, but its value is still well below its pre-referendum level against the euro (-11.1%) and the dollar (-10.0%). There is scope for a rebound in the event of a positive Brexit outcome. The euro has lost some of its value against the dollar in the last 12 months (-6.5%) amid concerns of slower European growth.

Mario Draghi's term as ECB President comes to an end in October 2019 after eight years, and to date, interest rates have not been raised during his tenure. Rates have been cut nine times from 1.5% to zero, where they have remained since March 2016. It is unlikely that the ECB will raise rates under current conditions in 2019.

The UK has begun modestly raising interest rates, with one increase each year in 2017 and 2018. The current rate of 0.75% is not projected to rise at all in 2019 given prevailing conditions, though a sharp uptick in imported inflation could alter that position.

These historically low interest rates arrest the ability for governments to influence demand and control the rate of inflation. This has raised asset prices and curbed savings rates through very low returns.

The US has acted differently, with the Federal Reserve (FED) raising rates nine times since the end of 2015, four times in 2018, with the most recent rise in December bringing the interest rate to 2.5%. There are fears that the FED will overtighten monetary policy, but recent signals suggest a cognisance of the fragile global conditions and this may slow the pace of planned increases.

Global currency movements

	Since Brexit referendum	Last 12 months	Last 3 months
€ - £	▲ 12.5%	▼ -2.2%	▼ -2.2%
€ - \$	▲ 1.2%	▼ -6.5%	▼ -0.8%
£ - €	▼ -11.1%	▲ 2.2%	▲ 2.2%
£ - \$	▼ -10.0%	▼ -4.5%	▲ 1.4%

Source: ofx.com

Note: Daily rates used for 22/06/16 (the day before referendum) and 26/01/19 (latest available at time of writing). Monthly rates used for October 2018 and January 2019

What does this mean for the island of Ireland?

The increased anxiety over the health of the global economy is concerning for the all-island economy. Although more directly impactful on ROI growth given its more global structure, it materially impacts both economies through demand for exports. Irish GDP can swing wildly on the fortunes of a few firms and their policies over the location of Intellectual Property (IP). Therefore, alarming swings need to be treated calmly and in tandem with other barometers of the state of the economy, such as the labour market.

There seems little evidence of a slowdown in inward investment into ROI, and NI reports a healthy pipeline too, suggesting concern may not yet have translated from the economists' pens to the corporate boardroom.

Economic outlook

Island forecasts

2018 beats expectations, weaker world outlook impacts ROI forecast

Headline growth forecasts

ROI is storming ahead with 8.3% growth expected for the full year 2018, and 3.9% in 2019, almost three times that expected from the UK.

NI is expected to have grown modestly ahead of the UK in 2018, at 1.5%, based on available labour market data. It is expected to experience much slower growth of under 1% in 2019.

The consensus across the island is that Brexit has not yet had a significant impact on growth in 2018. The fallout is expected to begin to impact the economic data from 2019, in which there may be an adjustment period if Brexit goes ahead as planned at the end of March. Section 2 presents potential scenarios for economic performance on the island.

EY growth forecasts

	2018	2019	2020	2021	2022	2023
ROI	8.3%	3.9%	3.2%	3.0%	3.1%	3.1%
ROI MDD*	4.2%	3.7%	3.5%	3.2%	3.0%	2.8%
NI	1.5%	0.9%	1.2%	1.5%	1.9%	2.0%
UK	1.4%	1.5%	1.7%	1.8%	2.0%	2.1%

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.

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Headline GDP suggests two economies moving at completely different speeds but in truth, both are ahead of expectations. Job growth is strong in both NI and ROI, with the unemployment rate currently lower in NI.

The dual strength of the domestic and international sectors in ROI is driving fast growth, whilst the structurally more insular NI is expanding at a more sedate, but still welcome, rate.

Neil Gibson
Chief Economist, EY Ireland

Economic outlook

ROI - reaching the top of the cycle?

Growth outlook - ROI

ROI is facing into Brexit headwinds on a strong foundation as GDP growth figures continue to impress. Removing the effects of IP relocation and aircraft leasing, Modified Domestic Demand (MDD) is predicted to be 4.2% for the domestic economy in 2018 and 3.7% in 2019.

This resilient economic performance reflects a strength in the domestic economy and healthier public finances, which complement the global sector.

Consumers

The strength of the domestic economy in ROI presents a buffer, albeit a temporary one, against a potential global slowdown. The consumer is booming, with low inflation and increasing employment providing spending power, and in-migration creating a larger customer base. The consumer outlook remains positive for 2019 on the back of the favourable demographic and earnings tailwinds.

Disposable incomes rose 4.8% in the year to Q3, wages by 3.2% and consumption expenditure of households by 4.9%. This contributed to the retail volume sales growth of 3.6% in the year to November, or 1.9% with motor trades excluded, on a seasonally adjusted basis.

The Irish grocery market grew by 3.0% in the 12 weeks to the end of December according to the latest research by Kantar Worldpanel. Sales values reached €995m in December, the highest monthly total ever recorded in the Irish grocery market, indicative of the favourable demographics and income profile.

Government

The latest Exchequer returns indicate that the government is on course for a small surplus for the 2018 fiscal year. Revenues were broad-based with large increases in the year in corporation tax (+26.6%), VAT (+7.0%) and income taxes (+3.5%). The latest returns for December show a small surplus for 2018, the first since 2007.

Corporation tax (CT) receipts remain strong, accounting for nearly 20% of tax revenue in 2018. ROI's CT revenue is concentrated in a small number of firms, with 10 companies making up 39% of CT receipts in 2017. Of these, 80% of CT revenue came from foreign owned Multinational Corporations (MNCs). This shows the risk of volatility from year to year in CT as a source of government income.

Capital investment

Government capital spending was 3.2% ahead of profile, which represented a 38.6% growth in the year to December. The booming labour market and rising wages are putting pressure on the housing market, increasing construction investment.

The Department of Housing, Planning and Local Government's spending was 8.8% above profile last year, reflecting the focus on homelessness and the cost of storm damage clean up in 2018.

Fears of a hit to foreign direct investment (FDI) on the back of increased concerns over global growth and a focus on tax contributions of MNCs does not seem to have materialised. Recent Irish job announcements, particularly in the tech industry, seem to show the commitment of foreign-owned MNCs and the resilience in ROI's appeal as a destination.

Trade

A by-product of a thriving consumer sector and growing demand for exports, is increased expenditure on imports. Goods exports increased by 8.6% and imports rose by 11.2% in the first three quarters of 2018. Services exports increased by 8.7% over the period, while services imports fell by 1.2% due to lower research and development (R&D) imports relating to IP.

Brexit is the biggest near-term risk to ROI's exports, with 20.5% (€16.6bn) of goods exports from January to November going to Great Britain, of which machinery and transport equipment (18.1%), mineral fuels (17.5%) and food and live animals (17.2%) make up the largest shares. The US is the second largest goods export country, accounting for €14.0bn (17.3%) of the total, of which machinery and transport equipment make up 60.7%, or €8.5bn, followed by chemicals and related products at 22.6% (€3.2bn). A 'disorderly Brexit' or US protectionist policies both have the potential to upset the Irish trade position.

Economic outlook

NI - steady, but beating expectations

Growth outlook - NI

The latest Q3 data for NI shows stronger than expected growth. The NI Composite index reported an increase of 2.1% in the year to Q3, ahead of the UK (1.5%) for the year, but marginally below the UK's quarter on quarter growth (0.4% compared to 0.6%). Coupled with strong labour market performance, the data has led to an upgrade of the 2018 NI growth forecast to 1.5%, up from 1.3% in the previous Economic Eye report.

Brexit appears to have had limited impact on the overall economy to date, though clearly individual firms have been affected. 2019 is a much more unpredictable picture, with Brexit likely to have a more noticeable impact on the headline figures.

Consumers

There are almost 48,000 more people in work in NI than there were five years ago. Real wages are running modestly ahead of inflation according to the 2018 earnings data, meaning workers are starting to feel richer. The National Living Wage will rise by 4.9% in April 2019, which may boost spending, but could put pressure on business margins.

Retail footfall in NI increased by 4.1% in December, in contrast to the fall of 2.1% for the UK as a whole, according to the British Retail Consortium. The weaker pound and the increasing employment levels likely attracted shoppers on both sides of the border to NI.

The consumer outlook is challenging, particularly if overall job growth slows and inflation spikes on a depreciated currency. This is perhaps the most significant threat to the short-term outlook.

Government

Two years have passed since there was an Executive in NI. Civil servants have performed admirably in ensuring only limited impact has been visible to the public. However, a number of key strategic decisions have not been made, for example resolving Higher Education funding problems or progressing key infrastructure projects. The Institute of Directors in NI estimates £2bn of delayed infrastructure projects, though it is fair to remark that delays may also have occurred with an Executive in place.

Trade

Unless frictionless trade can remain in place on the island, NI exporters are likely to face additional paperwork requirements and possibly customs checks. This is a highly contentious issue and one of the main stumbling blocks to progress on Brexit. It is currently unclear where checks would take place and what role technology could play in simplifying the process.

The proposed backstop arrangement keeping NI in the single market, remains a firm red line for Europe and for the Democratic Unionist Party, though for very different reasons.

Brexit could be very disruptive, particularly for agriculture, but there will be new opportunities even in an adverse no-deal scenario. If ROI's ability to sell competitively to GB was reduced, this could create potential sales to GB for NI firms. It is impossible to be prescriptive of the trade impacts without knowing the terms of Brexit and the solution to the border checks conundrum.

Capital investment

£11bn has been invested in NI public service capital projects since 2008, and a further £8bn is planned by 2021, according to the NI Audit Office.

The latest UK budget allocated £320m to the NI Executive and £350m to NI's City Deals, but there are a number of stages to go before shovels hit the ground.

Commercial capital investment has long been a weakness in NI, hampered by the relatively small scale of the private sector. The current level of uncertainty is likely to be acting as a further break on spending. Despite this, there are still notable projects to redevelop city centre areas and build new offices which suggests the situation is not entirely bleak.

Economic outlook

Labour market, earnings and prices

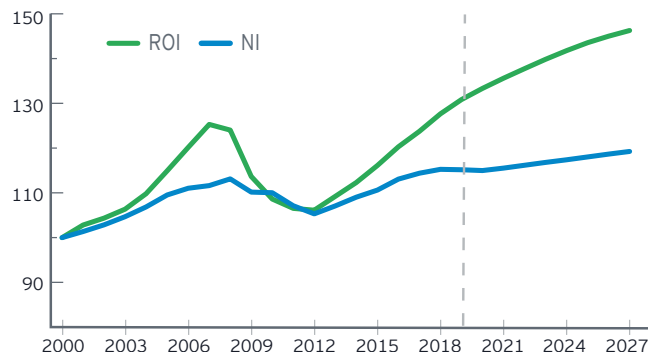
Labour market - a remarkable period of all-island expansion

We forecast contrasting labour market performance in 2019, with 2.5% growth in jobs for ROI, and a small contraction in NI jobs of -0.1%.

We expect that the exceptionally strong growth in ROI will moderate, partly reflecting a tighter labour market and higher labour costs, though over 211,000 more people are forecast to be in work across the island in 2024 than there are today. A small retraction in the NI labour market in 2019/2020 is the central forecast, on the back of relatively tight conditions for consumers and a slower UK economy.

Jobs and wages are growing in both economies, and this is a more tangible measure of real economic growth for the general population than GDP figures.

Employment forecast: ROI and NI



Source: EY Economic Eye

EY job forecasts (% change)

	2018	2019	2020	2021	2022	2023
ROI	3.1%	2.5%	1.9%	1.7%	1.6%	1.5%
NI	0.7%	-0.1%	-0.1%	0.5%	0.6%	0.5%
UK	0.5%	0.7%	0.5%	0.5%	0.5%	0.5%

Source: EY Economic Eye, UK ITEM Club

NI had modest job growth of 0.5% in the year to Q3. The highest increase in jobs was in human health and social work (+3,340), on a seasonally adjusted basis, while the overall increase in jobs was a modest 3,980. The largest decrease was in agriculture with a fall of 5,110 jobs, which shows the difficulties in the sector on both sides of the border, though this sector is notoriously hard to measure. We forecast a modest contraction in 2019, of just under 500 jobs.

ROI enjoyed 3.0% employment growth in the year to Q3 2018, or 66,700 new jobs. This compares with a 2.2% increase or 48,500 jobs in the previous year. There has been job growth in 10 out of 14 sectors, with the largest increase in construction (+18,000) in the year to Q3.

The tightening labour market should keep wages rising and begin to push inflation higher. Unemployment declined on an annual basis for a 25th consecutive quarter to Q3 and the long-term unemployment rate decreased from 2.7% to 2.1% over the year. We forecast an additional 56,600 ROI jobs in 2019 and 44,100 for 2020, which will require additional workers and supporting public infrastructure.

EY job growth forecast (2019-2024)

Sector	ROI	NI
Agriculture	-6,500	-2,130
Mining and quarrying	540	-10
Manufacturing	12,850	3,070
Utilities	2,770	10
Construction	39,140	3,260
Wholesale and retail	9,930	-4,570
Transport	8,520	330
Accommodation and food	29,600	2,390
ICT	18,800	6,780
Finance	6,330	100
Real Estate	1,680	340
Professional services	11,280	3,170
Administration services	23,640	2,650
Public administration	7,720	-1,640
Education	12,020	-140
Health	11,740	410
Arts	2,450	-210
Other services	1,520	3,260
Total	194,030	17,070

Source: EY Economic Eye

Earnings - finally picking up pace

Wage growth for ROI is set to continue on its upward trend as competition for jobs intensifies. This will put pressure on housing and rental prices, but with low headline inflation, people should feel richer, boosting the domestic consumer economy. Sectoral wage increases vary considerably, with administration (+16.3%) and professional services (14.5%) showing the largest increases in average weekly earnings in the last five years, with education (+4.2%) and public administration (+4.5%) rising at the slowest pace.

Average earnings for NI have come above headline UK inflation for 2018, meaning that in contrast to 2017, workers are experiencing real wage increases. Wage growth of close to 3% is expected until 2023.

With wage growth now running ahead of inflation across the island, real wages are rising, boosting consumers' spending power. This provides an upside risk to the weak retail forecasts for NI and may lead to a better outcome in consumer sectors than predicted in the base forecast.

EY wage forecasts (% change)

	2018	2019	2020	2021	2022	2023
ROI	3.5%	3.6%	3.7%	3.3%	3.0%	2.7%
NI	3.0%	3.2%	3.0%	2.9%	2.8%	2.8%
UK	3.2%	3.3%	3.1%	3.0%	3.0%	3.0%

Source: EY Economic Eye, UK ITEM Club

Inflation - strengthening real wages

An inflation target of 2% for price stability and to prevent the economy overheating has been the ECB and the Bank of England's (BoE) goal since 1998. ROI inflation is currently at 0.7% and has not been at 2% since 2012.

NI's headline inflation rate is not measured on a regular basis, but using overall UK inflation as a proxy, shows annual inflation of higher than 2% for the last 23 months, currently running at 2.1% for December 2018.

Despite low ROI, and modestly higher UK inflation, certain categories of inflation affect individual firms and households in very different ways. For example, housing and energy costs for ROI are rising at 4.6% in the year, 3.9 percentage points above the headline inflation rate. In contrast, falling food prices are providing increased spending power for ROI consumers.

UK housing costs are rising (+2.8%), but at a slower pace than ROI, while transport costs in the UK (3.4%) are rising 2.8 percentage points more than ROI (0.6%).

If headline wages are growing at 3.7% in ROI, but housing costs are rising by 4.6% and rent is one of the primary outgoing costs, then not all workers are seeing their real income rise. Lower food costs will be of particular benefit to lower income earners.

Consumer Price Index (annual % change)

Sector	ROI	UK
Housing, water and electricity	4.6%	2.8%
Alcohol and tobacco	2.8%	4.1%
Transport	0.6%	3.4%
Restaurants and hotels	2.1%	3.1%
Household furnishings	-3.5%	0.4%
Communications	-1.5%	2.9%
Food, non-alcoholic drink	-1.4%	0.7%
Total	0.7%	2.1%

Source: CSO, ONS

Note: Price growth from 12/2017 - 12/2018

2: Planning for uncertainty

Scenario modelling remains best approach

Is it possible to model Brexit?

Forecasting in the current level of unprecedented uncertainty is incredibly difficult for economists and their models. Some of the complications arise from the lack of clarity over Brexit and not knowing how businesses and firms will react. A lengthy list of publications have been produced already on Brexit impacts, and more will surely follow.

Various analysis techniques have been used to model the potential effects and there are debates as to how accurately certain behaviours can be predicted. Currency movements or migration effects are always difficult to project and even well-established techniques such as gravity models or the use of elasticities have been critiqued. It is not always clear in published estimates which approaches have been used and the extent to which the modelling incorporates all of the possible economic reactions.

Estimates published in late January by the Irish Government estimated the ROI economy would be 4.25% smaller in event of a no-deal situation by 2023. The report stressed the complexities in the modelling to arrive at the figures.

In addition, there is a significant focus on GDP in published impact reports, a valuable but rather abstract concept. An estimate that the economy will be 7% smaller in 2030 may excite economists, but it is not heavily used for businesses or relevant to the general public.

The value in scenario planning

All this complexity has led to a sense of fatigue around the validity of forecasts, but firms do need parameters to help them to scenario plan. To plan effectively, it is much wiser to look at the range of possible outcomes and how they might impact your business, than betting on a modelled outcome.

The potential for a more challenging economic outturn than the Economic Eye base case forecasts is clear. In addition to Brexit, there are other major threats, not least the possibility of a sharper downturn in global growth. The very different economic conditions across the two jurisdictions means that the short-term economic risks are more pronounced in NI than in ROI. Using the Economic Eye forecasting model, a weaker scenario has been constructed which encompasses a more fractious Brexit period.

Published estimates of GDP impact of Brexit – reduction in GDP (%) by 2030

Scenario	ROI	UK
EEA	-2.3 to -2.8	-1.4 to -3.75
FTA	-2.7 to -4.3	-4.9
WTO	-3.8 to -7	-7.6 to -10.5

Source: ROI - Copenhagen Economics, ESRI; UK - Bank of England, HM Treasury

The assumptions are as follows:

- ▶ Slower world growth, 1 percentage point lower than the central projection in 2019 and 2020
- ▶ A no-deal Brexit outcome with a move to WTO tariffs for the UK. This remains the prevailing condition in 2020 with no new trade deals explicitly modelled, reflecting the time delay in doing so
- ▶ A loss in UK confidence and retrenchment in spending (more formally, the savings ratio rises to 5%). This reflects the disruptive economic conditions, though it is worth noting that a retrenchment in consumer spending was always a major UK risk even in lieu of Brexit and global disruption

Results

- ▶ The results of the exercise produce a recession in NI and a marked slowdown in ROI. Collectively, GDP is 3.0% lower across the island in 2020
- ▶ Labour market reactions are more muted but still notable with NI falling 1.3% (11,000 jobs) and ROI 1.2% (28,000 jobs) compared to the base case in 2020
- ▶ The overall impact is lower than the impact produced by the Department for Finance. Likely factors for divergence are the greater level of absorption of labour into other sectors unaffected by Brexit and a boost to growth from some high value activities relocating to Ireland

A number of points are worth making from the analysis

- ▶ The ROI risks are predominantly external, stemming from a global slowdown. Domestic conditions are strong and likely to provide a short-term buffer to a slowdown (though rising costs are a domestic risk). This is due to the rate of job growth, low inflation and real-wage growth
- ▶ The job losses in ROI are limited, as other sectors absorb available talent, for example construction hiring agricultural workers. In addition, there will be jobs displaced from the UK, for example in finance, which provides a positive impact
- ▶ NI risks are both internal and external. The region is less impacted by global conditions than the ROI market, but consumers are in a more fragile position. Job growth is more modest, as is real-wage growth and the financial position of consumers is relatively precarious. With a falling currency in the scenario, imported inflation exerts downward pressure on consumer spending power
- ▶ Currency movements will have a considerable impact. A fall in Sterling (the model forecasts that the pound falls to €1.06) provides an offset to some of the potential trading losses as exports become more competitive. Service sector exports enjoy a currency boost (though the global slowdown in the scenario counterbalances this somewhat)
- ▶ The severity of slowdown in the UK is perhaps more modest than might be expected as economic performance is already weak in a number of areas. Investment is very low by historic standards and therefore only falls modestly. Equally, government spending is unlikely to fall for a range of political reasons. In fact, it may rise in an attempt to offset the slowdown (though this is not explicitly modelled)

ROI scenario results

	2019	2020	Deviation in 2020*
GDP/GVA (%)	2.5%	1.4%	-3.0%
Employment (%)	2.1%	1.1%	-1.2%

NI scenario results

	2019	2020	Deviation in 2020*
GDP/GVA (%)	-0.2%	-0.5%	-2.7%
Employment (%)	-0.8%	-0.6%	-1.3%

UK scenario results

	2019	2020	Deviation in 2020*
GDP/GVA (%)	0.7%	0.2%	-2.3%
Employment (%)	0.2%	0.1%	-0.9%

Source: EY Economic Eye scenario forecasting

* Deviation from 2020 Economic Eye, ITEM Club base forecasts

Economies recover and businesses respond

It is important to note that firms, and by extension the economies they contribute to, do not stand still when conditions change. Exchange rates move, people move to new locations and firms adjust their strategies and plans. Even in the harshest conditions, new opportunities are found and new businesses flourish.

Modelling a slowdown is helpful to think through the implications and establish reaction strategies, but the recent past warns against betting on an outcome built upon so many unknowns and interconnected effects.

It may seem unlikely at this time to consider a more positive outturn for the island than the base case, but it is worth remembering the GDP data in ROI, the composite index in NI for Q3 and the labour market data in both jurisdictions have outperformed expectations. The estimated economic outturn for 2018 has been revised up in both economies from the projection a year ago. Even in tough times businesses can surprise; a continuation of that trend would be very welcome in 2019/20.

3: Brexit

Implications already felt but real impact lies ahead

Given the ongoing uncertainty over the precise nature of Brexit on March 29, it remains challenging to attempt to measure the likely short-run impacts. As such, we have focused this Brexit update on the observable impacts to date and the actions firms are currently taking across the island.

It is certainly the case that the ROI economy is in better health than many predicted it might have been at this stage of the Brexit journey. The UK and NI position is more complex. Recent analysis by CITI on behalf of the Institute for Fiscal Studies (IFS) suggest that the overall position of the UK economy is about where post-referendum forecasts predicted, but the pattern has been different to what was expected. The report contends that economic growth did not fall sharply and then rebound slightly in the immediate aftermath of the vote as had been predicted, but the overall impact is roughly as expected. The analysis suggests that UK GDP is therefore below the projected position had the UK not voted to leave (almost 2% lower according to CITI).

There is an argument to be made that the pre-referendum forecasts were optimistic. Forecasts from most organisations had UK growth picking up towards a longer-term trend and the history of the last decade must at least raise a question mark about this assumption.

UK problems cannot all be traced to Brexit

Examining UK annual growth rates reveals a number of weaknesses that pre-date the referendum vote. Compared to the long run pre-referendum trend, GDP, employment and productivity are very similar to current growth rates. Looking at a shorter time period, pre and post the vote, there are more notable differences. Investment is markedly lower, as is government spending, while employment growth, though still strong, has halved. Consumer spending is, perhaps surprisingly, higher but exports and imports have both slowed. Perhaps the more significant issue is whether the changes that are happening that are too small to impact on the headline data will have a bigger effect in the future. For example, the finance jobs that have moved from London and the European Medicines Agency's move to Amsterdam may be small in scale but their impact may well be more profound.

A further area of economic impact has been on the level of savings which has fallen on the back of the vote, as consumers face higher prices due to the higher cost of imports.

Looking back at previous Economic Eye reports, it is important to reiterate that difficulties in the UK economy were identified long before the Brexit journey began. As such, the case could be made that slow growth was on the cards regardless of the vote outcome.

The ability to pick out a so-called 'Brexit effect' is even more challenging in the labour market, which shows little discernible Brexit impact at this point.

Long run UK growth rates

Component	CAGR 2000-2016	CAGR 2010-2016	CAGR 2016-2018
Consumption	1.8%	1.6%	2.1%
Government spending	1.9%	0.9%	-0.1%
Investment	0.7%	4.6%	0.9%
Exports	3.0%	2.9%	2.0%
Imports	3.2%	2.9%	2.4%
GDP	1.8%	2.0%	1.7%
Employment	0.9%	1.5%	0.7%
Productivity	0.9%	1.4%	1.0%

Source: ONS

Note: 2000 Q2, 2016 Q2 and 2018 Q2 data used

One of the major consequences of the UK avoiding a sharp contraction after the vote has been a loss of confidence in economic predictions. It is clearly the case that the forecasting of the immediate vote aftermath was wide of the mark. However, this may be leading to insufficient attention being paid to the adverse effects that may stem from a no-deal outcome. From the public's point of view, the tight labour market has reduced the feeling of a demonstrable Brexit effect. It is hard to imagine that UK employment would have been much higher had the UK voted to remain.

Ireland's boom makes Brexit effect hard to spot

For ROI, a demonstrable Brexit effect is harder to identify. With ROI growth currently so strong, headline data shows no break in trend after the referendum. ROI investment figures and import data are complicated by a range of issues including the allocation of IP, aircraft leasing and contract manufacturing, among others.

Similar to the UK, there is no post-Brexit vote shift in labour market trends either. The impact of a depreciation of Sterling has clearly been felt in parts of the economy, but sufficiently offset by growth elsewhere. Clearly for individual firms, the impact may have been acute, but as with the UK, there may be insufficient concern over no-deal consequences due to current strong performance.

Are firms ready?

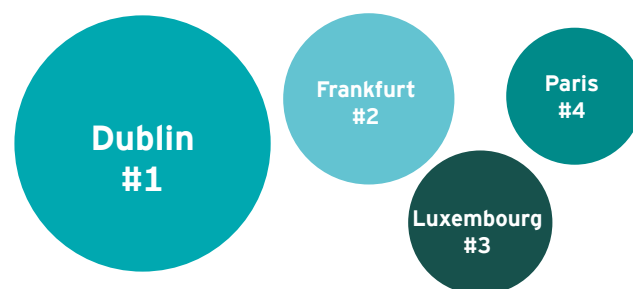
Thankfully, the relatively small number of reported business closures is a stark reminder that the aggregate data will never fully depict the individual or personal impacts that macroeconomic shifts can have. The aggregate data is simply the total effect of all the individual firms, people and governments' decisions. At a firm level, the reaction to Brexit was understandably circumspect at first. The continued lack of clarity is preventing firms from fully shifting their strategies. Pausing on investment decisions, at least in the UK, appears to be one clear Brexit impact, but survey data is more complicated.

The latest InterTradelreland all-island Business Monitor reveals a pattern of firms remarking that Brexit has been damaging, but still reporting strong performance figures and expectations within their own business. The number of firms reporting that they have a clear Brexit plan has been ticking upwards since the referendum, indicating an increased level of readiness. Currently close to a quarter of NI firms and just over 10% of firms in ROI have or intend to have a Brexit plan in place, according to InterTradelreland. While this number is still alarmingly low, for many businesses Brexit it is just one risk of many to consider as part of a wider strategy.

There are impacts of Brexit that can be observed behind the headlines. For example, the EY Financial Services tracker of major financial firms in London shows that 30% have relocated at least some people or activity as a result of Brexit, with Dublin being the most popular location. With 70% of firms still to make any move, there is the potential for more turbulence ahead.

EY Financial Services Brexit relocation tracker

Most popular destinations for companies who have confirmed plans to relocate:



Brexit not the only risk

The immediacy of needing sufficient talent to meet current demand, coupled with the worries over lagging global growth and skittish stock markets mean that there are plenty of challenges to face on the island of Ireland. Brexit does not have a monopoly on the risk conversations.

The UK and ROI Governments are hard at work preparing for all Brexit eventualities. In the case of ROI, the overall health of the economy means that it is well placed to face the challenges ahead. There is financial capacity to intervene and support particular sectors that may need transitional help in the event of an adverse Brexit, though EU law does limit what can be done, unless derogations and exceptions can be agreed.

Things are less favourable in NI, where the lack of an Executive and Assembly curtails the ability to respond with specific measures if required. The restrictions on what the Civil Service can and cannot do, may also need to be considered in the case of a disorderly Brexit.

Brexit

Brexit - not the answer to every question

Brexit is everywhere, appearing in every economic commentary report and a significant proportion of business headlines across the island. This is not surprising, given the profound nature of what is about to happen.

However, care must be taken not to make Brexit the answer to every question. It cannot be cited as the reason for all recorded weakness or underperformance. Frequently the UK's sluggish economic growth is referenced as being directly linked to Brexit, but the UK's economic difficulties had their roots long before the Brexit journey began.

The evidence of the long-term problems is clear when looking at the UK's trade deficit, the precarious nature of the public finances or declining productivity performance. That is not to say Brexit is not impacting, but misdiagnosing it as the cause of all ills will be hugely damaging in trying to find solutions. This misdiagnosis is less likely in ROI, where exceptionally strong growth means that there are less instances of underperformance in need of explanation.

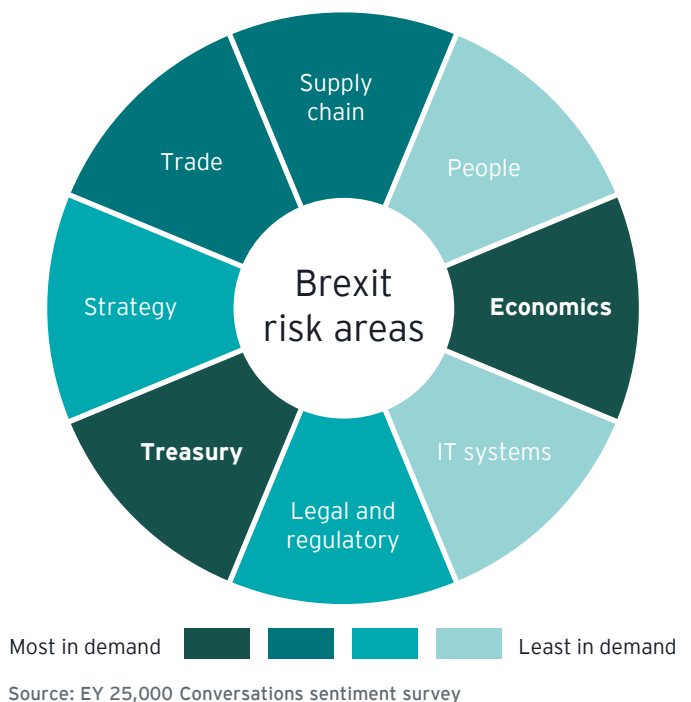
There are broader trends afoot that are impacting demand and they need to be fully considered. Would the car industry be facing challenges if urbanisation and public transport investment accelerate and attitudes to diesel change? Would high street retailing be facing challenges from the move to online shopping? Undoubtedly the answer to both of these questions is 'yes'.

It is tricky to unpick what is Brexit related and what is not, but the advice should be to think critically when reading the line 'due to Brexit', or pause when considering it as a reason for firm level underperformance. It is clearly a factor in much of what we observe in the all-island economy, but it is not the only one. Its overuse diminishes the possibility of finding an effective solution.

EY's most in demand Brexit-related services

EY's Brexit team, led by Partner Simon MacAllister, has experienced a range of demands from clients to help navigate the Brexit journey. The demands are constantly changing, with the focus shifting from month to month.

The diagram below depicts our engagement wheel and the colours depict which engagements are most in demand at present. It continues to be the case that Brexit preparation is rarely wasted, as the exercise usually unearths changes that are worth making, regardless of the final Brexit outcome.



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Brexit continues to be the great ‘known unknown’ for firms, with great uncertainty remaining over the manner of the UK’s exit from the EU. Planning has stepped up in recent months across most businesses, but as yet firms are wisely avoiding placing any large bets on a particular outcome. There has been an acceleration in the demand for support to get ready for the day one implications of a no-deal, for example, customs paperwork support or logistics advice.

With the economy, particularly in ROI, at a relatively high point in the cycle, it is at least a more positive time to face the challenge of Brexit than might have been the case.

Simon MacAllister
Partner and EY Brexit Lead

4: Constructing a better future

By Annette Hughes, Director,
EY-DKM Economic Advisory Services



Annette is a Director in EY-DKM with over 25 years' experience in the construction and property sectors. She is the Irish member of the Euroconstruct network.

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The need for infrastructure investment across the island is well understood, but the importance of the construction sector workforce is sometimes forgotten.

Infrastructure need now accepted

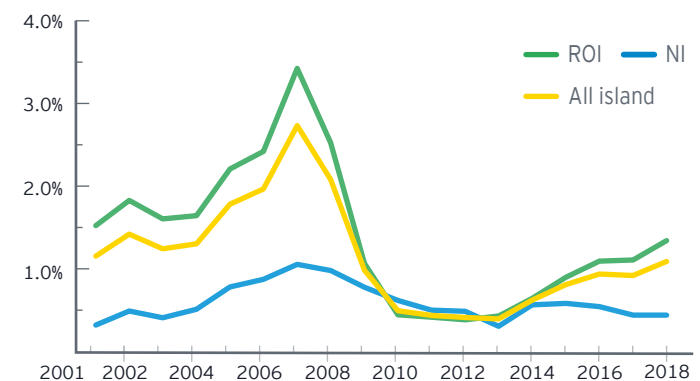
The need for high quality economic and physical infrastructure to enable economies to operate efficiently has been well established in economic literature. Businesses, suppliers and workers require efficient access in terms of our transportation networks; our population centres need fully functioning water supply and wastewater systems, as well as access to a high quality broadband network; an expanding economy keen to attract high value jobs requires a best in class educational infrastructure, from primary through to post-primary and third level; and our expanding population requires a first class health infrastructure.

For policy makers in ROI and NI, the objective has to be to ensure the right amount of economic and physical infrastructure is provided at the right time, when it is needed, and at the right price. A number of challenges arise in doing so, notably population growth and capacity issues. The required infrastructure also needs to be delivered while paying due attention to the environment and meeting climate change targets. A further complexity is the economic cycle and how infrastructure spend is treated. It is often treated like a tap that is turned on when the financial position allows, and off when it does not. This means it is often the first area of spending to be cut in a slowdown and it therefore has a more boom and bust lifecycle than other areas of public spending.

Infrastructure underpins economic growth

The demand for infrastructure is positively correlated with increased economic activity and population growth. The population on the island is currently 6.7m, following an annual average population growth of 0.7% over the past decade. In the labour market, job growth has been faster in ROI since 2012, partly reflecting the depth of the recession, but both economies have enjoyed a strong job creation record over the last three years.

Average annual population growth 2001-2018



Source: CSO, NISRA

The growth in employment over the past decade has been equally modest, reflecting the crisis post-2008, although a jobs recovery commenced in early 2012. Total employment expanded by 2.5% since 2008, with an additional 77,000 people at work by 2018. However, the recovery in the jobs market since 2012 led to an additional 487,000 jobs being created on the island in the last six years, with ROI accounting for around 8 out of every 10 jobs created over that period.

Total employment growth 2008-2018 (000's)

	2018 Q3	Growth since 2008*	Growth since 2012**
ROI	2,273	2.9%	22.0%
NI	878	1.6%	9.7%
All island	3,151	2.5%	18.3%

Source: CSO, NISRA, *2008 Q3 - 2018 Q3, **2012 Q1 - 2018 Q3

It is expected that there will be an additional 500,000 people living on the island by 2029. Recent history tells us that the population estimates may be conservative. ROI's net in-migration in the year to April 2018 (+34,000) was already above the upper CSO population projection. This population growth, combined with an ageing population, will mean an increased requirement for economic and physical infrastructure to ensure the economy can function efficiently. More people will mean more residential and non-residential (e.g. schools and healthcare) buildings, as well as more and better water and wastewater infrastructure and increased investment in energy, road, rail, airports, ports and telecommunications networks.

Actual and projected average annual population growth, 2019-2029 (000's)

	2019e Population (000's)	2019-2029f* (000's)
ROI	4,896	425.6
NI	1,888	68.5
All island	6,784	494.2

Source: CSO, NISRA

Note: e = estimate, f = forecast. *CSO M2F2 scenario - Assumptions: M2 = Moderate net inward migration 20,000 per annum; F2 = Total fertility rate decreases to 1.6 by 2031 from 1.8 in 2016.

Contribution of the construction sector to economic activity

Before looking at the public sector contribution, the size of the respective construction industries in each jurisdiction gives a sense of the role that construction plays in providing housing, non-residential buildings and civil engineering structures to sustain economic growth. Construction in both NI and ROI accounts for 7% of GDP (2017). However the total output per capita in ROI is over twice the level in NI. There is a substantial difference in the level of non-residential construction and infrastructure put in place, much of which would be funded by the public sector. This difference may be attributed to the fact that the private commercial and FDI sectors have been exceptionally strong in ROI over the past five years, having recovered from a very low base.

Value of construction output in ROI and NI, 2017 (€)

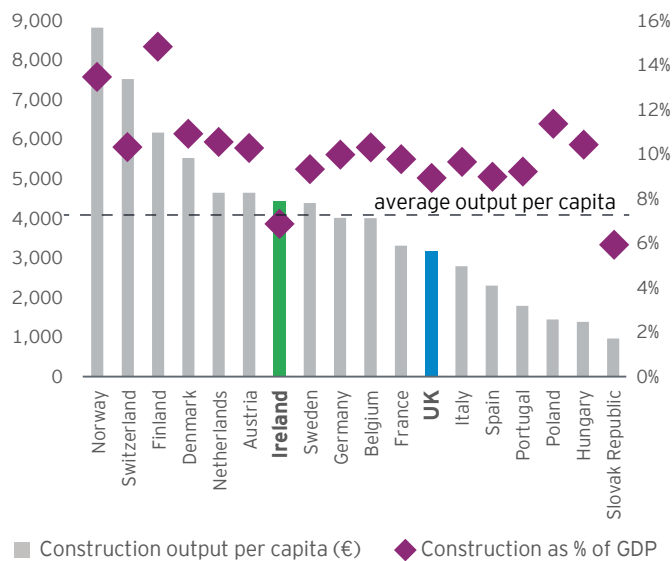
	Total output	Output per capita	Construction as % of GDP
ROI (€m)	20,616	4,302	7.0%
NI (€m)	3,457	1,848	7.0%
ROI : NI	6	2.3	

Source: CSO, NISRA, latest actual data available

2018 estimates from Euroconstruct show that the ROI construction sector ranks 7th out of 19 Western and Eastern European countries in terms of construction output per capita, while the UK ranks 12th, just below the average. NI had output per capita of €1,848m in 2017 and construction was 7.0% of GDP, meaning that it would likely sit at the lower end of the Euroconstruct chart for 2018. Given the scale of investment planned in the National Development Plan (NDP) in ROI, the expectation would be that the level of output per capita could approach the levels of the Scandinavian countries. However, much will depend on the construction industry having the capacity to deliver the projects in the NDP on time and within budget, without damaging cost competitiveness and overheating the economy. It will also require adopting a more long-term view of the sector's importance to avoid a marked slowdown when the next period of low growth is encountered.

Constructing a better future

Euroconstruct area – construction output per capita and as % of GDP, 2018 estimates



Source: Euroconstruct, November 2018. www.euroconstruct.org

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The increased prominence of infrastructure in policy documentation is encouraging, but the true test will be when the economic cycle is less favourable.

The investment need

One of the legacy impacts of the post-recession era of lower infrastructure investment is the existing quality of the physical infrastructure. It is well below what is required for both jurisdictions to realise their economic and social policy vision. The impact could potentially be hugely damaging in a number of areas, not just for competitiveness levels and business performance, but for quality of life and safety. For example, the ability to supply clean water and energy are areas of critical concern. The current infrastructure is barely sufficient to meet current demand, let alone expected future demand, and the cost of repairs is constantly climbing.

In other areas, such as transport or broadband, the impact may be more subtle but no less damaging, reducing quality of life for citizens, hampering business performance and the island's attractiveness as an investment location. Given the lead time in infrastructure delivery, a deficit can be extremely hard to recover from and the consequences can be damaging for a generation. The policy priority afforded to infrastructure in both jurisdictions is encouraging, but it will be in tougher economic conditions that the commitment to this priority will be demonstrated.

There are numerous areas of infrastructure under extreme pressure across the island. Water and sewage systems are operating above recommended capacity levels, commuting times are growing and the energy grid is not currently ready for the transition to an electrified transport system. There are numerous public service buildings that are no longer fit for purpose and gaps in transport connectivity and broadband coverage are other factors that are detrimentally impacting upon competitiveness.

Beyond the economic impact, there are societal, environmental and quality of life costs being incurred due to the current position. In the context of fast growth, and therefore increased pressure, the need for increased investment is increasingly apparent to all.

Housebuilding - a more pressing issue in ROI

The Government's main priority in ROI is now addressing the housing crisis. The housing challenges are wide ranging, encompassing a lack of housing supply, an escalating homelessness problem, a social housing waiting list with over 100,000 households, rising demand across all tenures, house price inflation and private rental levels which have already exceeded previous peak levels in 2007. Issues such as the supply crisis and the rising cost of accommodation are key concerns for competitiveness. The affordability issue could also impact ROI's ability to attract and retain FDI and the much needed skills and talent required to sustain economic growth.

There were just over 14,000 new dwellings completed in ROI in 2017. The corresponding figure is expected to be 19,000 for 2018. These levels of supply are substantially below what is required to accommodate indigenous demand and population growth. Assuming existing constraints can be addressed, in terms of planning and viability, the level of new housing delivered is expected to increase further to 24,000 in 2019 and 28,000 in 2020. ROI's population is expected to expand by around 425,000 by 2029, and housing demand could potentially reach 35,000 to 40,000 per annum.

There were 6,880 dwellings built in NI in 2017, less than half the corresponding figure in ROI. However, in 2014, the level of new dwellings was close to 5,500 in both jurisdictions. Yet both ROI and NI are building around four dwellings per 1,000 of the population, down from almost twice that level in ROI in 2008.

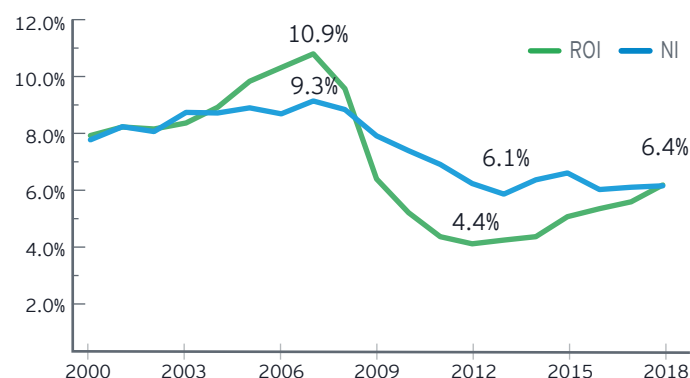
Construction capacity - employment

The cyclical nature of the construction industry consistently gives rise to a discussion about the capacity of the industry and the sector's ability to deliver over the coming decade. A key challenge for the construction market is the availability of workers from elementary construction occupations, to qualified skilled craft workers, operatives, technicians and professionals. More work needs to be done to promote a greater awareness of opportunities available through trades and encourage more apprenticeship opportunities. There are also reported to be difficulties sourcing specialised and experienced workers to meet the demand for renovation work in the regions.

This reflects where the industry has come from, with the stark boom and bust journey in ROI in particular creating a number of legacy issues for labour supply. Having lost close to 150,000 workers over the five years 2007-2012, the sector has only recovered by 58,000 jobs in the last five years. Although 2007 was not a level that is expected to be repeated, employment in the sector is still well below where it needs to be. With the value of construction output in ROI projected to increase to around 10%-12% of GDP from 7% currently (c.12% of GNI*), the skills deficit needs to be addressed, or the cost base in the industry will become uncompetitive.

There are almost 56,000 people employed in the NI construction sector, which is around 40% of the numbers employed in the ROI. Construction employment as a percentage of total employment is broadly similar in both jurisdictions, having fallen since their 2007 peaks. Similarly, the numbers employed per 1,000 of the population are similar in both jurisdictions, albeit the figure reached for ROI rose and fell drastically with the economic cycle.

Construction as % of total employment



Source: CSO, NISRA, *2018 = 2018 Q3

Constructing a better future

Construction costs and tender prices

Average annual earnings (all workers, including part-time employees) in construction in NI are currently higher than the average across the economy as a whole (+6.2%), while the gap is lower in ROI (+2.9%). Construction earnings are growing faster in NI than in ROI, while earnings across the economy are growing at a similar rate in both jurisdictions. This is despite the introduction of the Sectoral Employment Order (SEO) in ROI in October 2017 which increased pay rates for general craft workers and plumbers by approximately 10%.

There has also been a rise in tender prices, which can be attributed to the increase in demand and the limited resources. Construction price inflation in ROI is evident from the rate of tender price inflation, currently estimated at 6.5% on average in 2018, (Aecom, 2019). However the significant increase in activity in the Dublin region has led to average tender price inflation of 7.5%, with some high profile projects recording rates above this level. The risk in regard to cost escalation on public sector projects is that other projects may be postponed or cancelled due to constraints on funding. However, in recent years, other factors, notably new regulations and industry standards are adding to the building cost base.

Average annual earnings in construction, 2018, €

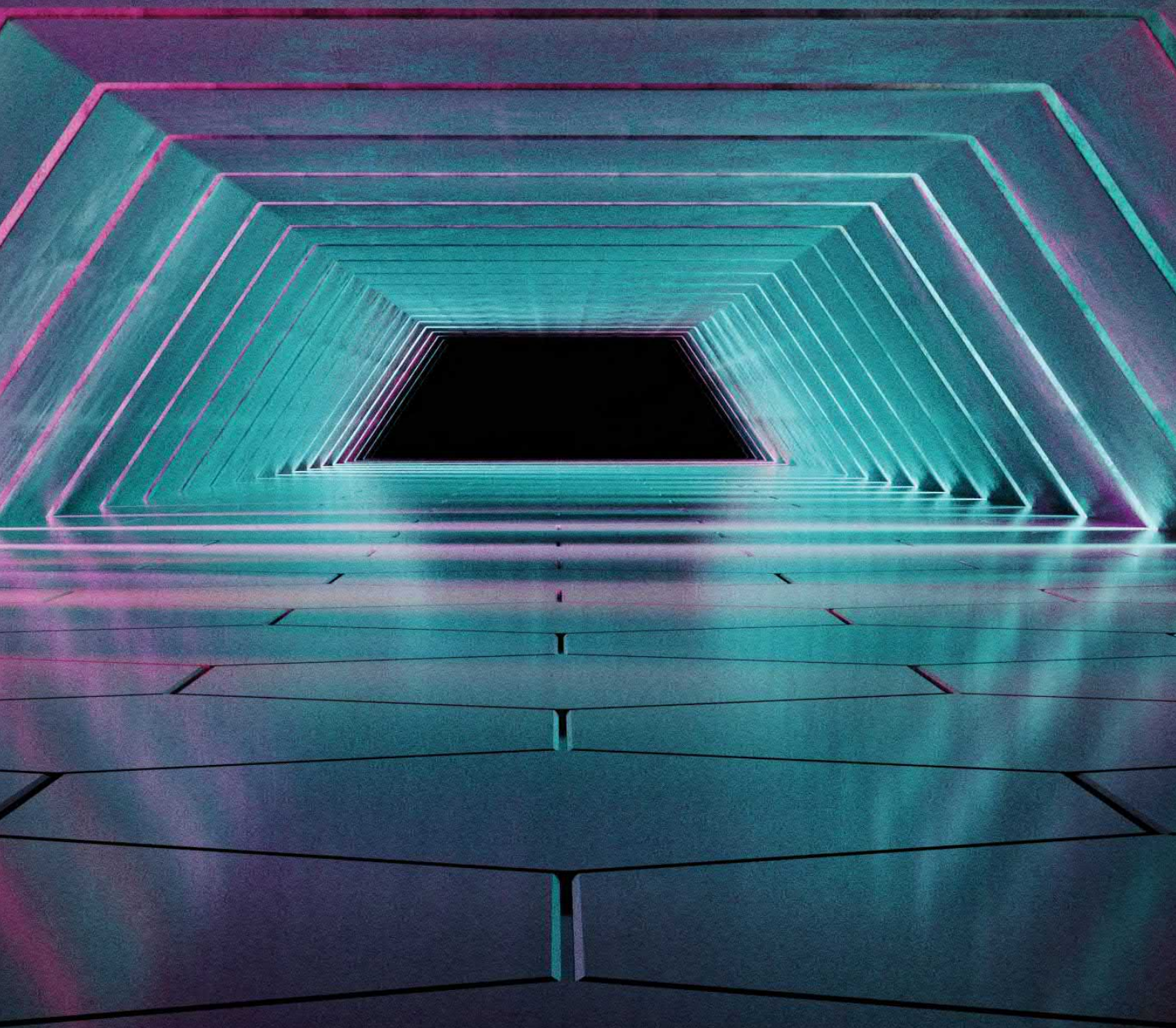
	ROI (€)	NI (€)
Whole economy	38,520	29,550
Construction	39,630	31,380
Construction premium	2.9%	6.2%
Annual % growth		
Whole economy	2.9%	3.8%
Construction	3.2%	5.4%

Source: CSO, seasonally adjusted annual growth based on four quarter average to Q3 2018; NISRA ASHE, average annual growth to latest available data, April 2018. Exchange rate as of 23/01/19

Construction - the foundation of the island's future

The analysis of infrastructure across the island and the construction sector which ensures its delivery and maintenance, reveals a crucial sector that perhaps does not achieve the attention it warrants. The role of infrastructure in underpinning economic success and influencing productivity levels is becoming more widely accepted, but the construction sector is rarely a focus or key sector in economic strategies and visions. Yet without it, there are no quality buildings to deliver the public services that our citizens value most and our ability to get to work and to connect with others would be lessened.

The recent past shows a challenging journey for the sector with an unhelpful boom followed by a devastating crash, the scars of which are still visible today in the sector. If it is accepted that infrastructure is a policy priority, then perhaps the workforce needs greater attention. Ensuring a less volatile construction pipeline, moving slowly towards a more countercyclical spending policy and taking a non-politicised view of project prioritisation are just a few of the ways in which the delivery of quality infrastructure could be improved. Realising the island's economic and social promises requires world class infrastructure and the construction sector is therefore at the heart of the island's future.



5: Risk register

25,000 Conversations Survey finds talent and Brexit top of the risk register

Key risks identified

Brexit

Finding talent

Rising salary costs

Competitiveness pressure

Increased compliance

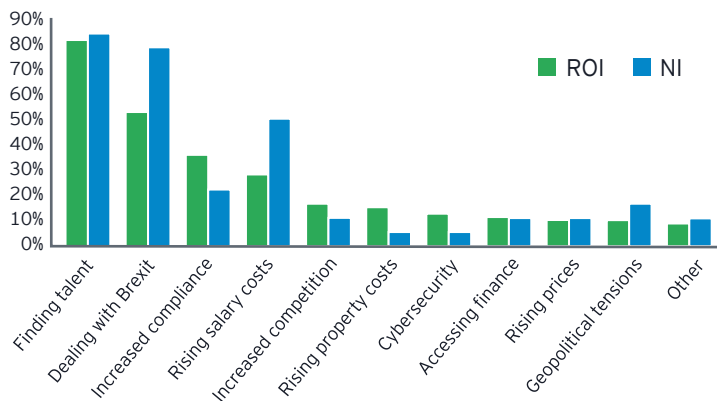
Busy in the face of risks

Translating economic risks into actionable business responses is complex and often falls behind dealing with ‘next day’ problems. Our clients span a range of locations, sectors and sizes, meaning that their exposure to different risks varies greatly and generic solutions are not applicable.

EY’s new survey of our 600 Senior Managers, Directors and Partners on the island of Ireland is designed to gather insight into current business conditions and firms’ views of risks, opportunities and priorities for the year ahead. It reflects the views gathered from over 25,000 senior business conversations each year.

The results reveal a remarkable level of optimism across our clients. Only 3% of respondents described their clients’ current mood as ‘concerned’, with none taking actions such as staff layoffs or divestment. Three-quarters of respondents reported that their clients felt either positive or confident, are either in steady growth or expansion mode and are winning new work and hiring new talent. It is encouraging that risks are being viewed with an upside lens; clients are aware of them, but with careful planning, they are being used to sustain and accelerate growth on the island.

What are the most significant challenges your clients are currently facing?



Source: EY 25,000 Conversations sentiment survey

Brexit

The 25,000 Conversation Survey's findings are in line with EY's Fast Growth Tracker, which surveys start-up executives and founders in the UK. It found that an overwhelmingly positive outlook is prevailing; over half of entrepreneurs anticipate revenue growth in excess of 50% this year, with a correspondingly strong appetite for funding to match this. Two-thirds expect to raise capital this year.

Asked whether Brexit concerned them, 58% of respondents cited having other more pressing concerns, while only 18% viewed it as their biggest risk. Clearly Brexit is being discussed in the boardroom – but it is just one risk on a list of many that firms must navigate.

Finding talent

Talent shortages and Brexit are the two most commonly cited challenges facing clients across the island, as they were in our last report. Given the current stage of the business cycle as identified by respondents, in which firms are steadily growing or accelerating pursuit of new business, it follows that they must find the talent to facilitate this. With demand outstripping supply, talent shortages are an inevitable consequence, exacerbated by a tightening labour market.

Rising salary costs

A key risk emerging from the survey is rising salary costs. This was experienced across both jurisdictions, though, perhaps surprisingly, was more frequently cited in NI. Higher inflation is putting upward pressure on wages and the tight labour market plus emerging evidence of less access to EU labour supply perhaps explains this finding.

Investing in existing staff and ensuring high retention levels should be at the top of business agendas given the talent challenges. In NI, 83% of respondents reported finding talent as one of the top three challenges facing their clients, but only 44% cited 'investing in recruiting and training staff' as one of the top three opportunities their clients were focusing on. This suggests a sluggish response to implementing an effective strategy to resolve the challenge.

Competitiveness pressures

When considering why addressing certain risks is so critical, the threat they pose extends outside the individual firms. For example, we must consider what makes a competitive economy. For ROI, its highest rankings in the World Economic Forum (WEF) 2018 Global Competitiveness Report are its labour market, dynamism and skills, placed 7th, 10th and 15th globally.

ROI has a young, highly skilled labour force, which draws on a large, (well-educated) migrant workforce (though measures of education performance do suggest weaknesses). It is vital that ROI continues to attract new talent and retain its domestic workforce. However, rising living costs, namely accelerating property costs, is increasingly becoming a disincentive for both domestic and foreign workers considering ROI as a destination. This is exacerbating talent shortages and increasing wage pressures.

If ROI is struggling to accommodate the current workforce, there is much work to be done if the nation is to capitalise on any Brexit-related relocations from the UK. It is encouraging to see infrastructure and housing increasingly prioritised in government policy.

A finding from the 25,000 Conversations Survey was that firms are struggling to staff teams in Dublin as their employees are reluctant to move to the city, citing the lack of affordable accommodation.

This means that even higher wage premiums for Dublin, or accommodation advances/allowances will need to be offered to attract key staff, further adding to wage pressures. This is not a new problem – 85% of our Dublin respondents cited physical infrastructure as their clients' public spending priority. This echoes the WEF 2017-18 finding that the inadequate supply of infrastructure is the most problematic factor for doing business in ROI.

Frustratingly, this is to a certain degree outside the control of firms seeking to attract talent. However, a firm's brand and working environment are non-price tools which can be used to differentiate from rivals and appeal to the changing preferences of the emerging workforce. This is true across the island in the face of rising salary pressures.

Risk register

According to the WEF report, the UK ranks well in innovation ecosystem, markets, enabling environment, but ranks lower than ROI for human capital. According to a 2018 study by Powwownow, around 75% of UK employees claimed that flexible working would make a job offer more attractive to them, with a third preferring this to a pay rise. This is unsurprising given the increased focus on quality of life. Despite the OECD ranking NI last out of the 12 UK regions for income and 11th for housing, it was ranked 2nd for life satisfaction. People's priorities are changing, and firms who accommodate and nurture this will have more success in their hiring and retention efforts.

Competitiveness – the four components

ROI 23rd overall

Human capital 16 th	Innovation ecosystem 20 th	Markets 26 th	Enabling environment 28 th
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UK 8th overall

Human capital 18 th	Innovation ecosystem 4 th	Markets 4 th	Enabling environment 11 th
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Source: WEF Global Competitiveness Report, 2018

Increased compliance

Several risks are universal across sectors, such as Brexit-related uncertainty or salary pressures. However, the degree to which certain risks weigh on business leaders' minds are somewhat dependent on the particular industry or sector in which they operate. One such issue is compliance and the growing burden that increased regulation represents in the financial services and banking sectors, which emerged as an issue in both the Dublin and Belfast cohorts of the 25,000 Conversations Survey.

Wider analysis shows that this risk emerges both independently, and in conjunction with Brexit. The 9th annual Global Bank Risk Management Survey, published by EY and the Institute of International Finance in December 2018, explores the issues facing banking institutions, drawing on 74 firms across 29 countries. 56% of respondents contended that they would be directly affected by Brexit; of these, half expected risk management compliance to increase.

This preoccupation with compliance corresponds with the concern surrounding GDPR data protection and transfer legislation. The UK is currently GDPR compliant since the legislation's introduction in May 2018, but at the time of writing, it is not known whether this will remain the case post-Brexit, or whether it will be deemed to be outside the regime altogether (a third-party country). In a no-deal scenario, it is a very real possibility that the UK will not be granted adequacy status and therefore would not be GDPR compliant.

Turning to the wider question of the most prevalent risks emerging over the next five years in the banking sector, 79% of all respondents cited 'integrity of data and data destruction'. This makes it the top issue weighing on banks' minds, tied with technological disruption. Therefore, independent of Brexit, data compliance and security concerns are mounting, meaning that a key risk mitigation strategy for all firms – and not just those in the financial services sector – is to ensure a compliant, streamlined and transparent approach to collecting, processing and storing data.

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Talent is emerging as the number one risk for businesses across the island, even pushing Brexit into second place. Businesses realise that having the right people can help tackle many of the other risks and turn them into opportunities. The potential afforded by advances in technology, or that emerge from periods of uncertainty, can only be harnessed with the right staff.

Increasingly, risks are hard to isolate and solutions cut across technology, people and strategy. Our survey shows that these risks are shared across the island despite the economic differences.

Michael Hall
Head of Markets, EY Ireland

6: Opportunities

Cost saving joins innovation and technology in perceived opportunities

Key opportunities

**Improving
efficiency**

**Innovation
in offering**

**New
technology**

**Increasing
market share**

M&A

Opportunities to be found despite the risks

Dwelling exclusively on the challenges and risks can be unhelpful. There are always possibilities to evolve, streamline and innovate and the evidence shows that this is happening across the island. Our EY Ireland Entrepreneur of the Year Survey highlights that entrepreneurs see an opportunity in almost everything, even issues that most others see as risks. The automation of certain professions has created a lively debate, disappointingly the focus is often on the potential for jobs to be lost. Digitisation and harnessing the potential of new technology has the power to greatly enhance productivity and ensure that resources, including highly skilled talent, are utilised more effectively.

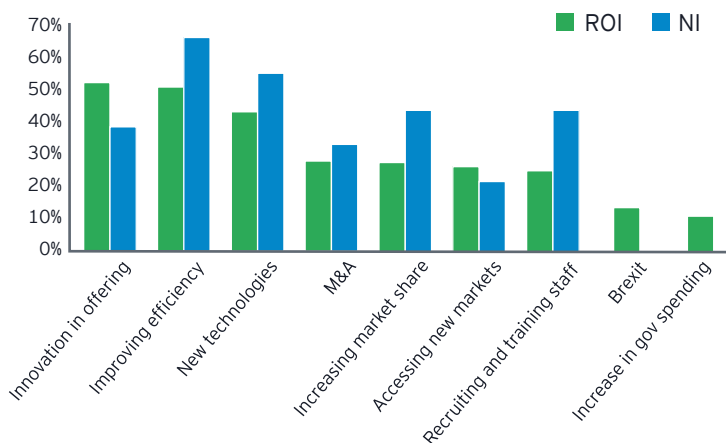
These themes are emerging from our client conversations, with the top three opportunities discussed relating to technology, improving efficiency, innovation in product and service offering and unlocking the potential of new technologies. It is encouraging that technological potential is being viewed as an opportunity by clients, and not regarded with unease.

Improving efficiency makes an interesting return towards the top of the opportunities list. After a period of aggressive cost-cutting post recession, firms had eased back on efficiency drives, largely feeling that there was little more progress that could be made. It is revealing that this is now back towards the top of the agenda. Sparked perhaps by new technology options, firms are once again looking at ways to streamline and to seek out more efficiency. This offers huge potential to providers of digital and innovative solutions that can help to reduce costs. Tighter labour markets and rising staff costs are further factors in this being elevated in the opportunities list.

A resurgence in efforts to improve efficiency reflects both the prevailing labour market conditions and the new potential offered by technology. This journey will create considerable business opportunities, but firms must engage fully with staff along the way.

If engagement is poor, the process can be viewed purely as a route to reduce headcount, a trend which can materially affect workers' willingness to spend, and thus impact the wider economy.

What opportunities are identified by clients?



Source: EY 25,000 Conversations sentiment survey

7: Key business and policy messages

Businesses - seeing past uncertainty

Uncertainty is usually considered unwelcome for businesses, but it also presents opportunities. For firms across the island, a potentially disruptive 2019 cannot lead to paralysis or caution. Our key messages for 2019 are:

Risk and response

Businesses need to identify all of the risks they face and have a mitigation strategy in place. Brexit is just one of the risks and requires consideration, but care must be taken not to focus too narrowly on one issue.

Talent and technology

The constantly evolving battle for talent is well known and firms are actively considering ways to respond. Increasingly, bringing this conversation together with the technology and innovation debate can unlock new solutions. Finding new people, investing in new ways of working and retraining staff into new areas can reap significant reward.

Know your competitors

In times of heightened uncertainty, and when access to talent is at a premium, the impact on competitors can be significant. There can be the potential to capture market share or perhaps explore merger or acquisition opportunities. This is often because prevailing conditions can edge many firms towards a more conservative mindset.

Efficiency and costs to the fore

After slipping down the corporate agenda when the economy was in the foothills of the economic recovery, rising costs are bringing back a focus on efficiency. Similar to talent, this can benefit from conversations that involve embracing the potential of rapidly evolving technology. Equally, revisiting property or locational strategies can be part of a refreshed review of costs and efficiency.

Creative solutions to challenges faced

Whether it be Brexit, talent shortages or costs, there are innovative solutions that can be considered. The use of managed services or flexible employment contracts can help with cost-reduction strategies and increased volatility. Agile firms can switch markets or product mix quickly in response to shocks or demand shifts, and this drive for reactivity is increasingly a focus for larger firms. The range of options available to firms to meet their challenges is evolving, looking at what was done before is not sufficient.

Policy - thinking long

The policy environment is understandably distracted by the Brexit debate. Resources and effort are being exerted in both jurisdictions to think of possible solutions to a range of potential difficulties and to develop a raft of contingency plans. There will be a number of benefits that will fall out of this effort regardless of outcome, but there are likely to be other policy areas starved of much needed attention and effort.

Critical for the island economy is to think long term, to see beyond the Brexit problems and focus on what delivers the economic and social vision that citizens want. This may mean considering the balance of social, economic and environmental goals, perhaps adopting a more holistic view of the future citizens want to live in. This may even mean less of a focus on 'more' and more on 'better'. A focus on quality of life measures, not purely how much more growth can be achieved, could be beneficial.

People and place are the foundations of economic success and ensuring the appropriate investment for both is essential. The renewed policy focus in both economies on infrastructure is welcome and necessary, but the true test of the commitment will come when the economy enters its next period of slow growth or contraction.

Looking beyond Brexit, there is work to do in both economies, but the economic data is a reminder of the talent and capability already present throughout the island. A return to a devolved government in NI remains a priority, and then perhaps both economies can begin to look longer term and seek out the opportunities that lie beyond Brexit.

8: Forecast tables

February 2019

ROI

	Consumption	Government spending	Investment	Exports	Imports	GDP	Jobs	Modified domestic demand
2016	4.0%	3.5%	51.7%	4.4%	18.5%	5.0%	3.6%	5.6%
2017	1.6%	3.9%	-31.0%	7.8%	-9.4%	7.2%	2.9%	3.2%
2018	3.1%	4.4%	3.6%	8.1%	3.5%	8.3%	3.1%	4.2%
2019	2.9%	3.0%	6.0%	5.1%	5.4%	3.9%	2.5%	3.7%
2020	2.7%	2.9%	5.5%	4.8%	5.4%	3.2%	1.9%	3.5%
2021	2.3%	2.3%	5.2%	4.7%	5.3%	3.0%	1.7%	3.2%
2022	2.2%	2.1%	4.5%	4.7%	5.2%	3.1%	1.6%	3.0%
2023	2.1%	1.9%	4.2%	4.4%	4.8%	3.1%	1.5%	2.8%

UK

	Consumption	Government spending	Investment	Exports	Imports	GDP	Jobs
2016	3.1%	0.8%	2.3%	1.0%	3.3%	1.8%	1.7%
2017	1.8%	-0.1%	3.3%	5.7%	3.2%	1.7%	1.0%
2018	1.6%	-1.4%	0.2%	-0.1%	0.6%	1.4%	0.5%
2019	1.5%	2.1%	1.1%	2.8%	3.2%	1.5%	0.7%
2020	1.7%	2.5%	2.5%	3.1%	2.9%	1.7%	0.5%
2021	1.8%	2.1%	2.2%	3.5%	3.4%	1.8%	0.5%
2022	2.1%	1.2%	2.9%	3.8%	3.8%	2.0%	0.5%
2023	2.1%	1.2%	3.0%	3.8%	3.7%	2.1%	0.5%

NI

	GVA	Jobs
2016	1.7%	2.2%
2017	1.7%	1.2%
2018	1.5%	0.7%
2019	0.9%	-0.1%
2020	1.2%	-0.1%
2021	1.5%	0.5%
2022	1.9%	0.6%
2023	2.0%	0.5%

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