Jersey's Fiscal Policy Panel

Deputy Susie Pinel
Minister for Treasury and Resources
(copied to all States Members)

23 March 2020

Updated Economic Assumptions

Dear Minister,

Thank you for your letter dated 18 March. The Panel is acutely aware of the disruption to the global economy that you outline in your letter and therefore the need to update its economic forecast and provide revised fiscal advice. The impact of the Covid-19 outbreak looks likely to represent mainly a short-term shock to demand. However, there is a risk that this could lead to longer-term structural weaknesses and therefore the Panel advises that these are the circumstances in which drawing on the Strategic Reserve is appropriate, in addition to use of the Stabilisation Fund, to support the economy. This is a fast-developing situation and we will update this advice as required.

The Panel's updated economic assumptions are included at Annex 1. These updated forecasts are made at a time of extreme uncertainty regarding the short-term outlook for the global economy, and for Jersey. The Organisation for Economic Cooperation and Development (OECD) has identified the global Covid-19 pandemic as the greatest threat to global growth since the financial crisis.

During March the severity of the health crisis and its probable economic effects have become clearer. Financial markets have been highly volatile, reflecting expectations for sharply weaker growth, with several equity indices seeing their largest falls since the financial crisis. Oil prices saw one of the biggest single-day falls in history, following significant increases in supply from Saudi Arabia – combined with expectations for subdued demand. Crude oil prices reached their lowest level since 2003, having fallen by more than 50% since the beginning of 2020. The immediate outlook for financial markets and oil prices is extremely uncertain.

As the virus has continued to spread, the expected negative impact on the global economy has intensified with all major European economies expected to experience severe contraction this year, in addition to significant economic disruption throughout Asia and in North America. The global economy is highly likely to fall into recession in the first half of 2020. As a small open economy, dependent on global trade, this will have significant effects on Jersey.

Even before the outbreak, data on the local economy suggested that there was a mild slowdown during 2019; in line with the Panel's October forecast. Now the outlook for 2020 has worsened significantly. The full health impact of the global pandemic has not yet been felt in Jersey, with a small number of confirmed cases to date. However, modelling undertaken by Jersey's Health and Community Services Department suggest this will increase in the coming weeks. While Jersey's government is committed to taking measures to slow the spread of the virus, the modelling indicates that even the most stringent efforts will not be able to stop the spread of the virus.

The Minister has requested the Panel to consider the impact of this on the economic outlook. It is very difficult to anticipate how this will manifest but there are a number of different transmission mechanisms, including:

1. Supply chain disruption – So far there has not yet been any significant disruption to supply chains as a result of the virus. There are some shortages in retail outlets, but this is attributed to panic-buying of non-perishables and specific items to combat the virus, e.g. hand-sanitiser. However, most of Jersey's goods come from or through the UK and as the number of infections increases there, there is likely to be some disruption to either the production or transport of goods. This is in addition to the broader disruption already to global supply chains.

2. Labour shortages – As infection rates increase in Jersey, this will result in increased time off work due to sickness. Self-isolation is also being advised for certain individuals, to prevent the spread of the virus. In addition, closing schools will result in many working parents and carers needing to stay at home. While many employees will be able to work from home during self-isolation, this will not be the case particularly for sectors that involve face-to-face interactions. For example, Jersey's financial sector is likely to see less disruption due to staff absence than might be the case in the residential care sector.
3. Demand shock – Jersey's government has advised individuals to self-isolate if they have returned from a prescribed list of affected areas; or if they are showing symptoms of the virus. In addition, social distancing has been advised for those aged 65 and over and is likely to be adopted to some extent by residents of all ages, as a precautionary measure. Coupled with what could be a severe fall in visitor numbers, this will result in a significant contraction of demand for local goods and services.
4. Permanent effects - Although we expect the direct economic impact of the virus to be severe but temporary, a prolonged period of economic dislocation may have permanent effects by, for example, pushing some firms and individuals into bankruptcy – a key policy goal should be to minimise these impacts.

Some activities will be hit harder than others. The hospitality and leisure/culture sectors will experience a decline in revenues as locals avoid public places, in addition to the loss of visitors. The travel sector is already facing challenges caused by the reduction in travel, with the collapse of Flybe at least partly driven by the global pandemic. While labour shortages will affect a range of sectors, it will be most acutely felt if there is disruption to the provision of essential services – not least the medical and care sectors, which will also see a spike in demand.

The Panel encourages Government and the private sector to coordinate as far as possible so that spare resources freed up from the lack of demand in some sectors can be redeployed to meet some of the excess demand in other sectors.

The impact of these four mechanisms on the economic outlook is extraordinarily difficult to predict. However, the Panel's judgement is that the most likely outcome will involve:

1. A fall in employment from the recent peak, as firms seek to cut costs to mitigate the fall in demand or are forced to close.
2. Lower inflation in 2020 due to lower oil prices and mortgage payments. However other inflation pressures could work in either direction, as supply chain disruption or other shortages could cause pockets of high prices but there will be downward pressure on other prices due to reduced demand.
3. A fall in average earnings, due to a combination of lower demand for labour and lower inflation.
4. Lower interest rates, in line with market expectations and with the Bank of England's decision to cut rates to a record low of 0.1%.
5. A fall in profits in the financial services industry, partly driven by lower interest rates, and a much sharper fall in non-finance sectors due to reduced demand and supply chain disruption.
6. A sharp slowdown in the housing market with a very limited number of sales during the peak of the outbreak and for some time after.
7. Some firms and individuals experiencing extreme economic hardship.

In our central forecast, this could see the Jersey economy (as measured by gross value added – GVA) contract by over 6% in 2020. However, this forecast for annual growth comprises a very sharp contraction within the year with a short period of very steep decline, particularly in the second and third quarters of the year, but with the first and last quarter seeing less impact. The Panel's central forecast is for a relatively quick recovery, regaining much of the loss of output in 2021.

Our forecast assumes that while there is considerable disruption on the Island, essential services continue to be provided and most supply lines remain open. It also assumes that Government provides an appropriate level of support to individuals and to employers, to ensure that any structural impacts are limited.

The Panel has not at this point cut its forecast for the long-term rate of ‘trend’ growth. This will be reviewed as the potential long-run impact of the global pandemic becomes clearer. Jersey is clearly vulnerable to any reduction in the interconnectedness of the global economy, and any permanent reduction in travel could pose further challenges for sectors that rely on visitors. More broadly, the reduction in demand could result in a permanent reduction in capacity if there are firm closures or significant downsizing.

While the Panel’s recent advice has been for Government to run surpluses while the economy was expected to be above its non-inflationary capacity, this period has now come to an abrupt halt. Even before the outbreak of the virus, Jersey’s positive output gap appeared to be closing. Faced with a very sharp contraction in demand, Jersey’s government should now be looking to provide urgent stimulus to the economy to support demand. The automatic stabilisers will clearly fall far short of what is required in the short term, so Government should look to expand its support to the economy.

The Panel notes the measures announced by the Government of Jersey to date to combat Covid-19 and mitigate its impact, including support to GPs, deferral of GST and Social Security contributions and a number of new funding mechanisms to support businesses. It is important that government spending can respond quickly to the changing situation and therefore fiscal policy decisions to respond should not be limited by the usual fiscal guidelines. Nevertheless, long-term fiscal sustainability remains paramount, and the focus of fiscal support should be on mitigating structural damage to the economy and alleviating hardship among the Jersey population. A short-term cyclical downturn cannot be averted.

The Public Finances Law allows the Treasury Minister to spend up to £10m in the event of immediate threat to the health or safety of any of the inhabitants of Jersey, to the stability of the economy in Jersey or to the environment. Given the need to move quickly, any additional expenditure that is required to directly combat/treat the virus should of course be done without first consulting with the FPP. Were further economic support required, the FPP can be consulted in parallel with policy development.

The impact of the reduction in tax revenues and additional expenditures to support the economy should be drawn from the Stabilisation Fund in the first instance. Given the risk that a short-term demand shock could lead to longer-term structural weaknesses, the Panel advises that these are the exceptional circumstances in which drawing on the Strategic Reserve is also appropriate. In deciding how to deploy resources and manage its financial commitments, the Government should consider flexibility in all of the financing options it has available, including borrowing. At a time of exceptional stress and illiquidity in financial markets, the government will need to consider the implications for its investment strategy over the longer term.

In the face of this significant shock to both supply and demand, other countries are putting in place various types of support for the economy and population are being put in place, including:

1. Liquidity and cash flow measures, to help otherwise sound firms with short-term shortfalls.
2. Support for business to ensure employment rates do not contract unnecessarily.
3. Short-term support for individuals and households in hardship.
4. A temporary package of fiscal stimulus.

Given the significant downside risks, there is much merit in urgently considering a package including all of these measures in Jersey.

The Panel is ready to update its advice should circumstances change significantly.

Yours sincerely

Kate Barker (Chair)
Francis Breedon and Richard Davies

Annex 1: Updated economic assumptions

March 2020 forecast

% change unless otherwise specified	2017	2018	2019	2020	2021	2022	2023	Trend 2024+
Real GVA	0.8	1.4	0.6	-6.3	4.4	1.0	0.6	0.6
RPI	3.1	3.9	2.9	1.2	2.2	2.5	2.5	2.6
RPIY	3.2	3.6	2.6	1.4	2.2	2.4	2.4	2.5
Nominal GVA	4.1	5.9	3.9	-5.1	6.0	2.7	2.8	3.1
Gross operating surplus (including rental)	-0.3	7.5	4.3	-8.2	7.7	2.2	2.5	3.2
Financial services profits	-6.4	9.6	2.0	-2.0	5.0	2.9	2.9	3.4
Compensation of employees	8.1	4.6	3.6	-2.5	4.6	3.1	3.0	3.1
Employment	2.3	1.4	1.0	-2.9	2.8	0.8	0.5	0.4
Average earnings	2.6	3.5	2.6	-0.6	2.2	2.3	2.5	2.7
Interest rates (%)	0.3	0.6	0.8	0.2	0.2	0.3	0.4	0.6*
House prices	2.9	7.1	7.0	-10.0	5.0	4.0	3.0	2.7
Housing transactions	7.8	5.3	-1.8	-50.0	45.0	15.0	7.0	1.5

* Bank Rate forecast for 2024 only

Previous (October 2019) forecast

% change unless otherwise specified	2017	2018	2019	2020	2021	2022	Trend 2023+	
Real GVA	0.8	1.4	0.9	1.0	1.3	0.8	0.6	0.6
RPI	3.1	3.9	2.8	2.4	2.6	2.7	2.6	2.6
RPIY	3.2	3.6	2.6	2.3	2.5	2.6	2.5	2.5
Nominal GVA	4.1	5.9	3.5	3.3	3.8	3.4	3.1	3.1
GOS (including rental)	-0.3	7.5	3.3	3.0	3.5	3.2	3.2	3.2
Financial services profits	-6.4	9.6	2.0	2.0	3.1	3.3	3.4	3.4
Compensation of employees	8.1	4.6	3.6	3.5	4.0	3.5	3.1	3.1
Employment	2.3	1.4	1.0	0.2	0.8	0.5	0.4	0.4
Average earnings	2.6	3.5	2.6	3.3	3.2	3.0	2.7	2.7
Interest rates (%)	0.3	0.6	0.7	0.6	0.5	0.5	0.5	0.5
House prices	2.9	7.1	6.3	5.4	4.5	3.6	2.7	2.7
Housing transactions	6.7	7.2	7.0	3.0	3.2	2.3	1.5	1.5

Changes since last forecast

% change unless otherwise specified	2019	2020	2021	2022	2023	Trend
Real GVA	-0.3	-7.3	3.1	0.2	0.0	0.0
RPI	0.1	-1.2	-0.4	-0.2	-0.1	0.0
RPIY	0.0	-0.9	-0.3	-0.2	-0.1	0.0
Nominal GVA	0.4	-8.4	2.2	-0.7	-0.3	0.0
GOS (including rental)	1.0	-11.2	4.2	-1.0	-0.7	0.0
Financial services profits	0.0	-4.0	1.9	-0.4	-0.5	0.0
Compensation of employees	0.0	-6.0	0.6	-0.4	-0.1	0.0
Employment	0.0	-3.1	2.0	0.3	0.1	0.0
Average earnings	0.0	-3.9	-1.0	-0.7	-0.2	0.0
Interest rates (%)	0.1	-0.4	-0.3	-0.2	-0.1	0.1
House prices	0.7	-15.4	0.5	0.4	0.3	0.0
Housing transactions	-8.8	-53.0	41.8	12.7	5.5	0.0

Annex 2: Letter from the Treasury and Resources Minister

Minister for
Treasury and Resources

19-21 Broad Street | St Helier
Jersey | JE2 4WE

Government *of* JERSEY

Dame Kate Barker

Chair of the Fiscal Policy Panel

18 March 2020

Dear Dame Kate,

At the time of the Fiscal Policy Panel's 2019 annual report, in October 2019, the Panel identified considerable uncertainty and consequent risks in the global economy. However, at that time these risks did not include the global pandemic caused by the coronavirus Covid-19, which began in China at the end of last year.

I understand that the Panel is currently preparing updated economic forecasts, to inform the development of the 2021-2024 Government Plan. With a pronounced slowdown in economic growth and exceptional uncertainty around its extent and duration this is a very difficult time to undertake any economic forecasting; but my Ministerial colleagues and I for the Government of Jersey greatly value the Panel's expertise at this challenging time.

Financial markets have been extremely volatile in recent weeks, with historic falls in equity indices and oil prices. Other jurisdictions have put in a wide range of policy responses, both to prevent the spread of the virus and to mitigate its impact on public health and the economy. Jersey is no different, and we have to date already put in place a number of measures to support the economy, including:

- deferring the payment of social security contributions;
- the deferral of GST payments; and
- payment deferrals where the Government is a landlord to local business.

Further, we note the steps announced in the UK's Budget last week, including additional funding for the health service, a hardship fund for households, a loan scheme for businesses and grants to small businesses. The Government of Jersey is working with stakeholders to consider how to support both businesses and households through the period of disruption.

In addition to considering the potential impact of the pandemic on your economic forecast; I would appreciate the Panel's views on any further fiscal policy response. To support us in developing the appropriate response, the Panel's advice is requested on which policy measures might be appropriate at different phases through the crisis.

Government is committed to mitigating the impact of the virus on Jersey to the extent this is possible but will require some flexibility to respond appropriately as conditions develop. In particular, I would appreciate your views on the advisability of transfers from both the Stabilisation Fund and Strategic Reserve, in order the fund the expenditure required, and stimulate the economy effectively in the short and long term.

I look forward to receiving your response in due course.