Economic Outlook | November 2014

States of Jersey
Economics Unit

HEADLINES

- The global economy has disappointed slightly this year, with growth expected to continue at the same pace as last year, increasing slightly in 2015. The UK and US are growing at a reasonable pace, although the euro area continues to struggle. A key risk to Jersey's outlook is the possibility that conditions in the euro area will hold back global and UK growth, pushing back the timing of interest rate increases.

- There are signs that the Jersey economy has returned to real growth in 2014. Robust employment numbers, another year of real average earnings growth and more positive business sentiments, particularly in the finance sector, suggest conditions are improving more quickly than previously expected. Also, unemployment has shown a sustained fall and conditions in the housing market are showing early signs of improvement.

- Last year, economic growth in Jersey was flat - the first time it did not shrink in six years. Altogether, the non-finance sectors grew slightly for the first time since 2008, but this was balanced out by a fall in the finance sector.

- Inflation has increased slightly but remains low by historical standards. Headline inflation will increase as UK interest rates start to rise, but importantly underlying inflation is expected to remain close to target out to 2016.

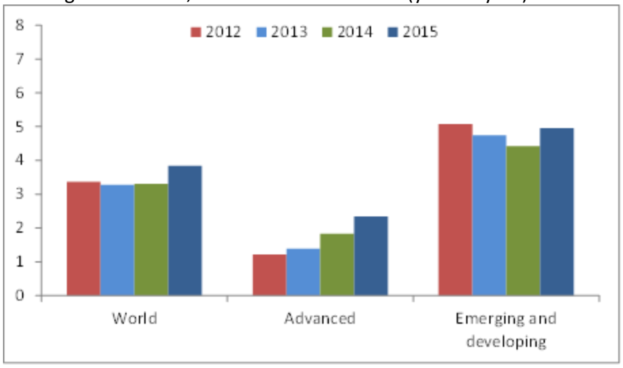
INTERNATIONAL ECONOMY

The global economy was expected to pick up pace in 2014 but this has not materialised, with slowing growth in emerging economies offsetting the acceleration in a number of the advanced economies. In their October 2014 World Economic Outlook, the IMF forecast world output to grow by 3.3% in 2014 – largely the same pace as in 2012 and 2013. Both emerging and advanced economies are expected to pick up slightly in 2015, with the IMF forecasting global growth of 3.8% next year.

There are significant variations in performance between countries – with the UK and US growing at a reasonable pace in 2014 while the euro area continues to struggle. Employment in the UK is growing strongly, but real wages continue to contract. The UK is expected to grow by 3.2% this year and 2.7% next year, with the euro area managing only 0.8% and 1.3% respectively. The IMF has significantly downgraded its forecast for a number of Europe's largest economies including Germany, France and Italy. Outside Europe, the IMF has also significantly lowered its forecasts for Japan, Russia and Brazil among others.

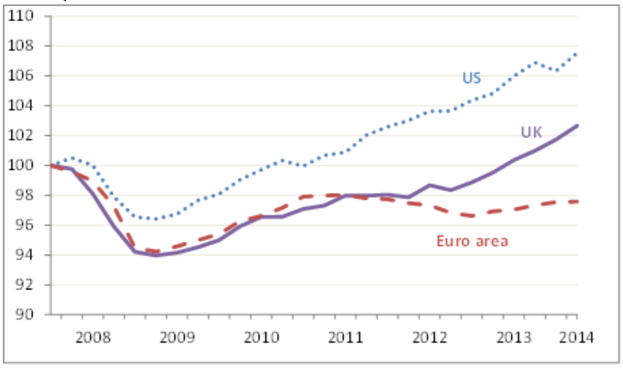
Moreover, the level of risk has increased recently, with the potential for global geopolitical tensions to have more wide-reaching impacts. The euro area continues to struggle with high unemployment and high levels of sovereign debt but also now faces the challenges of low inflation with a risk of deflation or a fall into a further recession. Financial imbalances and the potential impacts of monetary normalisation could also pose a threat to growth. The IMF state that *"the pace of the global recovery has disappointed in recent years"* and that the increased risks mean that *"the projected pickup in growth may again fail to materialize"*.

Figure 1: Economic output projections
% change in real GDP, estimates and forecasts (year on year)



Source: IMF World Economic Outlook, October 2014

Figure 2: Quarterly index of GDP for the UK, Euro area and US
2008 Q1 = 100



Source: OECD quarterly GDP volume index (SA), OECD Quarterly National Accounts

LOCAL ECONOMY

Economic activity – overall and finance sector

In 2013, economic activity in Jersey essentially remained at the same level as 2012 in real terms. This is encouraging news as it is the first time in six years that economic activity has not fallen on an annual basis (figure 3). Underneath this balanced picture, economic activity in the finance sector fell by 3% in real terms whilst economic activity in the non-finance sectors increased by 3%.

The Fiscal Policy Panel (FPP) provides independent economic advice to States members on matters relating to tax and spending policy. In July 2014, they forecast economic growth in Jersey of between -2% and +2% for 2014 and between -1% and +4% for 2015 (figure 4).

More recently published data suggests that Jersey's economy may have started to grow again in 2014. There has been real average earnings growth (albeit still weak in nominal terms), employment growth of 1.1% up to June 2014 and another quarter of maintained largely positive Business Tendency Survey (BTS) sentiments.

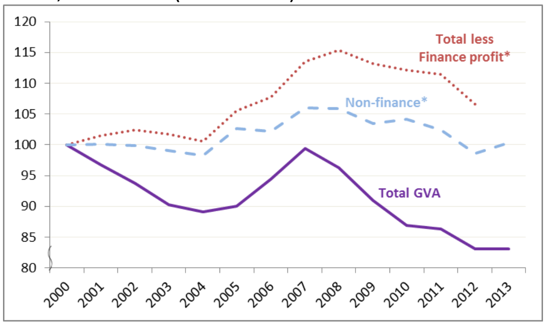
Survey results for the financial services sector have shown sustained improvement this year. BTS finance sector indicators for business activity, new business, profitability, current employment, business optimism, future business and future employment remain positive (figure 5). The current employment indicator is positive for the first time since the survey began.

In addition, 70% of finance companies (weighted by employment) are anticipating that profits will increase in 2014 whilst only 11% are expecting a fall (figure 6). Although this is more positive than in recent years, there has been a tendency for expectations not to be realised.

If market expectations for future interest rates are realised this should help to alleviate some of the pressure on banking profitability next year and beyond. This will help address one of the key factors that led to the large falls in Jersey GVA following the global financial crisis and the extremely low interest rate environment.

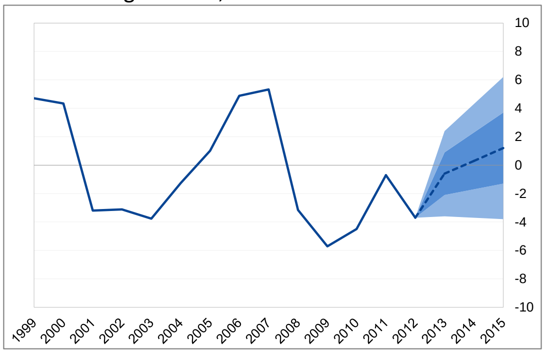
Key risks to the future performance of the finance sector still remain, including the risks to the global economic outlook mentioned above, further business rationalisation and changes to international financial services regulations.

Figure 3: Economic output (GVA)
Index, real terms (2000 = 100)



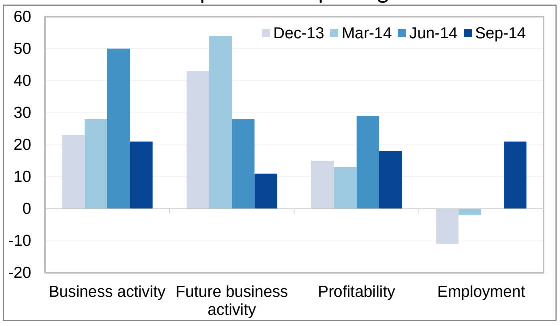
Source: Statistics Unit and Economics Unit calculations
* excludes rental activity. Finance profit not available for 2013 at the time of writing

Figure 4: Latest growth forecasts
Annual change in GVA, %



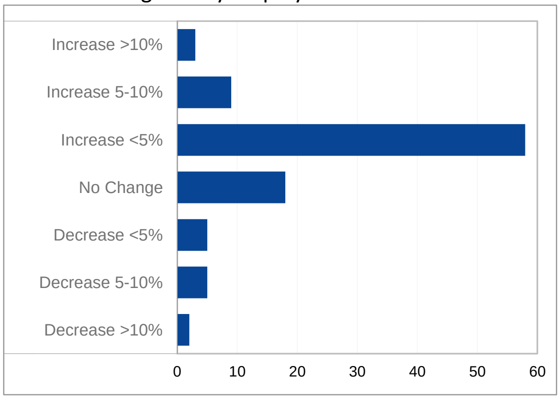
Source: Fiscal Policy Panel Annual Report 2014

Figure 5: Financial services business tendency
% net balance of respondents reporting an increase



Source: Business Tendency Survey Q3 2014

Figure 6: Financial services profit expectations for 2014
% of firms weighted by employment



Source: Business Tendency Survey Q2 2014

Economic activity – non finance sectors

For the first time since 2008, economic activity in the non-finance sectors of the economy has grown in real terms (by almost 2%) in 2013. In particular, agriculture; hotels, restaurants and bars; transport, storage and communications; electricity gas & water; the private sector service industries and the public sector recorded real growth in 2013.

In the September BTS, the indicators for overall business activity, future business activity and business optimism are slightly positive for the non-finance sectors (figure 7) and they are also the most positive readings since the survey began in 2009. Compared to the previous quarter, the capacity utilisation indicator worsened slightly, whilst the remaining nine indicators were largely unchanged.

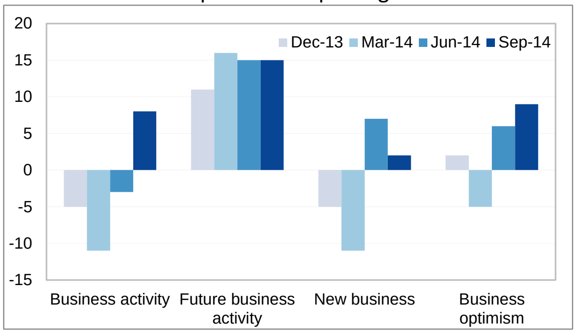
The States of Jersey plans significant investment in infrastructure over the next five to ten years, including a new hospital, liquid waste facility and social housing. This will increase public sector spending on major building projects at a time when private sector activity is also likely to increase. As such, the conditions and the capacity of the construction industry are going to be very important in the future. In recent years though, the conditions have been relatively weak. Construction GVA has fallen 17% (£43m) in real terms and employment by about 5% (300 jobs) since 2008 (figure 8). BTS data suggests that spare capacity still exists in the sector, although results have been volatile in recent quarters (figure 9). The sentiments of construction businesses have improved over the last year, although the profitability indicator remains negative.

Economic activity in hotels, restaurants and bars increased by 2% in real terms in 2013, the fifth annual increase in a row. However, the level of activity is still below that seen in the early 2000s. By the end of September 2014, almost 920,000 people travelled to Jersey by sea and air – about 4% more than the same period in 2013. This was mainly due to more staying leisure visitors. Since 2008, the number of staying leisure visitors fell from 362,000 to 326,000 (-10%), whilst the number of staying business visitors fell sharply before recovering back to 70,000.

The total volume of retail sales fell by 1% in the year up to Q2 2014 (figure 10). In 2013, the total volume of retail sales also fell by about 1%, although this was largely a result of trends in the non-food retail sector. Non-food volumes tend to be affected more in a weak economy and retailers are also facing more competition on the internet. Food volumes tend to be less susceptible to cyclical variations.

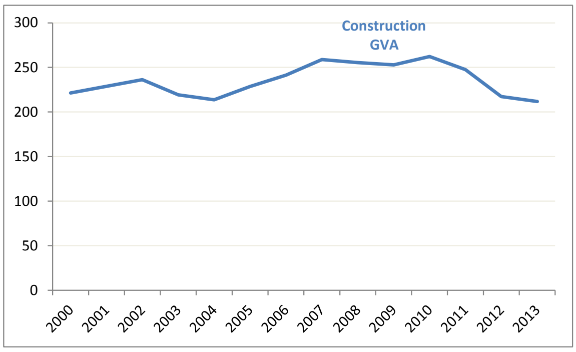
House prices were 5% higher in Q2 2014 compared to Q2 2013 and they were 1% higher compared to Q1 2014, on a rolling four-quarter basis. However, Q1 2014 had recorded the lowest level of average property price for more than five years.

Figure 7: Non-financial services business tendency
% net balance of respondents reporting an increase



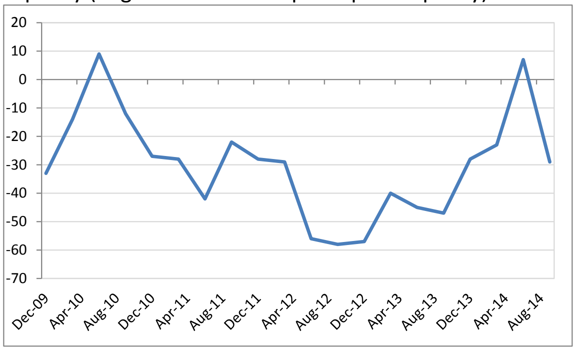
Source: Business Tendency Survey Q3 2014

Figure 8: Construction GVA
£m (real, 2013 prices)



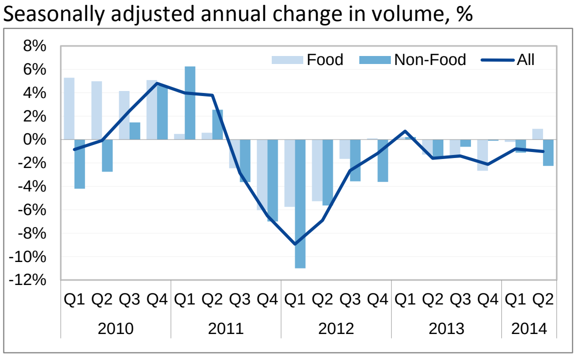
Source: Statistics Unit

Figure 9: Construction Capacity Utilisation
% net balance of respondents reporting above/below capacity (negative balance implies spare capacity)



Source: Business Tendency Survey Q3 2014

Figure 10: Retail Sales
Seasonally adjusted annual change in volume, %



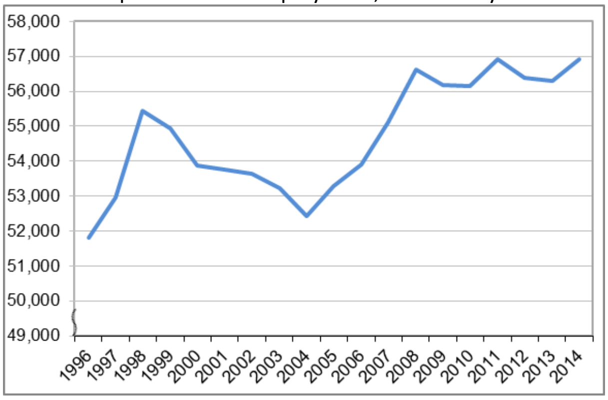
Source: Retail Sales Quarter 2 2014

Labour market

Total employment was at the highest level on record in June 2014 (56,910 equal with June 2011) and had increased by 620 since June 2013. However, total employment in December 2013 fell by 350 compared to December 2012, largely due to lower employment in fulfilment, part of the wholesale and retail sector. Over the last six years, total employment has remained remarkably stable considering the scale of the global financial crisis (figure 11).

Figure 11: Total employment

Private and public sector employment, June each year

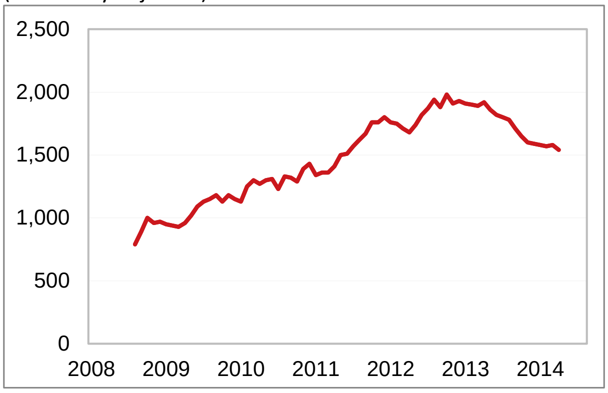


Source: Jersey Statistics Unit

Unemployment has fallen in Jersey during 2014 after increasing since 2008. The International Labour Organisation (ILO) unemployment rate is the most accurate indicator of trends (it includes those who are unemployed but not registered as unemployed) and was 4.6% (2,800 people) in June 2014 compared to 5.7% (3,200 people) in 2013. This compares to 6.6% in the UK and 10.2% in France. There were 1,450 people (seasonally adjusted figure) registered as unemployed and actively seeking work in September 2014, 360 less people than the year before (figure 12).

Figure 12: Changes in unemployment

Number registered as unemployed and seeking work (seasonally adjusted)



Source: Jersey Statistics Unit

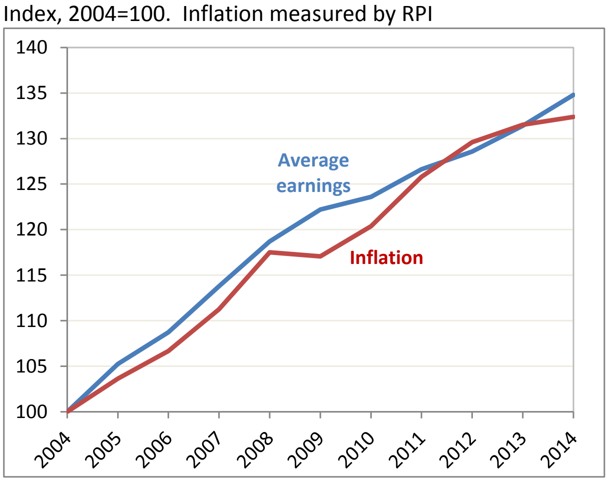
The finance sector remains the largest employer with 12,510 full-time equivalent employees (FTEs) (22% of the total) in June 2014. This was 110 higher than a year earlier, but more than 900 lower than the peak in December 2008. The number of employees in the banking sub-sector has fallen by about 1,300 (about 20% of the total in banking) since the last peak, whilst the other sub-sectors of finance, such as legal, trust and company administration and fund management have increased employment by about 400 altogether.

In the rest of the economy, employment in hotels, restaurants and bars; private sector service industries; and education, health and other services has increased since 2008.

Overall, the future employment indicator in the September 2014 BTS showed that most (67%) businesses would keep their employment the same next quarter. Construction businesses were more positive about increasing employment, while the other sectors were more neutral.

Figure 13: Inflation and average earnings

Index, 2004=100. Inflation measured by RPI



Source: Jersey Statistics Unit

Average earnings grew by 2.6% in 2014. Although this is not strong growth, it was slightly more than 2013 and importantly, once again, exceeded inflation (1.6%). This contrasts with the UK, where the squeeze in real earnings continues. Figure 13 shows average earnings have slightly exceeded prices since the bottom of the last economic cycle in 2004, despite the period after the global financial crisis (2008-2012) when prices increased more quickly than earnings.

Prices and inflation

The headline rate of inflation (RPI inflation) increased to 1.9% in September 2014, from 1.6% in the previous quarter. RPI(X) inflation, which excludes mortgage interest payments, accelerated to 2.1% while RPI(Y) inflation, which also excludes the effect of indirect taxes, accelerated to 1.8%. All three measures remain low compared to historical averages. Underlying inflation, as measured by RPIY, has now been below the 2.5% target for two years.

The recent increase in inflation has been largely due to accelerating costs of services – for example the fares and travel group (including parking, bus fares etc.) has increased by 10% over the last twelve months. Motoring costs had fallen significantly over the course of 2013, but these have now started to increase again – albeit prices remain below their 2012 levels on average.

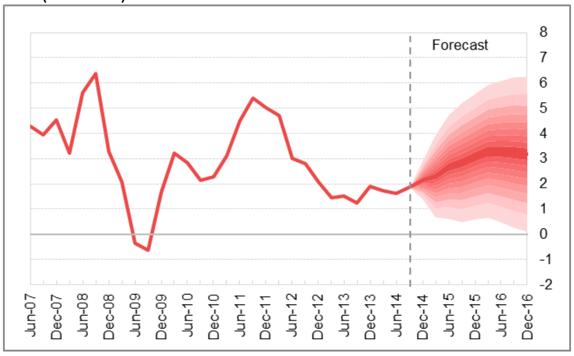
Inflation has been forecast out to 2016 and this is illustrated in Figure 14. These forecasts use statistical models to project the future path of prices based on information on the past behaviour of prices and on current expectations for indirect taxes, interest rates, oil prices and any other known price increases over the forecast period (such as preannounced increase in utility prices). The forecasts are presented using the fan chart format similar to that used by the Bank of England, where each band of the fan represents a 10% probability (+/- 5% either side of the median forecast).

The most recent forecasts indicate that inflation will continue to rise from the current relatively low rates. The headline measure of inflation (RPI) will accelerate most quickly as this measure includes mortgage interest payments and will therefore be impacted if the Bank of England Bank Rate begins to increase from 2015, as currently expected. However, underlying inflation (RPIY) is a better measure of inflationary trends in the local economy and this measure is forecast to be close to 2.5% throughout 2015 and 2016, remaining below long-term averages.

Figure 14

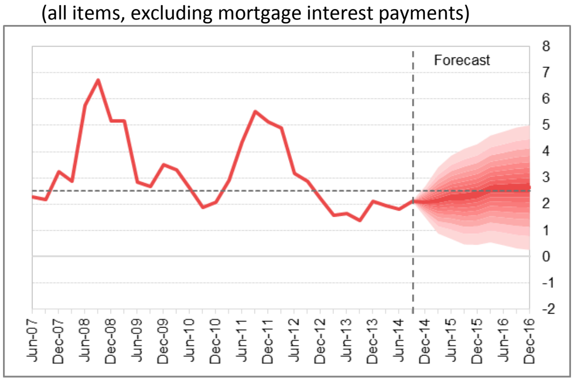
(a) Forecast of RPI inflation

(all items)



(b) Forecast of RPIX inflation

(all items, excluding mortgage interest payments)



(c) Forecast of RPIY inflation

(all items, excluding MIPs and indirect taxes)

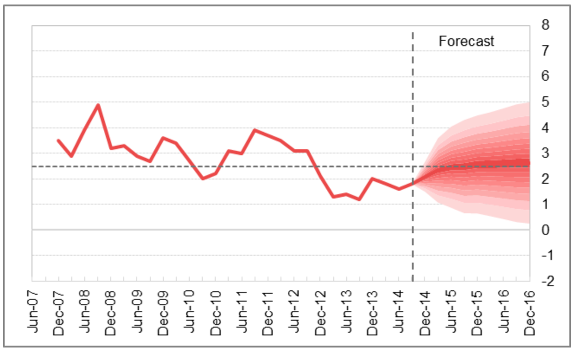


Figure 15: Table of inflation forecasts

% change in price index on same quarter previous year

	2014				2015				2016			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
RPI	*1.7*	*1.6*	*1.9*	2.1	2.3	2.7	2.8	3.1	3.3	3.3	3.2	3.2
RPIX	*1.9*	*1.8*	*2.1*	2.1	2.1	2.3	2.3	2.4	2.6	2.6	2.6	2.6
RPIY	*1.8*	*1.6*	*1.8*	2.1	2.3	2.5	2.5	2.6	2.6	2.6	2.6	2.6

Source: Economics Unit forecasts

Actual published figures are in *Italics*, from Jersey Statistics Unit

CONTACT

Dougie Peedle
Chief Economic Adviser
01534 440446
d.peedle@gov.je

Mark MacGregor
Economist
01534 440432
m.macgregor@gov.je

Greg Boyd
Economist
01534 440482
g.boyd@gov.je

http://www.gov.je/EconomicsUnit