Bouncing back or stepping forward?

Economic Eye

Winter 2020

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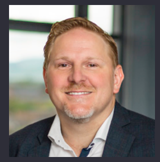

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Executive summary

Bouncing back or stepping forward?

2020 will be remembered as a year of profound disruption and change, one in which our way of living and working has totally transformed. Hopefully, it will also be remembered as a time when we recognised our own fragilities and those of our planet, as well as the need for a proactive and dynamic government to help us through challenging times. The importance of resilience and competitiveness as drivers of our economic future has become clearer. COVID-19 and Brexit are the twin challenges that dominate an assessment of the island economy in late 2020, but the outlook is about more than these two unpredictable forces. Beneath the headlines are pockets of remarkable transformation, ingenuity and prosperity. Firms across the island are not looking to simply bounce back to where they were, they are striving to step forward into a reshaped world full of opportunity. Our forecasts have been revised upwards from our mid-year estimates for the Republic of Ireland (ROI) and are almost unchanged for Northern Ireland (NI). The complexities of the data mean that these revisions are far from the whole story.

EY growth forecasts

	2019	2020	2021	2022	2023
ROI	5.6%	-3.9%	3.5%	3.8%	2.8%
ROI MDD*	3.3%	-7.7%	5.5%	3.9%	2.1%
NI	1.6%	-10.9%	5.5%	2.5%	1.8%
UK	1.3%	-10.1%	6.0%	2.9%	1.9%

Source: EY Economic Eye, UK ITEM Club

November 2020

* Modified domestic demand excludes trade and removes the impacts of IP relocation and aircraft leasing, giving a more accurate picture of the domestic economy.

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Graham Reid
Head of Markets, EY Ireland

EY Economic Eye Winter forecast 2020

> Future economic performance will be driven by the ability to build a more resilient, nimble and creative future.

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EY Ireland

How to measure the impact and form a view of the future?

Uncertain trends in health policy and a complex political environment across the globe have made this the most challenging all-island Economic Eye forecast to produce. The data which forms the building blocks of all economic models is incredibly complex to decipher at present and differences in measurement and policy frameworks make it almost impossible to compare the two economies. Through the lens of GDP, ROI appears to have fared much better than NI. The former contracted by 6.1% in Q2 compared to a fall of 19.8% in the UK (NI is projected to have contracted at a similar rate to that in the UK). The UK economy expanded by 15.5% in Q3, which represents the greatest quarterly expansion since Office for National Statistics (ONS) records began in 1955. However, the re-introduction of COVID-19 lockdown restrictions will be reflected in Q4 figures. In terms of the labour market, adjusted unemployment in ROI currently sits at 20.2% and reached 30.4% in late Spring. No such measure exists in NI, where the latest headline unemployment was 3.7% for the period July - September 2020. Detailed analysis of the data reveals a very similar level of disruption across the domestic economy on the island, with the large multinational sector providing some protection for overall ROI growth. It appears that the UK's decision not to implement an equivalent Pandemic Unemployment Payment (PUP) scheme resulted in more employees remaining on the payroll, at least in the short run.

Pandemic resurgence halting the recovery

Towards the end of the summer, monthly GDP forecast models for the two economies were edging upwards, particularly in ROI as Q2 data was factored in. The resurgence of COVID-19 cases and the return of restrictions have sadly moved the forecasts into reverse. ROI is predicted to contract by 3.9% in 2020 and NI by 10.9% before modest recoveries of 3.5% and 5.5% in 2021. The extending economic fallout of COVID-19 and the latest round of Brexit uncertainty have adversely impacted the forecasts for Q4 2020 and Q1 2021 and this greatly impacts the pace of recovery projected in 2021. The forecasts are based on the assumption that the current policy regime remains broadly unchanged and a light-touch Free Trade Agreement (FTA) emerges from the final round of Brexit trade talks.

Changed forever?

Long-term forecasting typically relies on historical data to help determine the trends and relationships that underpin our economy. Perhaps the profound changes of 2020 make the use of past data ineffective for building future forecasts. The acceleration of digital, the move to online shopping, more time at home, or away from the office and a realignment of what truly matters to citizens may completely change the direction of many sectors across the economy. Our research shows that not all of the changes will be long lasting and many behaviours, ways of working, living and entertaining will re-emerge strongly when safe to do so. Future economic performance will be driven by the ability to build a more resilient, nimble and creative future.

Economic outlook

Forecasts improving, but second wave may impact

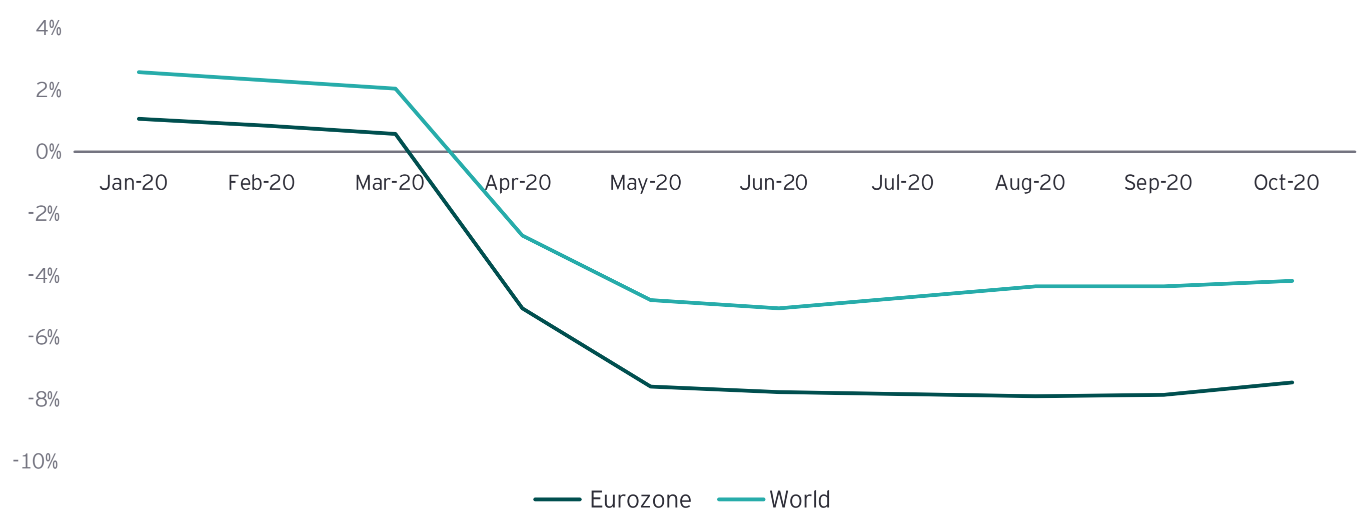
Global

Global forecasts have endured a roller-coaster ride during 2020. Initial projections of the impact of COVID-19 were relatively modest until the true scale of the pandemic and the ensuing necessary policy interventions became clear. Outlooks were subsequently revised down during the darkest months of the first wave in late spring and early summer. However, as restrictions began to lift, the resurgence in spending levels and confidence led to a return to the 'V' shaped narrative and expectations that the bounce back would be swifter than originally expected. Data from China showed a remarkable return to pre outbreak behaviour, with economic activity regaining losses and even travel and consumer behaviours reverting faster than projected.

Sadly, the resurgence in cases and deaths means that forecasts have fallen once again for most developed economies. The largest impact is expected in markets with a greater dependence on adversely impacted sectors – tourism, aerospace, entertainment and leisure. The scale of policy intervention on both the health and economic side also impacts the projections. Brexit and other major factors, such as the US election, are also influencing forecasts, but to a much lesser extent than COVID-19. It is likely the next revisions to the forecasts will, regrettably, be downwards again.

Global growth is expected to contract by 4.4% this year, which would equate to the worst year since records began, and considerably more pronounced than the previous drop of 0.1% in 2009. Only China is currently expected to avoid an overall contraction in headline GDP. Measurement issues mean that it is not possible to accurately compare labour market performance, but for most developed markets, effective unemployment rates have moved into double digits (people who have lost their job or still working but entirely under government support). Challenging economic conditions have impacted global elections this year and have set a different backdrop for the final stages of Brexit negotiations. Very few world leaders feel the same level of confidence they did a year ago.

Evolution of GDP growth forecasts for 2020



Source: Oxford Economics, January - October 2020. Chart shows the forecast for World and Eurozone GDP published by Oxford Economics in each month.

GDP forecasts, key markets

	2019	Revision	2020	Revision
Italy	-10.6%	▲	5.2%	▼
India	-10.3%	▼	8.8%	▲
UK	-9.8%	▲	5.9%	▼
France	-9.8%	▲	6.0%	▼
Euro area	-8.3%	▲	5.2%	▼
Canada	-7.1%	▲	5.2%	▲
Germany	-6.0%	▲	4.2%	▼
Brazil	-5.8%	▲	2.8%	▼
Japan	-5.3%	▲	2.3%	▼
World	-4.4%	▲	5.2%	▼
US	-4.3%	▲	3.1%	▼
China	1.9%	▲	8.2%	–

Source: IMF World Economic Outlook, Real GDP growth, October 2020

Note: Green indicates that forecasts are higher for 2020/2021 than in the previous June 2020 WEO report, red means forecasts have been downgraded.

> "Challenging economic conditions have set a different backdrop for the final stages of Brexit negotiations. Very few world leaders feel the same level of confidence they did a year ago.

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EY Ireland

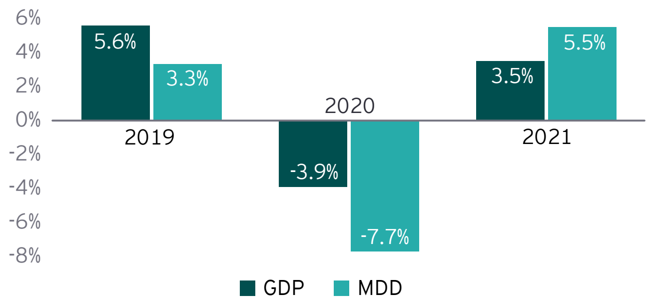
Republic of Ireland

Headline growth forecasts

ROI is projected to suffer its largest year-on-year contraction in GDP since 2009, before bouncing back modestly in 2021 and accelerating thereafter.

The potential for large distortions of headline growth due to IP movements and the impact of the multinational sector mean that the margin of error for this forecast is larger than for almost any other economy in the world. The relatively shallow contraction by European standards is primarily due to the outperformance of exports relative to ROI's peers. A predicted increase in exports of 1.4% in 2020 compares favourably to the contraction of 11.5% projected in the UK. ROI's exports, which are much larger than total GDP, have a huge impact on overall growth. The prolonged period of COVID-19-related disruption and Brexit uncertainty means that the recovery is shallower than in previous forecasts.

ROI growth forecasts



Source: EY Economic Eye. Modified Domestic Demand (MDD) removes the impacts of IP relocation and aircraft leasing, giving a more accurate picture of the domestic economy.

Consumers

-10.7%

Consumer spending is projected to contract by 10.7% in 2020, reflecting periods of restrictions during the year and the increased level of caution due to fears of job losses and future income falls. However, savings deposits have risen sharply and retail sales data in late summer reflect a willingness to bounce back amongst consumers. The measured savings ratio reached an unprecedented 35.4% in Q2 2020, the highest rate on record, with a quarterly increase of more than €10bn in savings.This suggests a very strong potential for a spending bounce, though a significant amount will leak out of the economy as people travel abroad or purchase imported goods. Higher levels of unemployment and the easing of government supports provide headwinds to the 2021 projection of 6.0% growth.

Investment

Investment:

-35.9%

Excluding Intangibles:

-16.8%

Underlying investment (excluding intangible assets) was severely impacted by the lockdown in late spring. With most building sites closed, a quarterly fall of 28.4% was recorded in Q2. With the housing market proving more robust than many forecasters expected and no requirement for sites to close in the latest restrictions, the bounce back has been relatively strong. However, many firms are now assessing their real estate plans and there is increasing evidence of commercial building being paused or postponed. Fortunately, a strong pipeline of government investment spending should provide an offsetting boost, helping investment to a strong forecast of 8.2% in 2021 after a contraction of 35.9% in 2020.

Government

+13.0%

Government spending is expected to contribute positively to Irish GDP in 2020 as increased health spending and other COVID-19-related spending flows into the economy. In the UK, real GDP in the government sector is measured differently and is linked to activity levels (such as numbers of classes run, or operations carried out) rather than wages paid. As such, it fell sharply in Q2 2020. Despite similar increases in nominal spending figures, the government sector is expected to increase by 13.0% in ROI but fall by 8.2% in the UK due entirely to the difference in measurement approach. If a similar measurement methodology is used, government spending trends are very similar across the island. Looking ahead, government spending will be unable to continue rising, due to the substantial increase in the national debt, perhaps €20-25bn. ROI already has one of the highest debt per person ratios in the world, which will require constraint in the future. For now, austerity is unpalatable, politically unpopular and will not be a major headwind for the economy in 2021, with a further 2.1% government spending growth projected.

Trade

Exports:

+1.4%

ROI's export strength in ICT, agri-foods and pharma is almost the perfect combination to support growth during a pandemic. Overall exports are expected to increase in 2020 by 1.4%. Despite the elevated levels of global turmoil, this is much stronger than in most peer economies and is a major factor in ROI's modest fall in GDP when compared to the rest of Europe.

Brexit adds an additional level of uncertainty, primarily relating to the agri-food sector, however, ROI remains one of the most popular relocation destinations for producers moving out of the UK. Exports are expected to remain an important driver of growth with 5.8% projected in 2021, despite possible disruption to trade with Britain, one of ROI's biggest markets.

Imports:

-10.3%

Import demand follows consumer and export performance, but transfers of IP and royalties have a distortionary effect on the headline numbers. These flows are largely offset in the capital investment figures but make interpretation of import data more complex. The strength of exports in 2020 prevents import levels from falling in line with the contraction in consumer spending. It is possible that Brexit will force import substitution, particularly in food, if a deal is not secured by 1 January 2021. This may partly offset the losses projected in exports.

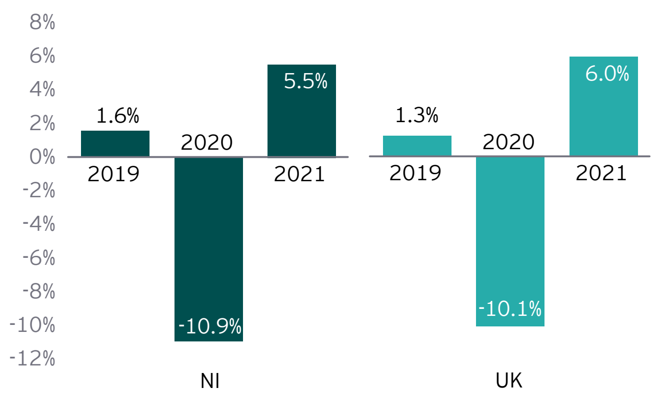
Northern Ireland and the UK

Headline growth forecasts

The NI economy is forecast to contract at broadly the same pace as the UK. NI GDP is projected to fall by 10.9% in 2020 before recovering by 5.5% in 2021, compared to a fall of 10.1% and a rebound of 6.0% in 2021 in the UK.

The region is heavily dependent on consumer sectors and has a concentration of industrial sectors which have been heavily impacted by COVID-19, namely heavy machinery and transport equipment. However, a large public sector provides a level of insulation which prevents a more severe contraction. The forecasts suggest that NI will continue to track UK economic growth rates, albeit lagging slightly due to its sectoral mix.

NI and UK growth forecasts



Source: EY Economic Eye, EY ITEM Club

Signs of underlying weakness as trade deadline looms

The most worrying concern for the NI economy is that the Composite Index (a proxy for overall growth) has been contracting since the start of 2020, before COVID-19 was a factor. This suggests a level of underlying weakness which is far from ideal as the deadline for the post-Brexit UK / EU trade deal fast approaches. The outcome of the final stages of the trade deal negotiations is critical for NI and its economic outlook. Despite the UK having already left the EU, much remains unclear regarding NI's unique position, making it very hard for businesses to effectively prepare.

Worryingly, the InterTradeIreland All-Island Business Monitor reports only 9% of NI firms have made plans for the impact of Brexit. This compares poorly to the figure in ROI of 22%, which itself appears low with just over a month to go. The forecast for NI is partly dependent on how Brexit settles down for the region. There is a degree of optimism that a 'best of both worlds' outcome could be achieved, whereby NI is the most advantageous UK region for investment, with access to both the EU and GB markets. Equally there is nervousness that a 'worst of both worlds' situation is also possible if GB to NI trade is heavily disrupted as the definition of 'unfettered access' is put to the test. Rules of Origin definitions are a further area undergoing debate in addition to a slew of smaller, but no less important issues, relating to mutual recognition of qualifications and data sharing policy. A further complexity to add is the uncertainty surrounding the workings of the Joint Committee to resolve disputes or how they might interpret the language of the policy and legal documents. The absence of EU funds may also be detrimental to economic progress in some areas, though it depends on what alternate support is put in place.

Encouragement in the data

Despite 2020 having been the most challenging year on record for the NI economy, there have been several areas that offer hope and encouragement for the recovery ahead. The labour market has shown remarkable resilience leading up to and throughout the pandemic. Unemployment spiked sharply at the beginning of the pandemic, but stabilised very quickly, remaining at a lower level than projected. This partly reflects the effectiveness of the furlough scheme, which has now been extended, but is also an endorsement of the flexibility and adaptability of NI businesses and workers, a commonly cited positive amongst investors to NI. Strong positive feedback has been reported on many NI firms regarding their ability to keep operating through such a disruptive time, particularly in the professional and administrative services sectors. A high degree of flexibility and nimbleness has been evident as many firms have moved to supplying Personal Protective Equipment (PPE) and most have adapted swiftly to new health guidelines to keep operating. These are important traits in a small open economy such as NI. Further encouragement can be found in the strength of the housing market, with search engine data showing an increased desire for home offices and garden space, which appears to be supporting demand.

Will NI productivity be digitally enhanced?

The headline data is creating a rather perplexing productivity puzzle. If GDP contracts by double-digit levels, but employment by much less, then measured productivity will fall sharply. This is a function of Government intervention which has kept people in work, or more specifically on the payroll, without the firms having any effective demand. A more accurate measure of productivity will come from a measurement of the output per hours worked. Digital technology is unlocking considerable productivity gains across a wide range of firms, but there is a concern that in a region heavily dominated by very small firms, there may be a lack of resources to make this investment. However, in an increasingly broad range of sectors, technology is lowering the cost of entry, removing the cost associated with peripherality and driving competition.

Brexit will require exporters to have better data systems in place and it is becoming clearer that digital progress will be a requirement, not an option.

Long-term strength may lie in broader measures of success

Perhaps one of the most encouraging aspects of the longer-term outlook is NI's strong performance on many quality of life or wellbeing metrics. These are increasingly being considered as a more effective way to measure true economic and social progress and the region is actively embracing them as their framework for the future. This could prove critical to the NI's attractiveness as a destination for investors and workers. It is important to remember that a vibrant economy is central to wellbeing, it should not be a trade-off between economic and societal outcomes.

UK macroeconomic drivers

Consumers

-12.8% (UK)

UK consumer spending is projected to contract by 12.8% in 2020 - a comparable level to ROI, reflecting the broadly similar behavioural impacts of COVID-19. In NI, an early move to enhanced restrictions on 16 October is likely to have curtailed the strong bounce in consumer spending that was underway. If restrictions extend further, there is risk that consumer spending, and consequently, overall growth, will be lower than forecast. However, there are some areas of growth amidst the disruption. Jobs are being created for delivery drivers and in the digital sector, as firms pivot to new operating models. This will help to maintain incomes along with the government support to date, and thus consumer spending is forecast to hold up better than might be expected given close to double digit unemployment rates.

Investment

-17.2% (UK)

Investment levels have long been weak in the UK and despite a commitment to increased government investment, the forecasts for investment growth remains modest, with a contraction of 17.2% forecast in 2020 followed by growth of 3.4% in 2021. In NI, investment levels were also muted, but accelerated public capital investment could provide an important boost if projects can effectively be 'brought forward'. The housing market has been remarkably strong post lockdown, as a backlog of demand works through the system and the inability to spend has caused an increase in deposit savings. This may offset a weak period for commercial investment, as firms rethink their real estate strategy in light of the increased capacity to work from home.

Government

-8.2% (UK)

The NI Government response to COVID-19 was initially deployed by Westminster, but as the policy focus narrows and generic supports are scaled back, more emphasis is being placed on local initiatives to plug gaps and tailor support to local conditions. At a UK level, the government sector is projected to fall by 8.2% in real terms in 2020, despite a strong rise in nominal spending levels and the equivalent NI figure would be similar. It is important to note that the UK approach in measuring the government GDP contribution is very different to ROI and does not reflect a difference in policy effectiveness.

Trade

Exports:

-11.5% (UK)

UK exports do not have as favourable a sectoral mix as ROI, with cars, heavy machinery and oil being the dominant goods sectors, though pharma is also a major UK export as it is in ROI. Overall, the contraction of 11.5% is only partially offset in 2021 with growth of 10.6% projected. For NI, the export base is relatively small (estimated at a quarter of GDP compared to 31% in UK and 128% in ROI) though this is partly because sales to GB are not technically considered exports.

Short-term Brexit disruption presents a downside risk to exports, though it remains possible that longer-term, NI will become the UK's most advantageous location for firms seeking to reach both UK and EU markets.

However, this outcome depends on the detail of any deal reached.

Imports:

-18.1% (UK)

Imports have contracted in the UK, as expected, along with exports and consumer spending which fell sharply. The pickup projected in consumer spending should drive import levels back up in 2021 with growth of 16.3% forecast, though Brexit could disrupt this and drive increased levels of domestic demand, as local suppliers substitute for imports. For NI, it is the detail of the Withdrawal Agreement that has the potential to impact import levels. Will ROI imports become more attractive at the expense of GB purchases, due to new paperwork requirements? At the time of writing, this is impossible to gauge.

"The forecasts suggest that NI will continue to track UK economic growth rates, albeit lagging slightly due to its sectoral mix. A large public sector provides a level of insulation, preventing a more severe contraction."

Professor Neil Gibson

Chief Economist
EY Ireland

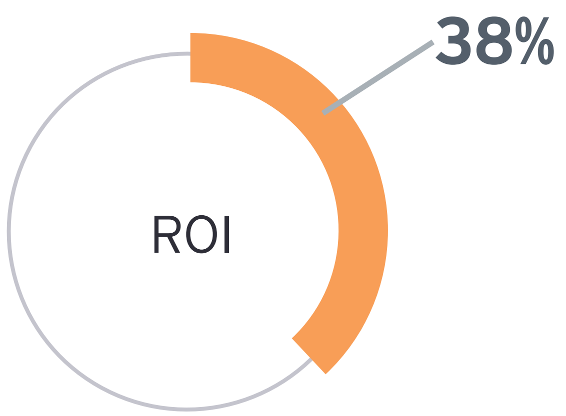
Labour market

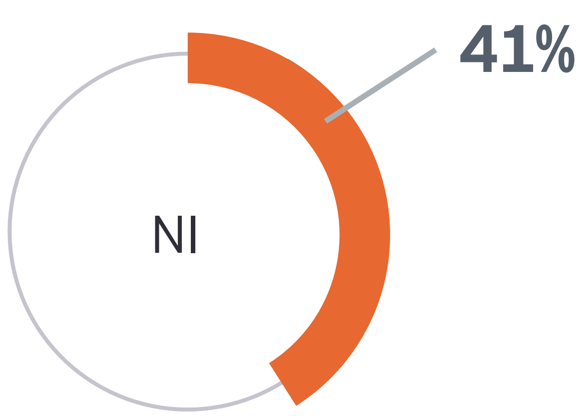
The labour market is usually the 'go to' indicator of economic performance for regional economists. It is more reliable than local GDP estimates, with fewer potential distortions and has often been a key feature of Economic Eye reports. However, the pandemic has brought disruption to even this most consistent of data sources. Differences in policy mix, confusion over measurement of who is in work and who is not, and problems with survey-based data collection have led to a very confusing picture across the island. In ROI, the PUP scheme which initially offered a relatively high level of weekly income for those made redundant, was taken up by 600,000 people at its peak, over 25% of the workforce. No such scheme existed in the UK, where its furlough scheme (paying 80% of wages for people unable to work) was the main intervention.

The broadly similar wage subsidy scheme in ROI was viewed initially as a little more complex and was not as actively adopted. However, the schemes have evolved in both economies, and continue to do so in response to the changing conditions and policy direction. EY estimates a broadly similar level of 'disrupted' employment across the two economies when the various schemes are considered collectively.

The CSO recognises the problems in labour market measurement and publishes an adjusted employment estimate. Using this figure, the losses would be 413,300, a fall of 17.5% on Q4 2019. The same Labour Force Survey (LFS) in the UK and NI does not have an adjusted figure, and with no PUP schemes, it would not be possible to produce one. A loss of just 2.4% is reported for NI in the first eight months of the year, along with a fall of 1.0% in the UK in the headline LFS employment figure.

ROI and NI disrupted jobs estimate





ROI: Disrupted jobs is the peak level of the wage subsidy scheme and PUP in ROI (early May), plus the increase in the Live Register up to that period from February 2020. There may be some overlap in the people who were added to the Live Register but were also on either PUP or TWSS.

NI: Disrupted jobs is the cumulative number of people furloughed as at 31 July in NI, plus the number of people receiving the self-employed support scheme allowance in the first tranche, plus the increase in the Universal Credit (UC) claimant count unemployment between February and May. There will be people who are on UC who are still in work and additionally there may be some overlap between schemes. The furlough number is a cumulative figure and may also include a small number of people who availed of the scheme on two separate occasions.

Making sense of this is extremely complex and is certainly the case in this pandemic year. The Q2 ROI employment figure is almost certainly higher than the 1.8 million published, though lower than the unadjusted estimate of 2.2m. Employment in ROI is forecast to contract by 12.7%, with NI falling by a much more modest 0.8%. This apparent divergence is due to the absence of an adjusted employment figure for NI. The recovery is stronger in ROI, but in both economies, the labour market is not forecast to regain its 2019 peak until 2023. Unemployment is expected to climb to 16.1% in ROI for 2020 on an annual average basis. In NI the LFS unemployment rate is expected to average under 5% for the calendar year, though it was projected to be over 7% by years end. The claimant count rate is expected to be higher, and was projected to reach close to 10% by the end of the year, but the decision to extend the furlough scheme and increase support for the self-employed will hold the rate down. The LFS unemployment rates across the island are forecast to converge somewhat in the forecasts, but NI remains consistently lower, a long-standing feature of the island economy, that is in contrast to GDP performance.

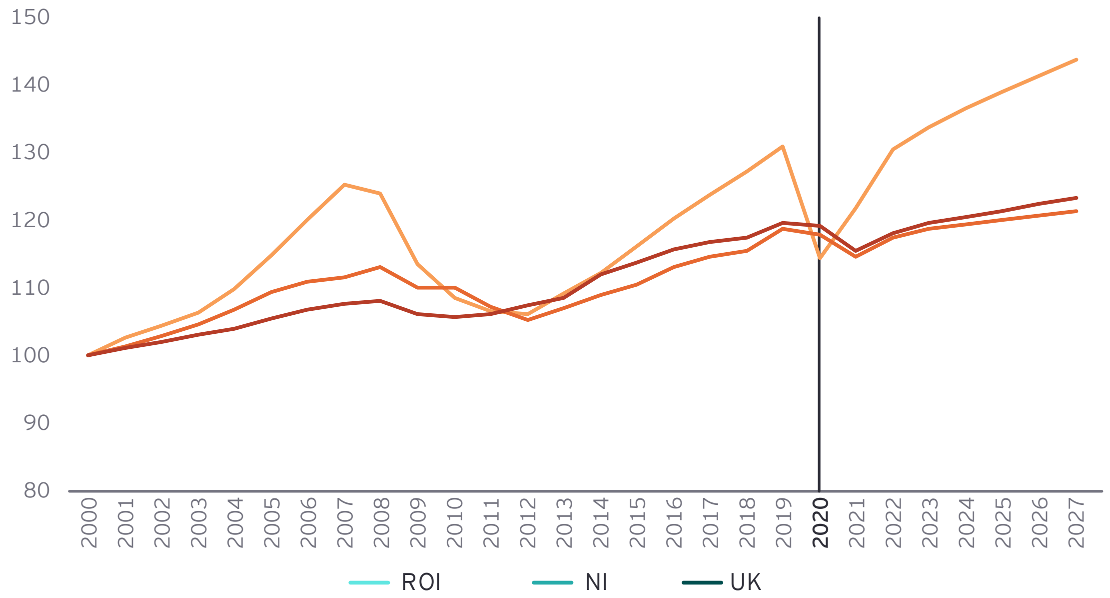
EY job forecasts

	2019	2020	2021	2022	2023
ROI	2.9%	-12.7%	6.5%	7.1%	2.5%
NI	2.9%	-0.8%	-2.9%	2.5%	1.1%
UK	1.7%	-0.2%	-3.1%	2.2%	1.3%

Source: EY Economic Eye, UK ITEM Club

For many sectors, the recovery will be long and arduous, and some may never employ as many people on the island again. Sectoral definitions are becoming increasingly inappropriate for describing the economy, as many firms straddle multiple sectors or have a definition that could be classified in a number of ways. For example, the boundaries between finance, professional services and ICT are increasingly blurred. Nevertheless, the broad sectoral categories provide valuable insight. In ROI, 25.7% of the workforce was employed in retail, accommodation, arts and other services at the end of 2019, the sectors at the front line of the COVID-19 disruption. In NI, the figure is broadly similar at 26.9% (26.6% in the UK). This is a stark reminder of the importance that these jobs play in the island economy and shows the potential labour market, and therefore, societal and community damage that could be caused. What sectors could these displaced workers transfer into? The journey back for accommodation and food, leisure and the arts appears particularly tough. Encouragingly, data from the late summer period shows how much people miss these services, therefore, a bounce back is in store, but the longer the disruption continues, the more challenging the ability to recover.

EY employment forecast



Forecast job growth 2019-2021

Source: EY Economic Eye, EY ITEM Club

EY jobs sector forecast

	ROI	NI
Sector	Back to peak levels	Back to peak levels
Agriculture	2025+	2023
Mining and quarrying	2024	2025+
Manufacturing	2023	2023
Utilities	2022	2024
Construction	2022	2021
Retail	2025+	2025+
Transport and storage	2023	2025+
Accommodation and food	2024	2025+
ICT	2022	2021
Finance	2023	2023
Real estate	2022	2021
Professional services	2023	2021
Admin services	2022	2022
Public admin	2024	2025+
Education	2023	2025+
Health	2023	2022
Arts	2023	2024
Other services	2023	2024
Whole economy	**2023**	**2024**

Source: EY Economic Eye
Note: Shaded sectors are expected to take five years or more to recover to 2019 levels

There is broad consensus across forecasters that ICT and professional services are likely to be major job creators in the UK and ROI, and to a lesser degree, a similar view exists over health. However, there are other areas of disagreement. Manufacturing is forecast to decline in NI by other forecasters and the EY weak retail jobs outlook is not shared universally. The increasing blurring of sectoral lines means caution should be applied to any sectoral analysis, but even with a vaccine in 2021, the labour market will be shaped differently than in the absence of COVID-19 or Brexit.

EY medium-term outlook: job creators (2019-2025)

	ROI	NI	UK
ICT	20,900	4,500	215,500
Health	17,600	9,700	267,600
Professional services	9,000	2,800	136,200
Education	6,700	-800	-28,300
Public admin	2,400	-1,600	-12,500
Utilities	2,300	200	28,000

Source: EY Economic Eye, UK ITEM Club.

Wage data has been heavily distorted by COVID-19. Although average wage data is often used as a proxy for wage inflation, this is only the case if the stock of jobs is broadly similar in the two time periods being compared. With COVID-19 job losses skewed strongly towards lower paid activities, this is no longer the case. In ROI, the average hourly earnings have increased by 7.9% in the year to Q2, with double digit growth in highly disrupted sectors like accommodation or arts. This makes the headline data rather meaningless for comparison purposes and is a challenge for organisations that use it as a basis for pay negotiations. To a lesser extent, inflation data has also been impacted by the shifts in purchasing patterns, meaning that the very low headline inflation levels may not reflect living costs for employees. Looking at the long-term relationship between wages and unemployment (effectively a Phillips wage curve), this suggests that average pay increases should be close to zero if the adjusted unemployment measure is used. Pay setting has become much more complex in late 2020.

"The journey back for accommodation and food, leisure and the arts appears particularly tough. Encouragingly, data from the late summer period shows how much people miss these services, therefore, a bounce back is in store, but the longer the disruption continues, the more challenging the ability to recover.

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Chief Economist
EY Ireland

Brexit

Simon MacAllister
Brexit Lead
EY Ireland

As we rapidly approach the end of the Brexit transition period on 31 December, we know change is coming. Far be it for me to question esteemed psychologist Abraham Maslow, but we currently have just one option. Businesses must step forward into growth because stepping back, or standing still, simply is not an option.

In my experience working with clients on Brexit, previous deadlines were characterised by seeing many businesses take a calculated gamble to do nothing. The reasons for that approach varied, but in hindsight it worked! We know this deadline is different, because the only guarantee is that things will be different. It will impact businesses across the island, and in different sectors, in different ways.

Regardless of whether it is "deal or no-deal", for some businesses the impact will actually be the same, and plans need to be well advanced for key areas like customs and supply chain.

If they have been put in place, for many these plans are unlikely to be the finished article. In this context, what should they be doing now? At EY, we are currently using the framework of "Now, Next & Beyond" to help our clients think about managing change and uncertainty.

There are three issues to consider moving beyond Now, into Next and Beyond.

1. Optimise
2. Build resilience
3. Manage uncertainty

> "In any given moment we have two options: to step forward into growth or step back into safety.
>
> **Abraham Maslow**

Optimise

For many businesses, some solutions they have implemented for 1 January 2021 are likely to be temporary. These solutions are designed to cover the requirements, for example, from customs paperwork, at a minimum or basic level. As the situation stabilises over the first quarter of 2021, businesses need to move to a situation where they are optimising. Whilst it will vary from business to business, that will typically cover:

- Safeguarding trade flows and how the business operates, by examining what is working in the supply chain and identifying areas for improvement. This could be identifying areas for improvement, such as the location of material suppliers
- Taking advantage of alternatives to reducing or eliminating tariffs (depending on location)
- Putting support processes on a permanent footing (e.g. IT and staffing) by streamlining processes and making changes to IT systems which provide the maximum efficiency benefits

These are practical issues, but in the first instance they require businesses to operate with a mindset which retains the ability to look beyond the Now and challenge themselves on how best to move toward Next. Everyone is busy, so in the first instance this is a mindset shift which requires conscious consideration of key issues, and a move away from focusing on the most urgent (but perhaps short-term) problem.

Build resilience

Throughout March and April of 2020, the impact of COVID-19 illustrated the fragility of many supply chains around the world. Just-in-time approaches with tight lead-times are widely used by sectors such as food and car manufacturing. Low stock levels, limited flexibility and a small number of key suppliers contributed to situations where the consumer demand (irrational as much of it was!) could not be met. Interruptions could not be managed properly and there was limited or no redundancy available within supply chains. Other businesses were held back by their lack of IT resilience as they rapidly adopted new ways of working and collaborating.

COVID-19 and Brexit planning teams should be brought together, so the business is looked at holistically or thematically rather than being based on individual issues. As you move to Beyond, how does the business become more resilient? This resilience is across the organisation, including balance sheet, IT, people, supply chain/operations and stakeholder management. For changes you make to these areas, do you sacrifice something else? Finding this balance (whether financial, flexibility, service or people impact) is the challenge, but one which must be addressed to ensure the business is the right shape for the next macro-economic threat.

Manage uncertainty

The world continues on an unceasing arc of complexity and unpredictability. With an unprecedented level of technological development, and a more interconnected world than ever, the complexity of the current landscape is continually increasing. How is your business configured to identify, respond and react to these factors? After COVID-19, Brexit, political turmoil and civil unrest, what's next and what does it mean for your business? Questions to consider include:

- Do you have people with the right skills, resilience and flexibility?
- Do you have processes and IT systems which are adaptable and scalable?
- Do you - or could you - have partners or alliances tailored to help protect or grow your business?

Do your teams contain people who thrive on uncertainty, or are they challenged by it? Will they have the proactivity and flexibility to help bring your business on a mission to change, rather than be constrained by existing structures, policies or practices? Some leaders are best suited to a "steady state" environment but do not have the vision or capability to identify and manage the tension that comes from uncertainty. Start by considering how your existing staff have each reacted and responded to the uncertainty of the last six months, and work from there on identifying areas to address.

An example of process capability is your financial planning & analysis function. Whilst we cannot ask them to guarantee the future outcome, we can expect them to design forecasting tools and frameworks which achieve the following:

- Flexibility to consider varying scenarios
- A forecasting mindset which considers which macro-economic trends will impact the business, and assess the consequences of these trends
- An honest assessment of the probability of outcome, balanced with a realisation of the impact if it occurs
- A response capability which acknowledges a trade-off between precision for speed

In recent years, we have seen many clients enter into alliances with new partners. These alliances take advantage of a speciality or technology, are quick to conclude, can be short term and do not carry the same integration risk as, for example, an acquisition. The financial profile of an alliance is different to an acquisition, but so is the risk.

As the curtain closes on an unforgettable 2020, now is a good time to reflect on what the year has meant for your business. However, more importantly, now can also be an opportunity to consider what you can do, whether relating to Brexit or other issues, to prepare your business for 2021 and Beyond. Businesses on the island of Ireland have shown their adaptability and resilience on many occasions and I expect the next six months will be no different. ■

What lies beyond?

Frank O'Dea
Chief Innovation Officer
EY Ireland

Business leaders across the island of Ireland, and indeed all over the world, are turning their attention to the shape of post-pandemic business. No-one has all the answers, but there are strong themes emerging and most are preparing for major and enduring changes.

The "back to normal" fallacy

The second lockdown has reinforced what many were already thinking. Without an effective deployed vaccine or better treatments, we will have to live with cycles of resurgence and potential mutation that could last for many more months, if not years. The stark reality of safely deploying vaccines at scale is daunting and while the investment levels and endeavour in inventing one is unprecedented, these things take time. In the meantime, better treatments may offer hope of lowering the consequences and fatality rate of infection. Learning from data about infection patterns and transmission may help "manage the peaks" and work towards sustainment in the lower levels of restrictive measures over time.

Most business leaders are seeing significant disruption continuing well into 2021 and for some it is a three to five-year horizon before a "new normality" will evolve. Most are anticipating that business and society is undergoing a permanent metamorphosis which will endure beyond the pandemic. Many are anticipating and designing for their new future state.

Continual economic shockwaves

The economic effects of the pandemic vary greatly by industry with retail, travel, hospitality and leisure industries amongst the hardest hit. Government supports are buffering the economic shock, but business leaders are wondering how long can the supports be sustained? Many businesses are restructuring workforces, debt, rent and other costs to prepare for further economic downside and create a buffer for survival. There is considerable anxiety over the future and the potential to restart and sustain hard-hit areas of the economy as the see-saw impact of lockdowns takes its toll.

On the other hand, some sectors are faring better and technology, telecommunications, life sciences, food and logistics are presenting opportunities for growth.

Most business leaders are seeing significant disruption continuing well into 2021 and for some it is a three to five-year horizon before a "new normality" will evolve.

Mass-market digitisation

The lockdowns and social distancing measures have accelerated digital business. These trends were already happening but the overnight shift to digital by the traditionally slow adopter consumer segments has seen a landslide to digital customer interaction and cashless transactions. There has been a surge in uptake by digital first timers and an extension of digital service consumption to a wide array of emerging new services such as medical consultations, fitness training and education.

Business to business interaction has gone virtual in the absence of trade shows, reps on the road, conferences and other traditional sales and marketing channels. Digital logistics have been ramped up and investments are being made in automated warehousing and transport to deliver everything door to door.

Many traditional businesses have been scrambling to create new digital customer interfaces and smaller business have struggled to compete with the customer experience and analytics on offer from global online retailing giants.

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From quick-fix tech to sustainable solutions

There is nothing new about remote working. In 1998 Mahon Apgar IV wrote about "The Alternative Workplace: Changing Where and How People Work" in the Harvard Business Review. He describes an experiment conducted in 1994 by AT&T involving 100,000 of its employees staying at home and "telecommuting". Fast forward 26 years and COVID-19 catapults most office workers on the planet into a similar experiment. So how is it working out?

Overall business leaders are relieved at how quickly their organisations have been able to sustain business working from home (WFH). In most cases, their technology was imperfect for a long-term switch and had been designed for partial WFH policies. Investments have been ramped up to implement enduring and secure WFH infrastructure, usually with video and collaboration software. Continued assistance to employees with their telecommunications bandwidth and home office ergonomics are high on the agenda but slower to progress. In the long term, it is expected that technology will not be a limiting factor and that the whole experience will improve with the deployment of better broadband and emerging innovations such as 3D headsets.

Leaders believe that overall productivity has been maintained for most of those who had to suddenly WFH. However, there is a considerable investment required to move out of "emergency" mode and into a sustainable future of remote working.

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The people and culture conundrum

Business leaders are universally concerned about the impact of WFH on their employees. The potential effects of isolation and the wider COVID-19 human impacts on wellbeing and mental health are top of mind. Measures to survey and check in on staff have been widely implemented.

The surveys are showing most employees would like to continue to WFH to some extent in the future, a hybrid of home and offices. At the extremes we are finding 5% to 10% who either want to be fully back in the office or who want to be fully WFH. Health concerns are weighing heavily on the minds of employees, particularly in relation to transport to and from the office rather than the office itself.

While the "gloss is wearing off," many employees are reporting better work-life balance due to reduced commute time. However, difficult home working environments, isolation and childcare are considerable concerns. Many employees are also reporting difficulty managing time and switching off, as work and home life are merging.

Engagement levels overall appear to be sustained where leaders have taken a concerted effort to host calls, create a feedback loop and check in with employees. Leaders are highly concerned about the loss of cultural connection and support as new employees are onboarded. "Managing by walking about" is sorely missed by leaders and customer relationship managers. The hybrid model is seen as allowing an essential physical in-person human interaction to augment the 2D video call which lacks "chemistry".

Hybrid models for collaboration, innovation and esprit de corps

There are major concerns about collaboration and teamwork which are seen as key to innovation and maintaining the "esprit de corps" of the people in organisations.

Leading organisations have been learning from "born on the web" companies who use collaboration technologies to facilitate ideation and design thinking sessions. However, even the most advanced are missing the opportunities to bring people together physically at times.

The areas consistently called out by leaders as needing physical interaction include: kicking off projects, forming new teams, major project review stages, brainstorming, ideation and sustaining a cadence of team interaction.

Most organisations are re-thinking their use of space as restrictions persist and capacity is limited. Many are seeing a repurposing of traditional office space to collaboration space where people come with a specific purpose to collaborate. When they are not working together, they are WFH. Organisations are also considering satellite offices to provide near-home options for employees rather that one central location. The "network of locations" model is emerging to provide options on "where" work gets done.

Some organisations are also increasing the flexibility in terms of "when" work gets done. In some cases, this is to help "flatten the peak" of demand for restricted space, but it is also seen as an opportunity to provide a better work-life balance for employees. Many businesses had already been drifting into a pattern of high office occupancy for three days of the week and very low occupancy for the remainder. They are seeing opportunities to provide a better work-life balance, better more purposeful collaboration while at the same time lowering the cost by "flattening the peak" and having between 40% to 60% of people working remotely at any time.

There are some leaders that point to the low past uptake of working from home such as the AT&T example of 26 years ago. They argue that presenteeism will mean that once some people move back into the office, the fear of being "out of sight and out of mind" will win out and more people will opt to be back in the office and commuting.

Others fear the "worst of both worlds" where the hybrid model means that teams are spread out and productivity suffers as some are in and some are out. They cite the famous cases where organisations have reversed WFH policies and forced everyone back to the office in the name of productivity.

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The future is agile

It is difficult to maintain energy and concentration for long video meetings. Video calls with smaller numbers of people are more effective. In a world where physical and virtual meetings are small and short, leaders are looking at ways to divide up the work into more manageable chunks. They see the future as lots of smaller interdependent things being progressed in shorter "sprints" which will require management to learn new ways of co-ordination.

Leaders have been taking major decisions at an unprecedented pace in the light of uncertainty and sudden change. A "new leadership muscle" is being developed to be ready for all eventualities and to be agile in responding. Decision-making processes are being fast tracked and data is seen as key to making the right decisions quickly. Extracting the insight from data to inform critically important decisions for the business has become central to navigating through the uncharted waters of the pandemic.

Business and societal convergence

The pandemic has caused many leaders to reflect on the role that business can and must play in wider society. The value of frontline health workers and other essential but sometimes unrecognised services has come into the spotlight in protecting us all at unprecedented scale. Many business leaders are stepping up to see how they can give something back to limit the wider downside and help emerge well. Community has become more important to employees as they reconnect locally and there is a greater awareness of the environmental consequences of a commuter-based model.

There is a recognition that the burden of restarting the economy cannot rest entirely with government. Businesses can invest in creating jobs, apprenticeships, reskilling and education to the benefit of society as a whole. Big business has a role to play in helping small and medium businesses. There is a growing recognition that in the long term, individual businesses can only be successful if the whole system is fully functional. It is all about long-term value and the right big picture.

Unifying business and society around this common purpose could be the most important aspect of what lies beyond. ■

> It is all about long-term value and the right big picture. Unifying business and society around this common purpose could be the most important aspect of what lies beyond.

Key conclusions

On the global outlook...

Global growth is expected to contract by 4.4% this year.

On the Irish outlook...

ROI economy set to contract by 3.9% in 2020 before returning to growth of 3.5% in 2021. The NI economy is forecast to fall by 10.9% in 2020 before recovering by 5.5% in 2021.

On the labour market...

Almost 2 out of every 5 jobs in the Republic have been disrupted.

On Brexit...

Exporters will need to have better data systems and digital progress will be a requirement, not an option.

On the future...

Economic performance will be driven by the ability to build a more resilient and nimble future based on data to inform critically important decisions.

EY Economic Eye Winter forecast 2020

Summary forecast

ROI

	Consumption	Government spending	Investment	Exports	Imports	GDP	Modified domestic demand	Jobs	Wages
2018	2.8%	5.8%	-6.2%	11.1%	4.0%	8.5%	4.3%	2.9%	3.3%
2019	3.2%	6.3%	74.8%	10.5%	32.4%	5.6%	3.3%	2.9%	3.6%
2020	-10.7%	13.0%	-35.9%	1.4%	-10.3%	-3.9%	-7.7%	-12.7%	0.8%
2021	6.0%	2.1%	8.2%	5.8%	5.8%	3.5%	5.5%	6.5%	2.1%
2022	3.2%	1.6%	6.1%	4.8%	5.5%	3.8%	3.9%	7.1%	3.0%
2023	2.0%	0.3%	3.0%	4.6%	5.1%	2.8%	2.1%	2.5%	2.8%

UK

	Consumption	Government spending	Investment	Exports	Imports	GDP	Jobs	Wages
2018	1.4%	0.6%	0.4%	3.0%	2.7%	1.3%	0.6%	3.0%
2019	0.9%	4.1%	1.5%	2.8%	3.3%	1.3%	1.7%	3.5%
2020	-12.8%	-8.2%	-17.2%	-11.5%	-18.1%	-10.1%	-0.2%	0.9%
2021	7.6%	6.6%	3.4%	10.6%	16.3%	6.0%	-3.1%	2.3%
2022	3.0%	2.3%	9.0%	5.5%	7.3%	2.9%	2.2%	2.9%
2023	2.0%	2.0%	2.9%	3.4%	3.8%	1.9%	1.3%	3.0%

NI

	GVA	Jobs	Wages
2018	-0.5%	0.8%	2.5%
2019	1.6%	2.9%	3.0%
2020	-10.9%	-0.8%	0.4%
2021	5.5%	-2.9%	1.8%
2022	2.5%	2.5%	2.4%
2023	1.8%	1.1%	2.6%

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