Jersey's Fiscal Policy Panel

Deputy Ian Gorst
Minister for Treasury and Resources

20 March 2023

Dear Minister,

Updated Economic Assumptions

Thank you for your letter of 13 March, requesting updated economic assumptions and the Panel's views on Jersey's borrowing. We have updated our economic forecasts and provided new fiscal advice to address your questions. Please find our updated economic assumptions appended to this letter (see Annex 1).

Although there are signs that the global outlook may have improved slightly since the 2022 Annual Report, global growth remains weak. The Panel remains cognisant of the ensuing uncertainty around the global economy and the challenges this may bring in forecasting Jersey's economic path in the near term.

As we have seen, inflation has dominated global economic policy in 2022, as a result of the Russian invasion of Ukraine and covid-related disruptions in the global supply chains. Over the course of 2022, the Bank of England tightened monetary policy to combat inflationary pressures in the UK, increasing Bank Rate eight times from 0.25% to 4.0%. The average annual rate of inflation for Jersey was 9.3% for the Retail Prices Index (RPI[1]) and 7.1% for RPI(X)[2] in 2022.

[1] RPI includes both indirect taxes and estimation of mortgage interest payments.
[2] RPI(X) excludes estimated mortgage interest payments.

Despite these global risks, the Jersey economy is currently operating above capacity as data suggests a growing economy but a tight labour market:

- House prices rose by 11% in 2022 (compared to 2021). This meant the price of a median house increased by £100,000. The number of transactions fell by 13% from a record high in 2021.
- Registered unemployment remains low at 670 in December 2022, with a majority of sectors reporting vacancies or difficulties in filling vacancies.
- Average earnings were 6.2% higher in June 2022 than the year before.
- The Business Tendency Survey indicated overall positive current and future business activity for the economy throughout 2022; in particular, strong profitability was shown for the financial services sector, with future business activity and employment also optimistic. However, the disaggregated results for the non-finance economy are less positive, with weakened current and future business activity noted in December 2022. Input costs remained high throughout the economy – a sign of the inflationary pressures experienced in 2022.

As such, growth is expected to continue into 2023 with some pressures on non-finance sectors.

There are indications that inflation may have reached its peak in the UK, as wholesale energy prices fall, and will come down sharply in the short to medium term. The Panel expects Jersey RPI to follow a similar path, peaking in Q1 2023 at 12.8%, before steadily falling (see Annex 2); although it will remain elevated throughout 2023 with an annual average inflation rate of 9.9% for the year.

Noting that the Jersey labour market remains tight, any additional action by the Government beyond the 2022 mini-budget to address the cost of living crisis should be targeted to avoid risks of overheating the economy and prolonged higher inflation.

The Panel further notes that the differential between RPI and RPI(X) inflation is likely to narrow in the middle of 2024, after which the Panel's current forecast suggests that the growth in RPI(X), which excludes estimated mortgage interest payments, will be greater than RPI.

Current market expectations show interest rates peaking earlier in 2023 than previously anticipated. This affects the profile of profits in the financial sector compared to that forecast in the 2022 Annual Report (see Annex 3). Profits in the financial sector are now expected to have grown faster in 2022 with slower but still high growth in 2023. As such, the Panel has revised its forecasts for real GVA growth in 2022 from 2.5% to 3.4% and from 5.9% to 3.9% in 2023.

The key remaining points in the Panel's updated forecast are:

- Slightly higher employment growth driven by higher profits in the financial sector.
- Slightly higher average earnings growth in 2023, before returning to below trend in the later years of the forecast period.
- A slowdown in the housing market. Both the increase in house prices and the number of housing transactions are forecast to slow down, as the effect of higher interest rates on mortgage costs feeds through.

The publication of the States of Jersey 2022 Annual Report and Accounts will set out the overall fiscal performance in 2022. Given the revisions to the economic assumptions, it is likely that tax receipts will be higher than previously forecast with the fiscal position aiming to generate significant surpluses. These can be used initially to pay down any outstanding short-term debt and to add funds to the Stabilisation Fund. In the longer-term, additions to the Strategic Reserve should also be considered.

The Minister has requested the Panel to consider the extent to which borrowing should be reduced or minimised, as an alternative to rebuilding the Stabilisation Fund or Strategic Reserve.

Short-term borrowing can result in refinancing pressures at times when the economy is weak, exacerbating pressure on the economy (it can be a 'pro-cyclical' force). The Panel recommends surpluses are used to reduce outstanding short-term borrowing. When considering long-term borrowing the key factors to be considered will include the likely cost of new borrowing, as compared with the projected returns on Jersey's investments. The latter are of course highly uncertain in the short-term – but may be somewhat more predictable over longer periods.

In addition, having outstanding debt offers Jersey optionality, and contacts with market participants. For this reason, it is not clear that the priority use for surpluses should be reducing long-term debt, rather than building up the reserves. Nor is there any inconsistency between having outstanding debt at the same time as Jersey holds various reserve accounts.

As we have commented before, any borrowing proposals should be assessed carefully against the aims and objectives set out in the Government's debt framework and strategy.

So, we would reiterate our view that the Government should build its reserves by transferring any surpluses, after the repayment of short-term borrowing, to the Stabilisation Fund or Strategic Reserve.

Yours sincerely

Kate Barker

Kate Barker (Chair)

Francis Breedon and Richard Davies

Annex 1: Updated economic assumptions

March 2023 Forecast

% change unless otherwise specified	2020	2021	2022	2023	2024	2025	2026	Trend 2027+
Real GVA	-9.6	9.2	4.3	3.9	1.6	0.4	0.4	0.5
RPI	1.3	2.7	9.3	9.9	1.8	0.8	0.2	2.4
RPIY	1.2	2.7	7.1	5.9	2.2	1.5	2.1	2.4
Nominal GVA	-8.1	12.1	12.1	10.3	4.3	2.2	2.7	2.9
Gross operating surplus (including rental)	-16.4	19.2	19.0	13.8	5.3	2.5	2.4	2.9
Financial services profits	*-18.8*	*13.1*	*30.0*	*20.0*	*5.5*	*1.0*	*1.0*	*3.2*
Compensation of employees (CoE)	-0.8	6.8	6.5	7.0	3.2	2.0	3.0	2.9
Financial services CoE	*-0.5*	*3.9*	*5.4*	*6.9*	*2.6*	*1.9*	*3.7*	*3.4*
Non-finance CoE	*-4.4*	*8.7*	*8.5*	*6.8*	*2.8*	*1.9*	*2.9*	*2.7*
Employment	-2.4	2.9	0.9	0.6	0.5	0.4	0.4	0.1
Average earnings	1.1	3.3	6.2	6.4	2.6	1.6	2.6	2.8
Interest rates (%)	0.2	0.1	1.5	4.2	4.0	3.5	3.3	3.2*
House prices	6.1	16.0	11.0	1.0	4.0	3.0	3.0	2.9
Housing transactions	-3.8	15.1	-12.9	3.0	2.5	2.5	2.5	4.0

*Trend interest rates represent market expectations for 2027

November 2022 Forecast

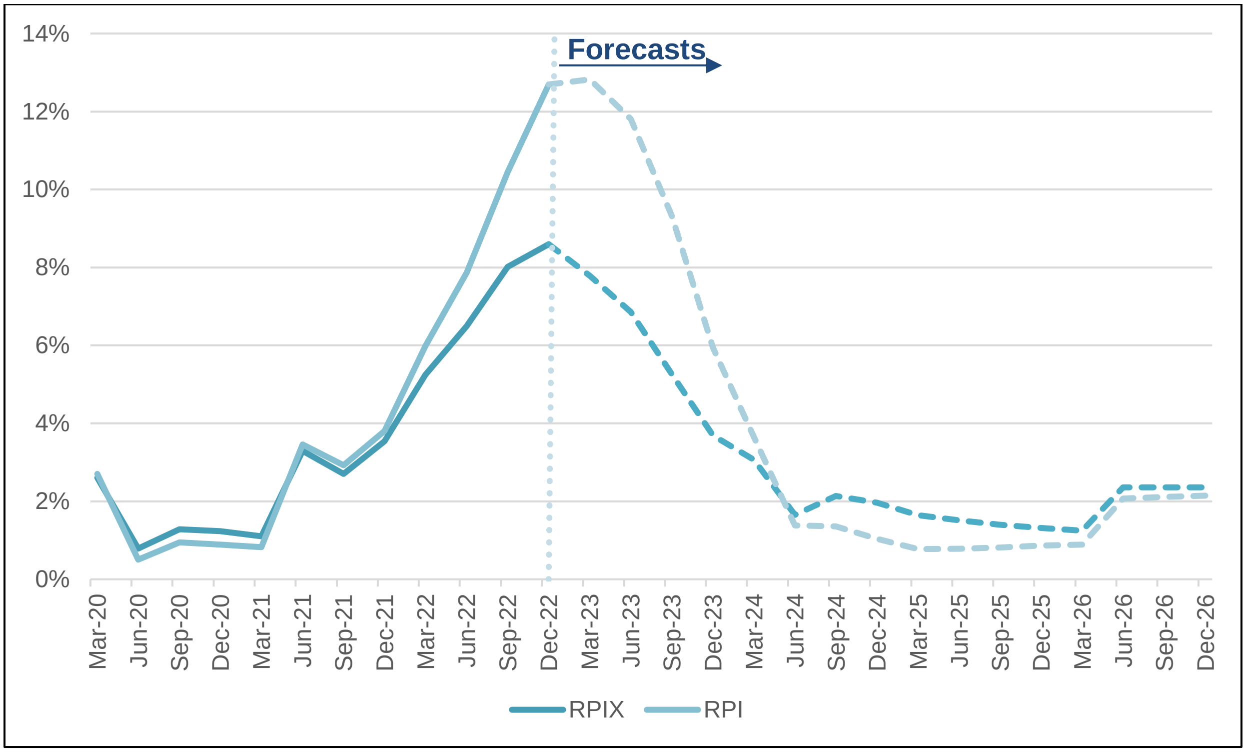
% change unless otherwise specified	2020	2021	2022	2023	2024	2025	2026
Real GVA	-9.6	9.2	2.5	5.9	3.1	0.3	0.5
RPI	1.3	2.7	9.1	9.7	3.1	1.7	2.4
RPIY	1.2	2.7	7.1	6.6	2.6	1.7	2.4
Nominal GVA	-8.1	12.1	9.5	12.6	6.0	2.2	2.9
Gross operating surplus (including rental)	-16.4	19.2	13.4	19.3	8.4	2.2	2.9
Financial services profits	*-18.8*	*13.1*	*20.0*	*35.0*	*12.0*	*1.0*	*3.2*
Compensation of employees (CoE)	-0.8	6.8	6.3	6.7	3.6	2.2	2.9
Financial services CoE	*-0.5*	*3.9*	*4.8*	*6.5*	*3.0*	*2.1*	*3.4*
Non-finance CoE	*-4.4*	*8.7*	*8.5*	*6.9*	*3.2*	*2.1*	*2.7*
Employment	-2.4	2.9	0.7	0.6	0.5	0.3	0.1
Average earnings	1.1	3.3	6.2	6.2	3.1	1.8	2.8
Interest rates (%)	0.2	0.1	1.4	3.9	4.4	4.4	4.3*
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

Change since November 2022

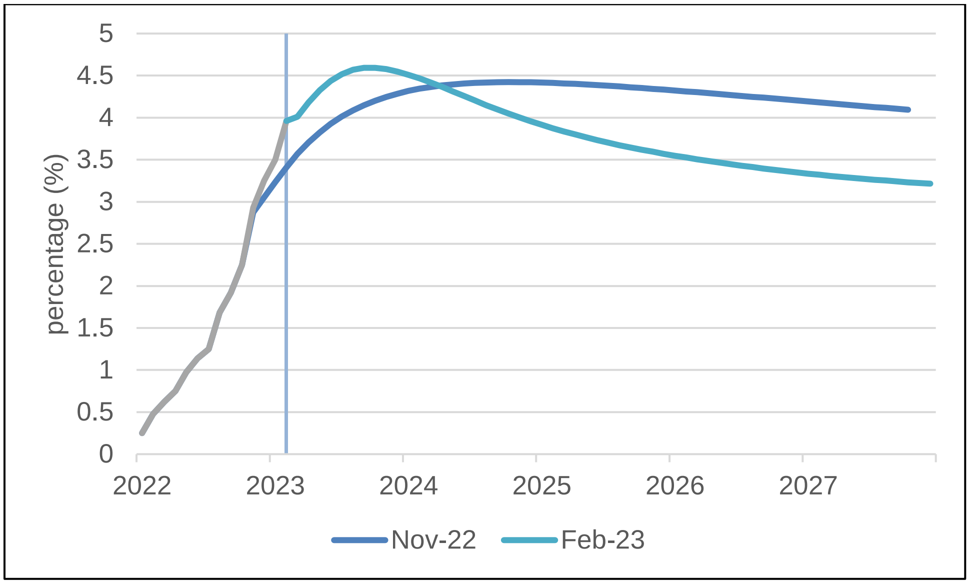
% change unless otherwise specified	2020	2021	2022	2023	2024	2025	2026
Real GVA	0.0	0.0	+1.8	-2.0	-1.5	+0.1	-0.1
RPI	0.0	0.0	+0.2	+0.2	-1.3	-0.9	-2.2
RPIY	0.0	0.0	0.0	-0.7	-0.4	-0.2	-0.3
Nominal GVA	0.0	0.0	+2.6	-2.3	-1.7	0.0	-0.2
Gross operating surplus (including rental)	0.0	0.0	+5.6	-5.5	-3.1	+0.3	-0.5
Financial services profits	*0.0*	*0.0*	*+10.0*	*-15.0*	*-6.5*	*0.0*	*-2.2*
Compensation of employees (CoE)	0.0	0.0	+0.2	+0.3	-0.4	-0.2	+0.1
Financial services CoE	*0.0*	*0.0*	*+0.6*	*+0.4*	*-0.4*	*-0.2*	*+0.3*
Non-finance CoE	*0.0*	*0.0*	*0.0*	*-0.1*	*-0.4*	*-0.2*	*+0.2*
Employment	0.0	0.0	+0.2	0.0	0.0	+0.1	+0.3
Average earnings	0.0	0.0	0.0	+0.2	-0.5	-0.2	-0.2
Interest rates (%)	0.0	0.0	+0.1	+0.3	-0.4	-0.9	-1.0
House prices	0.0	0.0	+5.0	-4.0	0.0	0.0	+0.1
Housing transactions	0.0	0.0	-16.4	0.0	0.0	0.0	-1.5

Annex 2: RPI(X) and RPI inflation forecast and table of quarterly year-on-year changes



Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
RPI Inflation (percentage change, %)								
12.7	12.8	11.8	9.3	5.9	3.6	1.4	1.4	1.0
RPI(X) Inflation (percentage change, %)								
8.6	7.8	6.9	5.3	3.7	3.0	1.7	2.1	2.0

Annex 3: Future market expectations for interest rates



Annex 4: Letter from the Treasury and Resources Minister

Minister for
Treasury and Resources

Government of JERSEY

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

Dame Kate Barker

Chair of the Fiscal Policy Panel

By email

13 March 2023

Dear Dame Kate,

Firstly, I would like to thank the Fiscal Policy Panel for their continued advice and support, which helps greatly to inform Government in the development of the Government Plan amid what has been an increasingly difficult forecasting environment.

In its 2022 Annual Report, the Fiscal Policy Panel noted that the global macroeconomic outlook remains weak, with global economies facing rising inflation and higher interest rates to combat the latter. Since this report, the level of uncertainty in the global economies, and within the geopolitical context, continues. The Russian invasion of Ukraine remains an ongoing humanitarian crisis, with no clear conclusion in sight. The Government of Jersey has committed to stand alongside the UK and international partners in its condemnation of the actions of Russia against Ukraine.

The geopolitical environment, amongst other factors, has seen low economic growth and a surge in inflation and consequently, a rise in interest rates, across the globe. The Government has acted to address the ensuing cost of living crisis in the mini-budget to support Islanders facing rising costs and the effects of rising interest rates.

Given the current economic environment, I welcome the Panel's views on an updated set of economic assumptions and how these might impact the outlook for Jersey's economy. The advice and assumptions will be crucial in supporting the development of this year's Government Plan 2024 to 2027.

In particular, I would appreciate the Panel's views on the extent to which borrowing should be reduced and minimised, as an alternative to rebuilding the Stabilisation Fund or growing the Strategic Reserve.

I look forward to receiving your response in due course.

Yours sincerely,

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