,

**Jersey's Fiscal Policy Panel**

**Deputy Sam Mézec**

Chair Corporate Services Scrutiny Panel

Scrutiny Office, States Greffe, Morier House

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18th August 2022

**Corporate Service Panel - Cost-of-living Mini-budget review**

Dear Deputy Mezec

Chief Economist Thomas Holvey passed on your letter asking for the Fiscal Policy Panel's (FPP) views in relation to Corporate Services Scrutiny Panel's review of the recent Mini-Budget. We are pleased to respond to this request.

Your letter asks for views on eight key areas. As you will be aware, the FPP has a defined Terms of Reference, and we seek to remain within those ToR in our commentary. So below we have responded only on questions which fall within our remit, which generally precludes comment on specific taxation or expenditure measures. However, with regard to your first question, it might be helpful to comment that the FPP was not specifically consulted on the size of the package in the Mini-Budget, although when we produced our July 2022 report we were aware that this kind of policy initiative was under active discussion.

Turing to your question about the economic impact of the proposed budget measures. It was apparent when we visited Jersey in June that the economy was robust - indeed we judged it to be above trend capacity with a number of sectors facing upward wage pressure. However, many households were starting to struggle with the rising cost of living (due primarily to a combination of higher fuel and food prices, exacerbated by sterling weakness) and this seemed set to worsen later in 2022.

Since our visit the upward trend in energy prices has intensified, and the IMF's forecasts for global growth have been revised downward. For the UK, Jersey's major trading partner, the Bank of England now expects a period of modest recession. In the absence of any policy action, Jersey's economy was likely to be somewhat weaker over the next 18 months than our July forecast, with government tax revenues consequently smaller. Offsetting this somewhat, a slightly stronger expected path for interest rates may bring further profit growth for the Jersey banking sector and so support government finances. Lower-income households are still set to experience an erosion of their inflation-adjusted disposable income after paying for essentials such as food and fuel.

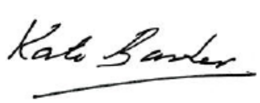
The scale of the Mini-Budget is significant at £45 million (excluding the change to income tax allowances that was previously planned). This is around 2% of estimated annual household income and less than 1% of the GVA estimate for 2022. It is likely to have a more significant impact for lower and middle income households. The Government needs to strike a difficult balance: doing too little will leave low-income households bearing disproportionate costs; doing too much will adding upward pressure on inflation. Given the deteriorating outlook, the scale of this package seems reasonable. But this judgement is made against a highly uncertain backdrop.

The next question is whether the proposed budget measures align with appropriate macroeconomic policy for Jersey. There are two main considerations here. The first is the inflation concern set out above. This risk is amplified by the facts that the economy is already close to full employment. Stimulus spending in an island economy that is at capacity will to some extent be spent on imports (or kept as savings) rather than producing beneficial second round effects for the local economy. However, given the size of the package, and the scale of the probable shock to households and business of higher energy prices, at present long-term inflation is not a major concern. This could change, given uncertainty around the scale and persistence of the energy price shock, and the prospects for the UK economy. As a consequence, the Government should consider whether any of the support could be readily withdrawn in the event that the gloomy predictions prove to be overdone.

The second consideration is whether this is an appropriate balance for fiscal policy. With an economy running above long-term trend capacity the FPP would normally recommend a budget surplus with funds used to pay down borrowing and rebuild the depleted stabilisation fund. Although we have not seen any updated projections from Treasury, the Mini-Budget paper indicates that a surplus is still expected after the costs of this package are met. However, the size of the surplus is important as both the repayment of the RCF and some rebuilding of the stabilisation fund will be needed. If, for example, the energy price shock proves prolonged, and interest rates were to fall (removing the financial sector boost to Jersey's finances) this would mean difficult fiscal choices lying ahead.

The final issue you raise is how will monetary relief provided through the budget be recovered. The present robust outlook for the public finances suggests that this is not an immediate concern - however as outlined above the Government will need to consider all the policy implications should there be a persistent higher energy price level.

Yours sincerely



Dame Kate Barker (Chair)

Professors Francis Breedon and Richard Davies