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Northern Ireland and the border counties of Ireland

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BCIU

II. THE MACROECONOMIC SETTING AND OUTLOOK

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THE MACROECONOMIC SETTING AND OUTLOOK: EXECUTIVE SUMMARY

The economic outlook globally, as well as in Europe and the United States, is favorable both in the near term and longer term for business growth in Northern Ireland and the six border counties of the Republic of Ireland. Given the dominance of exports in the economies of both Ireland and Northern Ireland, prospects for economic growth and job creation rest on growing export markets, specifically the United Kingdom (UK), the rest of the European Union (EU), the United States, and the world economy in general.

- The world economy grew 3 percent in 1994, the fastest since 1989. Prospects for 1995 are for continued strong growth, and long-term expectations are for stronger growth in the next five years than in the last five.

- Growth in the EU is particularly favorable, with the 15 members of the EU now accounting for a total Gross Domestic Product (GDP) of over $7.3 trillion. The EU is widely expected to show real GDP growth of roughly 3 percent in 1995, following the 2.6 percent growth in 1994. This means that the EU's GDP will grow over $200 billion in 1995 -- an amount equivalent to finding a new market the size of Taiwan's!

- Prospects for 1996 are also favorable -- indicating three years of good growth following the worst recession in Europe since World War II.

    This economic setting is critical for the resurgence of economic growth in Northern Ireland and the border counties, for the European Union is by far the largest market for the goods and services produced on the island of Ireland.

- Expected U.S. economic conditions are also favorable for increased business with and in Northern Ireland and the border counties. A sustainable rate of economic growth and moderate inflation augur well for U.S. exports and reduced U.S. import demand, with many U.S. companies looking to expansion of their operations in Europe, both for U.S. exports and for export-related investments.

THE GLOBAL ECONOMIC OUTLOOK

Summary

The world economy improved substantially in 1994 with GDP growing at about a 3 percent rate, the fastest since 1989. Stronger mid decade world economic growth should provide additional export opportunities for goods produced in the Northern Ireland and Ireland economies.

Many industrialized countries, especially in Europe, finally threw off the recession that had plagued the OECD countries since 1990. Developing countries--which generally avoided that recession but whose growth had slowed--also picked up speed in 1994 and the countries in transition from socialism appeared to be bottoming out. The major point of weakness in 1994 was Japan, the world's second largest economy, which, with a greatly appreciated currency, continues to have difficulty resuming a normal growth track.

Cross border trade and investment is driving the recovery. World trade volume (adjusted for inflation) grew 9 percent last year according to the WTO, the fastest growth since 1976.

The recovery in world GDP growth has been accompanied by relatively little inflation--with some exceptions as commodity prices show signs of rebounding from a long slump. This may help some of the commodity-oriented developing countries where growth has been exceptionally weak in recent years. Manufacturing-oriented developing countries, by contrast, have done very well.

> *The outlook for 1995, according to consensus forecasts, is for slightly slower growth in the United States, Canada and the United Kingdom (UK)--all of which have been leading the industrialized countries recovery cycle--but for faster GDP and trade growth in most other countries.*
>
> **Economists view the slowdown in these three key countries as good news, for the expectations are now for a sustainable rate of growth rather than excessive rates of growth which could have led to overheating and inflation.**

Over the next five years, most forecasters expect stronger world economic growth than the weak performance of the first half of the decade

DRI, for example, predicts annual growth averaging 3.2 percent through 2000 compared to only 2 percent annual growth from 1990-1994. Developing countries in Asia are again expected to lead world economic growth with an average 6 percent per year growth, but the gap between their performance and other developing countries of Latin America, Africa and the Middle East is expected to narrow. This year may be the best of the decade for the industrialized countries in terms of growth. DRI expects growth in these countries to slow, but only slightly, over the remainder of the decade.

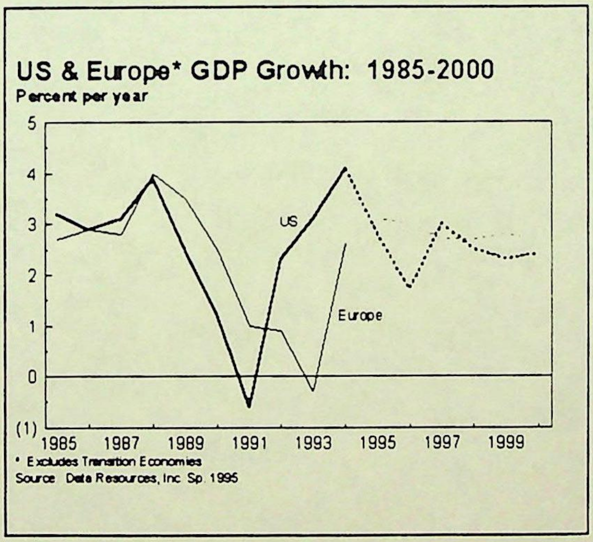
THE EUROPEAN ECONOMIC OUTLOOK

Summary

The European Union and especially the UK economy – will maintain their places as the major, traditional markets for exports from Northern Ireland and the border counties. As the impressive recovery from recession in the United Kingdom and the EU turns into continued steady economic growth, exporting companies in the region will find growing markets for their output. Companies investing in Northern Ireland and the border counties of Ireland can expect to experience a rapidly growing export base, particularly given the competitiveness expected for producing and service enterprises on both sides of the border.

Europe surprised forecasters last year with a stronger than expected rebound from a dismal 1993 performance. GDP growth of about 2.6 percent followed a 0.3 percent decline in 1993 and minimal growth in 1991 and 1992. By the end of last year all of the major countries in the EU were growing fairly strongly.

- Export growth, both to the rest of Europe, to the United States, and to Asia stimulated the rebound. Real exports were up almost 8 percent according to estimates by DRI. Investment growth, especially in Germany, also contributed strongly to growth.



- Domestic consumer demand, in contrast, contributed only slightly to economic growth, hurt by continuing high unemployment and interest rates that remained high relative to inflation. Intra-EU imports expanded rapidly--helped by the continuing impact of the Single Market Act--but import growth from the rest of the world was weak.

- While U.S. exports of investment goods to Europe did well, the generally weak consumer demand limited overall U.S. goods export growth to 5 percent. With U.S. goods imports from Europe surging by 13 percent, the U.S. goods deficit jumped to $8 billion, from $1 billion in 1994.

Forecasters expect European GDP growth to peak this year at about 3.1 percent and to maintain annual growth averaging as much as 2.8 percent through the year 2000, slightly faster than expected U.S. economic growth.

- Consumer spending will have to expand faster than last year to feed this growth and investment will have to remain strong. Imports are expected to grow faster than exports.

- Population growth in Europe is a very slow 0.5 percent per year and declining--in some countries population growth is negative--a constraint on long-term GDP growth.

While most forecasts are optimistic, there are several concerns that could throw the expansion off track. These include:

- Government deficits in Europe averaged 5.2 percent of GDP in 1994, a slight improvement from 1993, but much higher than can be sustained over the long-term. Intense efforts to increase taxes and decrease spending may slow the expansion. Ireland and Luxembourg are the only European Union countries that met the Maastricht fiscal criteria in 1994.

- These deficits reflect large government involvement in their economies. European governments spent 49 percent of their GDP in 1994, by far the highest share of any region. The ratio in Asia was about 31 percent and in North America, about 23 percent. Again, Ireland has less of a problem, with government spending occupying about 38 percent of GDP.

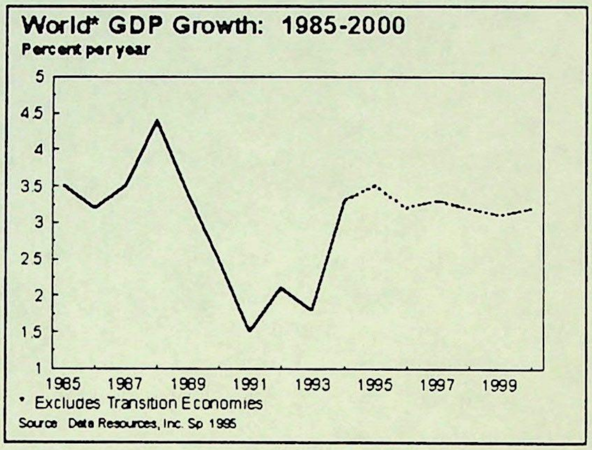
- The strong DM has driven up exchange rates and interest rates in all of the European Monetary System countries and threatens to dampen Europe's overall export competitiveness.

- Unemployment in the EU, although on the decline, is unlikely to fall below 8 percent of the labor force as many structural impediments to the labor market remain. High unemployment rates lower consumer confidence and require larger government transfer payments.

THE UK ECONOMIC OUTLOOK

Summary

The United Kingdom is the major destination for goods produced in Northern Ireland and the Republic of Ireland. While growth is expected to slow from the high rate of last year, growth is expected to continue in a strong and sustainable manner. Consumer demand has been strong in recent years. As capital investment picks up, increased spending for capital goods will occur.



The UK economy is linked strongly to both Europe and North America and its business cycle thus reflects conditions on both sides of the Atlantic. In 1990, when the United States went into recession, the UK simultaneously slipped into recession as well. In 1992, with the U.S. economy in recovery, the UK also began a strong export and consumer-led recovery which it has maintained to the present.

- Like the United States, the UK economy is showing signs of slowing. Forecasters expect growth to slow from 3.9 percent in 1994 to 3.1 percent this year and 2.3 percent by the year 2000. This rate of growth, however, compares favorably to the rest of Europe.

- Also like the United States but unlike the rest of Europe, consumer spending has been strong over the past two years. Unlike the United States, however, investment spending has been growing only slowly.

- Lack of capacity growth is giving rise to new concerns over inflation. Inflation has been well controlled over the past two years but now may be beginning to increase, causing interest rates to rise and possibly cutting off consumer spending growth.

Following a substantial devaluation of sterling in 1993, the UK current account balance shifted from a large deficit to near balance in 1994. Exports jumped 9 percent in real terms last year while imports rose only 4 percent. Forecasters expect export growth to slow gradually and import growth to pick up over the next few years leading to a small current account deficit in 2000.

- The UK sterling is not currently adhering to the European exchange rate mechanism and is free to float against the DM and other European currencies--in effect to depreciate in value and improve its export competitiveness but at a cost in terms of imported inflation.

Northern Ireland in the context of the UK economy

Northern Ireland, as a part of the UK, is a small regional economy closely linked with the national, UK economy. With a population of 1.6 million -- out of the total UK population of 59 million--its GDP accounts for roughly 2 percent of the UK's total. Approximately one-third of the region's manufacturing output is sold locally, one-third to the rest of the UK and one-third in exports. Per capita income is about 10 percent lower than in Great Britain.

- A major problem for the region is *unemployment* . The unemployment rate stood at 12.1 percent in February 1995, compared to 8.4 percent in the rest of the UK.

- *Employment* growth in the past few years, however, has exceeded that in the rest of the UK, and unemployment has declined below its peak of 19 percent in 1986. Northern Ireland thus offers an available labor pool that may offer U.S. companies better opportunities for establishment and growth than in other locations.

Over the longer term, trends in the Northern Ireland economy have closely reflected the rest of the UK, but in recent years--during the 1990 recession and subsequent recovery--Northern Ireland has outperformed the rest of the country in terms of aggregate demand and employment growth. For instance, the 1990 recession lasted 7 quarters in the UK, and industrial output dropped 7.6 percent, but it lasted only 2 quarters in Northern Ireland and output dropped only 2.4 percent. This better performance in part stems from an improved competitiveness of Northern Ireland industry as smaller wage increases and higher productivity gains relative to the rest of the country have dramatically lowered unit labor costs.