

Jersey's Fiscal Policy Panel

Senator Alan Maclean
Minister for Treasury and Resources
Cyril Le Marquand House
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Dear Minister

Economic Assumptions

As required under the Council of Ministers Fiscal Framework I am pleased to attach the latest set of central economic assumptions (figure 1 in the appendix) which the Panel has overseen for the purpose of updating the States financial forecasts.

In arriving at these assumptions we have considered the latest developments in the local and international economies. In our 2015 Annual Report we highlighted the risks to the economic outlook in terms of the fragility in the euro area, the slowdown in China and other emerging markets, continuing geopolitical tensions and the volatility in stock markets.

Since that report our view is that these risks have, if anything, increased still further. In these conditions, it is important to ensure that the MTFP Addition has sufficient flexibility to adapt to changing economic circumstances. Also these assumptions should be used with more than the usual caution.

We have also taken the opportunity to refresh the analysis we undertook as part of our 2015 Pre-MTFP Report and have looked again at the issues of trend growth and spare capacity in the Jersey economy. As previously stated this type of analysis is fraught with difficulty in larger economies and more so in Jersey given the data limitations and nature of the economy. However, the Panel wanted to give further detailed consideration to the issue of the stronger than expected growth recorded in 2014 and what it implies about the degree of spare capacity in the economy looking ahead.

The conclusion of this work is that the trend rate of growth over the 2004-2013 period may have been slightly higher than anticipated and that by 2013 there was significantly more spare capacity in the economy than previously estimated. This means that more of the fall in GVA from 2008 to 2013 was likely to have been cyclical rather than a structural decline.

It appears that finance sector profits increased significantly in 2014 because there were factors which were previously holding profits down and which were partially reversed. This means that the finance sector was able to grow strongly in 2014 without significantly altering the outlook for spare capacity over the life of the MTFP. It is the FPP's view that a significant output gap still remains and that further cyclical growth could be expected as the Jersey economy uses up spare capacity.

Figure 2 in the appendix to this letter updates figure 2.6 from our 2015 Pre-MTFP Report. It shows that the economy is still expected to return to capacity between 2017 and 2019. The Panel has previously pointed out that this assessment is subject to great uncertainty relating mainly to: the speed and stability of global economic growth, the


competitiveness of Jersey financial services and the ability of businesses to employ people with the right skills locally and internationally.

In the light of this updated analysis of trend growth and the economic outlook, the FPP reiterate their previous advice that the focus of the MTFP should be to address any structural imbalance in States finances by 2018/2019 whilst ensuring that the range and timing of the measures minimises the risk to the economic recovery. This continues to mean that in the early years of the MTFP it may be appropriate to use the States' reserves to strike the right balance.

Given the significant uncertainty surrounding the global and local economic outlooks and the degree of spare capacity in the Jersey economy, the FPP continue to emphasise that plans should include sufficient flexibility to meet changing economic circumstances. This includes the contrasting situations where there is a deterioration in the economic outlook in which case plans would need to be adjusted to support the economic recovery, and the possibility that the economy performs more strongly with evidence that capacity is used up more quickly than expected in which case more emphasis should be given to the need to address the structural position.

I hope you find these comments and additional analysis helpful as you plan for the MTFP Addition.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Joly Dixon', with a horizontal line extending to the right.

Joly Dixon (Chair)

Tera Allas, Christopher Allsopp and Dame Kate Barker

Appendix

Figure 1: Economic assumptions

% change unless otherwise stated

	2014	2015	2016	2017	Return to trend	
					2018	2019
Real GVA	4.9	2.3	1.4	1.4	0.0	0.0
RPI	1.6	0.6	1.8	2.6	3.3	3.3
RPIY	1.6	0.6	1.8	2.4	3.0	3.0
Nominal GVA	6.6	2.9	3.2	3.8	3.0	3.0
Company profits	10.5	2.5	3.1	3.4	3.0	3.0
Financial services profits	19.4	2.1	3.1	3.3	3.0	3.0
Compensation of employees(a)	4.9	3.3	3.3	4.1	3.0	3.0
Employment	2.3	1.5	0.5	0.5	0.0	0.0
Average earnings	2.6	1.8	2.8	3.6	3.0	3.0
Interest rates (%)	0.5	0.5	0.5	0.7	0.9	1.5
House prices	3.0	4.2	4.0	5.0	3.0	3.0

(a) Total employment costs

Outturns

Figure 2: Updated GVA forecasts and trend GVA estimates

£m 2013 prices

