Jersey's Fiscal Policy Panel

Senator Alan Maclean
Minister for Treasury and Resources
Cyril Le Marquand House
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2 August 2017

Dear Minister

Economic Assumptions

Please find attached our latest economic assumptions (figure 1 attached) which the Panel have overseen for the purpose of updating the States financial forecasts ahead of Budget 2018. This is in keeping with our responsibilities under the Council of Ministers' published Fiscal Framework.

In arriving at these assumptions we have considered the latest developments in the Jersey economy following our fact finding visit to the Island in July. We have also drawn on the latest information on the UK and international economies.

The IMF have identified in their latest World Economic Outlook that while the global economic recovery is firming they have lowered their forecast for the UK given the economy's tepid performance so far this year. The IMF also highlight that the ultimate impact of Brexit on the UK remains unclear.

On assessing the situation in Jersey we have concluded that the significant levels of uncertainty that we identified in our 2016 Annual Report and reiterated in our letter to you in March this year remain. That is, considerable uncertainty regarding the likely short- and long-term economic implications of the UK's exit from the EU, and the impact on Jersey, and the on-island uncertainties around the financial sector's performance.

Since our March letter the developments in the Jersey economy have been largely positive. In particular:

- Total employment in December reached the highest on record and was 1.3% higher than a year previous. The increase was driven by growth in private sector employment, particularly in private sector services and construction. Overall, growth in employment in 2016 turned out slightly higher than expected.
- Inward migration in 2016 reflected the strong growth in employment in 2016 with net migration of 1,300 people, down only slightly from that of 1,500 in 2015. This will contribute to growth in total output.
- The latest data on registered unemployment suggest a continuation of these strong labour market trends into 2017 with the unadjusted total standing at 1,000 in June, 390 lower than a year earlier and the lowest recorded since October 2009.
- The Business Tendency Survey (BTS) for June 2017 shows a slightly more positive response for 2017Q2 than that for 2017Q1. The headline business activity indicator has improved slightly, as has the indicator for new business. Businesses overall are slightly more optimistic and future expectations about business activity and employment remain positive. These general trends are reflected in both the finance and non-finance sector although finance is generally more positive than non-finance. Similar sentiments were expressed to the Panel on their fact finding visit in July.
- The BTS did suggest that cost pressures remain strong and businesses reported this to the Panel on their fact finding visit and that it was largely a result of the fall in the value of sterling. The survey results point to pressure on prices across the

economy and profitability in non-finance. In addition there was modest concern about upward wage pressure in some sectors.

- Headline inflation in Jersey was higher than expected in the first quarter of 2017 but fell back to 2.5% in the second quarter. This means that inflation on average in the first half was in line with our previous forecast of 2.7% for 2017. We expect the continued weakness of sterling to keep some upward pressure on inflation in Jersey going forward. Given the UK is experiencing the same trends we have assumed that inflation will move in line with the UK and fall back again in 2018, assuming there is no further downward pressure on sterling.

It is notable that the performance of the financial services sector in 2016 was worse than expected. GVA of the finance sector fell by 2% in real terms, with profits falling 2% and expenditure on employment falling by 1%. The fall in finance GVA was driven by a sharp fall in banking GVA which fell 6% in real terms and which overshadowed growth in the trusts sector. There were already signs that banking profits were under pressure and banking employment fell in 2016 but overall these trends suggest there may have been little overall growth in the economy in 2016. The Panel have noted that financial services profits can be volatile and have assumed that profits will grow in line with the latest results from the Business Tendency Survey in 2017, although this has not been a reliable indicator in recent years. Thereafter it is assumed that they will remain flat in real terms over the forecast period. This is notwithstanding the generally positive picture for financial services painted by the BTS and the discussions with the finance industry during the Panel's fact finding mission, but takes into account the uncertainty about Brexit consequences. On the whole, GVA trends in 2016 look to have been worse than expected although the underlying performance of the economy seems quite strong and this should mean there are good chances of moderate growth in 2017. However, the medium-term outlook for the Jersey economy has not changed and the challenges remain the same as those we have previously highlighted:

- Uncertainty regarding the precise implications of the change in the UK's relationship with the EU for the Jersey economy. During the fact finding visit this was reiterated by businesses across all sectors of the local economy;

- Despite some optimism about trends in the short-term, continued economic, competitive and regulatory challenges face the financial services industry in Jersey;
- The ageing of the existing population will provide fiscal and economic challenges similar to those in other economies facing the same demographic pressures;
- Productivity for the finance sector as a whole decreased by 4% in real terms in 2016 and serves as a reminder of the need to address the weakness in the underlying rate of productivity growth in Jersey across the whole economy.

The Panel will update its analysis of the long-term trend rate of growth and degree of spare capacity in the Jersey economy as more information becomes available but at the moment the policy advice from our previous reports holds: the focus in the medium-term should be on balancing the States' current budget by 2018/19. While it is still appropriate to support the economy in the short term, attention must remain firmly on putting in place measures that contribute to balancing the budget.

The Panel are concerned that, following the decision not to bring forward a new health charge, the States has also delayed the decision on waste charges. It is not within the Panel's remit to comment on individual fiscal measures but if these decisions are a sign that the revenue raising measures originally proposed in the MTFP Addition are proving difficult to introduce then this will limit the ability to balance the budget as the economy reaches the trend level of output. It is therefore imperative that equivalent expenditure and/or revenue measures are put in place to deliver the same degree of fiscal balancing as previously planned in the MTFP Addition by 2018/19. With reasonably positive short-term economic indicators, this is surely a good time to introduce the measures needed.

This is because States' finances are likely to face additional structural pressures in the medium-term, as set out above. Failure to make the required adjustment in the current MTFP period will only serve to require larger adjustments in the future and increase the risk that Jersey continues to struggle to address the underlying structural pressures in its finances.

We hope that you find these comments helpful as you plan for Budget 2018 and we will expand on some of these issues in more detail in our next Annual Report due to be published in October.

Yours sincerely

Kate Barker (Chair)

Tera Allas and Francis Breedon

Figure 1: Economic assumptions
% change unless otherwise stated

	2014	2015	2016	2017	2018	Return to trend 2019	2020
Real GVA	4.9	*2.2*	0.2	1.2	0.6	0.0	0.0
RPI	1.6	0.6	1.7	2.8	2.4	3.3	3.3
RPIY	1.6	0.6	1.7	2.8	2.4	3.0	3.0
Nominal GVA	6.6	2.9	1.9	4.0	3.0	3.0	3.0
Company profits	12.3	-0.7	0.9	3.9	2.9	3.0	3.0
Financial services profits	19.4	-7.6	*-0.6*	4.0	2.4	3.0	3.0
Compensation of employees	2.1	5.9	2.8	4.0	3.0	3.0	3.0
Employment	2.3	2.0	**2.0**	1.0	0.5	0.0	0.0
Average earnings	2.6	1.8	2.1	3.0	2.5	3.0	3.0
Interest rates (%)	0.5	0.5	0.4	0.2	0.3	0.4	0.5
House prices	3.0	4.0	4.0	3.0	3.0	3.0	3.0

New outturns in bold

March assumptions

	2014	2015	2016	2017	2018	Return to trend 2019	2020
Real GVA	4.9	*2.2*	1.5	1.0	0.0	0.0	0.0
RPI	1.6	0.6	*1.7*	2.7	3.0	3.3	3.3
RPIY	1.6	0.6	*1.7*	2.7	3.0	3.0	3.0
Nominal GVA	6.6	*2.9*	3.2	3.7	3.0	3.0	3.0
Company profits	12.3	*-0.7*	2.8	3.7	3.0	3.0	3.0
Financial services profits	19.4	*-7.6*	2.6	4.4	3.0	3.0	3.0
Compensation of employees	2.1	*5.9*	3.6	3.7	3.0	3.0	3.0
Employment	2.3	1.9	1.5	0.8	0.0	0.0	0.0
Average Earnings	2.6	1.8	2.1	2.9	3.0	3.0	3.0
Interest rates (%)	0.5	0.5	*0.4*	0.3	0.4	0.6	0.8
House prices	3.0	4.0	*4.0*	3.0	3.0	3.0	3.0

Change

	2014	2015	2016	2017	2018	Return to trend 2019	2020
Real GVA	0.0	0.0	-1.3	0.2	0.6	0.0	0.0
RPI	0.0	0.0	0.0	0.1	-0.6	0.0	0.0
RPIY	0.0	0.0	0.0	0.1	-0.6	0.0	0.0
Nominal GVA	0.0	0.0	-1.3	0.3	0.0	0.0	0.0
Company profits	0.0	0.0	-1.9	0.2	-0.1	0.0	0.0
Financial services profits	0.0	0.0	-3.2	-0.4	-0.6	0.0	0.0
Compensation of employees	0.0	0.0	-0.8	0.3	0.0	0.0	0.0
Employment	0.0	0.1	0.5	0.3	0.5	0.0	0.0
Average Earnings	0.0	0.0	0.0	0.1	-0.5	0.0	0.0
Interest rates (%)	0.0	0.0	0.0	0.0	-0.1	-0.2	-0.3
House prices	0.0	0.0	0.0	0.0	0.0	0.0	0.0

OUTTURNS