PART E – THE ECONOMIC OUTLOOK
10. Economic Outlook 2016-2020

International Developments

The latest forecasts from the International Monetary Fund (“IMF”) were released in early October and were revised down slightly compared to their April forecasts. The outlook was considered to be more subdued for the advanced economies as a consequence of the UK referendum result and weaker than expected growth in the US. Overall global economic growth is projected to slow to 3.1% in 2016, rising to 3.4% in 2017, both 0.1% lower than the April forecast. These developments were considered to have put further downward pressure on global interest rates, implying they will remain low for longer.

The IMF are of the view that the initial market reaction to the UK referendum result “was reassuringly orderly”. However, they believe that “the ultimate impact remains very unclear” as the future institutional and trade arrangements between the UK and EU are still uncertain. The forecast for economic growth in the UK has only been revised down slightly in 2016 although is now 1.1% lower in 2017 than the April forecast.

Although the outlook for emerging markets has not deteriorated a number of economies “face daunting policy challenges in adjusting to weaker commodity prices”. The IMF also highlight that for the advanced economies the outlook is “subject to sizable uncertainty and downside risks” and this could “fuel further political discontent”. They conclude that these risks to global economic prospects make it more urgent that a broad-based policy response to raise growth and manage risks is put in place.

FIGURE 27 – World economic growth

% changes in real GDP, figures represent changes since April forecast

Source: IMF World Economic Outlook October 2016
Jersey Economy

In their 2016 Annual Report published in August the Fiscal Policy Panel ("FPP") emphasised that:

There was some improvement in a number of economic indicators for Jersey in 2015, with employment reaching record highs, and a generally positive sentiment in the first half of 2016. However, more recently there has been considerable uncertainty regarding the likely short- and long-term economic implications and the terms of the UK exit from the EU, and the impact these might have on Jersey.

Since the FPP published their Annual Report there have been two key economic data releases for Jersey and both were better than anticipated in August. Economic growth in Jersey in 2015 was 2.2%, more than double that expected by the FPP. Although clearly this data is for the period before the UK referendum result was known it does paint a generally positive picture of Jersey’s economic performance. The chart below shows that headline GVA is still below its peak in 2007, although this is largely a consequence of the impact on low interest rates on the banking sector profitability. Given the volatility in financial service profitability it is important to look at both headline GVA and the underlying components to get a full understanding of the performance of the economy. If GVA excluding financial services gross operating surplus (profits) is considered (i.e. the profits of non-finance and the salary costs of non-finance and finance) then Figure 28 below shows that measure of GVA has increased for the last three years at an average rate of nearly 3% and is now above its previous peak in 2008.

**FIGURE 28 – Trends in Jersey GVA**

Real GVA £m, 2013 prices, GVA of non-finance sectors and GVA excluding the gross operating surplus of financial services ("FGOS")

Source: Statistics Unit/Economics Unit calculations

Productivity in Jersey (as measured by GVA per full time equivalent employee) declined slightly in 2015 (by 0.2%). However, as the chart below shows, this was made up of an increase of 3% in non-finance sectors and a decrease of 4% in finance (driven by the fall in profitability). The increase in non-finance productivity was broadly based across the sectors, with the only fall in manufacturing. These shorter term trends are indicative of the longer term ones where non-finance productivity has increased.
marginally over the 1998-2015 period (see Figure 29 below) and finance productivity has declined, partly reflecting the falling profitability of banking as a result of low interest rates.

FIGURE 29 – Productivity trends in Jersey

% change in real GVA per full time equivalent employee

Source: Statistics Unit/Economics Unit calculations

GVA per head of the population increased slightly in 2015 – by 0.5% in real terms – the second consecutive year this measure of the standard of living has increased. The chart below shows that GVA per head is still about 20% below its peak in 2000. However, the key driver of this trend has been the fall in financial services profitability over that period as Figure 30 also shows that GVA (excluding financial services gross operating surplus) per head has actually increased over the same period and is about 3% below the peak in 2008. It is important to consider trends in headline GVA and some of the key components to better understand Jersey’s economic performance. The volatility in financial services profits can make it difficult to interpret the underlying trends.
The FPP have consistently highlighted concerns about Jersey productivity performance in their annual reports and the fact that for a sustained period it has shown no real increase. As well as investing in health, education and infrastructure as set out in his MTFP Addition, the Strategic Plan sets out how Council of Ministers aims to rectify this productivity performance and optimise economic growth by:

- Promoting jobs and growth in the technology sector, with a particular focus on Fintech.
- Delivering and further enhancing the existing Financial Services Policy Framework
- Promoting higher productivity in all economic strategies, including the new Tourism, Retail and Rural Economy Strategies
- Developing a new and challenging Enterprise Strategy, a new Innovation Strategy and attracting more inward investment
- Reviewing and upgrading the existing Skills Strategy
- Developing a new Competition Framework and reviewing opportunities to promote competition
- Identifying and addressing barriers to work for key groups
- Adopting environmental management principles to help improve productivity and efficiency and attract environmental businesses in line with our economic growth objectives

Labour market trends are also a key indicator of Jersey’s economic performance. The latest data shows that total employment in June 2016 was 60,320 – the highest on record and 2.1% higher than a year ago. Private sector employment was 3.1% higher in June 2016 than a year ago, reaching 52,480 and also the highest on record. By contrast public sector employment was 3.8% lower than in June 2015 and the second consecutive fall on an annual basis.
The increase in employment in the private sector was broadly based. As Figure 32 below shows the largest increases compared with a year ago (both in % terms and number of jobs) were seen in the service sectors – education, health and other services such as nursing homes and other business activities such as recruitment agencies which increased by 680 and 290 respectively. There was also strong growth in employment in the computer and related activities sector, although as a relatively small sector the actual increase in the number of jobs was only 60. Employment in financial services increased by 190 with banking employment down 330 and that in trusts and company administration up 420. The only sectors where employment fell in June were agriculture and wholesale and retail - both 70 lower than a year ago. Of the 1,600 increase in private sector employment, 740 were full-time, 690 zero hours and 280 part-time positions.
Average earnings increased by 2.1% in the year to June 2016 and as Figure 33 below shows this represents the fourth year in a row that earnings have increased at a faster rate than headline inflation. This contrasts with the period immediately after the global financial crisis when inflation increased at a sharper rate than earnings for 4 out of 5 years between 2008 and 2012. While private sector earnings increased at a sharper rate than inflation in June 2016, public sector earnings increased at a rate below inflation for the second consecutive year.

**FIGURE 33 – Average earnings and inflation**

% change on year ago, June each year

![Average earnings and inflation chart](chart.png)

Source: Statistics Unit

The chart above shows that a contributing factor to the sustained growth in real earnings has been a period of low inflation since 2013, aided by lower commodity prices such as those for oil and food. The significant fall in the value of sterling since the UK referendum result is likely (if sustained) to feed through into higher prices. Figure 34 below shows that the trade weighted effective sterling exchange rate fell 16% between its peak in November last year and September this year. Sterling has fallen further so far in October and is currently just over 20% below the peak last year. A weaker currency does make exports more competitive – both for the UK and Jersey in non-sterling markets. However, the flip side is that it makes imports more expensive and can lead to higher inflation. The chart below shows manufacturing input prices (for raw materials and fuel) tend to move inversely to the exchange rate, have already started to rise and were 7.6% higher than a year ago in August. This is likely to feed through into higher goods prices and ultimately higher inflation in the UK and Jersey.
FIGURE 34 – Inflation and exchange rate trends

% change in UK manufacturing input prices and Jersey RPI, sterling effective exchange rate index 2005=100


In their 2016 Annual Report the FPP highlighted that although the economy appears to have been relatively buoyant in the first half of 2016 there were concerns about the impact of the UK referendum and the build up to Brexit. The FPP stated that “the impact of the vote may take some time to be felt” and downgraded their forecast for 2016-2017. As Figure 35 below indicates, the Panel forecast GVA growth to be largely flat in 2017 and 2018, as the impact of the referendum result becomes more fully felt. The FPP also highlighted the uncertainty facing the economic outlook and that:

the impact of the referendum on the Jersey economy is still very uncertain and likely to remain so at least until negotiations are complete. Therefore, there is a wide range of possible outcomes around this central projection – even wider than before, due to increased uncertainty.

FIGURE 35 – GVA trends

% change in real GVA, actual (blue bars) and FPP assumptions (red bars)

Source: Fiscal Policy Panel
The FPP revised down their forecasts for real GVA growth in 2016 by 1% and 1.4% in 2017 between March and August, in the light of the UK referendum result. When compared with the revisions to the average for the UK independent forecasts (see Figure 36 below) published by HM Treasury, economic growth for 2016 has been revised down to a greater extent in 2016 in Jersey and to a similar degree in 2017 relative to the equivalent forecasts for the UK.

Figure 36 – Changes to economic growth forecasts

% difference in real economic growth forecast between March and August 2016

Source: Fiscal Policy Panel and HM Treasury