# Economic Eye

Summer forecast
2019

EY DKM

## Contents




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“Economic growth across the island is all the more remarkable given the challenges faced by firms. Their ingenuity will be challenged in what promises to be a difficult second half of 2019. Meeting the expectations of citizens and businesses will be a challenge for governments, but a ‘see problem, solve problem’ mentality has driven firms across the island to achieve success despite a demanding environment.

**Michael Hall**
**Head of Markets, EY Ireland**

Executive summary

# Executive summary

## Heightened risk driving more job growth

Firms are busy, job growth is rapid, real wages are increasing and access to talent is cited as the number one business concern, yet the economics fraternity is very concerned. Talk of overheating, impending slow-downs and downside risks seems at odds with many of the data points. Should we be worried, or is the all-island economy still booming?

### Economists and business leaders diverge

This contrast is not unique to Ireland. According to **EY's Global Capital Confidence Barometer**, 93% of firms see the global economy as improving. However, the early 2019 macroeconomic data points to signs of weakness. Global forecasts have been revised downwards with continuing trade wars and sectoral disruption adversely impacting the outlook. Generally, strong job creation, low inflation and interest rates globally have bolstered domestic economies.

### Labour market leads to modest upward revision in ROI

These forecasts are little changed from last quarter's report with Republic of Ireland (ROI) growth modestly higher at 4.1% in 2019 and 3.3% in 2020. Northern Ireland (NI) forecast growth has been revised upwards to 1.1% for 2019, though UK forecasts are downgraded to 1.3% due to Brexit effects on investment and problems in the automotive sector. The upward revision in ROI is mainly due to positive quarter one jobs data with a further 20,600 net jobs created, resulting in over 81,000 net jobs in the year to Q1. NI employment rose by 1.7% (14,700 workforce jobs) in the year to Q1 2019, and we project modest growth for 2019 as a delayed Brexit and the associated paused investment postpones the modest contraction in employment to 2020.

### Is inflation beginning to pick up?

In a tight labour market, economic theory suggests that pay increases should accelerate. After a long period of stagnation, that is beginning to occur. Both jurisdictions are experiencing overall wage increases above the rate of inflation (3.6% and 3.1% projected in 2019 for ROI and NI respectively). Although not expected to be a growing trend of accelerating wage demands, it should put upward pressure on inflation and increase business costs. Our forecasts expect a more rapid pick up in ROI inflation than most other forecasters (1.7% and 2.3% in 2019 and 2020 respectively), which in turn will slightly arrest growth in consumer spending.

### How would the island cope with a 'bad' Brexit?

The Irish economy appears strong enough to avoid outright recession on the back of a 'bad' Brexit in which tariffs apply, though it would be very damaging for particular locations and sectors. EY's **Europe Attractiveness Survey** shows significant pick up in ROI Foreign Direct Investment (FDI) (52% increase in 2018), a major component of which is an acceleration of British FDI into ROI. This concurs with our **EY Financial Services Brexit Tracker** which places Dublin as the most attractive destination for Financial Services moving from London. A global slowdown presents a much greater threat to ROI headline GDP growth than Brexit. NI's growth is weaker and without a relocation boost, would likely be pushed into recession.

EY growth forecasts (assuming avoidance of a hard Brexit)

| | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| ROI | 4.1% | 3.3% | 3.2% | 2.9% | 2.8% |
| ROI MDD* | 4.1% | 3.6% | 3.3% | 3.0% | 2.8% |
| NI | 1.1% | 1.2% | 1.6% | 1.6% | 1.9% |
| UK | 1.3% | 1.5% | 1.8% | 1.9% | 2.0% |

Source: EY Economic Eye, UK ITEM Club
* Modified domestic demand excludes trade and removes the impacts of IP relocation and aircraft leasing, giving a more accurate picture of the domestic economy.

**Economic outlook**

# Global outlook

## Mixed global growth amid political instability

Global growth forecasts are being revised down for 2019/2020, impacted by uncertainty from escalating trade tensions and geopolitical instability. Countries such as Australia and India are responding by cutting interest rates, while the ECB ruled out a rate increase and signalled it would act as appropriate if signs of a slowdown became more pronounced. The US Fed stated it will "act as appropriate" to sustain labour market expansion and achieve its target inflation rate of 2%.

Euro area growth of 0.4% in Q1 2019 continued 24 quarters of growth and was coupled with the lowest unemployment since 2008. The consumer and services sectors are performing well, with lower inflation boosting spending. By contrast, recent data shows manufacturing slowing down, particularly in Germany, affected by disruption in the auto industry, slower Chinese demand and the threat of US tariffs on imported cars.

European FDI remains high, but declined by 4% in 2018 for the first time in six years according to EY's Attractiveness Survey. A decline of 13% in FDI projects for both the UK and German markets led to the overall decline, but large increases in Italy (+63%), Ireland (+52%), Poland (+38%) and Spain (+32%) delivered welcome news. Only 27% of companies surveyed, a seven-year low, plan to grow operations in Europe over the next year. Brexit has become the number one risks affecting Europe's attractiveness in the next three years, followed by political instability and a rise in populist and protectionist sentiment.

Trade tensions weigh heavily on the global outlook. The latest US tariffs on Chinese imports will cost the average American household $831 annually, according to the Fed[1]. The threat and subsequent postponement of new tariffs on Mexican imports and the end of preferential trade with India and Turkey highlight the volatile nature of current trade negotiations. This further adds to the burden on consumers and hampers employment and investment decisions for businesses.

The latest Global Capital Confidence Barometer shows a growing disconnect between the confidence of executives and the outlook of economic forecasters. Despite growing uncertainty, there has been a boardroom shift in 2019 towards seizing the opportunities it affords. 87% of respondents predict improving corporate earnings in 2019, a rise of 10 percentage points on last year's survey.

The forecast for a slowdown in US growth in 2020 is a particular risk for the ROI economy. Coupled with weak growth in the UK, German and French markets, the external conditions are projected to become more challenging. The ability to reach new markets will be important and it is encouraging that a number of large markets are expected to improve in 2020, including India, Brazil and Canada. The externally-focused nature of the ROI economy increases the importance of tracking growth in key markets.

According to the OECD, *"while growth was synchronised eighteen months ago, divergence has emerged between sectors and countries depending on their exposure to trade tensions, the strength of fiscal responses and policy uncertainties."* [2]

Global growth forecasts (OECD)

| | 2019 | 2020 |
|---|---|---|
| US | 2.8% | 2.3% |
| China | 6.2% | 6.0% |
| Japan | 0.7% | 0.6% |
| Germany | 0.7% | 1.2% |
| UK* | 1.2% | 1.0% |
| India | 7.2% | 7.4% |
| France | 1.3% | 1.3% |
| Italy | 0.0% | 0.6% |
| Brazil | 1.4% | 2.3% |
| Canada | 1.3% | 2.0% |
| Euro area | 1.2% | 1.4% |
| World | 3.2% | 3.4% |

Source: OECD Economic Outlook, Real GDP growth, May 2019
* UK ITEM Club forecasts UK growth of 1.3% in 2019 and 1.5% in 2020

[1] New China Tariffs Increase Costs to U.S. Households, May 2019

[2] Laurence Boone, OECD Chief Economist, Global Economic Outlook, May 2019

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The economic data points to a difficult 2019, but global business appears more upbeat, reflecting a buoyant job market in most developed economies. Firms must be vigilant about weaker growth in key markets, but the resilience shown thus far to a chaotic trading environment, suggests that even risk brings opportunities to the brave.

**Neil Gibson**
**Chief Economist, EY Ireland**

### Economic outlook

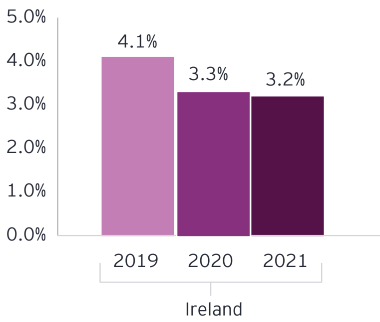
# Republic of Ireland

## Headline growth forecasts

ROI's growth is remarkable, even acknowledging that GDP only partially reflects true growth. Combining a range of indicators such as tax receipts, labour market and spending data, suggests growth in the 4-5% range for 2018. Economists argue that this is the time to enact a counter-cyclical approach to government spending, but the need for public services and infrastructure make this politically impractical.

ROI performance is expected to remain strong in 2019, before moderating in 2020 and 2021. This moderation is due to rising prices and a very tight labour market, but still leaves ROI with an enviable level of economic growth.

ROI growth forecasts




Source: EY Economic Eye

## Consumers

2.7%
2019

2.6% growth in personal consumption in the year to Q4 2018 reflects the stimulus effect of low inflation, rising employment and real wage growth. Consumer sentiment was stable in May, a potential effect of a delayed Brexit, however 69% of Irish consumers fear Brexit will increase their living costs[3], which may postpone spending decisions. Despite this, the consumer outlook is positive for 2019, although rising inflation may erode future spending power.

## Government

5.5%
2019

Strong increases in government spending in 2018 suggest less restraint than indicated politically. This is partiality due to a relaxation of pay constraints and a return to hiring after a long period of austerity. Increasing in-migration will place further pressure on public services, and political pressure to reverse austerity cuts is likely to keep government spending high, in the short run.

## Investment

7.1%
2019

Investment growth has been strong in ROI, even after removing the volatile intangibles category. Capital investment in housing and buildings was well into double-digit growth in 2018. Investment in machinery and equipment fell, albeit in the latest quarters when aircraft leasing is excluded. Strong investment is forecast to continue as housing demand is buoyed by rising migration flows and office building, particularly in Dublin. Escalating building costs may act as a headwind, especially for public sector investment.

## Trade

Exports

5.0%
2019

Imports

5.7%
2019

Headline trade data is complicated by contract manufacturing and merchandising[4] which can make it rather volatile. The forecast is for export growth to slow to 5.0% in 2019 as the global economy stutters. Imports will reduce accordingly, but the strength of the domestic economy should provide an upside and therefore the trade surplus is expected to close slightly.

[3] KBC Consumer Sentiment, May 2019

[4] Contract manufacturing refers to goods that are contracted by Irish-based firms to be produced by firms outside ROI and never enter the Irish market, but are treated as an Irish export in the data

**Economic outlook**

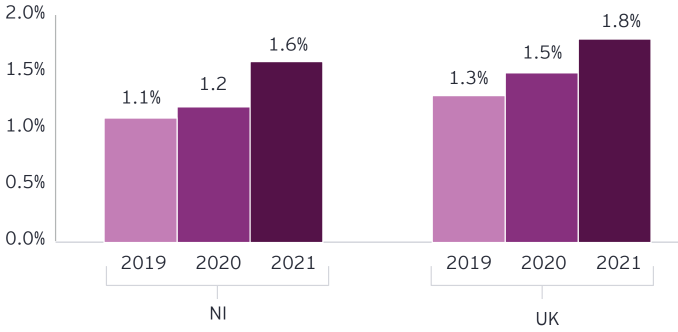
# UK and Northern Ireland

## Headline growth forecasts

NI economic activity (1.9%) grew faster than the UK (1.4%) in the year to Q4 2018 according to the Composite Index, although falls in construction and manufacturing output highlight the diversity of this performance. A strong rate of job creation has supported consumer spending and the easing of austerity has also bolstered economic growth in the UK and NI. This has been helpful in offsetting poor levels of investment and a disappointing trade performance. UK performance in Q1 2019 was more encouraging (+0.5%) but is projected to slow considerably later in the year.

UK quoted companies issued 89 profit warnings in Q1 2019, according to EY's Profit Warnings, a rise of 22% year-on-year and the highest number since 2009. Just 10% of these warnings were Brexit related, which shows that Brexit is only one factor affecting UK firms.

UK & NI growth forecasts




Source: EY Economic Eye, UK ITEM Club

## Consumers

1.4%
2019 (UK)

Wage growth faster than inflation and low interest rates have created favourable conditions for consumers. There is little sign that Brexit or trade wars are impacting UK consumer behaviour at present. The data reflects an economy with more consumers, more of whom are in work, but who are saving very little. The UK and NI's vulnerability to a consumer slowdown has been well documented. The trigger is unlikely to be interest rate rises, but any sudden loss in confidence would likely push the UK and NI towards recession.

## Government

2.4%
2019 (UK)

UK Government policy remains watchful and still strives to bring government spending back into balance. Any relaxation of the purse strings, given the improvement in the public finances, may reflect a political desire to keep the capacity for stimulus spending for a more challenging time. The lack of an NI Executive is hampering decision making, but as spending is largely determined by Westminster and local Civil Servants, it is modestly increasing in line with GB.

## Investment

-1.0%
2019 (UK)

Weakening investment in the UK is one of the most visible impacts of Brexit and the latest data depicts very sluggish levels. Business investment in machinery and equipment has been very weak, at least in part a side effect of Brexit uncertainty delaying investment decisions. Traditionally, NI has had very low capital investment levels. A steady housing market and continuing inward investment flows suggest more commercial building, but the absence of an Executive does little for public sector investment. The forecast is for investment levels to remain very low until greater Brexit clarity emerges.

## Trade

Exports

2.7%
2019 (UK)

Imports

3.9%
2019 (UK)

The UK trade deficit remains concerning, a reflection of a long-term trend of sustained consumer imports and a struggling exporting sector. Weakening global demand and problems in the auto industry exert further downward pressure on exports. Following a record deficit in January, subsequent months saw a welcome but modest improvement. Recent high profile NI manufacturing closures have hit overall export levels. With little prospect of Brexit clarity until later in 2019 and concerns over global growth, export growth is projected to be modest and overall trade will depend heavily on consumer behaviour.

**Economic outlook**

# Labour market

## ROI maintains momentum, NI slows but unemployment low across the island

The ROI labour market continues to prosper with 81,200 net new jobs (+3.7%) in the year to Q1 2019, exceeding previous Economic Eye forecasts. This builds on the 62,400 net jobs in the year to Q1 2018. Employment growth continues to be broad-based with 12 of 14 sectors experiencing increases over the year. Unemployment fell to 5.0% in Q1, the lowest rate since 2007.

Strong employment gains are forecast to continue in 2019, with the pace of growth slowing in 2020 and 2021 as tighter labour market conditions and accelerating wage growth make it more challenging to fill positions.

NI and UK employment both increased by 1.7% in the year to Q1 2019. The current UK unemployment rate of 3.8% is the lowest since 1974 and NI fell to a historic low of 2.9%. Q1 seasonally adjusted employee job figures exceeded expectations and suggest further job creation in NI. As a result, the contraction in employment forecast for 2019 in the previous Economic Eye report is now not expected until 2020. The delayed Brexit date has positively impacted the employment picture for 2019, but the effects of paused Brexit investment and a reduced labour supply are expected to bite next year. The UK market will experience moderate growth, as low unemployment, Brexit uncertainty and potential restrictions on the talent pool dampen growth.

EY job forecasts

| | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| ROI | 2.8% | 1.8% | 1.6% | 1.5% | 1.4% |
| NI | 0.2% | -0.1% | 0.4% | 0.7% | 0.5% |
| UK | 1.0% | 0.6% | 0.7% | 0.5% | 0.5% |

Source: EY Economic Eye, UK ITEM Club

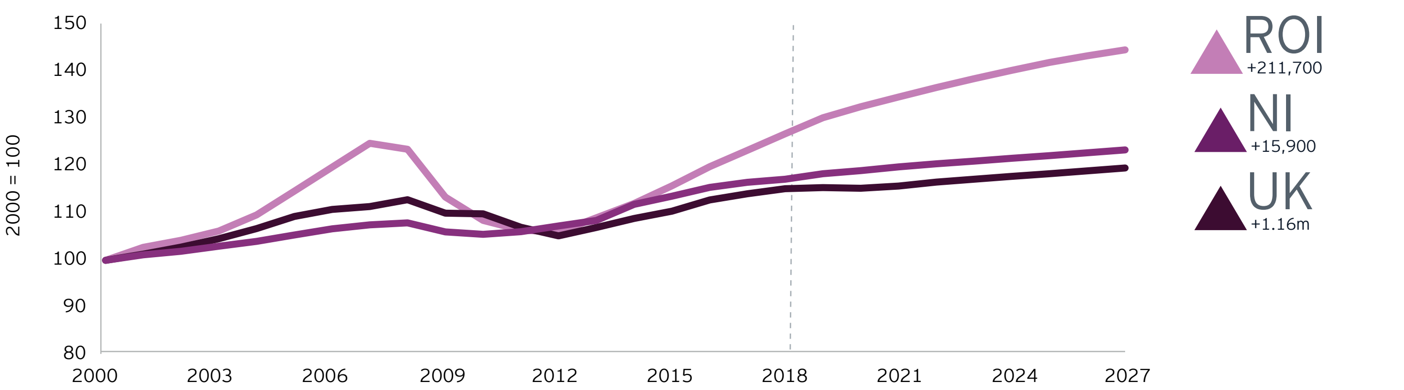
ROI earnings rose by 3.4% in the year to Q1 2019 with an average 1.2% rise in the public sector and 4.2% in the private sector, with sectors such as administration and support services (+10.0%) and transportation and storage (+8.7%) experiencing the largest percentage increases. Inflation remained low for 2018, with a sharp increase to 1.7% in April, but falling back to 1.0% for May. Inflation is forecast to be 1.7% for 2019, as increasing wages and low unemployment allow businesses to edge prices upwards. Any appreciation in the exchange rate with the UK will dampen inflation.

Healthy wage growth is likely to continue in ROI in 2019, with workers commanding higher wages in a favourable job market. 2020 and 2021 will slow as wage costs push employers towards outsourced or technology-based solutions.

[5] Workforce jobs

EY employment forecast

Forecast job growth 2018-2023




Source: EY Economic Eye, UK ITEM Club

NI earnings have performed relatively well, but in a different inflation environment to ROI, meaning growth in spending power has been more muted. UK inflation was running at 2.5% in 2018 but has slowed in 2019, with workers starting to see increased spending power. UK average weekly earnings grew by 3.3% in the year to Q1 2019 and are forecast at 3.2% in 2019 and 2020, and will edge back towards inflation thereafter. Wage inflation is likely to be more modest in NI due to the expected tailing off in job growth and the sensitivity that many investors in NI have to wage increases, given that affordability of staff is a key factor in choosing to locate there.

EY wage forecasts

| | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| ROI | 3.6% | 3.7% | 3.4% | 3.1% | 2.9% |
| NI | 3.1% | 3.0% | 2.9% | 2.8% | 2.8% |
| UK | 3.2% | 3.2% | 3.0% | 3.0% | 3.0% |

Source: EY Economic Eye, UK ITEM Club

EY job growth forecast (2018-2023)

| Sector | ROI | NI |
|---|---|---|
| Agriculture | -5,400 | -1,800 |
| Mining and quarrying | 600 | - |
| Manufacturing | 15,800 | 2,300 |
| Utilities | 3,000 | - 100 |
| Construction | 40,000 | 2,900 |
| Wholesale and retail | 11,600 | -3,200 |
| Transport | 9,600 | 900 |
| Accommodation and food | 25,400 | 2,900 |
| ICT | 20,800 | 5,400 |
| Finance | 6,500 | - |
| Real Estate | 1,700 | 300 |
| Professional services | 18,300 | 3,400 |
| Administration services | 20,800 | 2,400 |
| Public administration | 7,800 | -1,600 |
| Education | 12,800 | - 200 |
| Health | 13,600 | 700 |
| Arts | 3,300 | 100 |
| Other services | 5,700 | 1,600 |
| **Total** | **211,700** | **15,900** |

Source: EY Economic Eye
Note: Totals may not sum due to rounding

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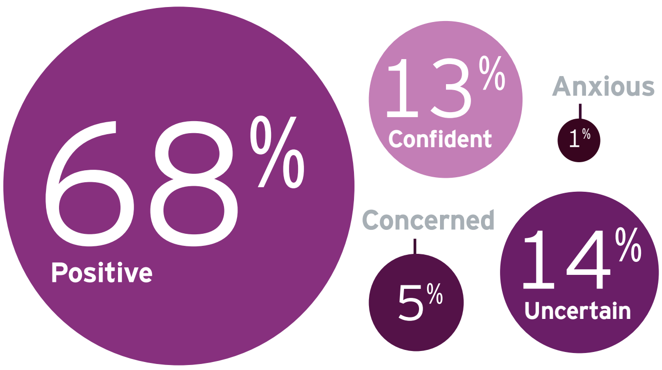
The fact that half a million more people are in employment across the island compared with six years ago is testament to the way firms have approached the well-publicised risks that were expected to derail growth. The downside of this success is that the premium on talent is consistently rising and is unsurprisingly an area of focus for almost all of our clients.

**Neil Gibson**
**Chief Economist, EY Ireland**

# Business sentiment

## Positivity still outweighs concern

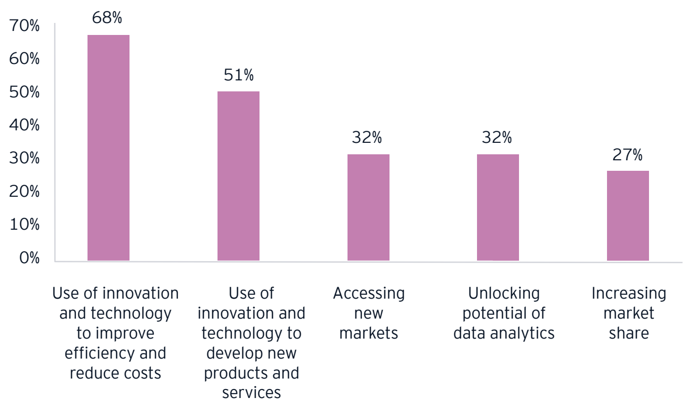
Every year, EY's senior team have over 25,000 conversations with business leaders across the island. Drawing on these, our quarterly gauge of sentiment suggests continued optimism but a recognition of significant risks. 68% of leaders view their clients as feeling positive, suggesting that they are growing and actively pursuing new opportunities. This is encouraging and perhaps unsurprising given job growth across the island. Reported levels of concern or anxiety, where firms would actively cut staff and review their operations, is encouragingly low.




Innovation and analytics top the list of opportunities being actively pursued by clients across the island. Arguably, the economy is always facing disruptive pressures and firms must continually innovate, but the pace of change is accelerating, requiring firms to respond faster. The structural changes in retail are an example of how entire business models are being re-fashioned. Agriculture, manufacturing and professional services are also undergoing disruption as the true potential of analytics and digitisation becomes clearer.

This transformation is blurring sectoral lines, leading firms to hire new people to solve new problems and to provide new ways of thinking with data scientists, analysts and creative thinkers in high demand. In the M&A market, acquisitions are increasingly outside traditional business models. In the short run, this disruption is creating jobs, as firms wrestle with the streams of information and devise ways to compete with innovative new entrants. The threat to jobs in the longer run is clear, but for now disruption is creating opportunity.

### What are the key opportunities identified by clients?

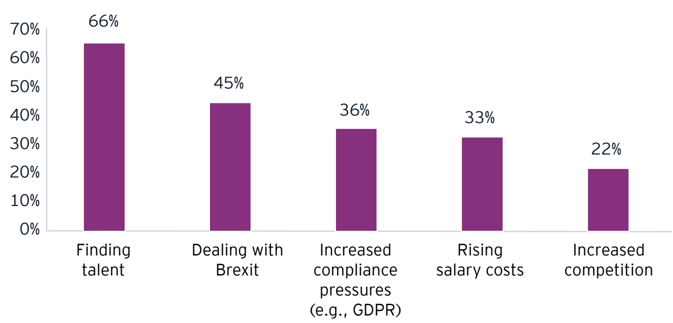



Source: EY 25,000 Conversations sentiment survey

Talent is by far the most frequently cited risk for clients across the island. This reflects the need to hire differently to deal with disruption and sustained levels of demand. Brexit is the second most frequently cited risk, ahead of compliance which has become more prominent. GDPR, just one area of change in compliance, requires a significant adjustment to how firms use and store data at a time when it is becoming more valuable.

Salary costs are the only cost risk in the top five, consistent with the talent message. Notably, geo-political tensions and firms reducing their environmental costs are a top three issue for less than 10% of firms. These are two areas that might prove more impactful than, perhaps, firms are ready for.

### What are the key risks identified by clients?




Source: EY 25,000 Conversations sentiment survey

# Forecast tables

**ROI**

| | Consumption | Government spending | Investment | Exports | Imports | GDP | Modified domestic demand | Jobs | Wages |
|---|---|---|---|---|---|---|---|---|---|
| 2016 | 4.0% | 3.5% | 51.7% | 4.4% | 18.5% | 5.0% | 5.6% | 3.6% | 1.3% |
| 2017 | 1.6% | 3.9% | -31.0% | 7.8% | -9.4% | 7.2% | 3.2% | 2.9% | 2.2% |
| 2018 | 3.0% | 6.4% | 9.8% | 8.9% | 7.0% | 6.7% | 4.5% | 2.9% | 3.4% |
| 2019 | 2.7% | 5.5% | 7.1% | 5.0% | 5.7% | 4.1% | 4.1% | 2.8% | 3.6% |
| 2020 | 2.3% | 4.1% | 5.7% | 4.7% | 5.4% | 3.3% | 3.6% | 1.8% | 3.7% |
| 2021 | 2.1% | 3.5% | 5.2% | 4.7% | 5.3% | 3.2% | 3.3% | 1.6% | 3.4% |
| 2022 | 1.9% | 2.8% | 4.7% | 4.5% | 5.2% | 2.9% | 3.0% | 1.5% | 3.1% |
| 2023 | 1.8% | 2.4% | 4.2% | 4.3% | 4.9% | 2.8% | 2.8% | 1.4% | 2.9% |

**UK**

| | Consumption | Government spending | Investment | Exports | Imports | GDP | Jobs | Wages |
|---|---|---|---|---|---|---|---|---|
| 2016 | 3.1% | 0.8% | 2.3% | 1.0% | 3.3% | 1.8% | 1.7% | 2.3% |
| 2017 | 2.1% | -0.2% | 3.5% | 5.6% | 3.5% | 1.8% | 1.0% | 2.4% |
| 2018 | 1.7% | -2.6% | 0.2% | 0.1% | 0.7% | 1.4% | 0.6% | 3.0% |
| 2019 | 1.4% | 2.4% | -1.0% | 2.7% | 3.9% | 1.3% | 1.0% | 3.2% |
| 2020 | 1.7% | 2.6% | 1.7% | 2.9% | 2.8% | 1.5% | 0.6% | 3.2% |
| 2021 | 1.9% | 2.1% | 2.8% | 3.5% | 3.4% | 1.8% | 0.7% | 3.0% |
| 2022 | 2.0% | 1.5% | 2.6% | 3.8% | 3.8% | 1.9% | 0.5% | 3.0% |
| 2023 | 2.1% | 1.2% | 2.8% | 3.8% | 3.7% | 2.0% | 0.5% | 3.0% |

**NI**

| | GVA | Jobs | Wages |
|---|---|---|---|
| 2016 | 1.7% | 2.2% | 2.8% |
| 2017 | 1.7% | 1.2% | 2.8% |
| 2018 | 1.6% | 0.9% | 3.0% |
| 2019 | 1.1% | 0.2% | 3.1% |
| 2020 | 1.2% | -0.1% | 3.0% |
| 2021 | 1.6% | 0.4% | 2.9% |
| 2022 | 1.6% | 0.7% | 2.8% |
| 2023 | 1.9% | 0.5% | 2.8% |

EY | Assurance | Tax | Transactions | Advisory



86933.indd 04/19. Artwork by the BSC (Ireland). ED None.



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