Economic Outlook | May 2012

States of Jersey
Economics Unit

HEADLINES

- *Global economic prospects are extremely fragile. Continued intensification of the crisis in Greece and the wider Eurozone would pose such a significant threat to the global recovery that even the most recent IMF forecasts would rapidly become out of date.*
- *Local business sentiment, particularly in non-finance sectors of the economy, continues to decline, whilst unemployment continues to rise. Employment is at its highest level, although there has been a small underlying shift from full-time to part time employment.*
- *The latest forecast for the Jersey economy shows growth of -2% to +2% is anticipated in 2012. The Fiscal Policy Panel have stated that the trends seen in Jersey recently are more in line with the downside scenario in the forecast. Continuing developments in the Eurozone only make their advice more prescient.*
- *RPI inflation fell to 4.7% in March 2012, suggesting that the downward trend anticipated in the last Economic Outlook is materialising. RPI is forecast to fall further this year to around 3% by the end of 2012 as the impact of GST falls out and commodity price pressures continue to ease. Interest rates are not expected to increase until 2014 at the earliest.*

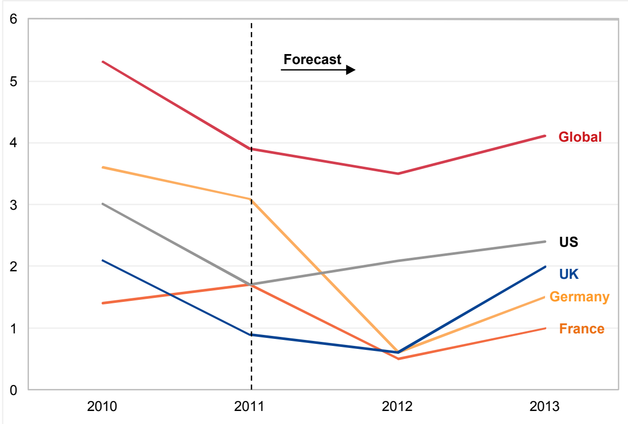
INTERNATIONAL ECONOMY

Global prospects are still extremely fragile and significant downside risks remain. The latest forecasts for 2012 and 2013 published by the International Monetary Fund (IMF) in April were slightly improved because growth in advanced economies in the latter half of 2011 was slightly stronger than expected. Activity took a turn for the worse in the Euro area at the end of the year but weak economic growth was forecast for 2012 and 2013 (figure 1).

The main downside risk to global growth was exacerbation of the sovereign debt crisis in Europe. The debate continues as to how to balance the short-term impacts of fiscal consolidation and bank deleveraging with the need for economic growth. Action by the European Central Bank (ECB) to avoid a liquidity squeeze and by Italy and Spain on fiscal and structural reforms, have been welcomed by the IMF but there is a lot further to go. The markets are increasingly concerned about the prospects of the Euro area's weaker economies and Greece in particular. The chances of Greece exiting from the Euro increase daily but while the direct impact for the wider global economy may be small the real risk is of contagion to other larger Eurozone countries through a banking crisis and spiralling public debt costs. The wider impact on the global economy of either would be much larger but hard to quantify at this stage.

Continuing political tensions between countries affecting the oil market is another risk. If Iran, the world's third largest exporter of crude oil, halts its exports to all major western economies it would trigger a sharp price increase, the amount depending on how much supply is offset by other oil producers. This has not been factored into the IMF forecasts but they suggest a sharp increase in oil prices of about 50% over two years would lower global output by 1.25% from a forecast level of 3.5% and 4% in 2012 and 2013.

Figure 1: Economic output projections
% change in real GDP year on year



Source: IMF World Economic Outlook April 2012

Box 1: Recent economic performance in the UK

In 2009 and 2010 the UK started to recover slowly from the great recession and returned to weak growth. This was helped by policy-makers reacting quickly by lowering interest rates, supporting financial institutions and government spending measures. However, despite this, for much of 2010 and 2011 growth has stuttered (Figure 2).

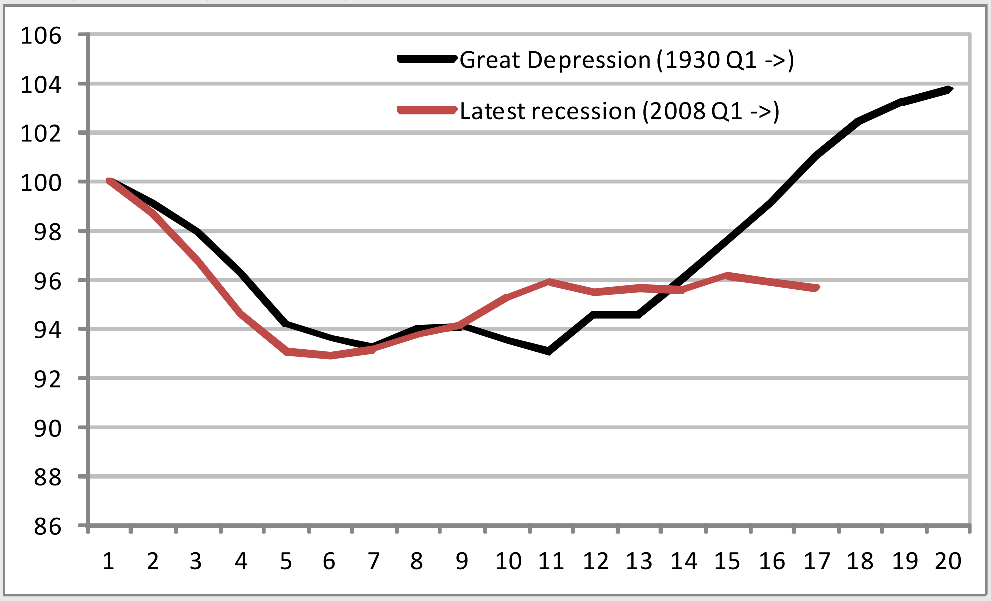
The recent two quarters of slight decline is technically a recession, but it distracts from the overall picture of economic activity being essentially flat. The small estimated decline of -0.2 percentage points in GDP for the UK in Q1 2012 is mainly due to a decline in construction sector activity. Changes in construction sector activity tend to be volatile from quarter to quarter and although it is a small part of the UK economy (less than 8% by GDP value) significant changes can affect overall estimates for economic growth particularly when the rest of the economy is weak.

There are several factors responsible for the stuttering performance in the UK. Household spending which accounts for half of all spending fell slightly in 2011 affected by falls in real earnings and growing unemployment. Government spending which typically amounts to about 20% of all spending has been reduced by fiscal austerity measures. Trade, in particular exports, has improved mainly with non-EU trading partners (but this has a relatively small influence) and business investment prospects although having held up well are vulnerable, particularly if credit conditions deteriorate.

The chart below compares the present recovery with that of the Great Depression in the 1930s. Four years on from the last peak economic activity is still about 4% below its previous level. By contrast, in the 1930s, economic activity had recovered and continued to grow by the same stage.

Economic activity in the UK is also well below where it would have been if it had followed a similar path to either of the recessions in the early 1980s or early 1990s.

Figure 2: Decline and recovery in GDP levels during the latest recession and the 1930s depression
no. of quarters from pre-recession peak (= 100)



Source: Office for National Statistics, UK. (http://www.ons.gov.uk/ons/dcp171766_263951.pdf)

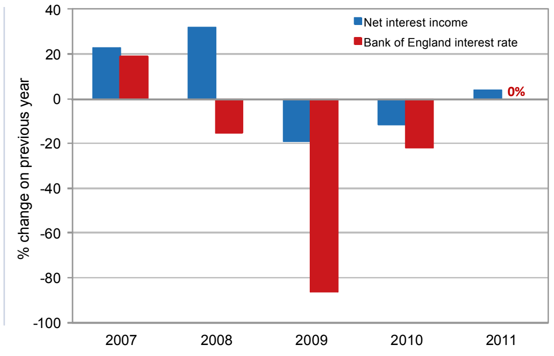
Economic activity - finance

Figure 3 shows how the net interest income of Jersey banks has been affected by changes in interest rates. Net interest income stabilised and increased slightly in 2011 after sharp falls in preceding years. This is the first time net interest income has increased since the start of the financial crisis and it was due to an increase in deposit volumes offsetting a continued decline in margins, which are determined to a large extent by the very low UK interest rate.

Importantly, banking profits increased as well, helped by a further reduction in bad debt provision. Interest rate rises are not expected to occur until 2014 at the earliest. If the sovereign debt or banking related risks come to pass then it is possible interest rates may remain on hold for even longer.

The Business Tendency Survey (BTS) provides qualitative information on ten indicators of business performance each quarter. The Q1 2012 survey findings for the finance sector suggest a different picture for performance recently. Seven of the ten indicators were at similar levels once more but the business activity indicator was negative for the first time and the future business activity indicator was at its least positive level to date. The employment and future employment indicators were both negative. The only noticeable improvement in the indicators was in business optimism which moved from strongly negative to marginally negative.

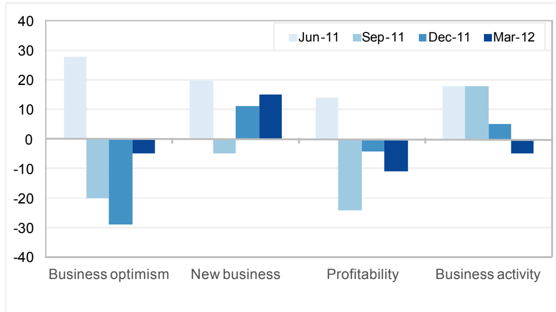
Figure 3: Net interest income of Jersey banks



	2007	2008	2009	2010	2011
Net interest income, £m	1,253	1,653	1,338	1,183	1,229
B of E interest rate, average %	5.5	4.7	0.6	0.5	0.5

Source: Jersey Financial Services Commission Banking Statistics and Bank of England Statistics

Figure 4: Financial services business tendency
% net balance of respondents reporting an increase



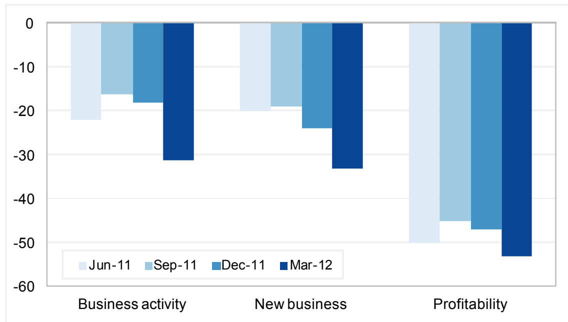
Source: Business Tendency Survey March 2012, Jersey Statistics Unit

Economic activity – non finance

The non-finance sector has remained consistently negative across many of the business performance indicators for more than a year now. In March, the business activity and new business indicators were at their most negative level to date.

The Construction sector accounts for 10% of Jersey's total workforce and about 7% of total economic activity. The responses from these businesses generally remained negative in the first quarter of 2012 (although less negative compared to earlier quarters). This continues to suggest that they expect to see future levels of work and activity decline relative to current levels.

Figure 5: Non-financial services business tendency
% net balance of respondents reporting an increase



Source: Business Tendency Survey March 2012

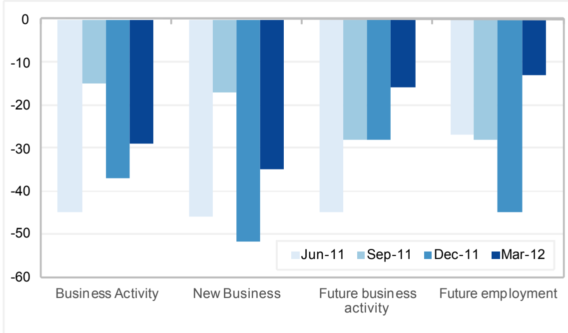
The volume of Jersey retail sales fell by 6% in 2011 compared to the previous year (figure 7). Since then the BTS suggests that the retail sector has seen further falls in business activity and new business, and business optimism is at its lowest level to date.

Footfall on the high street is lower so far in 2012 than was the case for the same period last year. The removal of Low Value Consignment Relief (LVCR) from April 1 2012 will have a significant impact on retailers exporting to the UK.

The number of staying leisure visitors and business visitors to Jersey grew slightly (0.5%) in 2011 which is a positive sign after the annual declines seen up until 2008. During the first four months in 2012 there were 192,000 arrivals by air and 68,000 arrivals by sea. The number of air arrivals so far is similar to the number seen last year, however the number of arrivals by sea is 4,000 (7%) lower.

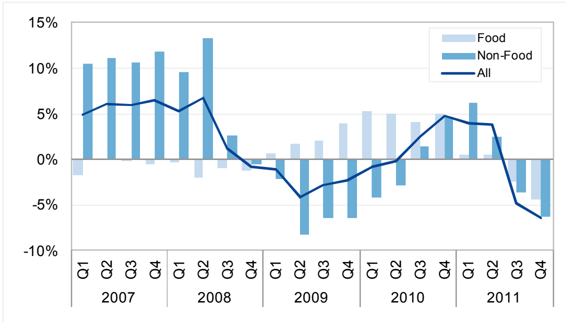
In October 2011, the Fiscal Policy Panel (FPP) forecast modest economic growth of 0 to 3% for 2011 and -2% to 2% for 2012 and stressed that the risks were more to the downside (figure 8). Since then, the FPP have stated that the risks have materialised to some extent and the trends seen in Jersey in recent months are more in line with the downside scenario in the forecast. An updated economic forecast will be part of the FPP's next annual report which is due to be published in September.

Figure 6: Construction business tendency
% net balance of respondents reporting an increase



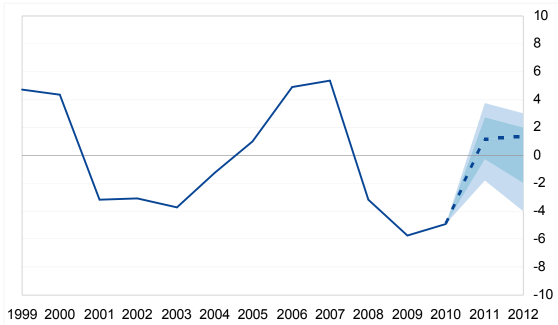
Source: Business Tendency Survey March 2012

Figure 7: Retail sales performance
Seasonally adjusted annual change in volume, %



Source: Retail Sales, Jersey Statistics Unit

Figure 8: Latest growth forecasts
Annual change in GVA, %



Source: Fiscal Policy Panel Annual Report – October 2011

Labour market

At the end of 2011, total employment stood at 53,790 which was 260 higher (or 1% higher) than the end of 2010 and was the highest level recorded for at least 15 years. This was made up of an increase in the private sector of around 320 and a reduction in the public sector of around 60. The increase in private sector employment was due to increases in the service industries – predominantly businesses servicing other businesses and businesses servicing private households.

The finance sector recorded an increase of 140 employees during the first half of 2011 but a fall of 60 employees during the second half of the year. Finance sector employment has been flat the last couple of years after a large fall (550 employees or 4% of the total employed in finance) in 2009. Subsequent falls in employment in the banking sub-sector during 2010 and 2011 have been broadly matched by increases in the trust and company administration, fund management and legal sub-sectors.

Although total employment was relatively high there are signs of underemployment. The number of full-time employees in the private sector was 37,730 at the end of 2011 – 50 lower than the end of 2010 and at its lowest level for five years. The number of part-time employees was 9,340 – 370 more than at the end of 2010 reaching the highest level recorded. These movements were driven by the wholesale and retail sector which recorded a decrease of 220 full-time staff and an increase of 200 part-time staff.

Unemployment has continued to rise. The number registered as actively seeking work (ASW) provides a monthly indicator of changes in unemployment. The seasonally adjusted total for ASW in March 2012 was 1,760 and about 470 higher than the same month the year before (figure 9).

The International Labour Organisation (ILO) measure is the best indicator of the number of unemployed because it includes those that are unemployed and looking for work even if they are not registered as Actively Seeking Work (ASW). The ILO measure of unemployed was 2,600 people from the Census in March 2011. The increase in ASW during the last year suggests the ILO number of unemployed has increased further. It is likely unemployment will continue to rise in the short term especially as the full impact of the removal of LVCR on the fulfilment industry has still to be felt.

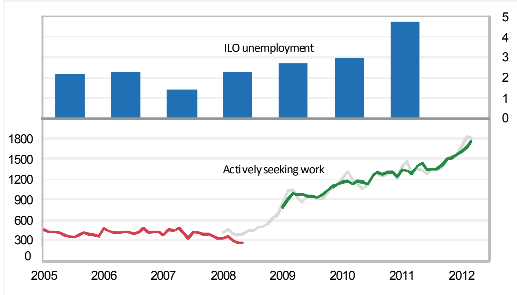
The number of long-term unemployed (registered for more than a year) has increased to 330 people in the last year. Long term unemployment, particularly amongst young people, has large negative social and economic costs damaging the economy's future productive potential.

The Business Tendency Survey suggests that in the first quarter of 2012 businesses on balance reduced employment and expected further reductions in the second quarter (figure 10). Sentiment regarding employment and future employment is similarly negative for both finance and non-finance firms (figure 11).

Figure 9: Changes in unemployment

Upper: ILO unemployment rate

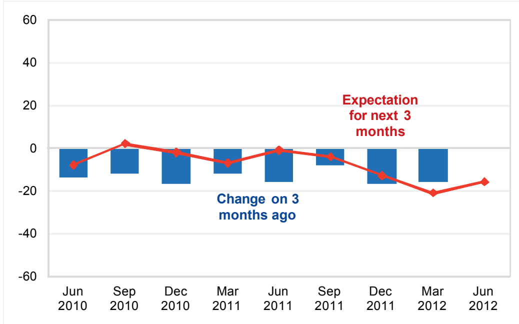
Lower: Number registered as unemployed and ASW



Source: Jersey Statistics Unit

Figure 10: Firms report continuing reductions in employment

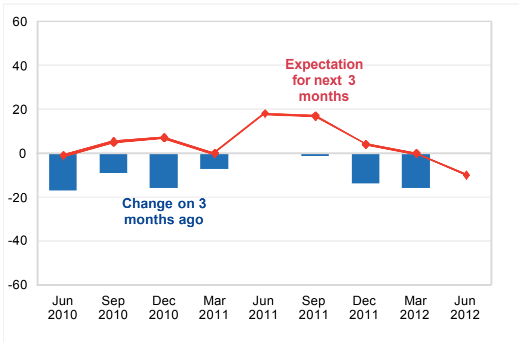
All sectors, weighted net balance, percentage points



Source: Jersey Statistics Unit

Figure 11: Financial services report a reduction in employment and are more negative about the future

Finance sector, weighted net balance, percentage points



Source: Jersey Statistics Unit

Prices and inflation

Retail price index (RPI) inflation in Jersey fell to 4.7% in March 2012 and underlying (RPIX) inflation also fell to 4.9%. The fall in inflation in the latest quarter is largely down to a falls in motoring and fuel and light costs. The headline numbers are impacted by the increase in GST from 3% to 5% in June 2011 which has a temporary upward effect of around 1.3-1.4 % for 12 months. From June 2012 this effect no longer continues.

Figures 12 (a), (b) and (c) illustrate the latest forecasts for RPI, RPIX and RPIY inflation. The forecasts are based on statistical models that use information on the past behaviour of inflation to project how inflation is likely to change in the future, using expectations for variables such as indirect taxes, interest rates, oil prices and other known price increases (such as pre-announced 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).

It is expected that RPI and RPIX will gradually fall from its current level to around 3% by 2013 (Figure 13) as the one-off effect of GST on prices drops out and commodity price pressures ease.

The RPI forecast for inflation is strongly influenced by when interest rates are expected to increase. They are expected to remain on hold until 2014 at the earliest which means that RPI and RPIX should follow each other closely until this time.

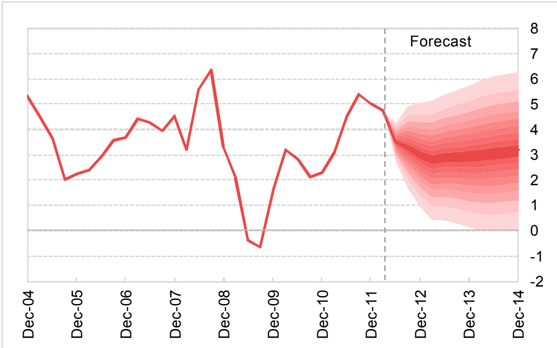
The best measure of underlying inflation in Jersey is RPIY, because it excludes the impact of mortgage interest payments and indirect taxes which during times of significant change can have large temporary effects on the other measures of inflation.

RPIY is expected to gradually fall from 3.5% to 3.0% over the year and the outlook beyond looks similar to RPIX (2.9% in 2013 and 2014) and slightly below RPI because of the impact of expected increases to the interest rate (figure 13).

Figure 12

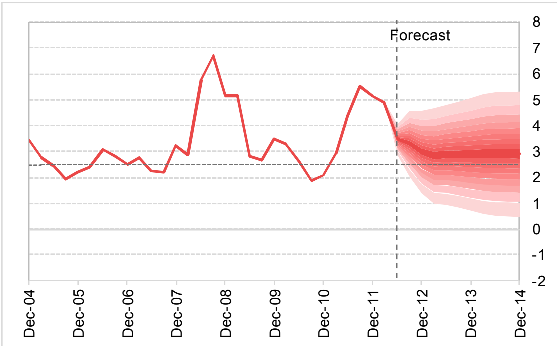
(a) Forecast of RPI inflation

% change in index (all items)



(b) Forecast of RPIX inflation

% change in index (all items, excluding mortgage interest payments)



(c) Forecast of RPIY Inflation

% change in index (all items, ex. MIPS and indirect taxes)

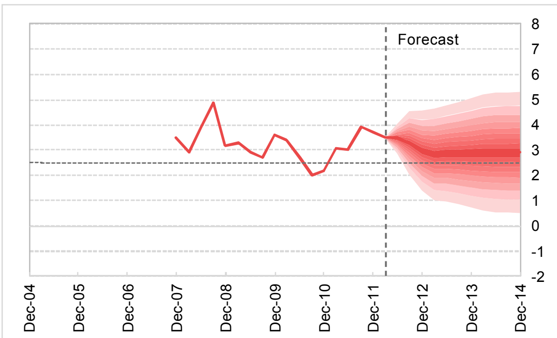


Figure 13: Table of inflation forecasts

% change on same quarter previous year

	2012				2013				2014			
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**
RPI	*4.7*	3.5	3.3	3.0	2.8	2.9	2.9	2.9	3.0	3.0	3.1	3.2
RPIX	*4.9*	3.5	3.3	3.0	2.8	2.9	2.9	2.9	2.9	2.9	2.9	2.9
RPIY	*3.5*	3.5	3.3	3.0	2.8	2.9	2.9	2.9	2.9	2.9	2.9	2.9

Source: Economics Unit

Italics are actual published figures.

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