Department of
Enterprise, Trade and Investment
www.detini.gov.uk

DETI Economic Commentary

30 January 2012

FOREWORD

Since the publication of the previous edition of the economic commentary in November 2011, there have been many developments, both in the local economy and worldwide. Chief amongst these has been the continuing uncertainty in the Euro zone and, as yet, the lack of a decisive and transparent solution by EU or Euro zone Governments. These uncertainties are weighing heavily on global economic growth – something that is further impacting on labour markets, locally and abroad, while also generating much pessimism around the immediate and longer term economic prospects for many regions and countries.

However, the New Year sees the start of an exciting year for our local tourism sector. The *ni2012 Our time Our place* programme is a series of events including the 100th anniversary of Titanic and the opening of the new Giants Causeway Visitor centre, designed to put NI on the global tourism map. I am also delighted at the recent announcement that Royal Portrush will host this year's Irish Open, which will showcase our golf tourism to a global audience. The latest tourism figures show a significant increase in visitor numbers and spend in 2011 and I hope this momentum will build in 2012.

A new Programme for Government (PfG) has been published for consultation with the economy once again at its centre. Only by prioritising growing the Northern Ireland economy can we achieve many of the PfG's aspirations such as tackling poverty and deprivation.

The draft NI Economic Strategy has also been published by the Executive, which aims to rebuild and rebalance the local economy. The strategy has a focus on export led growth, which evidence shows is a proven route for small open economies such as Northern Ireland to grow. I encourage everyone to respond to this important consultation by 22 February 2012[1].

The latest statistics show that world trade is recovering which means there is a significant opportunity for growth in our exports. This edition of the commentary launches a new Exports Monitor which enables us to more readily gauge the export performance of the Northern Ireland economy, using data published by HMRC. The Exports Monitor indicates that exports from Northern Ireland have increased by

[1] For details on how to respond to the consultation please see http://www.northernireland.gov.uk/economic-strategy

9.5% over the last year (to Q3 2011). However, our export markets remain concentrated on advanced economies such as the Republic of Ireland, Great Britain and North America. Northern Ireland must diversify its export base to avoid over-reliance on a small number of markets and to take advantage of opportunities in the faster growing emerging economies.

The last few weeks have seen publication of many of the annual statistics that point towards how the local economy is performing on the major drivers of growth. I am delighted that spending on Research and Development in Northern Ireland has once again increased this year to reach record levels, which shows the value our businesses place on innovation and knowledge as drivers for growth and recovery.

However, other annual statistics such as living standards and wages show that Northern Ireland continues to lag behind the United Kingdom. This illustrates why the Executive is continuing to push for new powers, such as the devolution of Corporation Tax, to help transform our economy. I and my Executive colleagues have not been content to accept the status quo and have taken proactive steps to place the Northern Ireland economy on a higher growth trajectory. Through our ongoing work on the Joint Ministerial Working Group we are addressing some of the issues involved with gaining this important economic power and I am hopeful of a successful outcome this summer.

This edition of my Department's Economic Commentary also analyses the contribution of different sized firms to the local economy. While Northern Ireland is still a Small and Medium Sized Enterprise dominated economy, large firms play an important role in terms of driving exports and expenditure on research and development. The Invest NI Boosting Business campaign, which I launched last November, continues to assist businesses of all sizes, through the drivers of jobs, exports, R&D, new technology and skills. The Jobs Fund, which will create 4,000 jobs by March 2014, has continued to bear fruit with further job announcements over the Christmas and New Year period.

Going forward I will continue to do all I can to help to boost our businesses, large and small, local or foreign owned, through challenging economic conditions in order to enable them to drive our economy.

Arlene Foster MLA

Minister of Enterprise, Trade and Investment

Department of
Enterprise, Trade and Investment
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January 2012

Economic Commentary

- Global uncertainty, and the Euro Zone debt crisis, continues with the slowdown expected to impact on labour markets
- Prospects for Global, UK and NI economic growth remain muted
- The new DETI Exports Monitor reveals that Northern Ireland exports increased by 9.5% on the previous year
- The latest GVA figures show that Northern Ireland was one of the UK regions most severely impacted by the downturn
- Business spend on Research and Development has nearly doubled over the last two years

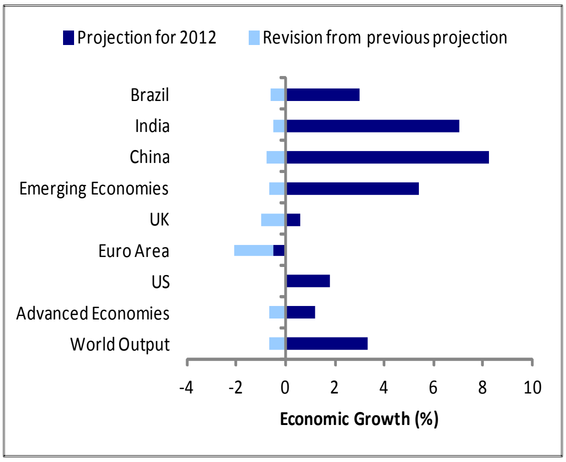
GLOBAL CONTEXT

The world economy, which had started to recover from the global financial crisis, saw a resurgence of the global economic downturn in 2011, following a number of economic shocks in the first half of the year. These included the earthquake in Japan, unrest in the Middle East and Africa, with the resulting rising oil prices, and an escalation of the financial crisis in the Euro area.

The impact of these shocks has slowed worldwide economic growth and the forecast for 2012 is for the world economy to expand at a rate of around 3.25%, a downwards revision of three-quarters of a percentage point between the International Monetary Fund's (IMF) September 2011and January 2012economic forecasts. This lower forecast for global growth is mainly due to the euro area, which is expected by the IMF to enter a "mild" recession in 2012, with output contracting by 0.5%. Advanced economies are predicted to grow by around 1.2%, a downward revision of 0.7 per cent from September 2011, and the emerging economies are expected to continue to have a rate of growth well above the advanced economies.

Figure 1

World Economic Growth Forecasts



Source: International Monetary Fund, World Economic Outlook Update, January 2012

While emerging economies are forecast to experience strong growth and have not experienced such significant downgrades over the last year in their growth projections as advanced economies, there continue to be overheating fears for a number of these countries. Overheating describes a situation where growth is rising so quickly that it results in inflation, as producers are not able to keep up with demand levels for goods and services and raise prices instead. Last year The Economist estimated that Argentina, Brazil and India are considered to be in the Top 5 countries at greatest danger of overheating.[2] This assessment was based on a range of indicators including inflation, economic growth, interest rates and bank lending.

The economic slowdown is expected to further impact on already fragile labour markets, with the International Labour Organisation (ILO)[3] suggesting that an economic slowdown takes around six months to impact labour markets. However, given the already weakened state of some labour markets following the initial global economic downturn, the current economic slowdown may affect labour markets more quickly or more strongly than previously. Indeed the latest international labour market indicators suggest that the slowdown in employment has started to materialise. Current rates of global economic growth are not sufficient to create substantial amounts of jobs or make a significant dent in high unemployment.

Markets around the world have been, and continued to be, affected by the uncertainty around the financial stability of the Euro zone. Yields on government debt in countries such as Italy and Spain rose sharply at the height of the Euro crisis due to heightened fears regarding their ability to repay debt. However, the yields on UK government debt nearly halved during 2011, reaching under 2% in December - indicating that the UK economy is still viewed by investors as a safe haven during times of instability.

The European Central Bank (ECB) has provided liquidity support of some €500bn to its banks. The ultimate impact of this support is difficult to predict since there a range of possible approaches that different banks might deploy in utilising these funds. The three most plausible options available to individual banks appear to be:

- Re-deposit at the ECB – possibility to ensure availability of loan finance when other debt matures and needs rolled over.
- Lend to business – which might help credit conditions in the Euro zone.
- Buy Government bonds – which might help reduce the yields faced by some Euro zone countries.

World trade is rising again after the initial downturn and is projected to grow by 5.8% in 2012. The top three traders are the United States, Germany and China – and together they represent 28% of world merchandise trade, with Asia accounting for a further 30%. Trade in services also presents potential for growth, with exports increasing by 9% in 2010. The EU and the US dominate in terms of trade, however, the most rapid growth in recent years has been in the emerging economies of China and India.[4]

Global demographic change presents further challenges and opportunities for the world economy. The United Nations[5] estimates that the world population reached 7 billion in October 2011, which poses challenges such as ensuring the provision of adequate food and clean water, to guaranteeing equal access to

[2] http://www.economist.com/node/21522520

[3] World of Work Report 2011, International Labour Organisation and International Institute for Labour Studies, October 2011 http://www.ilo.org/wcmsp5/groups/public/—dgreports/—dcomm/—publ/documents/publication/wcms_166021.pdf

[4] International Trade Statistics 2011, World Trade Organisation

[5] State of World Population 2011, UNFPA http://www.unfpa.org/swp/

security and justice. It also impacts on economic indicators such as securing sufficient employment and the impact on food prices. However, this high population can also present opportunities such as a young productive labour force to drive economies. The composition of the global population across continents is also expected to change, for example the proportion of the world's population living in Africa is predicted to rise while that from Europe will decrease.

UK ECONOMY

The UK economy continues to experience difficulties with declining output growth and rising unemployment. First estimates suggest that the UK economy contracted by 0.2% in the fourth quarter of 2011, following growth of 0.6% in the third quarter and no change in output during the second quarter. This decline was driven by decreases in the production and construction output, while services output was unchanged over the quarter. The public sector strike in November 2011 is likely to have had some impact, however ONS have not quantified the effect. In addition, the economic outlook for the UK economy was recently significantly downgraded by the Office for Budget Responsibility (OBR), which now forecasts GDP growth of 0.7% in 2012.

The uncertainty in the Euro zone also has implications for countries which do not use the single currency. For example, here in the UK, the Bank of England stated in November 2011 that the lack of an effective policy response in the Euro area posed the single biggest risk to the UK's recovery.

Labour market conditions in the UK also remain challenging with unemployment continuing to rise; unemployment is now at its highest level since 1994 and youth unemployment stands at 1.04 million.

COST OF LIVING

Inflationary pressures are already showing signs of subsiding this year, after record levels were recorded in 2011. The OBR considers inflation, and its impacts on household incomes and consumer spending, to be the main reason why the UK economy has not grown as quickly as expected since June 2010.

The Bank of England forecast, in its November 2011 report, that inflation will fall back sharply through 2012 as the contributions of VAT, energy and import prices decline, and downward pressure from slack in the labour market persists. The rise in VAT in January 2011 is estimated to have added about 1 percentage point to CPI inflation in 2011 – the impact of the VAT rise will drop out in the February 2012 CPI figures. The current Consumer Price Inflation rate for December 2011 at 4.2%, down from a peak of 5.2% recorded in September 2011.

Recent analysis by The Office of Fair Trading[6] (OFT) has highlighted that the cost of motor insurance in NI is 11% higher than the rest of the United Kingdom, with customers in rural areas at a particular disadvantage, paying between 30 and 70% more than customers in rural areas of Great Britain. However, the OFT notes that higher costs may be due to the different legal system in NI and the higher compensation levels.

The price of fuel continues to impact on consumers and businesses, with a recent survey by the AA finding that motorists were planning to drive more economically and drive less often in 2012. AA research also shows significantly reduced petrol purchases in the UK, with a decrease of 1 billion litres (over 6%) in the first nine months of 2011, from one year previously. Despite weaker global demand predicted for 2012, the IMF expects that oil

[6] http://www.oft.gov.uk/shared_oft/markets-work/private-motor-insurance/Motor_Insurance.pdf

prices will ease only marginally this year, due to the risk of political uncertainty and supply issues.

The Chancellor announced in November's Autumn Statement a freeze on Fuel Duty until January 2012 and a smaller increase in August 2012, which the Treasury estimates will save the average family £144 per year. Figures recently published show that fuel duty comprises nearly half the price of each litre of petrol. However, evidence from ONS[7] shows that fuel duty as a proportion of the total petrol price has fallen in recent years, as fuel duty has been frozen while the crude oil price has risen. This analysis also shows that the burden of fuel duty is greatest on the lowest income households.

REPUBLIC OF IRELAND

The Republic of Ireland announced its latest budget in December 2011, introducing further austerity measures totalling €3.8 billion. These measures include:

- A two percentage point rise in the level of VAT to 23% from 1 January 2012.
- The introduction of a €100 household charge
- Tax rises on tobacco and motor tax

The latest economic data suggests that the Irish economy returned to growth in 2011, with quarterly GDP growth of 1.9 and 1.6% in the first two quarters of 2011. The economy is expected to have grown by 1% for the full 2011 year with GNP growth of 0.4%. The Department of Finance in Dublin has issued downgraded forecasts for economic growth in 2012, with GDP increasing by 1.3% and GNP is expected to rise by 0.7%, partly due to the weakened international outlook. The forecast for inflation has also been increased, partly due to the rise in VAT.

[7] The effect of duties on petrol and diesel on household disposable income, November 2011, Office for National Statistics

Recovery in the Republic of Ireland economy is being led by exports, with a 5.5% increase in the level of exports in the first half of 2011. The Department of Finance expects export growth to continue into 2012, albeit at a lower rate of 3.6%.

However, prospects for export growth from NI to the Republic of Ireland in the immediate future continue to look muted, with personal consumption predicted to have contracted by 2.5% in 2011 and domestic demand expected to fall again in 2012.

Labour market conditions in the Republic of Ireland continue to be difficult, with continued high unemployment (315,000 in July – September 2011) and an unemployment rate of 14.3%, well above the rates for Northern Ireland and the UK. Unemployment increased by 5.3% over the last year and is forecast to continue to increase in 2012 and then begin to fall.

NORTHERN IRELAND

OUTPUT

GVA

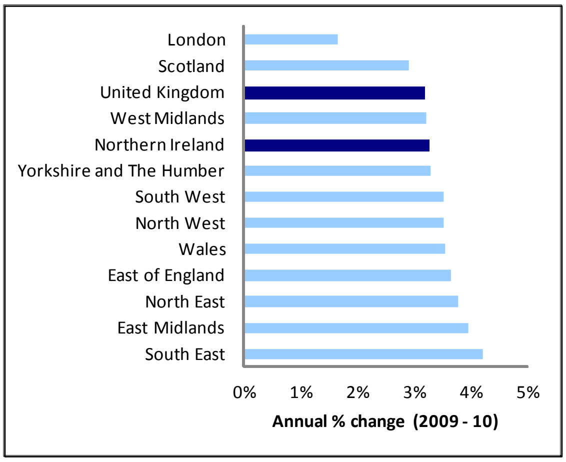
Regional Gross Value Added (GVA) figures are a key measure of regional economic output. The latest data for 2010 show that Northern Ireland's GVA increased by 3.2%, in line with the overall UK increase which was also 3.2%. The decline in GVA in 2009 of 4.3% was the largest of any UK region and in 2008 Northern Ireland was one of the first UK regions to report declining output.

Readers should note that regional GVA figures are published in nominal (cash) terms, while statistics around economic growth are typically expressed in real terms. Reliable regional figures are not available for inflation. At a national level, as a broad indication, the UK GDP deflator for 2010 was 2.86, while nominal GVA growth for both NI and the UK was 3.2%.

However, the Regional GVA figures are still useful to give an indication of the trend in output and indicate which regions have been most severely impacted by the recession.

Figure 2

UK Regional GVA



Source: Regional Gross Value Added (ONS)

Following the uncertainty in the Euro zone and the downgrade in world economic growth forecasts, a number of local economic commentators have downgraded their forecasts for the Northern Ireland economy, as we predicted in the November 2011 edition of the economic commentary. Commentators now expect economic growth in the region of around 1 per cent in 2012.

Production / Manufacturing

Overall production output rose by 5.2% in the third quarter of 2011, compared with a minimal increase of 0.1% in total UK output. The local manufacturing sector, which accounts for the vast majority of production output, is currently experiencing much stronger growth than the UK. NI manufacturing output grew by 5.7% in Q3 2011, while there was no change in UK output. There was a similar pattern in output over the last year, with NI manufacturing growing by 10.3%, while the UK rate of increase was 1.5%. The number of manufacturing jobs has also recently seen some reversal of its long term decline, with an increase of over 1,000 jobs (1.5%) over the last year.

Services

Output in the service sector increased by 1.9% in the second quarter of 2011, which was the second quarterly increase following a year of contracting output. Services output is down over 13% since its peak in 2006 and the number of jobs has fallen by around 10,000 (1.8%) over the last three years. At a sub-sectoral level, the retail & hotels, and food services; and transport & communication sub-sectors have reported increasing output, while the business services & finance sub-sector is experiencing declining output.

The retail sector continues to experience difficulties. While shopping centres in Belfast have reported record visitor numbers over the Christmas period, retail commentators have cautioned that high footfall may not necessarily correspond to high sales levels.

The increased level of VAT in the Republic of Ireland may offer some local retailers optimism for attracting cross-border shoppers. However, independent commentators have sounded a note of caution, pointing out that changes in the Euro / Sterling exchange rate could easily wipe out any price advantage NI retailers might have. Also consumers from the Republic are likely to have less disposable income now than they did at the height of the cross border shopping boom several years ago.

Construction

The construction sector has been the most severely impacted in Northern Ireland, both in terms of output and jobs. Construction output peaked in 2007, and was the first sector to demonstrate a slow down. The most recent data shows a small rise in construction output of 0.8% in the third quarter of 2011, which is the first quarterly increase in over three years. However output is now down 38% on its peak and over the last year output contracted by 12.5%.

The housing market has been particularly impacted with Northern Ireland experiencing a severe house price correction of 40% over the last 4 years, the greatest of any UK region. Local house prices continue to fall with an annual decline of 12%, again the largest of any UK region. Detailed data from the Index of Construction also shows that housing output continues to fall, and is now at less than half of its peak output in 2007.

As well as the impact on output, the downturn in construction has also impacted on the sector's labour market with the number of jobs and self-employment well down on peak levels. The number of unemployment benefit claimants from construction has also more than doubled since 2007.

Anecdotal evidence also suggests that the downturn in the local property market is also affecting local businesses, which normally trade outside the property sector, as they may have invested in property during the boom times and the value of these assets is now reduced. The work of the National Asset Management Agency in the Republic of Ireland is also impacting the local economy. This agency has taken over a portfolio of loans from the RoI banking sector as a result of excessive property lending including some relating to Northern Ireland. These NI loans relate to 180 debtors and have a value of £3.35billion.[8]

LABOUR MARKET

The local labour market continues to experience difficulties and the renewed economic downturn may place additional pressure on unemployment and jobs.

The number of people claiming unemployment benefits currently stands at 60,700, increasing by 2,400 (4.1%) over the last year, which was lower than the increase for the UK (9.8%) and was the second lowest annual increase among UK regions. All of this year's net increase in claimants in Northern Ireland has been driven by an increase in female claimants (+2,700), with the number of male claimants falling by 300. A similar gender pattern has also been noted for the UK. This pattern may reflect the impact of UK wide reforms of benefits for lone parents, with some people previously claiming Income Support moving to Jobseeker's Allowance.

The unemployment rate for Northern Ireland at 6.8% remains below the UK average of 8.4% and the European Union (9.8%) and Republic of Ireland rate of 14.3%. The number of employee jobs in Northern Ireland fell by 8,700 (1.2%) over the last year, to Q3 2011. The Quarterly Employment Survey series has decreased for twelve of the last thirteen quarters, since peaking in Q2 2008.

The Business Register and Employment Survey (BRES)[9] is a new survey which measures the number of jobs in the Northern Ireland economy. It will be carried out in the years when a full Census of Employment is not conducted (currently run every two years) and will not produce as detailed information, in terms of sectors and geography, as the Census. However, it provides more information than the Quarterly Employment Survey. The first edition of this survey revealed a 0.5% decrease in jobs in Northern Ireland between 2009 and 2010, with the construction sector experiencing the largest relative decrease in jobs. Jobs in the public sector decreased by almost 4,000 and there was also a significant decrease in the number of part time jobs.

There were 245 confirmed redundancies in December 2011, an increase from 93 in the previous month. In contrast, the level of redundancies has fallen over the last year, with a reduction of 18%. However, these

[8] http://www.nama.ie/news/nama-updates-position-in-relation-to-northern-ireland-loans-and-assets/

[9] For more information please see http://www.detini.gov.uk/deti-stats-index/stats-surveys/stats-census-of-employment-2.htm

statistics do not fully capture the level of redundancies as employers are only obliged to report 20 or more redundancies.

Recent analysis published by the Office for National Statistics[10] for the UK reveals that the rate of people changing jobs voluntarily (resigning) in the private sector has decreased significantly during the economic downturn. However, the rate of people leaving their main job due to redundancy more than doubled between 2008 and 2009, with the largest increases in construction, manufacturing and banking and finance.

ECONOMY STRUCTURE

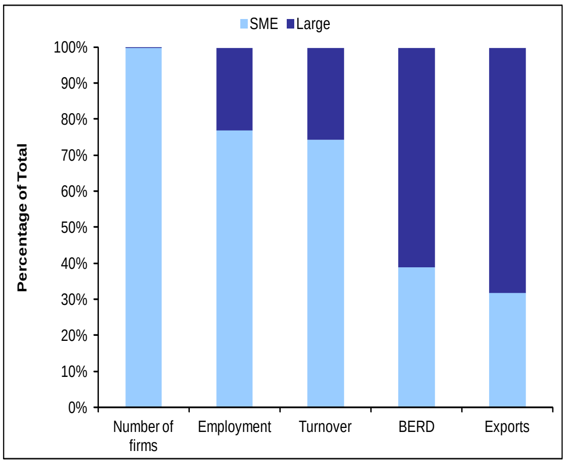
The local economy is dominated by Small and Medium Sized Enterprises (SMEs)[11] which account for 99.9% of the number of businesses in Northern Ireland and these make an important contribution to employment and turnover. They also account for nearly two-fifths (39%) of spending on research and development in 2010 and 32% of exports.

However, the latest statistics show that while large businesses may be small in number in Northern Ireland (with just 200 firms employing more than 250 people), they make a significant contribution in terms of employment, turnover, Research & Development (R&D) and Exports.

Despite their small number, large firms in Northern Ireland account for around one quarter of total employment (23%) and turnover (26%). They also make up the majority of expenditure on research and development (61% of total) and two thirds of exports (68%).

Figure 3

Contribution to economy by firm size



Source: Business Population Estimates (BIS), Northern Ireland Research and Development Statistics (DFP), NI Manufacturing Sales and Exports Survey (DFP)

While the majority of exports (sales outside the UK) are accounted for by large firms, the Manufacturing Sales and Exports Survey reveals that SMEs account for a greater proportion of sales within Northern Ireland, to Great Britain and to the Republic of Ireland, than their proportion of export sales. For example SMEs account for over three-quarters (78%) of sales within Northern Ireland.

As would be expected, large firms are concentrated around the major urban areas such as Belfast and Londonderry. Some areas of Northern Ireland are highly SME concentrated, with 10 of the 18 District Council Areas having no large businesses within their boundaries (businesses employing more than 250 people).

Evidence shows that the majority (89%) of the projects supported by Invest NI over the last year belonged to locally owned small and medium sized firms, with SMEs receiving nearly one third (32%) of the assistance offered over the same period.

Foreign owned firms are also important to the Northern Ireland economy. In March 2011

[10] Reasons for leaving last job – 2011, Office for National Statistics, 9 November 2011
[11] Firms with less than 250 employees

there were 765 foreign owned companies operating in Northern Ireland, mostly in the wholesale, production and retail sectors. One third (32%) of these foreign owned firms had owners originating in the Republic of Ireland. Analysis of the BRES survey suggests that in September 2010 there were an estimated 75,000 jobs in foreign-owned businesses and nearly 335,000 jobs in SMEs. Research has found that FDI brings new technology and working practices and boosts productivity. Companies with ownership outside NI play an important part in financing R&D in the region, with over two thirds (68%) of business R&D spend accounted for by externally owned companies.

The ONS Business Demography Statistics measures business births and deaths and therefore the "turnover" of an economy's stock of businesses. The latest figures show that there were 4,600 business births in Northern Ireland in 2010, with 5,400 business deaths in the same year. The business birth rate in NI was 7.8%, which was the lowest of the twelve UK regions. The Northern Ireland business death rate was also the lowest of all the regions.

DRIVERS OF GROWTH

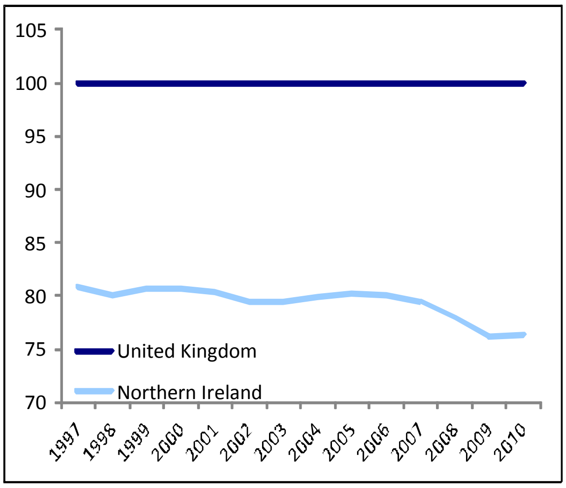
The draft NI Economic Strategy outlines priorities under a number of headings for growth.

Living standards

Low prosperity has been a long term problem, with living standards in Northern Ireland, measured by GVA per head, remaining at around 20% below the UK average for many years. In 2010, NI GVA per head was around three-quarters (76.4%) of the UK average, the lowest of any UK region apart from Wales.

Figure 4

NI Living Standards



Source: Regional GVA (ONS)

Living standards in NI relative to the UK have actually declined in the last number of years. While UK living standards are relatively high in an international context, there is still room for improvement against the likes of countries such as Norway, Sweden and Switzerland.
However, monetary measures do not provide a fully rounded picture of welfare standards, with wider measures of the economy and social welfare measures such as education and health proposed as providing a fuller picture of well being. Alternative measures have been developed to take account of these issues such as the UN Human Development Index, and work is ongoing in the UK by ONS to develop a measure of national well-being, including indicators such as the economy, health, relationships and people's own assessment of their well-being[12].

Initial measures of life satisfaction have revealed that despite the challenging economic circumstances, most people in the UK are relatively happy, with around 77% of people satisfied with life in 2009/10[13]. The OECD's *How's Life* survey revealed that British people

[12] http://www.ons.gov.uk/ons/rel/wellbeing/measuring-national-well-being/discussion-paper-on-domains-and-measures/measuring-national-well-being--discussion-paper-on-domains-and-measures.html
[13] Based on a question on Life Satisfaction in the British Household Panel Survey (Understanding Society).

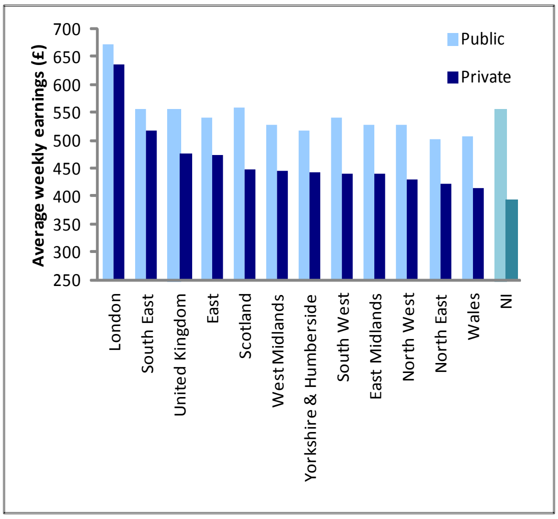
are among the happiest in the world, rating themselves at 7 out of 10 on a scale of satisfaction with life in 2010. This was above France and Germany, with the Danish ranked top, with a rank of 7.8.

Wages

Wages in Northern Ireland have historically lagged behind those in the UK, with earnings which are some of the lowest in the UK. The rate of growth in average full-time wages over the last year was 3.0%, which was higher than the increase in the UK of 0.4%. This narrowed the gap between NI and UK full-time pay to 90.0% of the UK figure, compared to 87.7% a year earlier. Despite the growth in nominal wages, and given the high levels of inflation experienced in 2011, there will have been no growth in real wage levels. The Bank of England expects that real wages will begin to increase again in 2012 as inflation falls to its target level of 2%.

Figure 5

Wages by UK Region



Source: ASHE 2011 (DFP, ONS)

A new publication provides details on pay in the Northern Ireland Civil Service (NICS). The NISRA Civil Service Pay Bulletin (December 2011), reveals that the average salary in the NICS was nearly £21,500. A basic salary of £17,000 would put someone in the bottom 10% of NICS staff in terms of earnings, whereas a basic salary of £38,000 would put someone in the top 10% of NICS staff. The bulletin contains further analysis by gender and grade, which can be downloaded from the NISRA website. [14]

The UK Autumn Statement also contained a commitment to launch a Regional Pay Review. If this were to be introduced it would have significant implications for Northern Ireland, which has some of the lowest levels of private sector wages and highest public sector wages in the UK.

While the persistently low wages relative to other UK regions are disappointing for wealth creation, the alternative side of the argument is that Northern Ireland has the most competitive labour costs in the UK, which may be of benefit when competing for foreign direct investment, especially in these difficult economic conditions.

Regional Productivity

Labour productivity in Northern Ireland is below the rest of the UK, both in terms of output per job and output per hour and has lagged behind the UK for a number of years, with productivity around 80% of the UK average. The latest figures for 2010 show slight convergence on the GVA per hour measure, which increased from 79.2% of the UK average to 81.0%. On the GVA per filled jobs measure there was a slight divergence from the UK between 2009 and 2010, with a reduction from 81.6% of the UK average to 81.0%.

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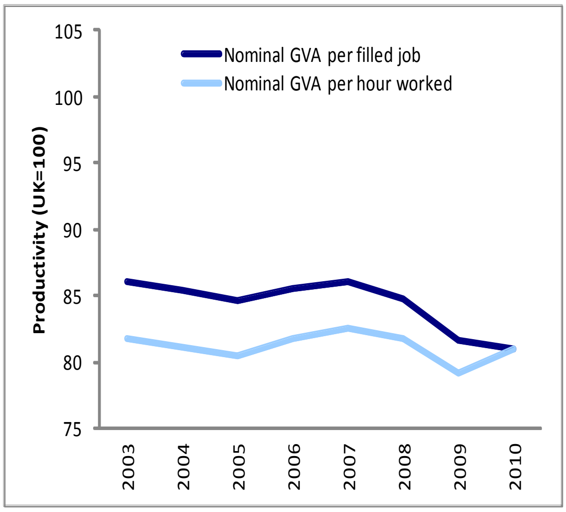
14 http://www.nisra.gov.uk/publications/Pay%20Statistics%20for%20the%20NICS%20-%202011.pdf

Figure 6

Labour Productivity

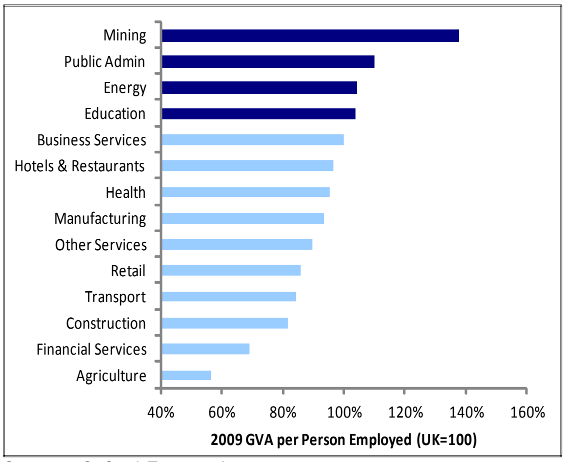


Source: Labour Productivity (ONS)

Northern Ireland's lower labour productivity is driven by relatively low productivity in key sectors such as Financial Services, Construction and Retail, and an industrial structure which is less focussed on higher value added activities.

Figure 7

Productivity by Sector



Source: Oxford Economics

Exports

The goal of the Executive's current draft Economic Strategy for NI is export led growth, which evidence demonstrates is a proven route for a small open economy with a limited domestic market to drive economic growth.

International trade grew quickly in 2010, driving recovery in economies across the globe. From its low point at the beginning of 2009, triggered by the initial global financial crisis, the volume of global trade has now grown by 25% and recently surpassed pre-crisis peaks. Despite the recent global economic slowdown, world trade in goods and services is projected to grow at a rate of 5.8% in 2012, albeit with growth slower than in 2011, when trade increased by 7.5%.

The latest figures from the DFP Manufacturing Sales and Exports Survey for 2010/11 show that exports fell marginally during by 0.6%. However most of this was driven by a significant fall in exports to the Republic of Ireland of some 15%, which was the only NI export market to report decreasing sales. Sales to Great Britain increased by 4.4%.

Table 1

DETI Exports Monitor

£ million	Latest Year Q4 2010 - Q3 2011	Previous Year Q4 2009 - Q3 2010	Change	
Total Exports	£5,681	£5,189	9.5%	
RoI	£2,116	£2,056	2.9%	
EU	£3,225	£3,084	4.6%	
North America	£1,060	£958	10.6%	
BRIC Countries	£139	£107	29.7%	

Source: Regional Trade Statistics (HMRC)

More up to date information from the new DETI Exports Monitor reveals that Northern Ireland exports increased by 9.5% over the last year (to Q3 2011). The DETI Exports Monitor uses HMRC Regional Trade Statistics to track Northern Ireland's export performance on a quarterly basis. The Exports Monitor reveals Northern Ireland was experiencing strong export growth prior to the global economic downturn, with exports increasing by 13.2% between 2007 and 2008. Exports decreased significantly during the downturn, with a decrease of 17% in 2009, followed by a slight recovery of 2.9% in 2010.

The monitor also reveals that while all exports destinations have experienced growth over the last year, exports to the emerging BRIC economies (Brazil, Russia, India and China) have experienced the fastest rate of increase, albeit from a relatively low base.

Table 2

Exports Destinations

£ million	Proportion of Total Exports
RoI	37.2%
EU	56.8%
North America	18.7%
BRIC Countries	2.4%

Source: Regional Trade Statistics (HMRC)

Diversifying our export base is important not only to prevent over reliance on a small number of markets, but also to take advantage of opportunities elsewhere. An examination of Northern Ireland's current export destinations reveals that these are currently heavily focussed on the slower growing advanced economies, particularly in the Euro zone and the US. However it is the emerging economies which are forecast to provide the greatest potential for growth but analysis shows that our exports to these markets are currently at a very low level, with just 2.4% of Northern Ireland's exports going to BRIC countries in the last year (Q4 2010 – Q3 2011).

Therefore NI should be targeting exports to key emerging markets such as China and India. Last year Invest NI led trade missions to a number of emerging economies including Brazil, Russia and India, and the recently announced programme of market visits for 2012/13 focuses on opportunities in countries such as China and India.

This strategy of targeting emerging markets would present its own challenges in terms of ensuring Northern Ireland had the right products and necessary skills to export to these markets. However caution should be noted as weaker consumer spending in emerging economies for example in China, may dampen hopes for it emerging as a driver of demand for other economies in the short term.

NI has a rate of exports similar to the UK average, however internationally countries such as the Republic of Ireland, Sweden and Finland have levels of exports (relative to their GDP) which are much higher than the UK.

Innovation, Research and Development

Evidence has shown that innovative economies are more productive and faster growing, delivering higher living standards[15]. At the company level, research by NESTA[16] reveals that innovative businesses grow twice as fast, in terms of employment and sales, as businesses that fail to innovate.

Spending by businesses in NI on research and development has almost doubled over the last two years. Northern Ireland's spending on R&D

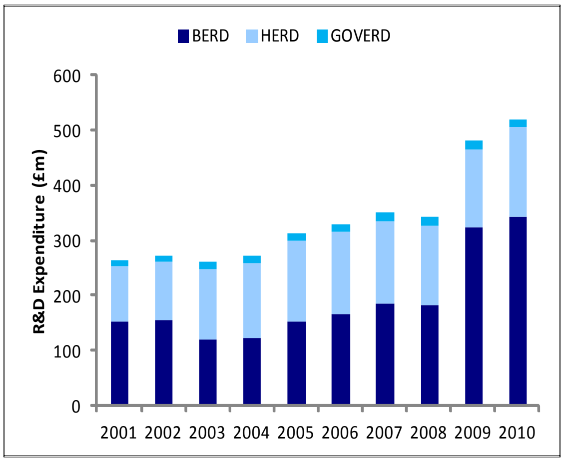
[15] Innovation and Research Strategy for Growth, Department for Business, Innovation and Skills, December 2011

[16] The vital 6 per cent, NESTA, 2009

has been historically low, however following a large increase in Business Expenditure on Research and Development (BERD) in 2009 and a further increase in 2010, expenditure reached a record level of £344 million.

Figure 8

Expenditure on Research and Development



Source: Northern Ireland Research and Development Statistics (DFP)

Note: BERD – Business Expenditure on R&D

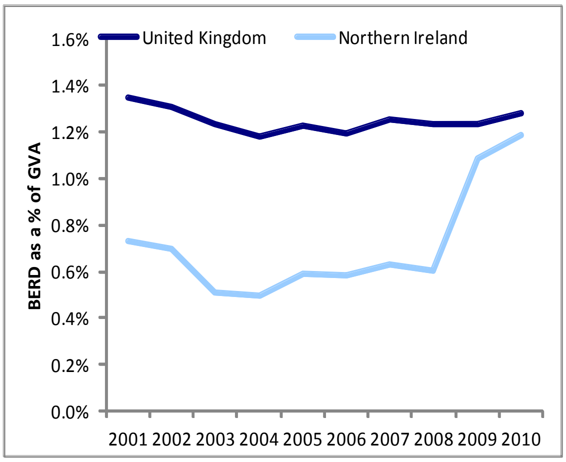
HERD – Higher Education Expenditure on R&D

GOVERD – Government Expenditure on R&D

This significant increase in 2009 resulted in the Northern Ireland BERD rate becoming similar to the UK average and this has been maintained in 2010, with NI now ranked sixth of the twelve UK regions. However, this is not typical of historical performance versus the UK where there has typically been a 0.6%-0.7% gap. And the UK is not a good benchmark internationally, with countries such as Finland, Sweden and the United States having much higher rates of expenditure on Research and Development.

Figure 9

BERD as % of GVA – NI and UK



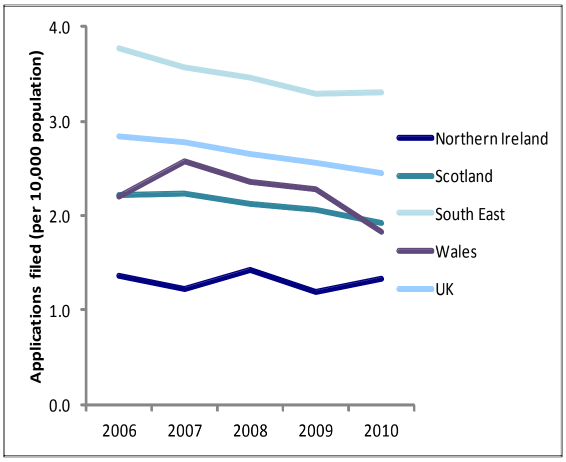
Source: Regional GVA (ONS), UK Business Enterprise Research and Development (ONS)

Most of the research and development expenditure was in the manufacturing sector, accounting for 71%, with the service sector accounting for the remainder. The total number of companies in Northern Ireland spending on R&D is relatively small at 424 and NI is also dependant on a relatively small number of companies for a significant proportion of R&D expenditure, with the ten biggest spending companies accounting for 59% of the total R&D spend in Northern Ireland in 2010, Locally owned companies reported a large annual increase in R&D in 2010, with expenditure increasing by 27% (£23.2m), however SME expenditure on R&D fell by £10.9m (-8%) over the year.

On wider measures of innovation activity Northern Ireland also lags remains behind the UK, with 55% of local firms “innovation active” in 2009. This was below the UK average of 58% and was the lowest of all UK regions. In addition the level of patent applications, which demonstrate a commercial output of research and innovation, is low in Northern Ireland with fewer patent applications (once population size has been accounted for) than any other UK region and around half the UK rate.

Figure 10

Patent Applications



Source: Intellectual Property Office

A report on the knowledge economy[17] published by the Northern Ireland Science Park Connect illustrates the potential for the local economy to benefit from embracing innovation and knowledge transfer. A knowledge economy is one fuelled by innovation, technology and talent. This report assessed Northern Ireland's current knowledge economy base relative to international comparators and found that in a UK context, NI lags behind other regions, lacking in measures such as private funding in venture capital investment.

The knowledge economy sector in Northern Ireland is currently relatively small, but important as it supports over 30,000 high-value jobs directly, with a further 27,000 through supply chains and £300m of expenditure on research and development. However, the sector is only around half the size of that in the UK.
International experience shows that there is potential to achieving economic growth and job creation through knowledge-based growth and this opportunity will help drive the local economy.

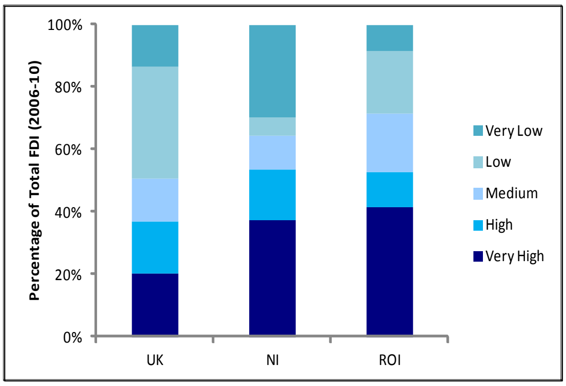
Inward Investment

Inward investment plays a crucial role as a catalyst for economic growth. For an economy receiving inward investment, it can provide benefits as a source of new technologies, capital, processes, products and management skills. The latest data available shows that in 2010/11 inward investment of over £300m into Northern Ireland was planned.

Forthcoming research from FDI Intelligence commissioned by DETI[18] finds that although Northern Ireland has a successful track record in terms of the overall level of Foreign Direct Investment (FDI) attracted, too many of these jobs have been very low value added.

Figure 11

FDI by Value



Source: FDI Intelligence

Invest NI is seeking to shift the pattern of FDI towards higher value added jobs and projects, however in the currently difficult economic climate it is accepted that rebuilding the economy and providing job opportunities are also important.

Entrepreneurship

Enterprise is the seizing of new business opportunities by both start ups and existing firms. New enterprises can bring innovative

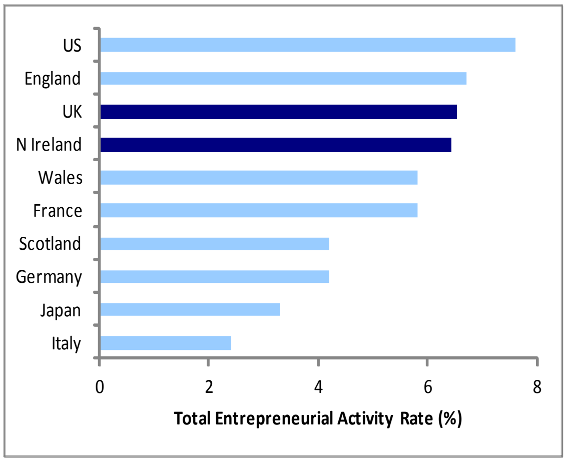
[17] The full report can be downloaded from http://www.nisp.co.uk/?page_id=302

[18] Draft research on FDI is due to be published in Spring 2012 and will be available to download from the DETI website

processes and technologies to market, forcing existing firms to improve their productivity to remain competitive.

Figure 12

Entrepreneurship Rates



Source: Global Entrepreneurship Monitor

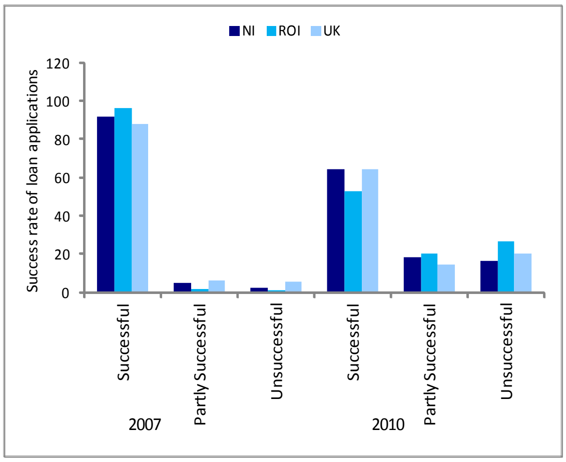
The latest statistics from the Global Entrepreneurship Monitor show that Northern Ireland has a similar rate of entrepreneurial activity[19] to the UK average and above that in Wales and Scotland. In an international context, Northern Ireland and the UK fare relatively well, with entrepreneurship rates above those in France and Germany, with the US ranked the most entrepreneurial.

Access to Finance

Access to finance is a key area of concern in the local economy and a constraint facing business. Survey findings reveal that over the course of the economic downturn, businesses in Northern Ireland, in common with those across the UK and the Republic of Ireland, have found it more difficult to obtain finance.

Figure 13

Access to Finance



Source: Access to Finance Survey (DFP)

The recent NI Access to Finance survey[20] found that similar levels of firms had applied for finance in 2007 and 2010, however, success rates fell significantly over this three year period. The construction sector faced the most marked decline in success at obtaining finance. Success rates in Northern Ireland and the UK were similar in 2010. However, banks in Northern Ireland are more likely not to give a reason for refusing an application for finance.

Invest NI has recently announced a new £50m Growth Loans Fund for small and medium sized enterprises. This fund will support businesses in manufacturing and tradable services and will make loans typically in the region of £50k to £500k, complementing existing sources of finance. The fund will target firms with high growth potential and exporting businesses. This fund is expected to be operational by the end of March 2012 and aims to generate sales growth of £150m each year in SMEs.

Proposals have also been developed for a £5 million Small, Medium, Micro Enterprises (SMME) Loan Fund, which will provide loans of between £1,000 and £50,000 to viable businesses from a wider business base, including social enterprises. The fund is expected to be in place by Summer 2012.

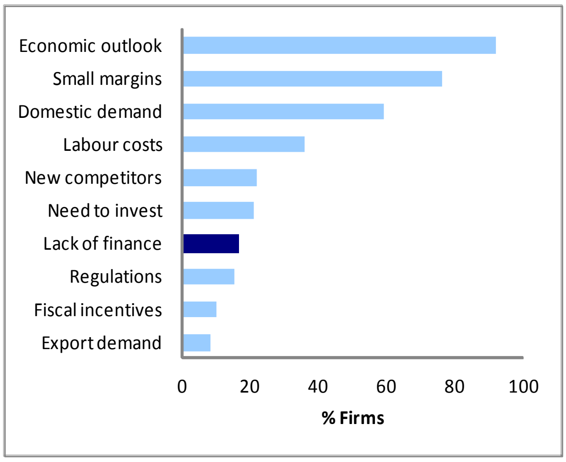
[19] Total Entrepreneurial Activity measures the proportion of adults with a very early stage business or a new firm between 3 and 42 months old.

[20] http://www.detini.gov.uk/deti-stats-index/stats-surveys/northern_ireland_access_to_finance.htm

Invest NI has also recently launched a series of Focus on Finance workshops across Northern Ireland, designed to help local businesses better manage their cashflow and their finances, to help them through the current economic difficulties.

Figure 14

Constraints affecting business



Source: Access to Finance Survey (DFP)

However, access to finance is not the only constraint affecting business. The main factor which firms considered would limit their business growth to 2013, was the general economic outlook, with 92% of respondents citing this as a factor. Three quarters of businesses (76%) pointed to small margins, while nearly 60% thought that reduced demand in the domestic market would limit the growth of their business. Lack of finance was noted by 16% of businesses as a factor limiting growth, however it should be noted that 44% of NI SMEs thought they would require finance in the next three years. Therefore access to finance remains an important ongoing concern.

CONCLUSION

The large increase in spending by Northern Ireland businesses on Research and Development over the last two years is very welcome. This shows the value local firms place on knowledge and innovation as drivers of growth in their business.

However, disappointingly the latest annual figures on living standards and productivity show that Northern Ireland continues to lag behind the UK. The draft Executive Economic Strategy aims to addresses many of these weaknesses in our economy and rebalance it towards the private sector.

Export led growth is a proven route for growing small open economies such as Northern Ireland where the domestic market is limited. Therefore the draft NI Economic Strategy prioritises export led growth. The latest figures available show that exports grew by 9.5% over this year (up to the third quarter of 2011) compared with the previous year.

2012 will be a challenging year for the world economy, with declining prospects for global economic growth and the impact of this on already fragile labour markets. The continued uncertainty around the financial crisis in the Euro Zone is predicted to result in recession there. Nationally the UK economy is expected to have weak output growth over the year, with declining GDP in the fourth quarter of 2011. As a small open economy, all of the above are expected to impact on the Northern Ireland economy.

With advanced economies experiencing sluggish economic growth, the forecast stronger economic growth in emerging countries present significant opportunities for Northern Ireland businesses to increase their exports and by diversifying our export base prevents over reliance on a small number of countries as export markets.

The local business base remains dominated by Small and Medium Sized companies, however large companies make a significant contribution to employment, Research and Development and our exports. Invest NI continues to offer assistance to all sizes of firms, with small and medium sized firms accounting for the majority of the projects support over the last year and receiving nearly a third of all assistance offered. Invest NI are also bringing forward several funds in the near future to help improve SMEs access to finance.

STATISTICAL ANNEX

Economic Growth

Indicator	Period	NI		UK	
		Quarterly Change	Annual Change	Quarterly Change	Annual Change
GDP Growth	Q3 2011	-	-	-0.2%	+0.7%
GVA Growth	2009	-	- 2.0%	-	- 2.1%
Manufacturing Output	Q3 2011	+ 5.7%	+ 10.3%	0.0%	+ 1.5%
Services Output	Q3 2011	+ 1.9%	- 0.8%	+ 0.7%	+ 1.3%

Labour Market

Indicator	Period	NI			UK
		Level	Quarterly Change	Rate	Rate
Employment	Sep - Nov 2011	803 000	+ 4 000	67.8%	70.3%
Employee Jobs	Sept 2011	698 390	- 750	-	-
Unemployment	Sep - Nov 2011	59 000	- 7 000	6.8%	8.4%
Claimant Count	Dec 2011	60 700	+ 100	6.9%	5.0%
Economically Inactive	Sep - Nov 2011	547 000	+ 5 000	27.1%	23.1%

Productivity and Drivers of Growth

Indicator	Period	NI		UK	
		Level	Annual Change	Level	Annual Change
Output per Job	2010	81.0	-0.6	100	-
Output per Hour	2010	81.0	+0.8	100	-
Manufacturing Exports	2009/10	£5 240m	- 8.5%	£232 242	- 4.8%
as % of GVA	2010/11	19.5%	+1.0pp	21.1	+2.6pp
BERD	2010	£324m	9.1%	£16 067m	+ 3.7%
as % of GVA	2010	1.2%	+ 0.1pp	1.3%	+ 0.1pp
Innovation Activity	2006-08	55%	- 2 pp	58%	- 6pp

Sources: GDP Preliminary Estimate (ONS); Regional GVA (ONS); Index of Production (ONS, NISRA); Index of Services (ONS, NISRA); Labour Force Survey (ONS, NISRA); Quarterly Employment Survey (DETI); Claimant Count (NISRA); Productivity First Release (ONS); Manufacturing Sales and Exports Survey (DETI); UK Trade (ONS); UK Trade Info (HMRC); NI Research & Development Survey (DETI); UK Business Enterprise Research and Development (ONS); UK Innovation Survey: NI Results (DETI).

Notes: Productivity figures are presented as UK=100; NI exports (as % of GVA) uses HMRC data on exports of goods for comparability with UK and does not correspond with manufacturing exports from DETI survey; NI BERD uses DETI R&D data whereas NI BERD (as % of GVA) uses ONS data to allow comparability with UK total; innovation activity refers to % of all enterprises and change from the previous survey (2004-06).

FURTHER INFORMATION

The DETI Economic Commentary was launched in June 2010 and provides commentary and analysis on the latest statistics available for the Northern Ireland economy.

Past editions of the DETI Economic Commentary, and the previous publication, the Quarterly Economic Review can be downloaded from the Economic Briefing page of the DETI website:
http://www.detini.gov.uk/deti-stats-index/deti-stats-index-4.htm

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