JERSEY'S FISCAL POLICY PANEL

Medium Term Report

July 2022

Introduction

The Fiscal Policy Panel was placed on a statutory basis in 2014. The FPP's statutory role was reiterated in the Public Finances Law (2019), which requires the Panel to comment on Jersey's fiscal policy with reference to:

a. the strength of the economy in Jersey;
b. the outlook for the economy in Jersey;
c. the outlook for world economies and financial markets;
d. the economic cycle in Jersey;
e. the medium-term and long-term sustainability of the States' finances and the States' financial assets and liabilities;
f. the advisability of transfers to or from the Strategic Reserve Fund and Stabilisation Fund

The Panel's work is guided by five key principles. These are:

1. Economic stability is at the heart of sustainable prosperity;
2. Fiscal policy needs to be focused on the medium term;
3. Policy should aim to be predictable, with flexibility to adapt to economic conditions to assist in creating a more stable economic environment;
4. Supply in the economy is as important as demand; and
5. Low inflation is fundamental to the competitiveness of the economy.

The Fiscal Policy Panel (FPP) welcomes the opportunity to present this special report, which provides advice and recommendations for the new Government to consider in developing its first Government Plan.

In contrast to last November's Annual Report, this report has a greater focus on medium term issues which will become more important over the next 10-15 years such as the impacts of an ageing demographic. It also includes an update to trend assumptions including trend growth, having considered likely developments in productivity, working age population and participation rate.

This therefore provides an update to the previous 'Fiscal Policy Panel Advice for the Government Plan 2020-23' which will be referred to as the previous Medium-Term Report.

This report has been prepared at yet another time of significant uncertainty. There are strong current inflationary pressures and global headwinds which may impact on Jersey. Further updates to this advice will be provided as necessary, including the potential for updated forecasts. We also look forward to reviewing the draft Government Plan when it is lodged in the autumn. The Panel will produce their Annual Report in the autumn, to help inform the subsequent Government Plan debate.

Executive Summary

Economic Outlook

- Since the November 2021 Annual Report, the global macroeconomic outlook has changed for the worse. The conflict in Ukraine has proved a significant negative shock, causing supply chain disruption, energy supply concerns and contributing to inflation.
- However, Jersey has, so far, been somewhat insulated from this shock. This is due to the positive impact of rising interest rates on some parts of the financial sector, a relatively muted inflation surge in Jersey compared with the UK and the robust growth of the Jersey economy that was already underway before this shock hit.
- The Panel's forecasts for economic growth have been upgraded since March 2022 and now feature a near-term period of stronger growth mainly attributable to accelerated growth in financial services profits reflecting higher interest rates.
- Evidence from the labour market and businesses suggests that the economy has been recovering well from the Covid-19 pandemic. The number of people registered as actively seeking work, a measure of unemployment, is at its lowest level since comparable figures began in 2008, and vacancy rates are high suggesting a tight labour market.
- A lack of spare capacity has become a pervasive feature of Jersey's economy. A number of sectors are likely to be constrained over the next Government Plan period. The construction sector faces a shortfall of workers and materials, while accommodation and restaurant operators report difficulties in recruiting staff.
- Currently, it appears that Jersey's labour market has been resilient to the global shocks and the economy overall remains in a good position to weather them, however these shocks represent a short-term risk to the economic recovery.
- Looking further ahead, there are several important risks to be mindful of including: an ageing population, productivity challenges and the impact on households of interest rate rises. These face the Jersey economy over a range of time horizons.
- Lack of affordable housing poses a risk to economic growth and productivity. There is a risk of reduced migration of skilled workers as the lack of affordable housing makes the island less attractive to potential migrants. The robust success of the finance sector is starting to add cost pressures in the rest of the economy.

Public Finances

- Higher interest rates and earnings growth will likely lead to an upwards revision to the income forecasts.
- On the basis of current spending commitments, this will likely deliver surpluses in all years of the Government Plan. Given the strong labour market, and evidence of low spare capacity, it is currently appropriate to run surpluses over the 2023-2026 period.
- Jersey's net asset position has improved since the previous Medium-Term Report in 2019 to 162% of GVA from 150%. This has predominately been due to high equity returns over the last two years.
- Whilst the asset position has improved, the Stabilisation Fund is much depleted, and the Strategic Reserve is probably too low to meet a major crisis.
- The Social Security Reserve Fund is strong although this will be put under pressure by an ageing population, particularly if a zero or low (e.g. +325) migration target is pursued.
- There remains a wide range of risks to Jersey's fiscal position including uncertainty around future financial investment returns and challenges around an ageing population.

Summary of recommendations

1. **Fiscal spending**. The economy is currently strong with little spare capacity and historically low levels of unemployment. This is not the time for significant across the board additional spending or tax cuts which would cause further inflationary pressures.
2. **Inflation.** Alongside the overall picture, there are some households facing considerable constraints due to rising inflation. Some of the projected surpluses could be used to provide targeted support and offset a short-term risk to consumption.
3. **Funds.** Looking further ahead, there are long-term risks e.g. ageing population and therefore it is sensible to increase the balances of the Stabilisation Fund and the Strategic Reserve once the Covid debt is paid off. Surpluses and receipts from Prior Year Basis liabilities would be reasonable choices to increase the Funds' balances.
4. **Objectives of Funds.** The Government should ensure objectives for the Funds are clear and adjust policies in line with objectives. This will be particularly relevant after the actuarial review of the Social Security Funds.
5. **Housing.** The rising cost of housing risks becoming a drag on economic growth. This should be addressed as a priority.
6. **Capital programmes**. It will be increasingly important to ensure projects are carefully scheduled and the historic tendency to submit overly-ambitious timetables for capital projects should be eliminated.
7. **Rebalancing.** Rebalancing measures should only be included in the Government Plan if it is clear how they will be achieved. Including speculative measures may lead to pressures in later years if they are subsequently not found.
8. **Net zero.** The Climate Emergency Fund will not be sufficient to finance the transition to net zero which will require the careful use of both taxes and expenditure to create the right economic incentives. The government should consider the strategy for financing these challenges.

SECTION 1

Economic Outlook

1.1 International outlook

1.1.1 United Kingdom

The UK economy experienced a larger hit from the Covid-19 pandemic than other members of the G7 group of advanced industrial economies (Canada, France, Germany, Italy, Japan and the USA), and the UK economy's recovery to end-2023 is forecast to be the weakest in the G7 by the OECD. One of the reasons is that consumption and consumer-facing services are a larger part of the UK economy which means it was affected more heavily by the Covid restrictions and is more vulnerable to the impact from high inflation eroding households' real income.

According to the OECD's latest projection, by the end of 2023 the UK's real GDP will be (**Figure 1.1**), only 0.8% higher than it was at the end of 2019. Contributing factors include high inflation and its effects on consumer confidence and households' incomes; tightening fiscal and monetary policy; and supply shortages.

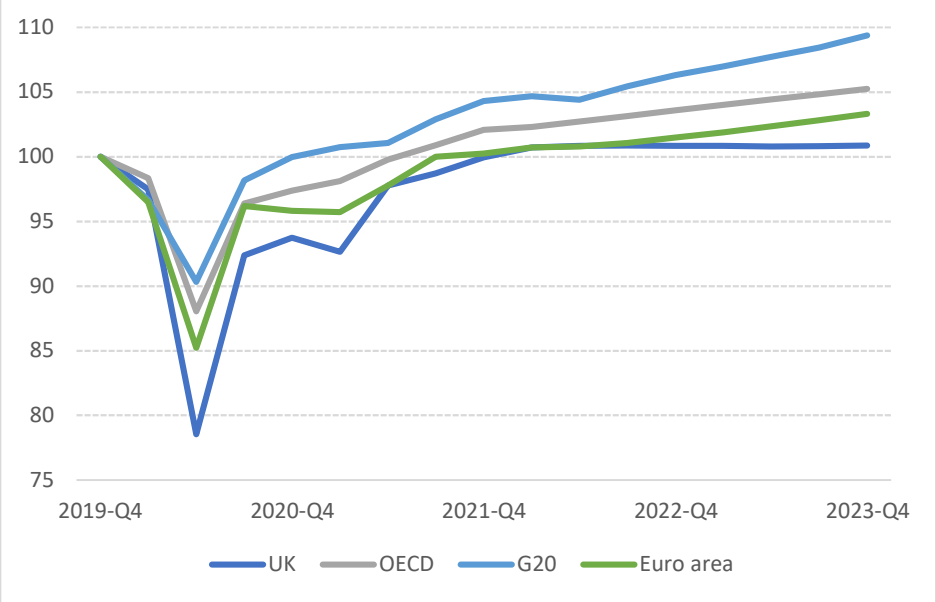
The weak performance of the UK economy relative to that of other advanced industrialised economies may be of particular significance for Jersey since the UK is our major trading partner.

Figure 1.1

Real GDP estimates/forecasts, Q4 2019 – Q4 2023, Q4 2019 = 100

OECD Real GDP estimates/forecasts, June 2022 projection, Q4 2019=100 for each group of countries, Q4 2019 – Q4 2023

Sources: OECD Economic Outlook: Statistics and Projections



1.1.2 World

The effects of the Covid-19 pandemic and the associated restrictions meant that real global GDP in 2021 was much lower than was forecast in 2019 (**Figure 1.2**). The relative difference between actual real GDP and the 2019 forecast was greater for emerging markets and developing economies than for

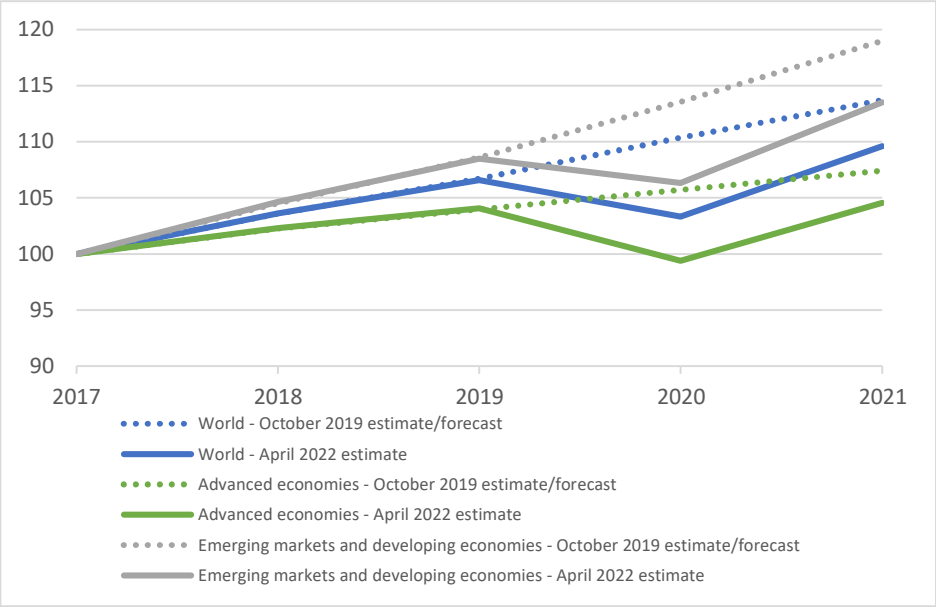
advanced economies, reflecting differences in access to healthcare and vaccines, differences in policy responses, and differences in the structure of economies in the two groups.

Figure 1.2

Real GDP, 2017 – 2021, 2017 = 100

Index of real GDP, 2017 – 2021, October 2019 estimates/forecasts and April 2022 estimates – dotted lines show October 2019 estimates/forecasts

Sources: International Monetary Fund World Economic Outlook



As **Figure 1.2** shows, most countries are experiencing a strong economic recovery as they bounce back from the pandemic which is replicated across advanced and developing economies alike. However, the world economy faces a number of headwinds now and in the medium term.

The conflict in Ukraine has an obvious high human cost, and also creates a significant negative economic shock. Food and energy prices have risen very significantly as a result of the conflict, since Russia and Ukraine are key exporters of natural gas, wheat and oil. These price rises are driving higher inflation in the rest of the world and bearing down on household consumption. In addition, the conflict's impact on confidence is deterring investment. Combined with existing issues around supply chains and labour shortages, the conflict is also driving increased volatility in financial markets along with rising government bond yields and falling equity prices in many countries.

Growth in China has also slowed. China has maintained a zero-Covid policy, meaning that in order to contain outbreaks, large, significant population centres have been placed into strict lockdowns that have constrained economic activity and reduced consumer confidence. These lockdowns have affected financial hubs as well as ports important for global supply chains. Reduced demand from China and disruptions to supply chains mean these lockdowns are likely to have a negative impact on global growth.

Growth in the US is also expected to slow in 2022 and 2023, due to a range of factors including supply chain disruptions, the conflict in Ukraine, and

tightening monetary policy.

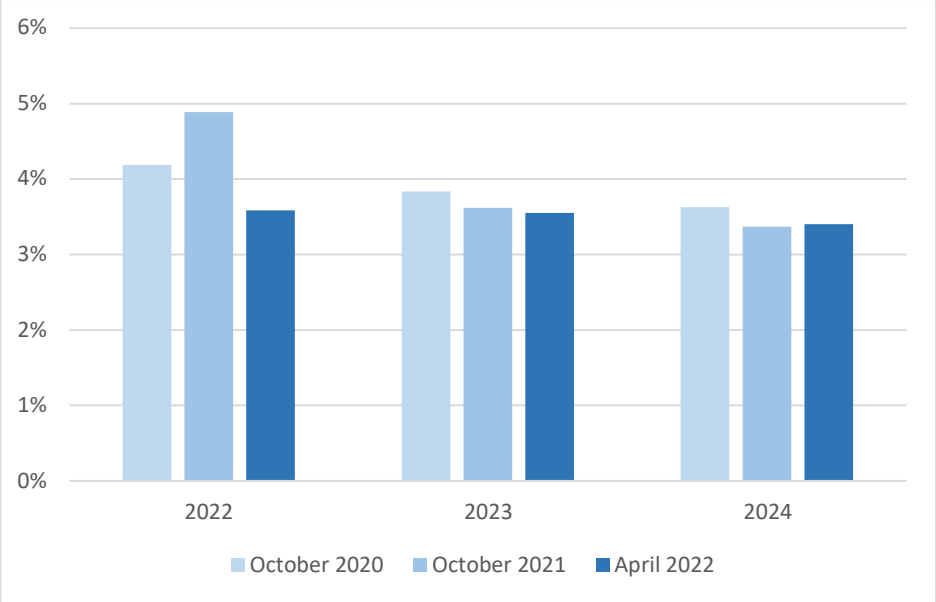
In light of these challenges, the International Monetary Fund (IMF) has revised down its forecasts for global economic growth in the coming years. **Figure 1.3** below shows the forecasts for rate of growth of the world economy (in terms of real GDP) for the years 2022-2024 in successive IMF forecasts. After being revised up from 4.2% to 4.9% between October 2020 and October 2021, the forecast for growth in 2022 was reduced to 3.6% in April 2022. The forecast for 2023 was also revised down whilst the forecast growth rate for 2024 was revised up slightly relative to October 2021 but remained lower than the forecast for that year in October 2020.

Figure 1.3

Forecasts of global real GDP growth, 2022 - 2024

Forecasts of global real GDP growth, 2022 – 2024, October 2020, October 2021 and April 2022 projections

Sources: International Monetary Fund World Economic Outlook



1.2 Jersey economic developments

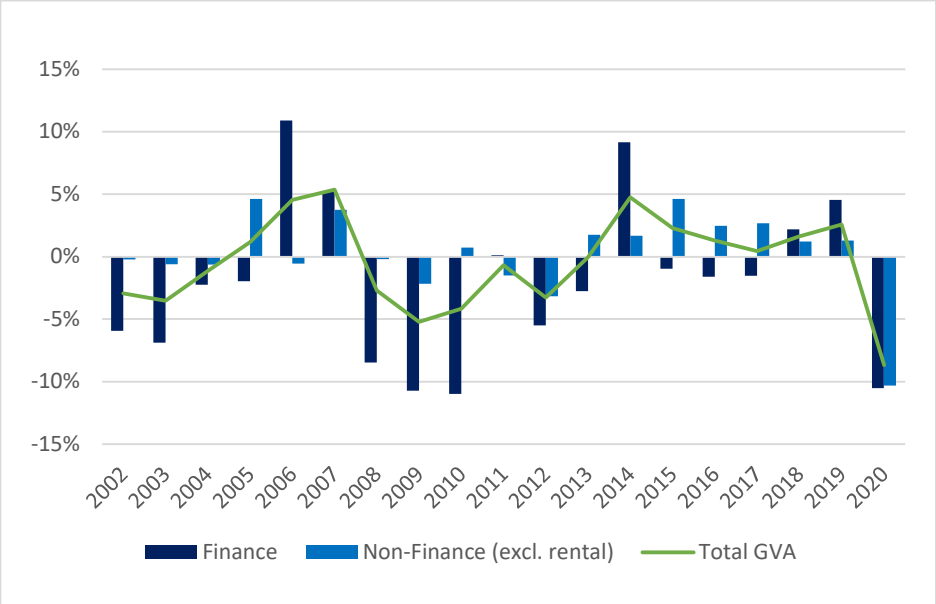
The most recent GVA data available, for 2020, captures the initial impact of Covid-19 on the Jersey economy. The economy shrank by 8.7% in 2020 real terms, similar to other advanced economies. This followed GVA growth of 2.1% in 2019, which exceeded the Panel's forecast. The record fall in GVA recorded in 2020 was driven by falls in consumption and Bank Rate cuts. Around half the economic contraction was driven by reduced profits in the financial services sector. Restrictions of varying severity were in place through most of 2020 and 2021. The decline in GVA varied by sector. There was a 45% contraction for hotels, restaurants and bars, the most severe contraction across all sectors. Financial services declined by 11%, whilst wholesale and retail (-6%), construction (-15%), agriculture (-23%) and other business (-9%) also saw contraction. The only sectors which grew in 2020, were public administration (+9%), electricity, gas and water (+5%) and manufacturing (+3%).

Figure 1.4

Jersey GVA growth

Annual percentage real terms change

Source: Statistics Jersey



However, as Jersey emerges from the pandemic, economic growth is likely to pick up. Financial sector losses, which made up half of the drop in GVA, are likely to be more than reversed due to efficiency improvements carried out over the past few years and significant interest rate rises set to improve banking profits considerably.

Data on the numbers of individuals who are actively seeking work act as a proxy for the number of unemployed workers. This is covered further in **Section 1.3.1** but shows that the number of ASW is at historic lows since comparable figures were available. Further, the number of private sector jobs in Jersey had also recovered to pre-pandemic levels by December 2021 and businesses were expecting employment to continue to increase to June 2022 based on the Business Tendency Survey. This suggests that the economy has been recovering well from the pandemic.

Jersey's headline measure of inflation, the retail price index (RPI) increased by 6.0% in the year to March 2022, as the rate of inflation stepped up sharply from 3.8% in the year to December 2021. RPI is not directly comparable with UK CPI as it includes the impact of mortgage interest payments but is the measure most used and commonly quoted. The increase to March 2022 was the largest twelve month increase in prices since September 2008. Following a period of very low inflation during the Covid-19 lockdown, inflation started to pick up in the second quarter of 2021. Initial increases were attributed to the easing of lockdown restrictions which enabled consumers to return to normal spending habits.

The main drivers of the more recent increases have been housing (parish rates, rents, and mortgage interest payments) which increased by 6.8% in the year to March 2022; fuel & light (particularly heating oil) prices, which rose by

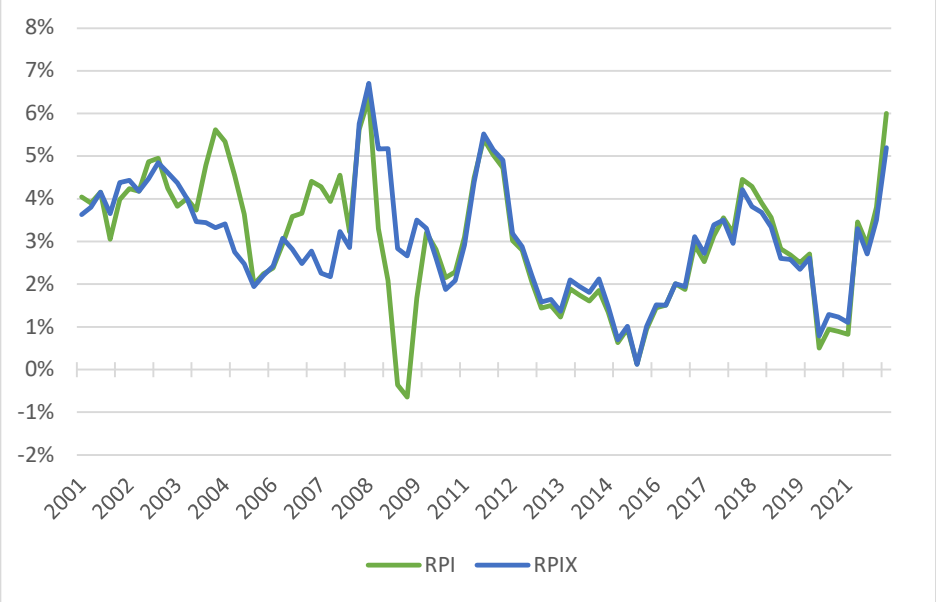
21.9% over the twelve months to March 2022; and motoring prices (including cars and fuel) which increased by 10.5% in the year to March 2022.

Figure 1.5

Inflation in Jersey

Annual percentage change in retail prices index (RPI) and retail prices index excluding mortgage interest payments (RPIX). Data to March 2022.

Source: Statistics Jersey



Across all sectors, businesses have reported an increase in input costs and are expecting increases in the prices of their own products and services. These increases are likely due to a number of factors including supply chain constraints, Covid-19 related disruption and energy price rises. Wage pressures are likely to affect some sectors in the coming months due to staff shortages and recruitment difficulties, with the potential to add further inflationary pressures.

The prices of construction materials have risen rapidly recently due to shortages and supply chain disruptions associated with Brexit and Covid-19. This rise in the price of construction materials comes against a backdrop of already-high construction costs in Jersey owing to the need to import materials and, often, labour from elsewhere.

Section 1.4 presents the Panel's updated economic assumptions.

1.3 Spare capacity

1.3.1 Unemployment

The proportion of the labour force that is currently unemployed is a key indicator of the level of spare capacity in the economy. Statistics Jersey measures unemployment using the number of people registered with the Customer and Local Services Department (CLS) as 'actively seeking work' (ASW). The ASW measure does not include all unemployed people, as there is no compulsion to register. However, it is a high frequency dataset which is useful to measure the level of spare capacity in the economy.

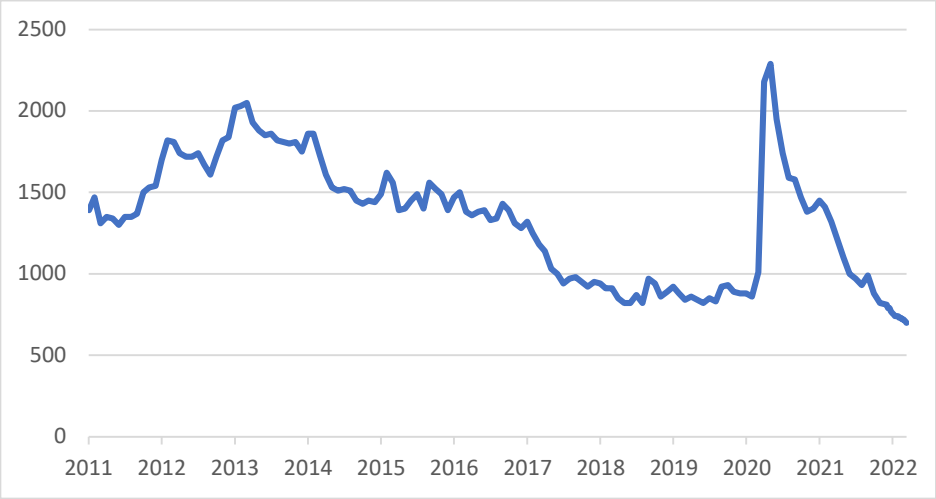
Figure 1.6 shows the number of people registered as ASW since 2011. The number of people ASW was stable from 2018 until the outbreak of the Covid-19 pandemic in 2020, when it rose sharply. After peaking in May 2020, the number of people ASW has shown a declining trend. By the end of 2021, the number of people ASW was lower than its pre-Covid level. The declining trend in the number of people ASW continued through to mid-April 2022, the latest data, leading to a 10-year low of comparable figures, despite population growth over the period.

Figure 1.6

Actively Seeking Work

Number of those registered as Actively Seeking Work, monthly, 2011 – 2021, with number of those registered as Actively Seeking Work, weekly, January 2022 – 10th April 2022

Source: Statistics Jersey / Customer and Local Services



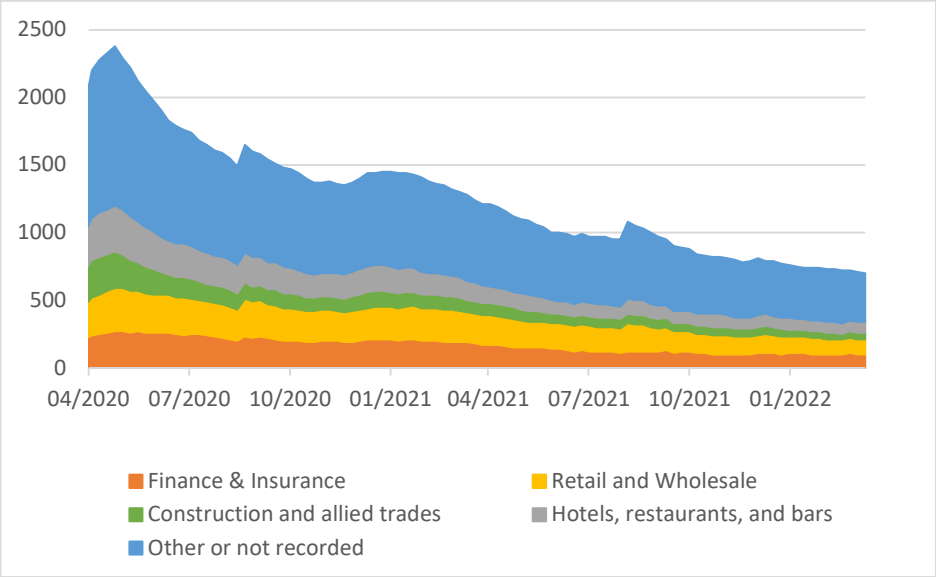
As shown in **Figure 1.7** below, this decline in the number of people ASW is observed across different sectors in Jersey's economy.

Figure 1.7

Actively Seeking Work by sector of last employment, from April 2020

Number of those registered as Actively Seeking Work by sector of last employment; 'Other or not record' calculated as the difference between those whose sector of last employment was one of those shown and the total number of those registered as Actively Seeking Work, weekly from April 2020

Source: Statistics Jersey



1.3.2 Vacancies

The number of vacancies in an economy is a useful measure of the level of spare capacity in an economy as it provides an indication of labour market shortages (unmet demand for labour).

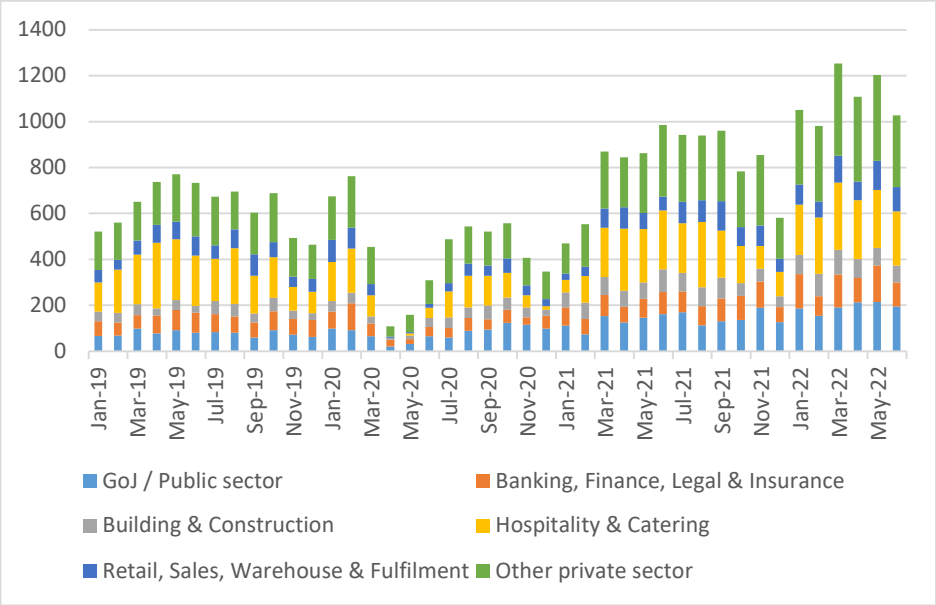
In spring and summer 2021 the total number of job postings across all sectors rose above those in equivalent months in 2019. Several sectors including hospitality have seen dramatic increases in job vacancies whilst the number of those registered as ASW from those sectors has been falling significantly (see **Figure 1.7** above), suggesting a growing issue of unmet demand for labour in these sectors. In 2022, vacancies have risen sharply in the early months, and far exceed the numbers posted in 2019. The increase in advertised vacancies has been seen across most sectors, particularly hospitality, and chimes with the feedback from industry representatives.

Figure 1.8

Vacancies in Jersey

Number of public sector vacancies in Jersey and number of private sector vacancies, by sector, posted on the Government of Jersey website. Postings on the site can be given three sector categories; for this chart, vacancies are assigned to the first sector listed. Postings with no sector listed are excluded.

Source: Government of Jersey



1.3.3 Capacity utilisation

Jersey's Business Tendency Survey includes a question asking firms if they are operating above or below normal capacity. This is a useful indicator of spare capacity within firms, complementing the unemployment figures that measure spare capacity outside firms. In addition, the capacity utilisation indicator may indicate broader capacity issues beyond labour constraints.

Capacity utilisation was much higher in the first quarter of 2022 than a year previously. Jersey's finance and non-finance sectors both indicated they were operating above capacity at the end of 2021 and start of 2022. However, capacity utilisation in the non-finance sector has declined since peaking in Q3 2021, such that the non-finance sector indicated that it is operating only slightly above capacity as of the start of 2022.

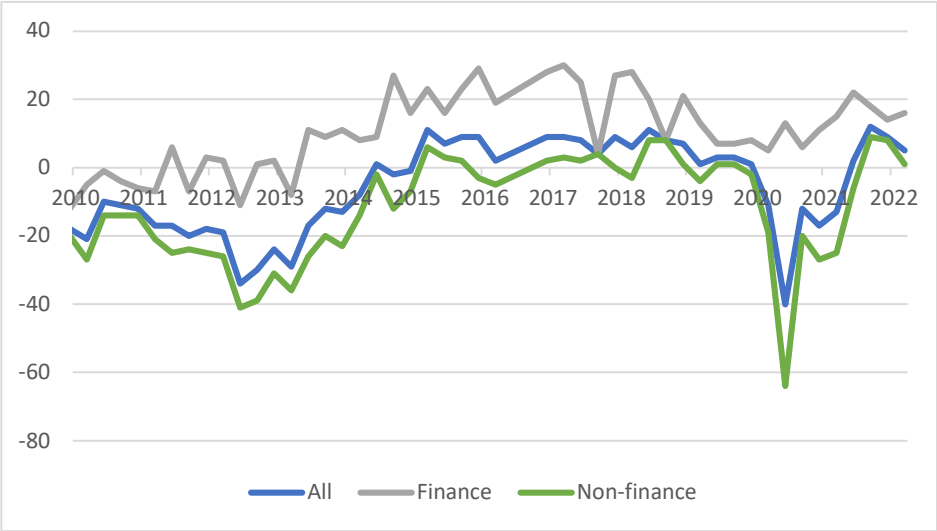
During the Panel's recent visit to the Island, business reported that they were facing capacity restraints. These restraints varied from recruitment difficulties to supply chain constraints and long waiting times for materials.

Figure 1.9

Capacity utilisation

Weighted net balance of respondents to Business Tendency Survey reporting operating above capacity (not seasonally adjusted)

Source: Statistics Jersey



1.3.4 Output gap

The output gap represents the difference between the current level of output in the economy and the potential level it could sustain without putting upward or downward pressure on inflation. The output gap depends on the levels of labour, capital and productivity and is commonly used to measure spare capacity or overheating in the economy.

Whilst the output gap is not directly observable, it can be estimated using Principal Component Analysis (PCA). PCA identifies a common determinant among several cyclical indicators including earnings data, vacancies data, employment and ASW rates, and BTS indicators. The Panel uses this common determinant as an indicator of the degree of spare capacity in the economy and therefore the output gap.

The interpretation of output gaps is particularly difficult at the current time, with significant swings in both demand and supply caused by the global pandemic and the unprecedented levels of disruption. For the UK, the Office of Budget Responsibility (OBR) recommends that even less weight than usual be placed on output gap estimates. Public health restrictions have simultaneously restricted supply and demand for a period (to varying degrees in different sectors). This makes it difficult to estimate an accurate level of potential output and consequently the output gap.

Figure 1.10 shows the results of the PCA output gap estimate. This demonstrates that the onset of the pandemic resulted in a significant degree of spare capacity as unemployment increased, job vacancies fell, and business sentiment became strongly negative. In the first half of 2021, the analysis suggests that this has reversed, and the spare capacity has been used up such that the output gap may have more than fully closed. However, this analysis is uncertain, partly driven by supply constraints that prove to be

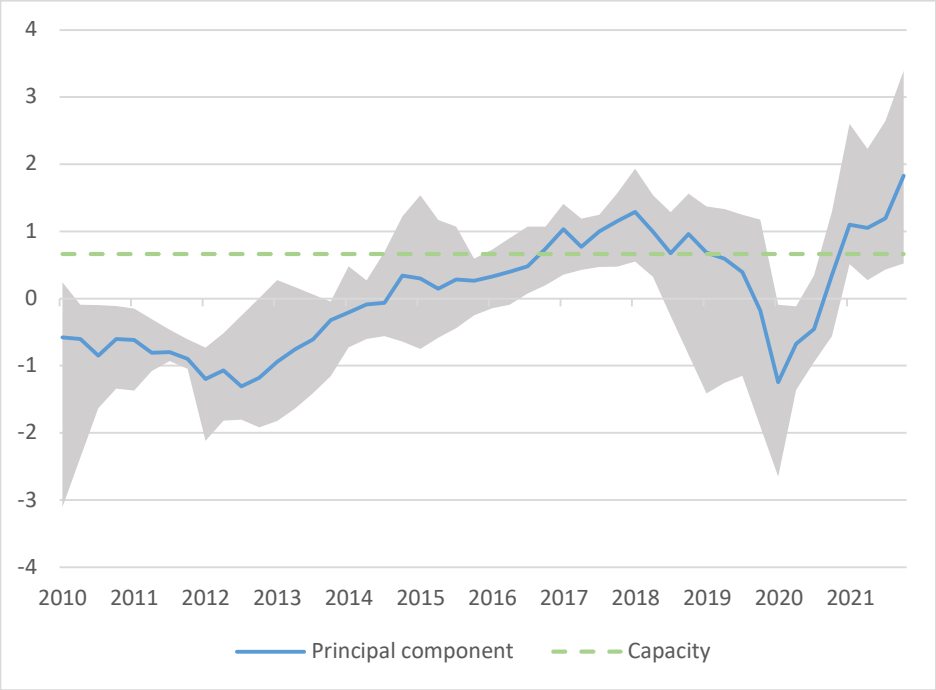
temporary. The level of spare capacity could be particularly volatile as both supply and demand recover. At the same time there are short-term expectations for a period of high inflation driven by global supply constraints rather than demand. The Panel's view is that Jersey should plan on the basis of spare capacity being at best limited across the next Government Plan period, particularly in the construction sector as capital programmes are likely to use a significant portion of the sector's capacity.

Figure 1.10

Output Gap estimate based on PCA

Blue line is Principal Component, grey swathe is the minimum and maximum of the scaled series used in PCA.

Sources: Statistics Jersey, Government of Jersey, Panel calculations



1.4 Updated Economic Assumptions

The Panel has updated its economic assumptions. This update suggests a mixed picture of the economic outlook. A sustained period of high inflation will cause those whose income does not rise with inflation to see their real income fall. At the same time rising interest rates used by the Bank of England to combat UK inflation will be positive for banking profits and government revenues.

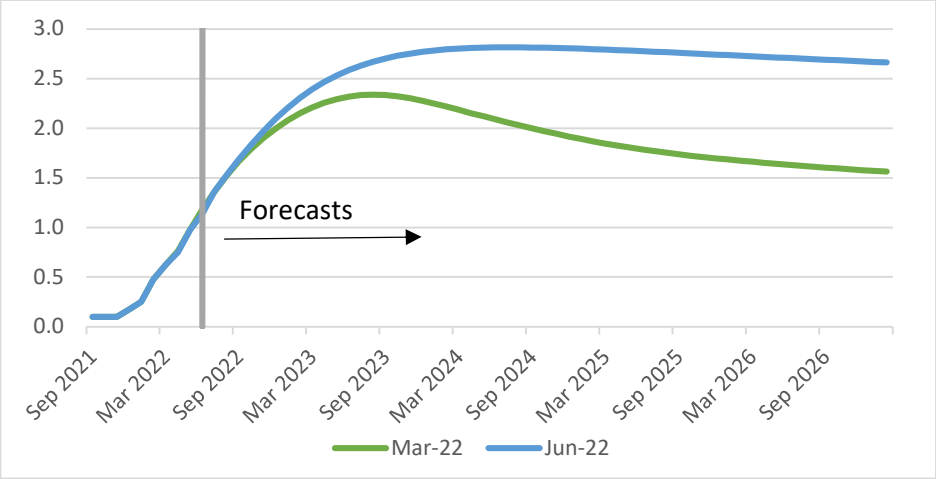
An average position of the financial markets expect rates to peak at 2.7% in 2024, which is reflected in the Panel's updated forecast. Sustained high interest rate expectations in the later years of the forecast will serve to reduce demand and consumption in the economy.

Figure 1.11

Interest rates forecast

Interest rates forecast, calculated as the yearly average of the OIS monthly forward curve

Sources: Bank of England



Inflation projections have also increased although they are still not as high as those in the UK. RPI, the headline measure of inflation is expected to peak at 9.2% in Q4 2022, and remain high for a protracted period, before slowly falling back to a long-run trend of 2.4% over the forecast horizon. The Panel has concluded that whilst inflation will not reach the peak expected in the UK, the impact will likely be more drawn out in the Island, with a longer period of above trend inflation.

A higher interest rate profile expected by markets drives the differential between RPIX, the closest comparator to UK CPI used to forecast Jersey's inflation, and RPI, the headline measure of inflation in the Island. RPI includes both indirect taxes and mortgage interest payments. RPIX excludes mortgage interest payments and RPIY excludes indirect taxes and mortgage interest payments. RPIX and RPIY track very closely and are assumed to be equal in this forecast in the absence of any new indirect taxes.

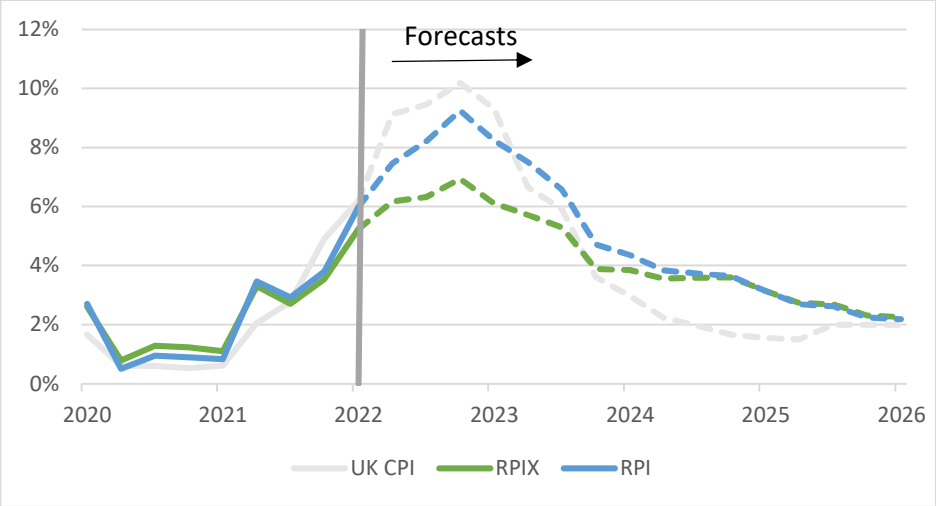
The differential between RPI and RPIX becomes smaller in the later years of the forecast as interest rates are expected to settle at 2.6%.

Figure 1.12

Inflation forecast (RPI and RPIX)

Blue line is Jersey RPI, green line is Jersey RPIX, grey line is UK CPI. Dotted lines indicate forecasts. The UK CPI forecast is produced by the MPC.

Sources: Statistics Jersey, Bank of England, Panel calculations



Box 1: Financial Services Profits

The financial services sector is made up of a diverse range of activities, some of which are more sensitive to interest rate changes.

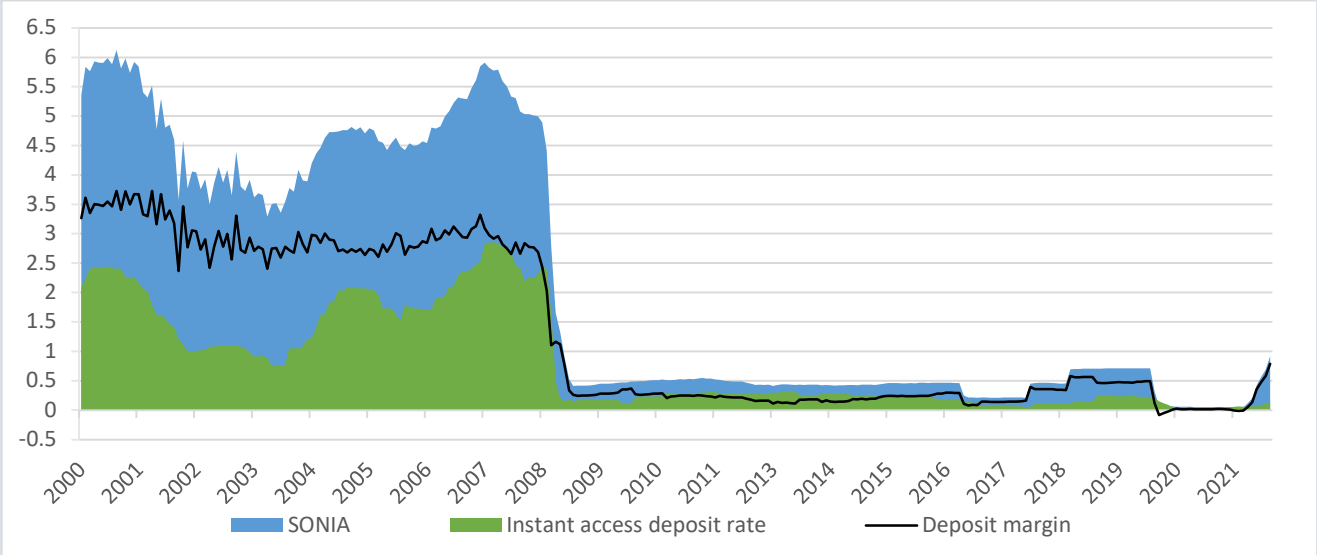
During 2020, the banking sector saw a real terms GVA contraction of 26%. Approximately 50% of Jersey's financial services GVA is attributed to the banking sector, although this share has been falling as non-banking sectors have been producing a greater share of output in recent years. During 2020, the non-banking sector, consisting of trusts and companies, funds, accounting and legal activities saw a 4.6% increase in real GVA.

The banking sector's profitability is particularly sensitive to the level of Bank Rate. Over the course of the last ten years, the banking sector has faced a very small deposit margin as seen below in **Figure 1.13.** The deposit margin is the difference between the rate banks lend at and the rate they give to customers on their deposits. The deposit margin fell to close to zero during the pandemic and in some months the margin was negative. Rising interest rates, which the BoE and other Central Banks are using to suppress demand and achieve its target of 2% Inflation, are now widening the deposit margins for banks, increasing their profitability.

Figure 1.13

Deposit margin (SONIA minus the instant access deposit rate)

Sources: Bank of England, Panel calculations



Data for Jersey Incorporated Banks (JIBs) suggests that there was a 45% increase in profits in 2021, excluding bad debt provisions. The Panel have analysed the relationship between profits relating to JIBs and the profits in the whole financial services sector, which suggests that in 2021 there was a large increase in financial services profits despite relatively constant, and slightly falling, interest rates.

For the increase in JIBs profits, approximately 2/3rds of this was attributable to reductions in the banks operating expenses, of which we assume that some of this is a permanent change and therefore is carried forward.

As interest rate expectations have been uprated from the March 2022 forecast, it follows that the forecast for financial services profits has also been upgraded. The forecast expects financial services profits to rise 26% (£270m) in 2022, and 42% in 2023 before flattening out in 2025 as present expectations are for little further Bank Rate change.

Figure 1.14 shows the Panel's July forecast, which has been updated for this report. The higher interest rates and increased. Financial Services profits leads to an upgrade in the GVA forecast for 2023. This is followed by a period of slower growth in 2024 and 2025 driven by sustained high interest rate expectations, combined with falling inflation and continued financial services profits, and slower growth in the non-finance sector.

Average earnings are expected to rise almost in line with inflation during the forecast as the tight labour market keeps demand for skills high and wages will reflect this. The previous forecast predicted a considerable fall in real terms earnings during the forecast, however after meeting with a range of key industry representatives, the Panel has upgraded this forecast. Across both the finance and non-finance sectors, real terms earnings are now expected to fall slightly by 0.5% in both 2022 and 2023, rising in line with inflation from 2024 onwards. Public sector inflationary pay increases are lagged by one year resulting in real terms falls in 2022 and 2023. This pushes any increase in real terms average earnings into 2025.

Employment is assumed to rise consistently in the financial services sector, whilst non-finance will see a period of above trend growth. This reflects a strong post-pandemic recovery in the labour market.

The forecast for house prices and transactions remains unchanged from the March 2022 assumptions, The trend growth for house prices and transactions has been updated in **Section 2.6** for 2026 onwards.

Figure 1.14

Central Economic Assumptions

Percentage change year on year unless otherwise stated, light blue indicates outturn data.

Note: changes in profits, earnings, employment costs and house prices are in nominal terms.

Real GVA is deflated with RPIY, however the rental component of GVA is deflated with a separate rental deflator.

Sources: Statistics Jersey, Panel calculations

July 2022 Forecast

% change unless otherwise specified	2020	2021	2022	2023	2024	2025	Trend 2026+
Real GVA	-8.7	5.4	4.1	8.6	1.3	0.1	0.5
RPI	1.3	2.7	7.7	6.7	3.9	2.7	2.4
RPIY	1.2	2.7	6.2	5.2	3.7	2.7	2.4
Nominal GVA	-7.2	8.2	10.5	14.1	4.9	2.8	2.9
Gross operating surplus (including rental)	-15.5	11.0	16.5	24.3	5.6	2.5	2.9
Financial services profits	*-18.1*	*19.5*	*26.2*	*42.3*	*6.2*	*1.6*	*3.2*
Compensation of employees (CoE)	-1.8	6.1	5.8	5.4	4.3	3.2	2.9
Financial services CoE	*0.3*	*3.6*	*6.1*	*5.1*	*4.1*	*3.1*	*3.4*
Non-finance CoE	*-0.1*	*8.0*	*6.7*	*5.5*	*4.3*	*3.1*	*2.7*
Employment	-2.4	3.0	0.7	0.6	0.5	0.3	0.1
Average earnings	1.1	3.3	5.3	4.9	3.8	2.9	2.8
Interest rates (%)	0.2	0.1	1.2	2.5	2.7	2.7	2.6*
House prices	6.1	16.0	6.0	5.0	4.0	3.0	2.9
Housing transactions	-3.8	15.1	3.5	3.0	2.5	2.5	4.0

*Trend interest rates represent market expectations for 2026

The remainder of this section sets out a number of economic risks to the Jersey economy over a longer time horizon.

1.5 Pandemic recovery

Although initial indications (e.g. numbers actively seeking work, business

expectations) are that the Jersey economy is recovering well from the pandemic, recent official data for output are not available yet, and there are risks that there may be longer term economic impacts. Downturns in economic output can have persistent effects even after output has recovered, particularly where there have been structural shifts in the economy on employment, investment and innovation.

There were many forced changes during the pandemic such as restrictions requiring many to work from home. In some sectors, employees have been able to continue working from home, at least in part. This has led to significant changes to travel patterns, and changes in spending patterns, including more online spending.

To the extent that these behavioural changes persist, then there will be longer term changes to the pattern of production, with some sectors gaining and some losing out. This would have consequences for the labour market, including for skills and training needs. It could also potentially lead to improvements in productivity and wellbeing if, for example, a shift to more remote working enabled people to have more leisure time and enabled higher levels of workforce participation for some groups, such as people with disabilities. However, the scope for remote working varies significantly by sector. In the latest Business Tendency Survey, for example, 58% of finance sector businesses reported that all their staff could work remotely compared to 7% of non-finance sector businesses.

Despite this increased flexibility, there appears to be a global trend of a falling participation rate for over 50s as more people have chosen to take earlier retirement. It is unclear the extent to which this will be a permanent change but it could result in lower participation rates.

The pandemic led to significant disruption for the visitor economy. Recent problems with flight capacity across Europe illustrate the difficulty that the travel industry has had in bringing capacity back to a level sufficient to meet demand. Changing travel patterns, including lower demand for business travel because of the widespread use of online conferencing, is a continuing risk for the visitor economy.

1.6 Other economic risks

There are several risks to Jersey's economy in the coming years in addition to those discussed in previous sections.

The economic effects of the conflict in Ukraine, identified in Section World1.1.2 could continue into the medium term. In particular, protracted supply chain issues may bear down on production and investment, particularly as supply chains are disrupted by factors such as lockdowns in China and the

conflict in Ukraine.

If tensions between the UK and the European Union lead to a deterioration in trade relations, this could have a negative impact on Jersey's economy. Jersey is a member of the UK-EU Trade and Cooperation Agreement (TCA), which means that goods from Jersey that are bound for the EU are treated as they would be if they came from the UK. A deterioration in UK-EU relations could therefore reduce Jersey exports to the EU. According to the Export Strategy Green Paper published by the Government of Jersey, the 'vast majority' of exports from Jersey that are not sent to the UK are sent to the EU.

The impacts of climate change also present a risk to the economy of Jersey, although there are significant opportunities associated with decarbonising the economy. The States Assembly has approved a Carbon Neutral Roadmap for Jersey, which focuses on the actions that need to be taken for decarbonisation from 2022 to 2026.

The emergence of a new more transmissible and/or more virulent strain of Covid-19, or of a new pandemic of another pathogen, could have a significant negative impact on the economy of Jersey and its trading partners.

Finally, upside risks to the economy are still present despite the dampened global forecasts. The outlook for the Island is positive, higher interest rates will increase financial sector profits, whilst there is potential for growth in other sectors which are recovering well from the impact of the pandemic. There are opportunities for the tourism sector to capture "closer to home" markets and expansion in other non-finance sectors.

SECTION 2

Trend growth

2.1 Introduction

A key element of the Panel's advice for the Government Plan is an update to the estimate of Jersey's likely trend rate of economic growth (as measured by GVA – Gross Value Added) over the medium-term planning period and beyond. The trend rate of growth is a key building block for the Panel in forming a view of the current structural position of the Government of Jersey's finances and informs the Panel's recommendations on the balance of fiscal policy over the Government Plan period.

The remainder of this section is divided as follows:

1. Trend GVA
2. Housing
3. Summary of trend forecast

2.2 Recent GVA Trends

The trend rate of growth is the rate of growth once cyclical factors are removed i.e. the underlying rate of growth over the business cycle. The trend rate of growth is closely related to the concept of 'potential output' (on-trend GVA); that is the level of economic output associated with full non-inflationary use of resources. When the economy is above potential output this implies demand is above the non-inflationary capacity of the economy and there is upward pressure on inflation with a positive 'output gap'. Conversely, when the economy is below potential output this implies under-utilisation of capacity and resources e.g. unemployment above its sustainable rate, and downward pressure on inflation. Neither the trend rate of growth nor the output gap can be measured/observed: they can only be estimated. **Figure 2.1** shows a stylised illustration of how actual measured GVA might move above and below estimated trend GVA through the economic cycle. The gradient of the trend GVA line here represents trend growth.

Figure 2.1

Illustration of trend GVA

Trend GVA (orange line) and actual GVA (blue line)

Note: this is a stylised representation

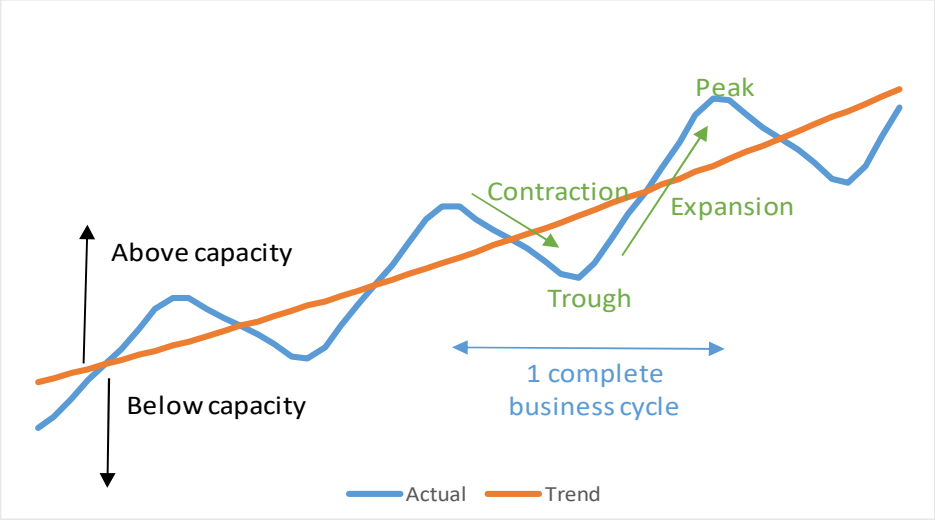


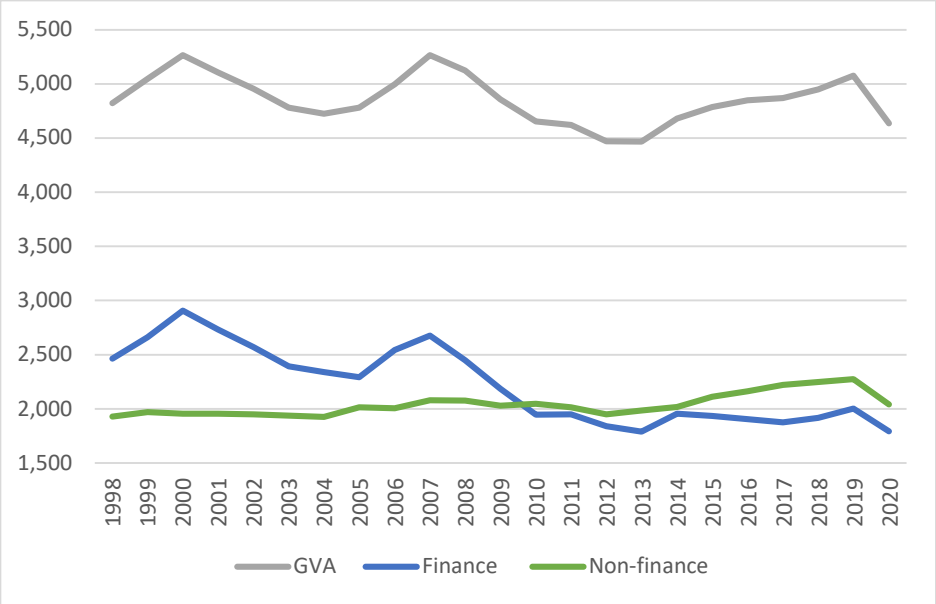
Figure 2.2 shows real GVA, over the period for which a consistent series is available, from 1998 to 2020. Financial services sector GVA has experienced sustained falls coinciding with global financial events and driven the shape of overall GVA. The non-finance sector has seen slow but steady growth over the period 1998-2020. Both finance and non-finance sectors experienced a fall of approximately 10% in 2020. The public sector grew 9% in 2020, accounted for by the increased public health measures. The impact of the pandemic was concentrated in banking and non-finance sectors which rely on social contact such as hospitality and retail. The pandemic appears to have led a significant economic downturn and some mild economic 'scarring', where the economy is permanently smaller than it otherwise would have been. Some sectors may be permanently smaller and the excess labour in these sectors will need to re-skill in other areas of the economy, similarly the adoption of technology to boost productivity will also require some up-skilling of the labour force. The early retirement trend may leave some roles vacant for longer as there is a smaller workforce to fill these roles. However, it appears unlikely that there has been permanent changes to the trend level of growth. Therefore, the pandemic is not expected to affect the estimate of the trend rate of growth.

Figure 2.2

Jersey GVA

Real GVA, constant 2020 prices (£m).

Source: Statistics Jersey



Jersey experienced a period of sustained growth from 2013 to 2019 following the sharp downturn attributed to the 2008 global financial crisis. A large part of that was due to falls in the interest rate which led to lower banking profits, which since 2008 have made up around 20% of Jersey's economy.

Whilst Jersey's GVA has been stagnant over the past twenty years and in some sector, it has fallen, this is a trend that it is more common in high income economies. As such, economists frequently refer to 'convergence' where those countries and regions with lower GDP per capita will tend to grow at quicker rates than those economies with higher GDP per capita when they have similar economic fundamentals. This can be seen in **Figure 2.3** below where although Jersey has experienced a negative annual growth rate, in large part due to a sustained period of depressed interest rates, this is not unusual for higher income countries and Jersey has one of the highest income per capita globally.

Figure 2.3

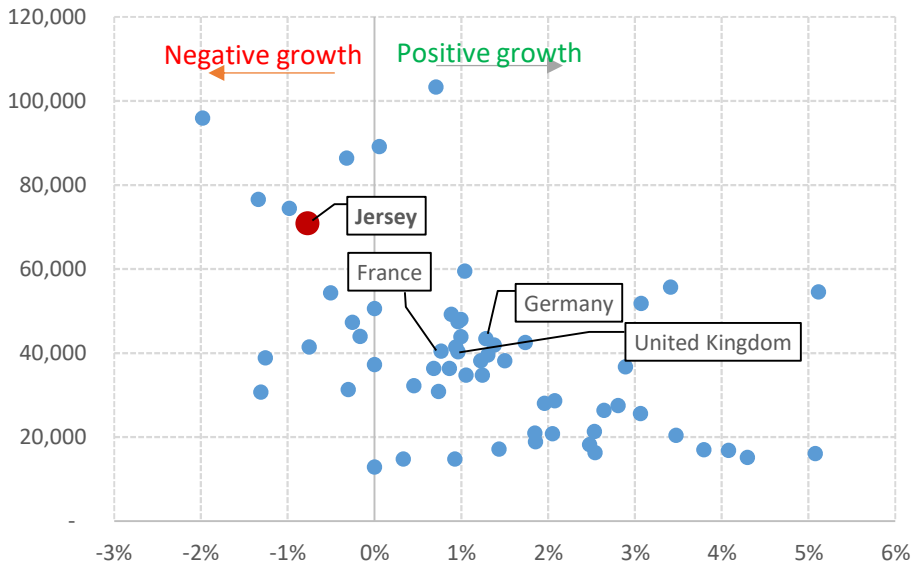
Growth rates and income levels for comparable economies

Vertical axis is GVA per capita in 2002 (2017 US$ prices, PPP)

Horizontal axis is GDP per capita compound annual growth rate between 2002 and 2019

Only high-income countries selected

Source: World Bank, OECD, Statistics Jersey



2.3 Margin adjusted trend

An important source of bank profits comes from recycling of funds from savings into loans for investment, known as intermediation, with the profit driven by differentials between the interest rates that banks pay on deposits and receive on loans. This can be split into the lending margin, which is based on the difference between the rate paid by borrowers and a benchmark rate; and the deposit margin, which is based on the difference between a benchmark rate and the rate paid to depositors.

As Jersey is primarily a deposit taking centre, the deposit margin has been used for the analysis presented in **Figure 2.4.** The level of deposit margin historically is discussed in Section 1 in **Figure 1.13.**

The low interest rate environment over the past decade has limited the ability of Jersey's banking sector to maintain their profit margins. Around 95% of Jersey's deposits are held in sterling, euro or US dollars – all three currencies have experienced historically low interest rates, and sometimes negative rates over the past ten years.

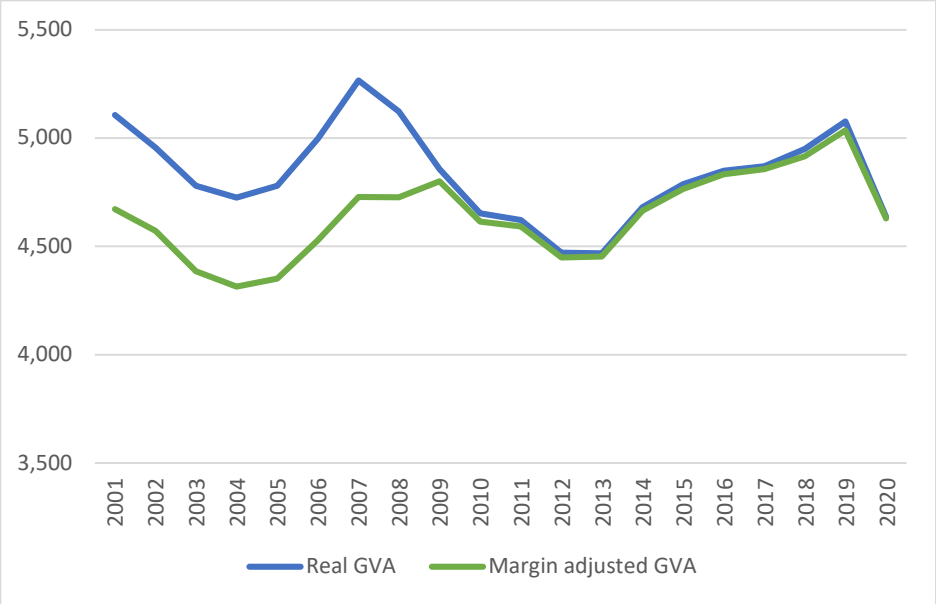
Because interest rates and the financial sector drives large fluctuations in the economic growth, the Panel has undertaken work to remove the impact of interest rates from GVA. This enables an estimate of the underlying, or trend growth rate. This suggests the underlying growth in the economy has been mildly positive over the period 2001-2019. The compound growth rate is 0.4% in real terms over this period. Whilst this estimate is imprecise, it shows that the margin-adjusted GVA growth is probably positive - i.e. when excluding interest rates, the economy has grown on average each year.

Figure 2.4

Margin adjusted GVA

Real GVA and real margin adjusted GVA, constant 2020 prices, £bn.

Source: Statistics Jersey, BoE, Panel calculations



2.4 The components of trend GVA

GVA growth and therefore trend GVA growth, can be broken down into three separate elements:

- Labour productivity (e.g. GVA per FTE)
- Employment rate (the ratio of employees to working-age population) and;
- Working age population

Looking at the trend rate of growth of each of these components shows us how quickly the workforce might grow and how efficiently this labour could be used to produce output. The Panel's estimate for the trend rate of growth of each of these elements leads to a bottom-up estimate of the trend rate of GVA growth.

Each of these components will be explored in more detail in the following sections.

2.4.1 Trend productivity

Labour productivity in Jersey is measured as GVA per FTE – the average output produced per full-time equivalent employee. This measures how efficiently labour resources are used to produce outputs, and how this changes over time.

Productivity tends to be pro-cyclical; it increases during periods in which the economy is growing but deteriorates when output is falling. **Figure 2.5** shows GVA per FTE for Jersey since 1998. Productivity has tended to be pro-cyclical for most of the period, with both productivity and GVA increasing in 1999-2000

and 2005-2007; and both falling in 2001-2003 and 2009-2012. However, in 2016 and 2017, productivity fell 1.3% in each year whilst output grew 1.3% and 0.4% respectively. This is partly explained by the fall in the UK Bank Rate in 2016 which impacted banking productivity.

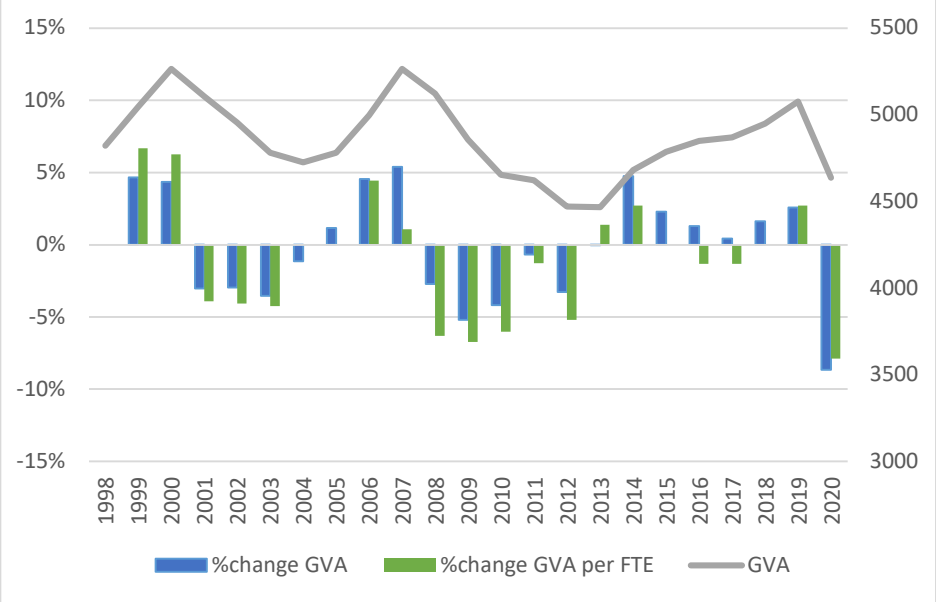
Weak productivity growth is an important issue for Jersey. Since the global financial crisis, productivity has not recovered, instead it stagnated at around £75,000 per FTE in 2020 prices until 2018. Productivity growth occurred across most sectors in 2019, particularly in financial services, but this was reversed in 2020 with a 7.9% fall in overall productivity, which can be largely attributed to the Covid-19 restrictions and a fall in interest rates.

Figure 2.5

GVA and GVA per FTE

Constant 2020 prices (£m), percentage change year on year (%).

Source: Statistics Jersey



Finance sector productivity

Productivity in the finance sector is difficult to measure. Under the income approach to calculating GVA, the method used in Jersey, this is expressed as the sum of profits and wages in the sector per employee. For banking, a large driver of profits is the difference in interest rate paid on deposits and received on loans and therefore 'productivity' in the financial sector is frequently distorted by interest rates. A financial firm that is more productive will undertake more activity given its inputs and will have higher profits or wages, or both. Given interest rates are determined by the Bank of England rather than banks themselves, a financial firm can become more 'productive' overnight due to rate rises, without any efficiencies in costs or achieving new revenue streams.

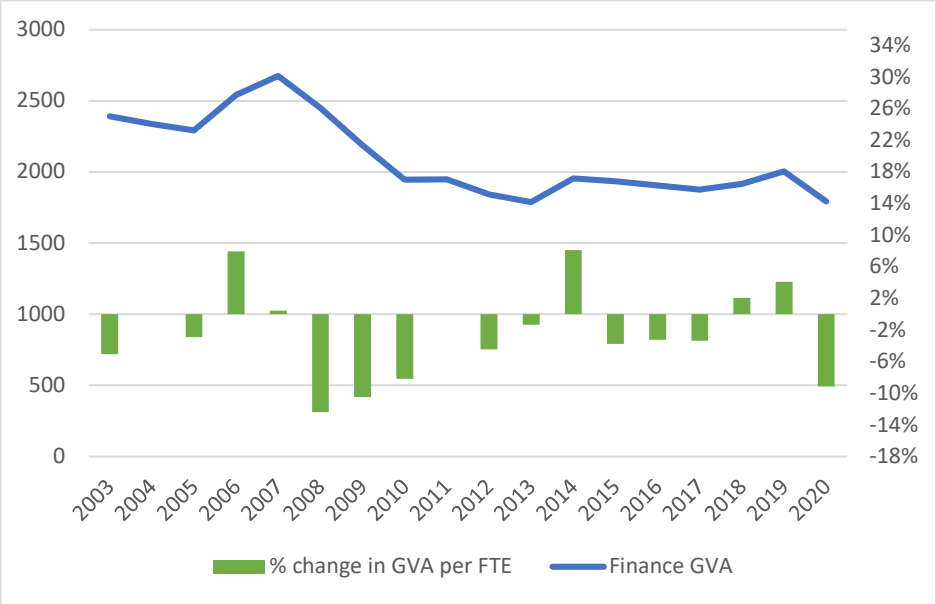
Productivity as measured in this sector is therefore highly volatile, with 16 of the last 22 years seeing movements of more than 3% in real terms compared to the previous year. The majority of these have been falls, but there have been some individual years of strong growth such as 2006 and 2014.

Figure 2.6

Financial Services GVA and GVA per FTE

Constant 2020 prices (£m), percentage change year on year (%).

Source: Statistics Jersey



In addition to the impact of deposit margins and sectoral change, there are further one-off factors related to the global financial crisis that may have led to step changes in productivity – rather than signalling a long-term downward trend. Firstly, some of the capital of Jersey's banks was transferred to support liquidity at the parent companies, reducing the future profitability of the Jersey bank as it no longer had access to this capital. As interest rates rise, and UK based parent companies become more profitable it is possible that some of this capital may be transferred back to Jersey banks.

Secondly, across the financial sector, there has been an increase in the resources required for regulatory compliance, resulting in increased costs which the Panel judges to have been largely a structural reduction in the profitability and level of output in the sector, rather than an impediment to future growth. The Island has proven resilient in overcoming past regulatory challenges and is a founding member of the OECD Inclusive Framework on Base Erosion and Profit Shifting (BEPS) and actively participated in the discussions on this two-pillar initiative. Jersey joined the international consensus of 137 Inclusive Framework member jurisdictions on the OECD two-pillar initiative in an October 2021 statement, committing the Island to implementing the minimum standards contained within both pillars. Feedback from representatives in the sector has revealed that the changing regulatory environment will not be an undue burden and that Jersey's strong regulatory framework is a key source of competitive advantage.

Thirdly, there was a significant reduction in the value of deposits held by Jersey banks since 2007, which is likely to have impacted on productivity over this period.

Looking forwards, there are reasons to expect a more positive trend. The banking sector is likely to see significant productivity gains in the next two to three years as deposit margins widen. Since the financial crisis, banks have had to contend with the ultra-low interest environment and as such productivity in the sector has lagged. Whilst some reductions in operating expenses have been seen in data from JIBs, the rising interest rates will be the key driver of increased productivity in the banking sector.

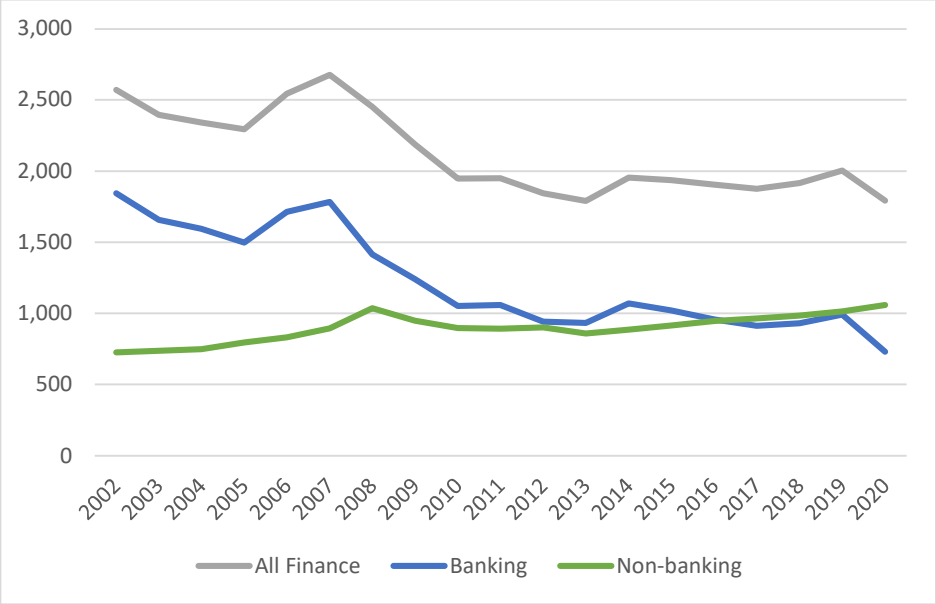
As introduced at the beginning of this section, it should be noted that due to the way that GVA and therefore the proxy for productivity, GVA per FTE, is measured, the productivity gains due to interest rate rises are however somewhat artificial and temporary in nature. They are not akin to what would typically be viewed as an increase in productivity in the non-finance sector such as technology adoption, development of new processes and increased knowledge or skills.

Figure 2.7

Finance and banking GVA

Real GVA, constant 2020 prices (£m).

Source: Statistics Jersey



Trust and company administration, fund management and legal activities associated with the finance sector are relatively less productive than the banking sector. The sectoral shift of employment from the relatively high-productivity banking sector into other financial services sectors has contributed to falling financial sector productivity over the past 20 years. However, the value of assets under administration in the island has been growing consistently over the last ten years, seeing a significant uptick. This sub-sector and other non-banking sub-sectors of the financial services industry has seen significant growth in the past ten years.

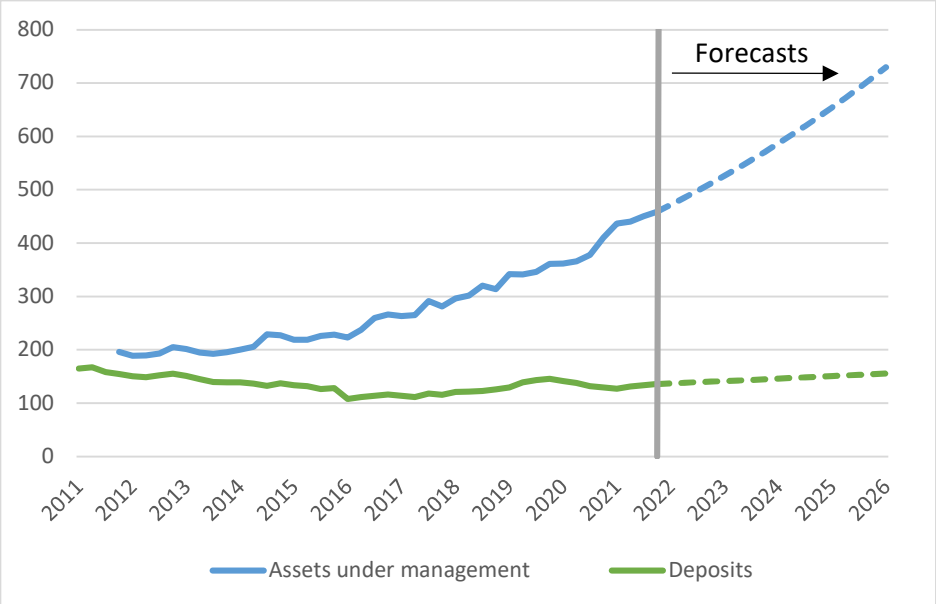
Assets under administration are expected to see strong growth over the next five years. Sentiment in the sector is positive as growth is expected globally and it is anticipated that Jersey will maintain its market share.

Figure 2.8

Deposits and funds

Total banking deposits held in Jersey and net asset value of regulated funds under administration (£bn)

Source: Statistics Jersey



In their central scenario forecast, the Panel has maintained its expectations for financial sector productivity. The central forecast is now for growth in productivity of 0.5% per year, with risks biased to the upside.

Non-finance sector productivity

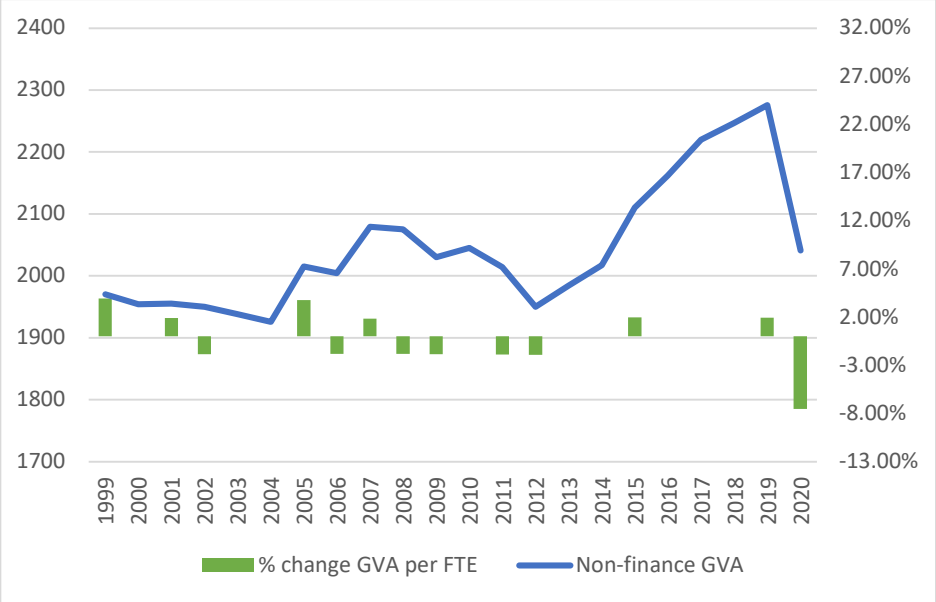
Productivity in the non-finance sector has been much less volatile than financial services, with growth being flat in many years (when rounded to the nearest £1,000). At the same time, this very diverse group of sectors has seen large increases in GVA from 2012 to 2019. This implies that the growth in GVA seen in the sector was due to higher employment rather than an increase in productivity. Sectors which were hard hit during the pandemic were typically lower-productivity sectors.

Figure 2.9

Non-finance GVA and GVA per FTE

Real GVA for the non-finance sector (excluding rental), constant 2020 prices (£m).

Source: Statistics Jersey



A summary of the non-finance sectoral performance from 1998 to 2019 is given below in **Figure 2.10.** This relates to the four biggest private sectors outside finance, accounting for 70% of FTE employment in the non-finance private sector. 2020 is excluded from this analysis due to the disproportionate impact on some non-finance sectors. The 'Other business activities' sector was the fastest growing non-finance sector in terms of GVA except for rental income. Other business activities, which predominantly consists of private sector service industries, has seen strong growth in employment, but has experienced a significant fall in productivity over the period.

Figure 2.10

Non-finance sectoral performance 1998-2019

Average annual growth in FTE and productivity

Source: Statistics Jersey

Sector	GVA growth	FTE growth	Productivity growth
Construction	2%	1%	1%
Wholesale & retail	-1%	-1%	0%
Hotels, restaurants and bars	0%	-1%	1%
Other business activities	3%	3%	-1%

Recent trends and ongoing structural shifts towards lower productivity sectors may have been disrupted by the pandemic as many businesses had to adapt and find newer and potentially more productive ways of delivering.

The public sector has seen steady expansion in recent years which was accelerated during the pandemic to provide essential services such as testing, track and trace and vaccination. The contribution made by the sector to GVA consists only of the compensation of employees as there are no profits in the public sector. Compensation of employees is a function of the number of staff, hours worked, and salaries paid. A higher skilled public sector reflected in higher salaries will increase the measure of productivity regardless of whether the sector is more productive or not.

The Outline Economic Strategy for Jersey sets out key goals for the Jersey economy, which include introducing medium- and long-term productivity measures aimed at increasing innovation, skills and investment.

Looking further ahead, automation could offer significant opportunities for improving productivity. Automation could allow labour to be redistributed away from lower-productivity, repetitive tasks and towards higher-productivity ones. The scarcity of labour and increasing costs could drive productivity in the future. The recently launched Productivity Support Scheme should enable businesses to make noticeable productivity improvements in the medium-term. For these reasons, the Panel has upgraded the central scenario for non-finance sector trend growth to 0.2%.

Overall trend productivity

Based on 0.5% growth in finance sector productivity, 0.2% growth in non-

finance productivity and no change in hours worked, the Panel's central estimate is for trend productivity (GVA per FTE) to grow by 0.35% per year in the central scenario. The Panel has also estimated a low scenario of 0% growth annual growth representing flat productivity growth in both the finance and non-finance sectors. This upgrade from the previous trend analysis also reflects a smaller downside risk. The Panel's high scenario has been raised and represents finance growing at 0.8% and 0.5% growth in non-finance.

Figure 2.11

Trend productivity forecast

Central, high and low annual growth forecasts for trend productivity by sector

Source: Panel judgement

	Low scenario	Central scenario	High scenario
Finance	0%	0.5%	0.8%
Non-finance	0%	0.2%	0.5%
	0%	**0.35%**	**0.65%**

2.4.2 Trend employment rate

The employment rate represents the proportion of the working-age population that is in work, either an employee or self-employed. This does not measure the hours or number of jobs worked, only whether or not an individual is employed or self-employed.

The Census bulletin which contains employment information is not due to be published until later in 2023. Therefore, the Panel have had to make assumptions about the employment rate based on the movements of individual social security contributors and actively seeking work numbers over the period 2011 to 2021. In order to draw comparisons to the 2011 Census, in which the employment rate was measured using women aged 16-59 and 16-64, the Panel has used the same population age groups in drawing conclusions about the rate of change of the employment rate.

Using this, the Panel has estimated that the employment rate was relatively consistent between 2011 and 2021, with perhaps a small rise. Comparing the movements of unemployment and social security data with Census population and employment data suggests that the annual growth of the employment rate is around 0.1%.

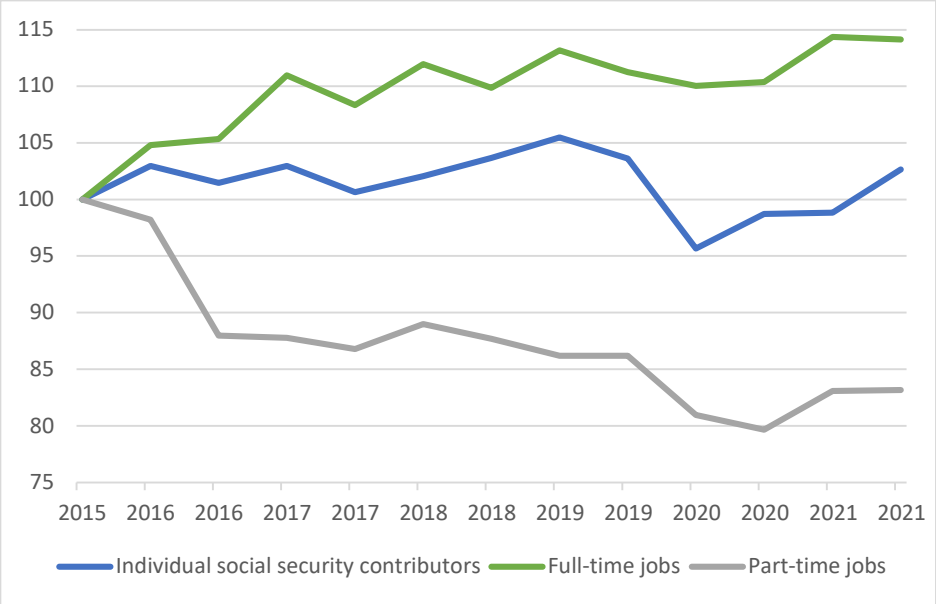
Over the past five years there has been a shift from part-time to full-time employment in the labour market. Whilst the source of this shift is unknown, this could be attributed to more women in the labour force and an increase in women working full time instead of part time jobs. **Figure 2.12** highlights this shift from part time to full time roles. The rising cost of housing and essential goods may have made it more difficult for households to maintain their standard of living on only one income.

Figure 2.12

Jobs vs employment

Individual social security contributors, number of full-time jobs and part-time jobs, indexed 2015 = 100. Observations are recorded in June and December.

Source: Government of Jersey, Statistics Jersey



The employment rate in Iceland has peaked as high as 86%, whilst Switzerland and the Netherlands also maintain close to 80% employment rates. This suggest that in a small, developed economy there is still possibility for growth in the employment rate above 80%. In Jersey, it appears likely that there may be some further increases in the employment rate. Therefore, the Panel has chosen to retain the employment rate trend growth at 0.1%.

2.4.3 Trend working age population

The 2021 Census revealed a population of 103,267, approximately 4,000 fewer than had been estimated using other data sources. In 2011, the population had been 5,400 fewer at 97,857. The population increase was characterised by natural growth (excess of births over deaths) of 2,100 and net migration of 3,300.

Total population has grown 5.5% over the ten-year period to 2021, although there has not been even growth across every age group, as the working age population grew only 1.3% over the same period.

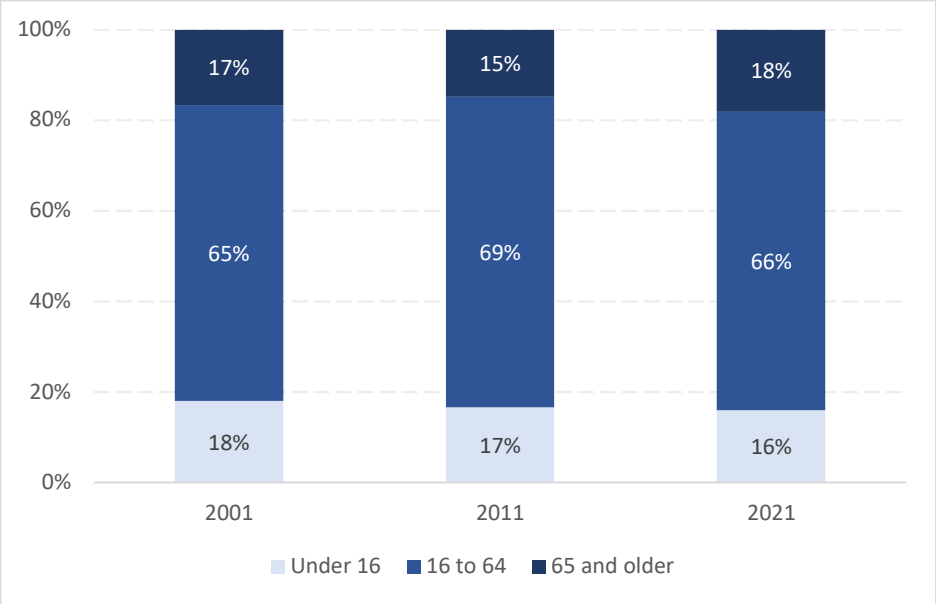
The percentage of Jersey's population accounted for by those aged 65 and over (i.e., above working age) had grown from 15% in 2011 to 18% to 2021, having fallen from 17% to 15% in the 10 years from 2001 (**Figure 2.13**).

Figure 2.13

Age structure of the population of Jersey

Percentage of the population of Jersey by age group, 2001, 2011 and 2021

Sources: Statistics Jersey



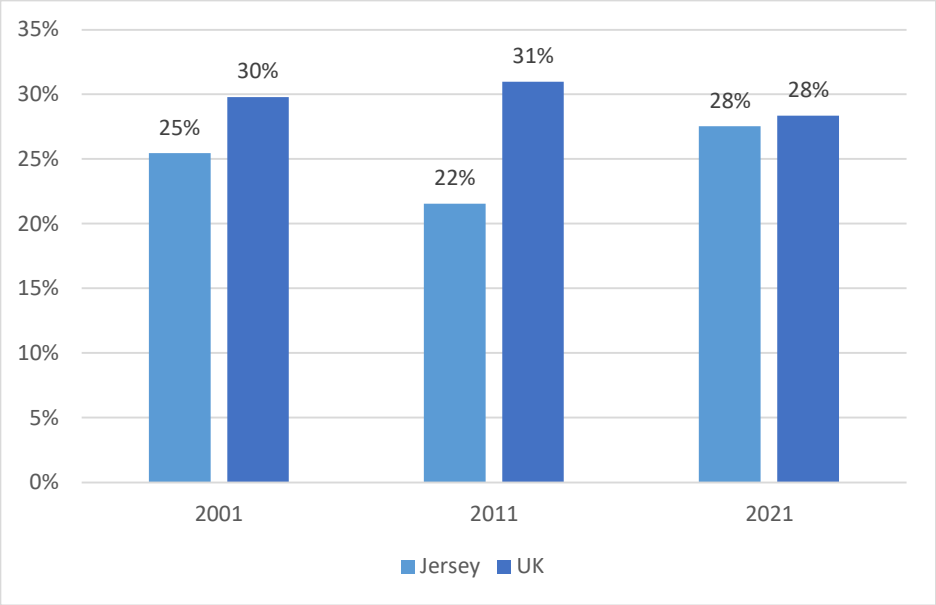
This expansion in the size of the elderly population relative to the working-age population saw Jersey's old-age dependency ratio rise from 22% to 28% between 2011 and 2021, exceeding its 2001 level (25%). The old-age dependency ratio is now very similar to the UK, where the dependency ratio had been greater over the last two decades. The fertility rate among women has fallen from 53.4 per 1,000 women aged 15-44 in 2011 to 42.2 per 1,000 in 2020. For comparison, the fertility rate in England was 55.3 per 1,000 in 2020.

Figure 2.14

Old-age dependency ratio

Number of people aged 65 and over as a percentage of working-age (16 - 64 years) population. UK figure for 2021 is a forecast.

Sources: Statistics Jersey, ONS



The 2021 Census was conducted during a time of increased uncertainty around migration patterns. Anecdotal evidence suggested that a significant portion of the migrant community left the Island during and in the aftermath of the pandemic. Similarly, there has been evidence that some longer-term residents have relocated to the UK citing returns on property investment and

cost of living pressures in the Island. With limited data available, the Panel have had to rely on their best judgement based on these data sources.

The Panel has considered the change in individual social security contributors and actively seeking work numbers which are high frequency datasets to compare employment patterns. These data sources suggest that the rate of growth of the working age population was faster than that given by the annualised average growth (0.13%) between the 2011 and 2021 Census, if employment patterns were maintained.

The Panel expects a period of growth in the working age population which represents a catch up from the fall during the pandemic. Following this, the Common Population Policy will determine future migration and therefore the growth in the working age population. Current policy indicates that Government aims to reduce the Island's reliance on inward migration.

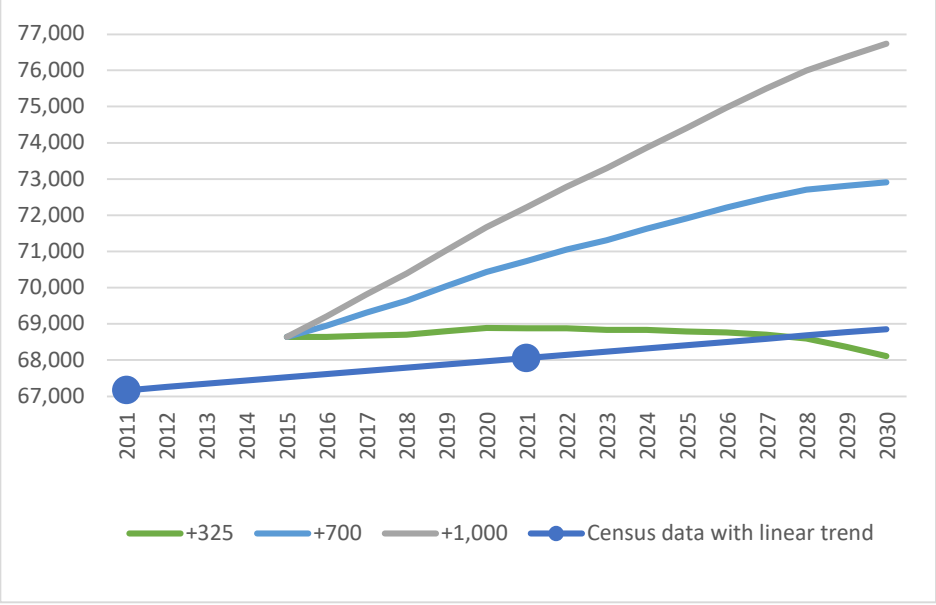
To maintain the working age population at a steady level over the medium term (2025-2035) the net migration scenario will need to be between +325 and +700. Net migration need not be steady each year to maintain the working age population; instead, it may flex in periods of high demand for labour and fall in periods of low demand. As the island is a small population, the birth rate is also subject to large annual fluctuations. Under this assumption, the Panel forecasts flat growth in the working age population under the central scenario for the period 2025-2035. If migration is restricted, then a downside scenario of negative annual growth of -0.2% could be realised. The upside scenario represents a +700 scenario for net migration which results in annual growth of +0.3%.

Figure 2.15

Census data and 2015 working age population projections

2011 and 2021 Census data plotted with a linear trend. Statistics Jersey population projections from 2015.

Source: Government of Jersey, Statistics Jersey



Conclusion for trend GVA

The Panel's update to the trend GVA forecast is shown below in **Figure 2.16.** The central scenario represents a slight downgrade to the forecast from the last update to trend GVA which is driven by falls in the working age population projections due to lower expected migration. Whilst the outlook for productivity growth has improved and the employment rate forecast remains unchanged, the potential for stagnation in the working age population places a drag on the overall forecast.

The central scenario has fallen by 0.15% due to the lower expectations for growth in the working age population. The previous scenario saw productivity grow by 0.2% annually, the working age population grew 0.3% whilst the employment rate saw growth of 0.1%. Combining these elements gave trend growth of 0.6%.

Figure 2.16

Calculation of trend GVA

Summary projections for trend in each component of GVA

Source: Panel calculation

Annual % growth in trend	Low	Central	High
Productivity	0	0.35	0.65
Employment Rate	0	0.1	0.2
Working Age Population	-0.2	0	0.3
Trend GVA	**-0.2**	**0.45**	**1.15**

2.5 Housing

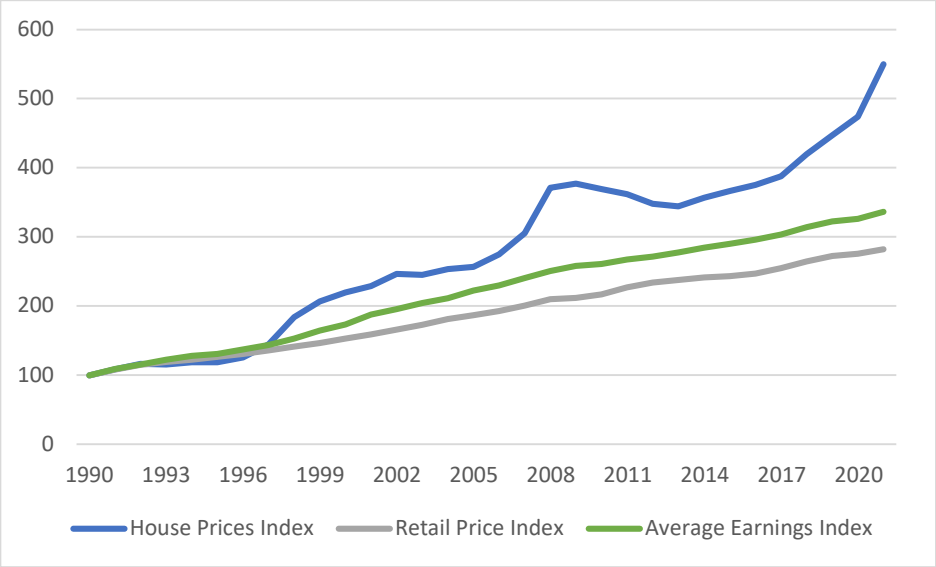
House price growth, as in many other countries, has far exceeded both RPI and Average Earnings growth since the late 1990s. A number of factors have contributed to this including limited land availability, depressed interest rates, a relatively high return on property assets for investors and competition for a limited number of properties.

Figure 2.17

House Prices, Retail Prices and Average Earnings Indices

Index 1990 = 100.

Source: Statistics Jersey



Statistics Jersey produce a detailed housing report annual, including affordability indices and an estimate of the 'deposit gap'. The 'deposit gap' represents the difference by which the median dwelling price exceeds the affordability threshold, expressed as a factor of mean net household income (£60,100). In 2021, the deposit gap for a 2,3 or 4-bedroom houses was 1.5, 4.4 and 10.6 respectively. Without a deposit which greatly exceeds the standard 10% of property value, a household with median income were unable to affordably service a mortgage on a 2-bedroom house.

In comparison to the UK, the average house price in Jersey was over £150k more than in London. However, due to higher median earnings in the Island, the ratio of median property prices to median earnings is lower in Jersey than in London, although above trend house price rises in Jersey in 2021 have brought the ratio very close to the most recent data available for London.

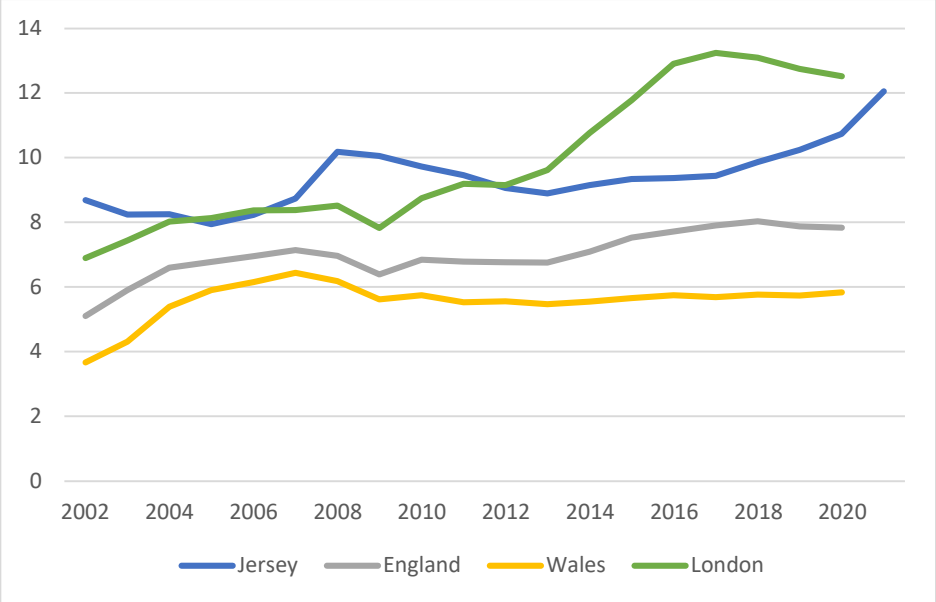
The average gross annual salary in a lower earnings sector such as hospitality or retail is around £26,000-£30,000, which is less than half of the net household income used to calculate the deposit gap. The affordability estimate is much worse for those below the median household income.

Figure 2.18

Housing affordability

Ratio of median property prices to median gross household income 2002-2021. Jersey data available to 2021, UK data available to 2020.

Source: Statistics Jersey



The proportion of vacant properties in the Island rose from 7% of private dwellings in 2011 to 8.3% in 2021. Compared to England, this is 3 times greater than the vacant dwelling rate of 2.6% in 2021. These are not direct comparisons as the ONS measure of vacant dwellings is compiled from multiple data sources whilst the Jersey Census shows only a snapshot on Census Day. The success of the financial sector is adding cost pressures for other sectors of the economy, this could be contributing to the accelerated growth in house prices.

This evidence suggests that there is some unused capacity in the current housing stock while housing unaffordability and lack of affordable rent supply poses a risk to economic growth. There is a risk of reduced migration of skilled workers as the lack of affordable housing makes the islands less attractive to potential immigrants. This should be addressed as a priority.

2.6 Update to other elements of the trend forecast

The Panel's updated trend forecast is presented below in **Figure 2.19.**

Figure 2.19

Summary of trend forecast

Summary projections for trend in each component of GVA

Source: Panel calculation

% change unless otherwise specified	Trend
Real GVA	0.5
RPI	2.4
RPIY	2.4
Nominal GVA	2.9
Gross operating surplus (including rental)	2.9
Financial services profits	*3.2*
Compensation of employees (CoE)	2.9
Financial services CoE	*3.4*
Non-finance CoE	*2.7*
Employment	0.1
Average earnings	2.8
Interest rates (%)	2.6
House prices	2.9
Housing transactions	4.0

2.6.1 Inflation

The Panel has undertaken analysis to compare the past trends in Jersey's RPIX (the Retail Prices Index excluding the cost of mortgage interest payments) inflation and the UK's most comparable measure, CPI (the Consumer Prices Index, which also excludes owner-occupiers' housing costs). This analysis shows that these two measures of inflation track closely together, with Jersey inflation trending slightly above that of the UK.

Based on the UK's long run target of 2% inflation and the assumption that the Bank of England will retain and broadly achieve its current central mandate, the Panel expects that Jersey's trend rate of RPIX inflation will be 2.4%. RPIY inflation is assumed to follow a similar path.

In previous versions of this trend analysis, RPI inflation has been assumed to be above that of RPIX due to expectations for rising interest rates in later years of the forecast. However, as market expectations for higher interest rates are expected to reach a peak in 2024 and fall only slightly in 2026 onwards, the differential between RPI and RPIX is reduced to zero.

2.6.2 Other trend indicators

Employment. The growth rate of employment is made up of the growth in the employment rate plus the growth in the working age population.

Compensation of employees. The Panel's forecast for trend compensation of employees is equal to nominal GVA.

Gross operating surplus/profits. The Panel's forecast for trend gross operating surplus is equal to nominal GVA.

Average earnings. The trend rate of growth in nominal average earnings is assumed to be equal to the trend rate of growth in productivity plus inflation.

House prices and transactions. The trend rate of growth in house prices is assumed to be equal to nominal GVA. Whilst this has been exceeded in the recent past, the Panel judges that due to the current lack of affordability in the market and interest rate rises, prices should not continue to be as buoyant in the medium term. Housing transactions will continue to grow as the number of households grow and therefore has been updated to reflect its ten-year trend.

SECTION 3

Medium-term fiscal considerations

3.1 Revenue and spending projections – future structural position

The headline metric in the Government Plan is the 'operating balance', which includes current spending and income and excludes capital spending. This metric includes depreciation as the expense of the capital stock 'used up' to deliver public services.

The measure differs from the 'primary structural balance', which is used in the fiscal framework. The primary structural balance differs from the operating balance in two ways:

1. It includes an adjustment for the economic cycle (i.e. it is a structural balance, that aims to remove any cyclical component in expenditure and revenue). This relies on the judgement of the Panel, as set out in **Section 1**.

2. It excludes investment returns and borrowing costs whereas the operating balance includes both borrowing costs (for the revolving credit facility, refinancing pension liabilities, Our Hospital and the housing bond) and some investment returns (on the Consolidated Fund and Currency and Coinage Fund). While the structural budget balance adjustment is more of a question of judgement, it is possible to produce the primary budget balance directly using figures in the Government Plan.

The 2021 Government Plan forecast a primary deficit in 2022 and primary surpluses from 2023 onwards as can be seen in **Figure 3.1**. It is likely that the fiscal position has improved substantially since then due to;

- The latest Personal Income Tax outturn in 2020 and ITIS data for 2021, which suggests higher than previously forecast receipts and will push up projected income receipts across the forecast period.
- Large increases to Corporate Income Tax from financial sector profits as interest rates are predicted to rise significantly across the horizon.

The Panel understands that the forecasts will be updated before the next Government Plan to incorporate the new economic assumptions in Section 1. This will likely have the impact of increasing States income as interest rate expectations have risen considerably since the last Income Forecasting Group revenue forecasts in Autumn.

Expenditure forecasts are likely also to have increased based on higher inflation rather than new policies.

The Panel set out the key drivers for the forecast increase in expenditure over the course of the Government Plan in its 2021 Annual Report, including the States Grant to the Social Security Fund being reinstated returning to its

formula after being halted between 2020 and 2023.

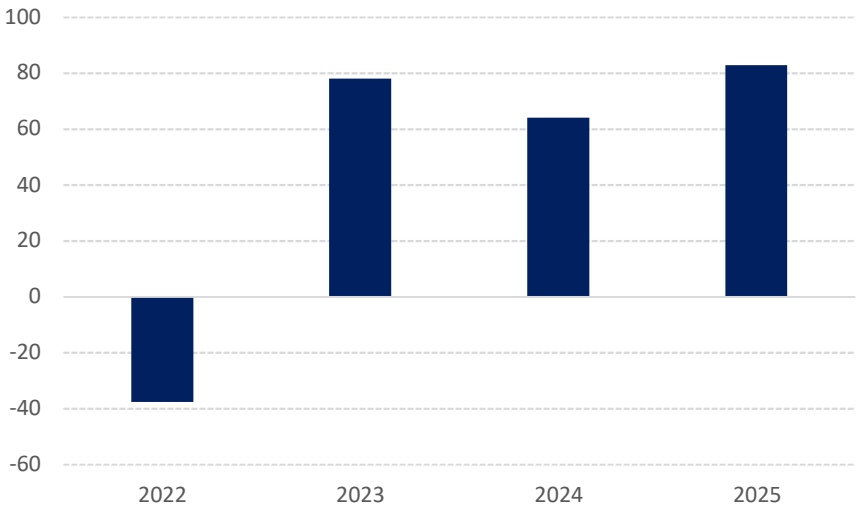
Figure 3.1

Primary surplus/deficit

As per Government Plan 2022-25

Primary budget surplus - £m (current prices)

Source: Treasury and Exchequer



These surpluses and likely upwards revisions should be set in the context of the economic forecasts from **Section 1**. One of the reasons for growth is due to the interest rate rises which are likely to boost government income throughout the period. The Panel's central forecast is for continued economic growth, despite some global headwinds, which is driven by pandemic recovery and improved financial sector profits. Based on the Panel's analysis, the Government of Jersey should plan to run surpluses over the 2023-2026 period. **The economy is currently strong with little spare capacity and historically low levels of unemployment. This is not the time for significant across the board additional spending or tax cuts which would cause further inflationary pressures.**

The large projected inflation rises outlined in **Section 1** will likely be challenging for some households especially for those where it outstrips wages, which the Panel predicts will be the case on average. **Some of the projected surpluses could be used to provide targeted support and offset a short-term risk to consumption.**

Surpluses generated should be used to improve the Government of Jersey balance sheet. This could be through paying off Covid debt, which was taken on to support the economy over the last two years, through rebuilding the Stabilisation Fund which is aimed at making fiscal policy more counter-cyclical or improving the Strategic Reserve balance. The Stabilisation Fund and Strategic Reserve are considered further in following sections.

3.2 Reserves and borrowing

The Government of Jersey has a strong overall net asset position, with total assets of £9.4bn and total liabilities of £1.3bn, as at the end of 2021. Net assets

therefore amounted to almost 162% of the FPP's estimate of 2021 GVA. The net assets change represents a nominal increase of 21% since the Panel provided advice for the first Government Plan in 2019. Part of the increase has been due to the strong market returns for key funds such as the Strategic Reserve and Social Security Reserve Fund.

Excluding property and other fixed assets, the net asset position is around 77% of GVA, having grown from 65% in the previous medium-term report.

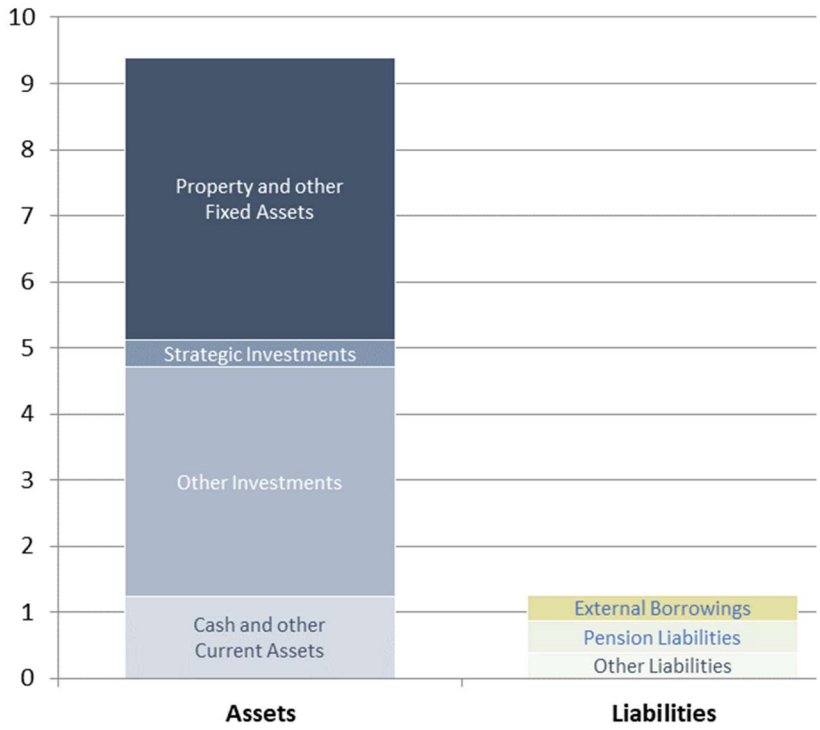
Figure 3.2

States assets and liabilities

Total year end assets and liabilities

£ billion (Current Prices)

Source: Treasury and Exchequer



Excluding fixed assets, the majority of government assets are held in seven funds: the Consolidated Fund, the Stabilisation Fund, the Strategic Reserve and four Social Security Funds. **Figure 3.3** shows that the value of these funds has risen significantly as a proportion of GVA from 58% in 2018 to a forecast ratio of 71% in 2021. Although there is a large fall to 64% based on the latest 2022 position due to strong economic growth and weaker investment returns. The Social Security Funds (in particular the Social Security Reserve Fund) comprise around 68% of the total, with the Strategic Reserve making up around 30%.

Figure 3.3

States reserves

Balance of main funds at year-end, £ million

Source: Treasury and Exchequer

	2017	2018	2019	2020	2021	2022
Consolidated Fund	120	127	161	336	55	1
Strategic Reserve	840	807	906	968	1,032	985
Stabilisation Fund	0	0	50	1	1	1
Social Security Reserve Fund	1,780	1,717	1,983	2,093	2,264	2,146
Social Security Fund	72	85	92	76	66	47
Health Insurance Fund	94	94	108	108	100	100
Long Term Care	25	25	26	37	41	63
Total	**2,930**	**2,857**	**3,327**	**3,618**	**3,558**	**3,342**
Total as proportion of GVA	*60%*	*58%*	*67%*	*78%*	*71%*	*64%*

*2022 is based on Funds position at 31 May 20222

The Panel sets out some key consideration for the main funds below.

3.2.1 Stabilisation Fund

Jersey's fiscal stance adapts somewhat to the stage of the economic cycle without specific government intervention. For example, social security expenditure, such as benefit payments conditional on low income, is not fixed but varies directly with unemployment. Likewise, individuals pay less tax when their income falls through reduced expenditure, and thus lower GST and duties expenditure, or through income tax. These mechanisms mean that when unemployment rises, the fall in households' income is partly offset by increased expenditure from government to households and reduced expenditure from households to government. The reverse also happens when the economy is growing. This means that a proportion of government expenditure is counter-cyclical and 'automatic'.

The Panel has previously estimated that the semi-elasticity of government borrowing/saving in response to the economic cycle is 0.16. Therefore, if the economy falls from trend to 1% below capacity, we would expect government net spending (i.e. spending less revenues) to rise by 0.16% of GVA automatically – without any changes in fiscal policy.

These counter-cyclical revenue and expenditure changes are called 'automatic stabilisers' because they have the desirable effect of offsetting the economic cycle. Therefore, when the economy is operating below capacity, fiscal policy automatically becomes more expansionary and vice versa in periods of high sustained economic growth. This is one of the mechanisms widely used for managing the economic cycle, with government borrowing or budget deficits rising in recessions and borrowing failing or budget surpluses or smaller deficits in economic booms.

In Jersey, the automatic stabilisers are particularly low vis-à-vis other countries as can be seen in **Figure 3.4** below meaning that government transfers to households in recessions and booms change less than in other

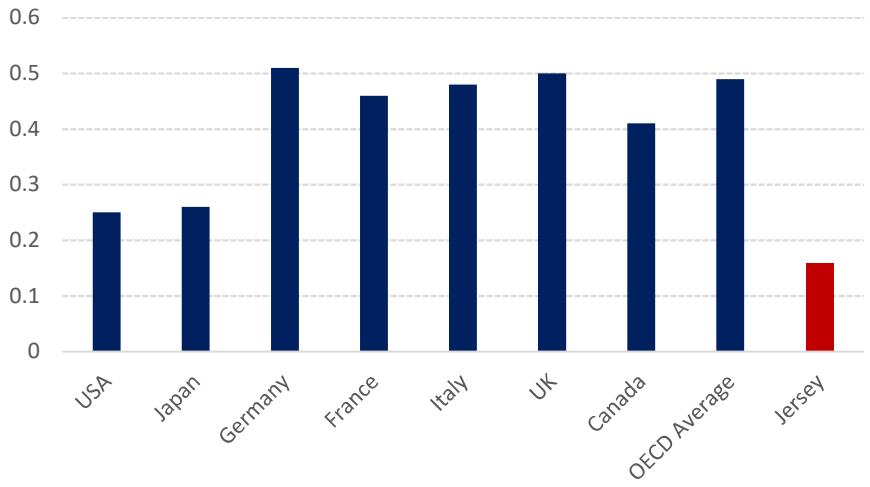
countries. Therefore, the Stabilisation Fund was created to manage government finances through the economic cycle, where expenditure could be drawn down in recessions and the Fund replenished through surpluses in economic booms and periods of above-trend growth.

Figure 3.4

Automatic Stabilisers in OECD economies

Change in net lending as a percentage of GDP for a 1% change in GDP

Source: Panel calculations



There is an important difference between the Strategic Reserve, frequently (if inappropriately) termed the 'Rainy Day Fund', and the Stabilisation Fund.

- The Stabilisation Fund was established in 2006 "to make fiscal policy more countercyclical and create in the Island a more stable economic environment with low inflation."[1]. It supports government finances in managing the economic cycle through cyclical effects which are not expected to permanently change the level or trend rate of growth in the economy substantially;
- The Strategic Reserve exists for exceptional circumstances including when an economic shock is structural and hence expected to permanently and significantly change the level of potential economic output and the trend rate of growth in the economy. In this case the Strategic Reserve would be used to enable economic adjustment.

Therefore, the Stabilisation Fund should be used for recessions and downturns like those seen during the Global Financial Crisis and that caused by the pandemic. The Strategic Reserve should be retained in the case of a large structural adjustment such as the loss of a major industry or major adverse weather event. Whilst the Global Financial Crisis and pandemic may have caused some economic 'scarring' or long-lasting economic damage, the fundamental structure of the economy has remained the same.

The initial four years of the Stabilisation Fund (2006-2009) saw cash injections

[1] P.133/2006 https://statesassembly.gov.je/Pages/Propositions.aspx?ref=P.133/2006

totalling £151m into the Fund. Following the financial crisis, £158m was drawn down over three years. Following that, other reserves were drawn down across 2009-2017 such as £107m from the Strategic Reserve, totalling almost £340m.

The Stabilisation Fund was topped up with £50m in 2019, however, this was drawn down in 2020 due to the pandemic and the balance now is negligible. Further, other funding mechanisms were set up to manage the pandemic-related economic impacts such as a Revolving Credit Facility, which was set up to provide short-term financing for the pandemic, and the Government stopped the States Grant from 2020-2023.

One of the major fiscal expenditures in the pandemic-related support was the Co-Funded Payroll Scheme (CFPS) which cost over £140m. The total direct fiscal cost of the pandemic in Jersey has been estimated at £430m to 2026 which includes funding for Test and Trace, vaccines, the Nightingale hospital, economic recovery and provisions for potential future requirements.

The Stabilisation Fund balance was not sufficient to provide this amount of support and it was appropriate to use other sources of finances such as the Revolving Credit Facility.

The last two recessions have been costly to public finances with the drawdown of reserves during 2009-2017 at £340m and the cost of the pandemic, including loss of income at £430m. If Jersey's economy was to experience a future similar protracted period below trend, then a similarly large amount could be required. This does not necessarily mean that the Stabilisation Fund should be built up to this level as funding using other reserves and other forms of financing can be used if necessary, such as the Revolving Credit Facility which may be sensible to use again in the future if required.

Whilst it is difficult to predict the funding required, it is advisable to replenish the Stabilisation Fund over the medium-term so that it can achieve its objective of making fiscal policy more countercyclical. The Panel understands that there remains a £39.8m outstanding balance in the Revolving Credit Facility. It would be appropriate to reduce this balance before building up the Stabilisation Fund.

Since automatic stabilisers in Jersey are quite weak with an elasticity of 0.16, compared to an OECD average of 0.49, there is an argument for the government of Jersey undertaking a more activist counter-cyclical fiscal policy to support the operation of these stabilisers (i.e. to actively cut spending/raise taxes in booms and vice versa in recessions). However, such activism presents a number of challenges since stabilising policies would need to be carefully calibrated and, in some cases, reversible.

The current revenue forecasts include a sizeable increase due to improved GVA forecasts. The contributions to or withdrawals from the Stabilisation Fund should at least mirror that part of the current Budget position driven by the automatic fiscal stabilisers. The Panel's forecast implies that the economy will be running 0.7% above capacity next year, meaning that the addition to the Stabilisation Fund should include 0.11% of GVA in 2023 (about £7m). The economy is projected to remain above capacity over the forecast period and therefore this amount, as a lower bound, is advisable to transfer to the Fund each year of the Government Plan whilst retaining flexibility to adapt plans.

A further transfer is also needed to replenish the past use of the Fund for active fiscal policy during the pandemic and ensure that the Fund can provide additional fiscal support in the event of a future downturn. It is possible that additional revenue from improved tax forecasts could be used to build up the Stabilisation Fund. **Figure 3.5** below shows a projection of the Fund if the £7m automatic stabilisers each year and some of the additional revenue likely to be received from financial services profits was transferred into the Fund. This includes the first £39.8m used to pay off the Covid-19 borrowing.

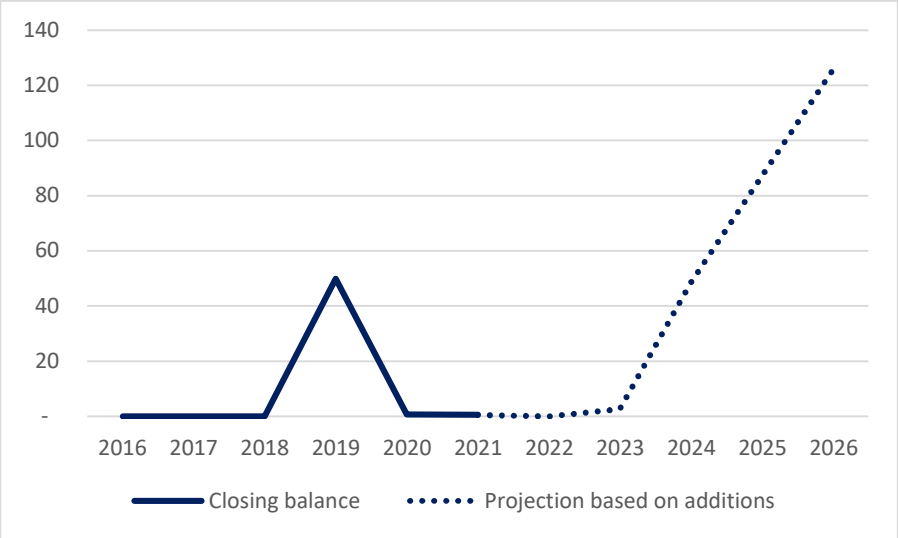
Given some of the increase in tax from the financial sector will be due to a return to deposit margin trend, it is reasonable that a small part of this may be used for other reasons such as targeted cost of living support.

Figure 3.5

Stabilisation Fund balance

Actual balance of the Stabilisation Fund and transfers from automatic stabiliser and upward revisions to tax from financial sector profits

Source: Treasury and Exchequer; Panel calculations



Given that the automatic stabilisers are relatively small in proportion to the economy, Government should plan to run surpluses when above trend which are in excess of those which result from the automatic stabilisers.

3.2.2 Social Security Funds

The majority of the Government of Jersey's reserves are held in four funds, collectively known as the Social Security Funds:

The Social Security Fund provides contribution-based benefits, primarily pensions but also in the event of death or incapacity. The Fund is financed through contributions from employees and employers, topped up by funding from general tax revenues (*the States Grant)* for lower earners.

The Social Security (Reserve) Fund is a reserve that can be used to smooth any increase in contributions caused by ageing demographics. Until 1998 the Social Security Fund was operated on a largely pay-as-you-go basis but the decision was taken to increase contributions such that a reserve could be built up.

The Health Insurance Fund provides a subsidy towards GP visits, the cost of prescriptions and other primary care contracts. This Fund is financed through contributions from employees and employers, collected as part of the Social Security contribution.

The Long-Term Care Fund provides benefits to adults with long-term care needs. It is funded through contributions collected from personal income tax payers, plus a government grant which is maintained in real terms.

The Panel has considered the combined Social Security and Social Security Reserve Fund in more detail below.

The Panel understands that all four of these funds will be actuarially reviewed in early 2023 which will assess the adequacy of the funds for their respective intended purpose. The Panel will provide more detailed commentary after this review has taken place.

Social Security Fund (including Social Security Reserve)

Since the Panel's previous Medium-Term Report, the Social Security Fund has been actuarially reviewed which assessed that the Fund to be healthy in the short to medium term and indicated a higher projected balance than in the previous 2015 review.

Since 2019, there have been several changes which could affect the underlying central assumptions. In **Section 1**, the Panel set out that there will be an anticipated increase in the dependency ratio – which will mean the number drawing down pensions from the Social Security Fund will increase as a proportion of the number of contributors. Under the range of population projections produced by Statistics Jersey in 2015, there is a significant increase in the dependency ratio.

In light of this, it is positive that Jersey has taken the prudent step to set up a Reserve Fund to ease the impact this will have on contribution rates and smooth the 'bulge' of an ageing population. The Reserve will be able to support the transition to a more stable dependency ratio in protecting the

current generation from higher contribution rates.

This is now more prominent with the latest Census results which seem to suggest a lower migration rate. Lower migration scenarios will likely drive a higher dependency ratio as migrants tend to be younger than the native population. The 2019 actuarial review established that at current contribution rates with net immigration of 325 people a year, the Fund would be exhausted between 2067 and 2077 at existing contribution rates as can be seen in **Figure 3.6** below. Whilst it is difficult to draw a clear conclusion about the migration rate from the latest Census results, the annualised net migration seems to be around 330 and the latest Common Population Policy sets an ambition to 'progressively reduce Jersey's reliance on net inward migration'. Therefore, this may cause strain on the Social Security Reserve Fund and its ability to hold current rates and retirement ages at the current levels. This will also be influenced by investment returns on the Fund.

It is likely that the Government will need to increase the retirement age and/or social security contribution rates in the future if it continues to pursue a reduction in net migration. The most recent actuarial review of the Fund concluded that based on the position at the end of 2017, contribution rates would need to rise to 14.5% by 2047 (from 10.5% currently) to meet the expected expenditure of the fund (under a +325 net migration scenario). **After the actuarial review, the Government should consider the future funding for the Social Security Fund and the use of the Reserve Fund. Any policy decisions should consider a range of different population scenarios and the impact these may have on the ability to pay future pensions.**

Further, the government should consider the overall composition of the States key Funds particularly the Social Security Fund and Strategic Reserve once the actuarial reviews have been completed and objectives for the Funds are decided. This will enable it to ensure the balances of Funds are appropriate given the stated objectives. For instance, if the objective of the Social Security Reserve was predominately to smooth the impacts of the ageing population and contribution rates were increased to break-even for the steady state, then any surplus balances could be used to support the Strategic Reserve. **The Government should ensure objectives for the Funds are clear and adjust policies in line with objectives. This will be particularly relevant after the actuarial review of the Social Security Funds.**

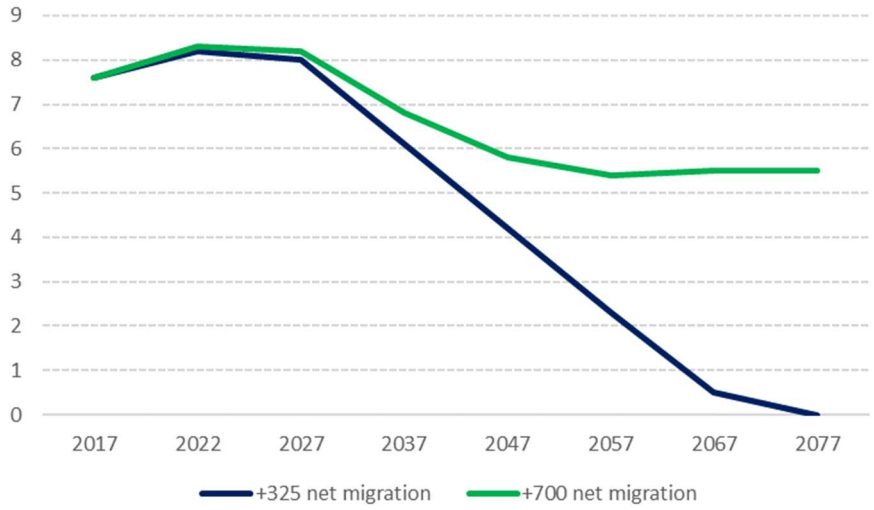
An updated actuarial review is due to be published next year. The Panel will consider the findings of this review in future reports.

Figure 3.6

Forecast Balance of Social Security Reserve

Based on actuarial review of Fund as at end of 2017

Source: UK Government Actuary's Department



3.2.3 Strategic Reserve

The Strategic Reserve is governed by legislation setting out that it may only be used in exceptional circumstances to insulate the Island's economy from severe structural decline such as the sudden collapse of a major Island industry or from major natural disaster.

In 2019, the Panel assessed that to meet its objectives, that a Strategic Reserve of between 30% and 60% of GVA would be prudent based on the experience of similar crises in other countries. In the Panel's most recent Annual Report, it advised that the current projections were that the Reserve would not meet its stated objective.

Since the Annual Report, the States agreed an amendment to the Government Plan that borrowing related to Covid-19 and the Fiscal Stimulus will be paid back over 5 years as opposed to through long-term debt issuance. The Panel understands that this will predominately be paid through reduced expenditure and unspent allocations through the Consolidated Fund. Previously, the debt repayment was planned to be sourced from the Strategic Reserve and a sinking fund set aside to pay for this with Prior Year Debts identified as a possible revenue stream.

Since then, GVA has increased quite substantially due to higher financial sector profit forecasts which has the effect of pushing down the Strategic Reserve to GVA ratio. Further, the interest rate on debt has increased which leads to a smaller Reserve in the long-term as can be seen in **Figure 3.7**.

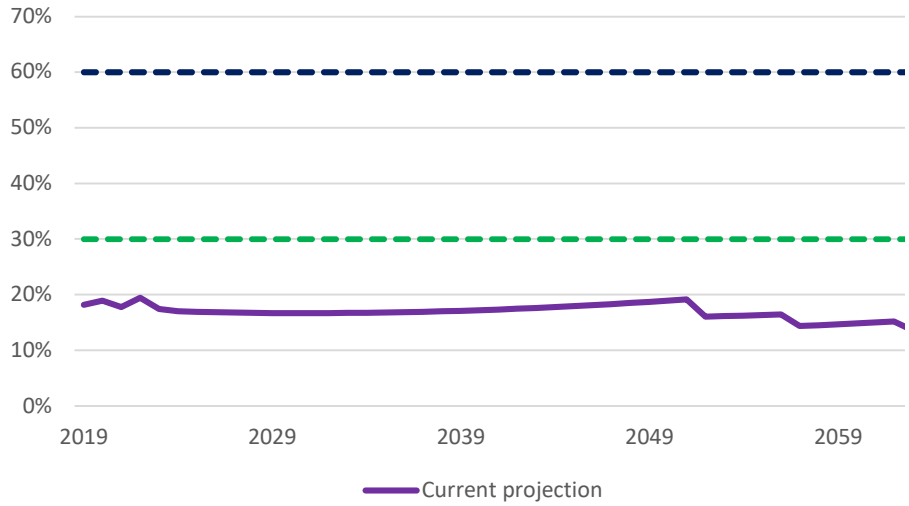
Figure 3.7

Strategic Reserve as % of GVA with Our Hospital bond issuance stripped out

Green line is 30%

Blue line is 60%

Source: Treasury and Exchequer, Panel calculations



This latest projection means that the Strategic Reserve on current projections will remain below the 30% ratio for the next forty years at between 15-20% of GDP based on a 4.6% nominal return rate. A slightly higher return rate would still lead to the Strategic Reserve achieving only around 20% of GDP across the next forty years.

Given the central scenario and low-returns scenario currently project that the Strategic Reserve will remain below 30% for the next 40 years, **the Government should consider working towards a larger Reserve through a long-term programme of contributions and retaining the returns from investment.**

The Government should consider different options for building up the Strategic Reserve. The Government Plan considered using receipts from the Prior Year Basis (PYB) liabilities to create a sinking fund for the Covid-19 debt. Whilst, this is no longer necessary given the changes to repayment of Covid-19 debt, **it is advisable to use the PYB debts to improve the Government's balance sheet and the Strategic Reserve would be an appropriate choice since payments will be one-off.** Under the central and high returns scenario, this would still lead to the Reserve not achieving the 30% across the forty years although would boost it above the current projection. This is subject to a number of assumptions around the repayment of the PYB debt and returns achieved on the Strategic Reserve.

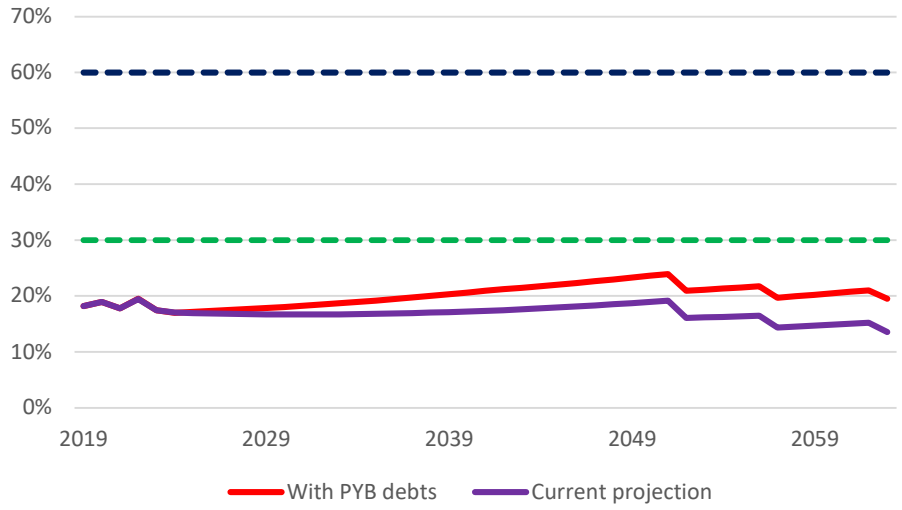
Figure 3.8

Strategic Reserve as % of GVA with Our Hospital bond issuance stripped out

Green dotted line is 30%

Blue dotted line is 60%

Source: Treasury and Exchequer, Panel calculations



3.2.4 Investment policies / borrowing

The Government of Jersey has considerable financial assets in a range of funds along with a low level of financial liabilities such as debt as outlined in **Section 3.2.** Public sector net financial assets are strongly positive. The funds are pooled for investment purposes in a Common Investment Fund (CIF). The individual funds' exposure to risk in the CIF is set by their investment strategy and is managed through the asset allocation published within the States Investment Strategies. Investment strategy is considered over a long-term horizon and diversifies risk across managers and assets.

Returns over 2020-2021 and recent history have been particularly high. For example, the Strategic Reserve achieved a net rate of return of 5.4% over the past three years to April 2022 and the Social Security (Reserve) Fund achieved a return in excess of 6% in the same period. These funds are predominately invested in global equities and the returns reflect the strong increase in equity market valuations since before the pandemic. This year has been more challenging than recent years for equity investment returns, as inflation, tightening monetary policy and slower growth have meant small declines over the past year with an average return rate year-to-date to April 2022 for the Strategic Reserve of -4.7%.

Equity returns are generally higher in the long run than fixed-rate investment returns such as bonds, but equities have a higher degree of volatility in their returns and hence risk. The experience of 2022 demonstrates this as returns over the last year to April for the Strategic Reserve and Social Security (Reserve) Fund were -1.9% and -2% respectively.

The Government of Jersey should consider its risks and returns across its entire portfolio of liabilities and assets jointly. For instance, Government revenues and expenditures are subject to the economic cycle as outlined in

Section 2, and likewise, financial sector prospects are partly dependent on developments in global financial markets. So investment strategies should consider the extent to which returns are correlated with Jersey's economic cycle (and significant economic risks) and aim for investment returns to offset rather than compound budgetary pressures over the cycle. Pursuing this strategy will mean that the Government can avoid drawing down reserves for counterbalancing the economic cycle or more serious shocks, at points when the balances are low.

More generally, government borrowing can support aggregate demand and smooth the economic cycle, including paying this off in periods of economic boom. The Government aims to meet this objective, without requiring the use of borrowing by using the Stabilisation Fund, which is discussed in Section 3.2.1.

The Panel set out reasons for borrowing in the previous Advice for Government Plan and these remain appropriate. Concisely:

- Borrowing for financing public corporations that charge for goods and services
- Financing public investment in infrastructure
- Financing fixed capital assets such as buildings to deliver public goods

It is possible that the Government could borrow from its owns funds to finance investment, however, the Panel highlights there are several reasons to be cautious about doing this. Most importantly, there may be a mismatch in timing and duration between the objective of the fund and repayment. This may mean that funds that are loaned out with scheduled repayment over a long time period means they are not available for their original purpose which would represent an additional liquidity and financing risk. This is risk is smaller for Funds where the objectives and liabilities fall over the longer term such as those in the Social Security Reserve Fund.

Regardless, this may weaken the ability of specific funds to meet specific liabilities. Further, there is the risk of this type of borrowing creating an implicit subsidy if the interest rate on any borrowing is set below the market rate. Therefore, it is advisable that if this borrowing were to occur, that borrowing should occur at the market rate to make clear the required rate of return on capital investment and opportunity cost of funds.

3.3 Capital expenditure

Looking historically, it has been particularly challenging for the Government to deliver capital projects as can be seen in Figure 3.9 where forecasts from a

year prior have consistently overestimated the amount of capital expenditure. Whilst this appears to have improved somewhat in recent years, this is predominately due to older projects being delayed which can cause issues for scheduling and future project delivery. The pressure on delivering capital projects is unlikely to abate over the short-term. There are new pressures arising due to large increases in materials and other costs as laid out in **Section 1 -** and contractors only committing to shorter-term quotes for projects.

Figure 3.9

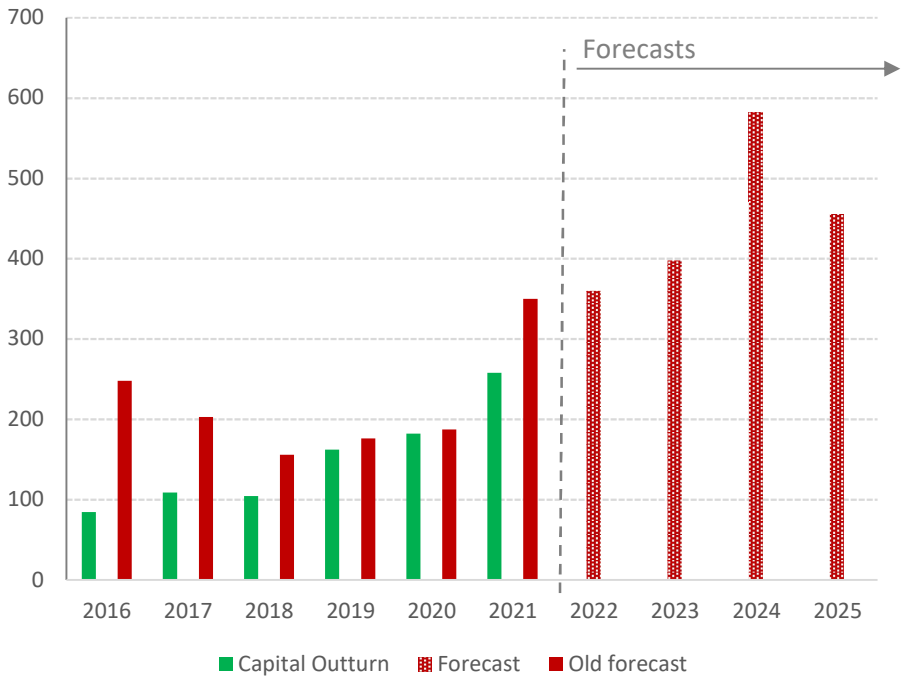
Capital spending - outturn and forecast

£m (current prices) including trading operations and subsidiary companies

Red bar is outturn and GP 2022-25 forecast

Green bar is most recent forecast before outturn from previous GPs and Budgets

Source: Treasury and Exchequer



Government capital expenditure can be particularly useful in downturns as it allows under-utilised resources to be used to invest in infrastructure that can increase productive capacity of the economy or support delivery of public services. However, there are challenges in delivering capital projects in a timely manner. Using major capital projects to contribute to cyclical management of the economy appears unlikely to succeed fully due to long-lead times and unpredictability around timing of delivery.

Managing capital projects going forward is likely to be even more crucial with a major capital programme, some more progressed than others, such as the Our Hospital project, new Andium homes and Waterfront development. These are likely to cause pressures on existing resources and supply chains in Jersey and therefore will require careful management. **It will be increasingly important to ensure projects are carefully scheduled and so the historic tendency to submit overly-ambitious timetables for capital projects should be eliminated if possible.**

The Panel understands that the current process for approving and delivering

capital expenditure is being reformed to improve ability to judge delivery timing, which is sensible to ensure the most efficient use of existing and constrained resources.

3.4 Rebalancing

The last Government Plan included a target of £120m of 'rebalancing' to be reached by 2024, relative to 2019. The Plan states that a wide range of fiscal measures will be required and therefore rebalancing incorporates efficiencies.

The 2019 Government Plan targeted £100m efficiencies across 2020-23 and a further £20m was subsequently added last year to be realised in 2024. Of the £40m efficiencies targeted for 2020 and £60m for 2021 (including the £40m recurring from 2020), £40m was achieved in 2020 albeit some being delivered through £15m one-off efficiencies.

As some of these efficiencies were one-off, this increased the new amount of rebalancing needed in 2021 so the target changed from £20m recurring to £35m. Of the new target, £30m were delivered on a recurring basis with £5m of one-off which again was added to 2022. The Government Plan sets out a target of £22m of rebalancing measures for 2022, with detail set out in the Plan.

The FPP recommends that efficiencies should be sought regardless of the stage of the economic cycle, however, it is worth noting that efficiencies can be difficult to deliver. One-off efficiencies have been necessary to achieve the challenging targets in the previous two years and it is likely the difficulty will increase as 'easy wins' have been completed.

Rebalancing measures should only be included in the Government Plan if it is clear how they will be achieved. Including speculative measures may lead to pressures in later years if they are subsequently not found.

3.5 Other fiscal considerations

There are other fiscal considerations over the long-term which the Government should consider. These are:

- Carbon Neutral Roadmap and associated costs and loss of incomes associated. Expert analysis produced for the States Assembly in 2019 suggests achieving net zero by 2030 would cost between £60m and £360m in the heating and road transport sectors, which account for the majority of Jersey emissions. **The Climate Emergency Fund will not be sufficient to finance the transition to net zero which will require the careful use of both taxes and expenditure to create the right economic incentives. The government should consider the strategy for**

financing these challenges.

- Ageing demographics will likely lead to higher expenditure on health and may require more financial support where individuals have not saved sufficient money into a pension or through other means. **The Government should consider the impacts of the ageing population on fiscal expenditure.**