Economic Outlook | December 2015

States of Jersey
Economics Unit

HEADLINES

- The global economy has slowed slightly in 2015, as a result of further slowing of emerging economies. Improvement is expected in 2016, though there are a number of significant risks to the outlook.

- The Jersey economy grew by 5% in 2014, the first year of real growth since 2007. The finance sector grew by 9%, driven by a significant increase in banking profits. Non-finance grew for the second successive year, with strong growth for hotels, bars and restaurants and construction. All the key economic indicators point to further growth in 2015.

- Employment reached a record high in June 2015, 1% higher than a year previous. Unemployment fell to 4% in 2014/15, just over half of the OECD average.

- Productivity grew in 2014, the first year of growth since 2007. However, achieving a sustained improvement in Jersey's underlying productivity performance remains the key economic challenge going forward.

- RPI Inflation has fallen to 0.1% in September 2015, with underlying (RPIY) inflation at 0% - the lowest level since this measure was introduced. Inflation is expected to pick up again over the next three years to 2.5-3.0%.

INTERNATIONAL ECONOMY

The International Monetary Fund (IMF) expects the global economy to grow by 3.1% in 2015, slightly slower than the 3.3%-3.4% growth rates of the previous three years. However, this masks an acceleration of a number of advanced economies and a continued slowdown in a number of emerging economies.

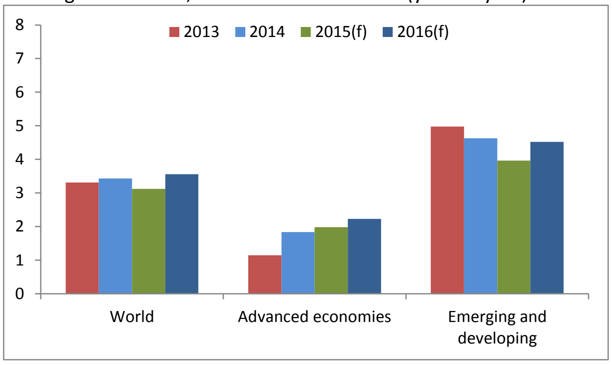
Amongst advanced economies, the US and UK have posted strong growth, with both growing at close to their 30 year average. The performance of the euro area has continued to improve in 2015, with particular progress in Spain, Italy and France, though the overall growth rate for the currency union is expected to be remain low, at around 1.5% this year, and GDP remains below the level from before the global financial crisis. Elsewhere, Japan continues to struggle, and energy exporters like Canada and Norway have seen slowdowns.

The picture is similarly mixed for emerging economies. China has continued to slow gradually, but countries such as Brazil and Russia have seen their economies contract significantly in 2015.

The global economy is expected to improve in 2016, as advanced economies continue to accelerate, and emerging economies pick up pace. Falls in the price of oil (65%) and food (25%) over the last eighteen months provide an opportunity for growth. However, there are a significant number of risks including financial market volatility, the potential for a more significant slowdown in China, ongoing uncertainty over Greece's future in the euro area and fears of further terror attacks.

Figure 1: Economic output projections

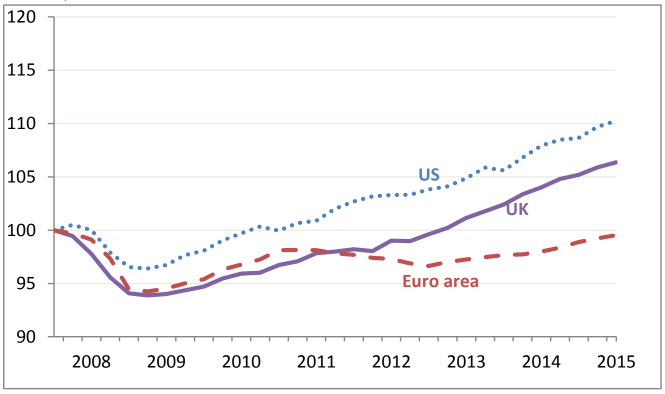
% change in real GDP, estimates and forecasts (year on year)



Source: IMF World Economic Outlook, October 2015

Figure 2: Quarterly index of GDP for the UK, euro area and US

2008 Q1 = 100



Source: OECD quarterly GDP volume index (seasonally-adjusted), OECD Quarterly National Accounts

LOCAL ECONOMY

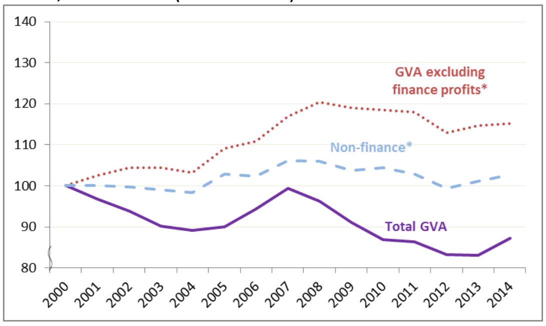
Economic activity

Jersey's economic output (as measured by gross value added – GVA) grew by 5% in 2014 in real terms (i.e. after allowing for inflation), representing the first year of growth since 2007. GVA in the finance sector grew by 9%, driven by a significant increase in banking sector profits, which was influenced by potentially one-off factors. GVA for the non-finance sectors grew by 2% and for the second consecutive year.

Despite the strong growth in 2014, GVA remains 12% below the 2007 peak. However, GVA is strongly influenced by profits of the financial services sector, which can be very volatile, particularly in banking, and can impact on the rest of the economy in different ways. Excluding this element, GVA has performed better and in 2014 was 4% below the peak.

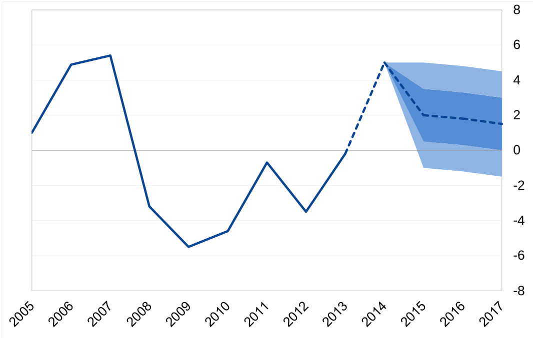
The Fiscal Policy Panel (FPP) provides independent economic advice to States members on matters relating to tax/spending policy and the economic outlook. In September 2015, the Panel forecast real-terms economic growth averaging close to 2% per year during 2015-2017.

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



Source: Statistics Unit and Economics Unit calculations
*also excludes rental activity.

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



Source: Statistics Unit; Fiscal Policy Panel Annual Report 2015

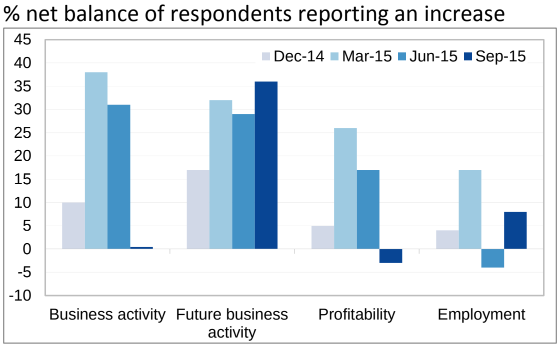
Financial services

For financial services, the 9% increase in output in 2014 was the result of a 19% increase in the profit element of GVA, with total wages and salaries falling somewhat in real terms. The Survey of Financial Institutions also reported a real-terms increase in the sector's expenditure on goods and services.

The headline business activity indicator of the Business Tendency Survey (BTS) fell for finance in the most recent survey (quarter 3), registering a neutral net response after over two years in positive territory. It is not clear to what extent this could be a short-term reaction to heightened risks to the global economy around this time. The majority of the other indicators remain positive, and future business activity has risen to its highest level since March 2014.

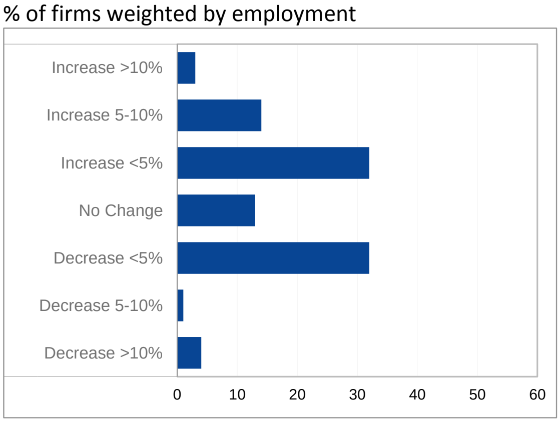
In addition, finance firms were positive about their expectations for 2015 as a whole when they were surveyed in June. 45% of firms anticipated profits to be higher than the previous year; with only 29% anticipating a fall in profits. Employment saw a similar picture, with more firms anticipating increases in employment over the course of 2015 (49%) than those anticipating falls (38%).

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



Source: Business Tendency Survey Q3 2015

Figure 6: Financial services profit expectations for 2015
% of firms weighted by employment



Source: Business Tendency Survey Q2 2015

Box 1: Productivity in Jersey

Productivity relates to the level of output for each unit of input and is a measure of how efficiently resources such as labour, land or raw materials are used in the economy. Productivity is a key driver of economic growth in the long run and is a crucial determinant in living standards.

Nobel Prize winning economist Paul Krugman summarised the importance of productivity in his 1990 book 'The Age of Diminished Expectations':
"Productivity isn't everything, but in the long run it is almost everything. A country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker."

Productivity improvements can be the result of increasing the quality of inputs, for example through enhancing the skill level of employees, or through improving the process by which goods and services are produced e.g. adopting new technology or implementing organisational improvements.

The Fiscal Policy Panel's January 2015 report set out their analysis of trends in the Jersey economy and concluded that productivity performance would have a profound effect on the trend rate of economic growth in Jersey in the future. The Panel further concluded that there is a risk that Jersey may not see a positive trend in productivity growth in the future.

One measure of labour productivity is gross value added per full-time equivalent employee (GVA per FTE). This is the headline measure of productivity in Jersey, and is reported annually by the States of Jersey Statistics Unit.

For the economy as a whole, GVA per FTE in 2014 was £65k (excluding the rental component of GVA), an increase of 3% compared to 2013. This is the first year in which productivity has improved since the onset of the global financial crisis in 2008. Financial services GVA/FTE was £143k while non-finance averaged £42k.

GVA per FTE by sector in 2014

Sector	GVA per FTE	Annual change
Financial services	£143,000	8%
Electricity, gas & water	£102,000	-2%
Transport, storage & communications	£55,000	-1%
Public administration	£53,000	3%
Construction	£49,000	3%
Manufacturing	£44,000	8%
Wholesale & retail	£40,000	-2%
Other business activities (excluding rental)	£37,000	-2%
Hotels, restaurants & bars	£28,000	3%
Agriculture	£23,000	-14%

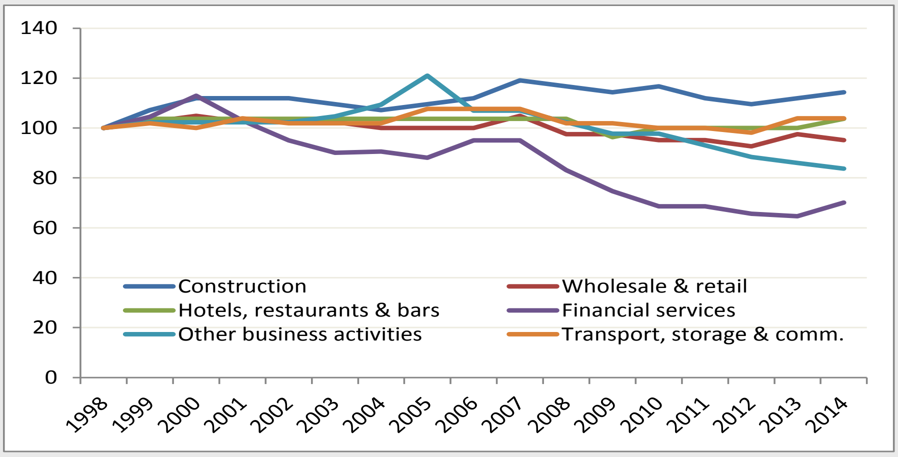
Source: States of Jersey Statistics Unit

2014 saw improvements in productivity for a number of sectors – notably financial services, construction, and hotels, restaurants and bars; while agriculture in particular saw a significant fall. Annual changes can be volatile, and the overall improvement in 2014 is likely to be somewhat driven by cyclical factors as the economy recovers from a period of contraction– particularly the significant increase in finance sector profits, which is likely to have been a one-off increase.

In spite of the growth in productivity in 2014, most sectors have seen productivity either flat or falling in the medium-term. Construction; hotels, bars and restaurants and transport and communications are the only sectors whose productivity in 2014 was above the ten year average. Financial services has seen significant falls since 2007, driven by falling profitability.

While cyclical factors may see some further improvement in productivity over the next few years, the Fiscal Policy Panel in September 2015 reaffirmed their view that there is a risk that productivity in Jersey may follow a flat trend in the future. The Panel have urged the States to develop a strategy to improve productivity, to support economic growth in the face of the ageing population.

Index of GVA per FTE in real terms, selected sectors (1998=100)



Source: States of Jersey Statistics Unit

Non-finance sectors

2014 saw the second successive year in which the output of the non-finance sectors increased in real terms. The hotels, bars and restaurants sector and construction sector grew strongly. Both the agriculture and retail sectors saw falls in GVA in 2014.

During the first half of 2015, the Business Tendency Survey suggested the non-finance sectors were at their most positive since the survey began, in 2009. The third quarter has seen a slight deterioration in this, but most indicators remains positive – with the headline business activity indicator having been positive for eighteen months.

Following strong GVA growth in 2014, the construction sector has reported positive sentiments for the business activity indicator for the first three quarters of 2015 – the first time the sector has recorded successive quarters of positive net responses. The profitability indicator remains negative, though business optimism, future business activity, employment and future employment are all strongly positive.

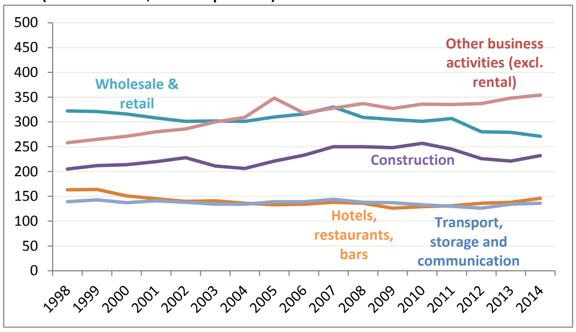
The hotels, bars and restaurants sector saw GVA grow by 6% in 2014, the fifth successive year of growth. GVA is at its highest since 2001 in real terms. The number of staying leisure visitors grew by 4% last year and the first eight months of 2015 saw 3½% growth compared to 2014.

The volume of retail sales in quarter 3 of 2015 was 2% higher than a year previous. Food volumes are at a four-year high, while non-food volumes have grown over the course of 2015, returning levels last seen in 2012. GVA of the wider wholesale and retail sector fell in 2014. In the Business Tendency Survey, the sector has responded largely positive or neutral since the middle of 2014. The future business activity and future employment indicators were strongly positive in the most recent survey.

House prices have hit an all-time high in quarter 3 of 2015, 6% higher than the same quarter of 2014. While the quarterly figures can be volatile, the four quarter moving average was also 6% higher than the previous four quarters.

Figure 7: GVA of non-finance sectors

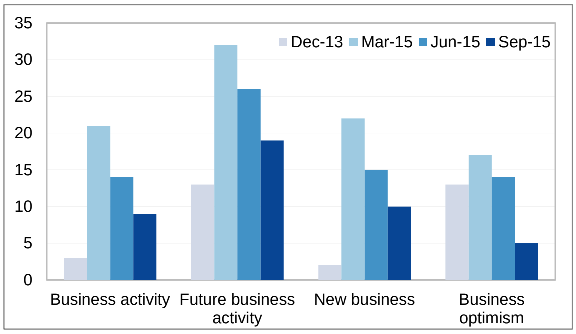
£m (real terms, 2013 prices)



Source: Statistics Unit

Figure 8: Non-finance business tendency

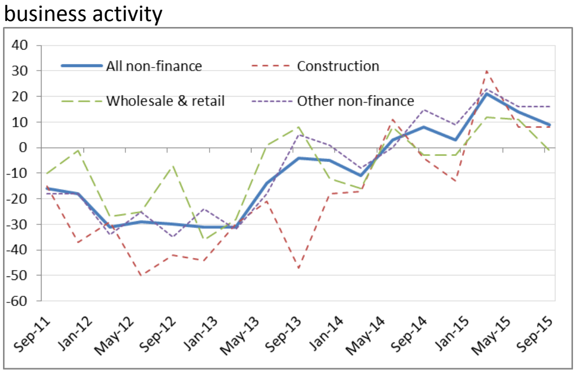
% net balance of respondents reporting an increase



Source: Business Tendency Survey Q3 2015

Figure 9: Business Tendency indicator for non-finance

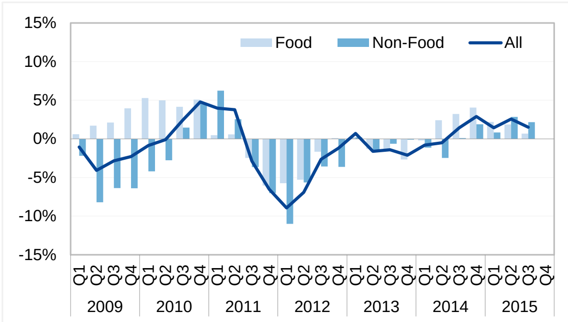
% net balance of respondents reporting an increase in business activity



Source: Business Tendency Survey Q3 2015

Figure 10: Retail Sales

Seasonally adjusted annual change in volume, %



Source: Retail Sales Quarter 3 2015

Labour market

Total employment was at the highest level on record in June 2015, increasing by 650 on an annual basis (1%). Private sector employment increased by 860 and public sector employment fell by 210, though most of the fall in the public sector was the result of moving staff into the private sector through e.g. the creation of Andium Homes.

Using the International Labour Organisation (ILO) definition, Jersey's unemployment rate in 2014/15 was 4%, significantly below the OECD average of 7.4% (for 2014). This represents 2,500 people unemployed, when compared to approximately 1,500 registered as 'actively seeking work' (ASW) over a similar period.

The ASW figure excludes those who are unemployed but not registered while including those who are 'underemployed' (i.e. their paid work was for less than 35 hours a week, and as such they remain on the register and continue to 'actively seek work'). The number of people actively seeking work has fallen by almost 20% over the last two years, with the numbers aged 16-24 falling by a half and the number ASW for more than twelve months falling by a third.

The finance sector remains the largest employer with 12,820 employees (25% of the total) in June 2015. This was 250 higher than a year earlier. The number of employees in the banking sub-sector fell by approximately 100 in the year to June 2015, similar to the average declines of the last three years. Employment in trust and company administration and fund management has increased by an average of 100 per year over the same period.

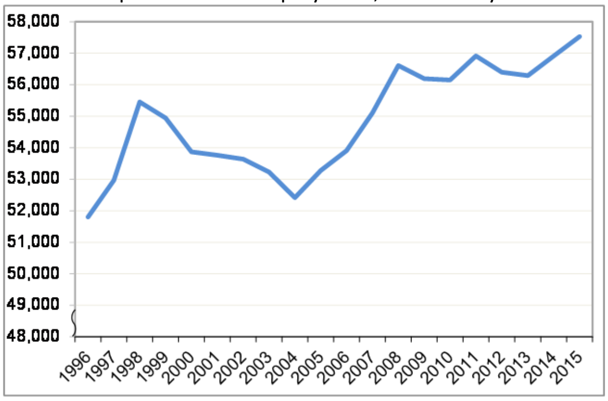
Employment increased in both the private sector service industries and construction sectors while agriculture and hotels, restaurants and bars saw falls in employment compared to one year earlier.

The Business Tendency Survey suggested that most (56%) businesses had not changed their employment in quarter 3, with a quarter of businesses reporting an increase in employment. Similarly, 64% anticipate no change in employment in quarter 4, with almost a quarter expecting an increase. The construction sector was the most positive on both indicators.

Average earnings grew by 1.8% in 2015, the third successive year of above-inflation increases. The private sector saw increases of 2.2% and the public sector saw no increase in average earnings. Over ten years, earnings growth has been matched by increases in prices, with a period of growing faster than inflation up to 2010, a period of growing more slowly than inflation during 2010-2012 and then three years of real increases.

Figure 11: Total employment

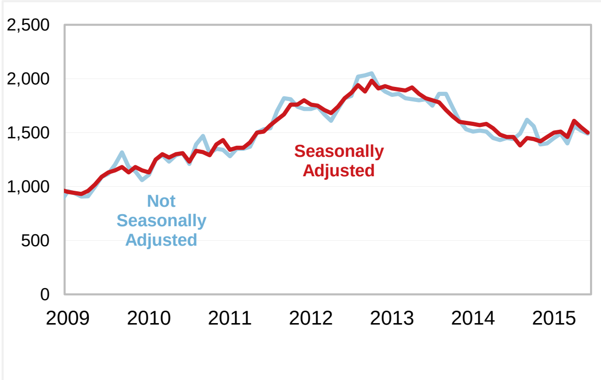
Private and public sector employment, June each year



Source: Jersey Statistics Unit

Figure 12: Registered unemployment

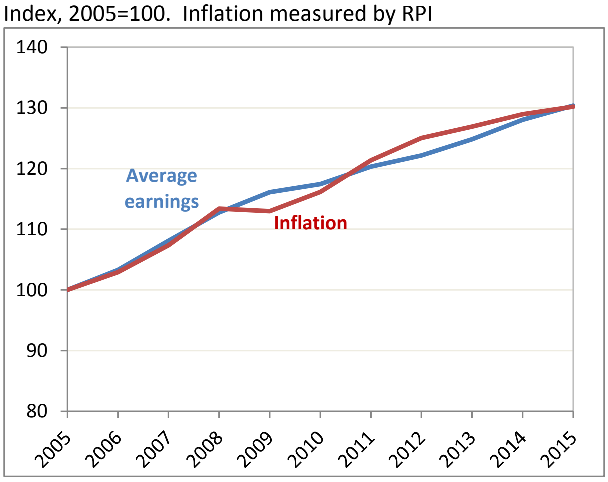
Number registered as actively seeking work



Source: Jersey Statistics Unit

Figure 13: Inflation and average earnings

Index, 2005=100. Inflation measured by RPI



Source: Jersey Statistics Unit

Prices and inflation

The headline rate of inflation (RPI inflation) fell to 0.1% in September 2014, from 0.9% in the previous quarter. RPI(X) inflation, which excludes mortgage interest payments, decelerated to 0.1% while RPI(Y) inflation, which also excludes the effect of indirect taxes, fell to 0.0%. Both RPIX and RPIY inflation are at their lowest levels since these measures were first introduced, in 2000 and 2007 respectively.

Part of the reason for very low inflation is falls in a number of prices. The cost of fuel and light in particular has fallen by 10% but there have also been falls in food, household goods, motoring, leisure goods and clothing and footwear.

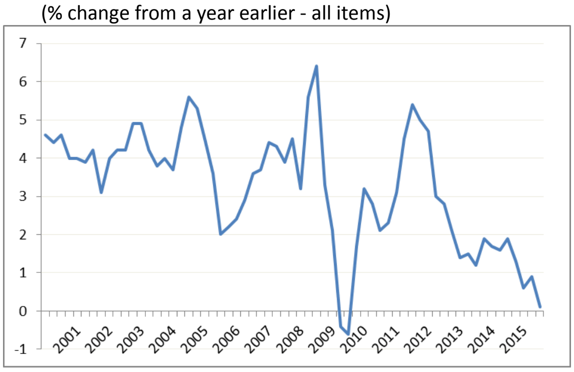
Inflation to date in 2015 has been lower than expected. In the longer term, the Fiscal Policy Panel's economic assumptions from September 2015 anticipated inflation returning to trend over the next three years. RPI inflation is expected to accelerate most quickly as this measure includes mortgage interest payments and will therefore be impacted if the Bank of England Bank Rate begins to increase. However, underlying inflation (RPIY) is a better measure of inflationary trends in the local economy and this measure is forecast to average 1.8% in 2016 and 2.5% in 2017, both below long-term averages.

At the time of the Bank of England's November Inflation Report, market expectations were that interest rates would not start increasing for some time and would remain below 1% throughout 2016 and 2017. This contrasts with the United States, where the Federal Reserve has recently raised interest rates by 0.25%. The Governor of the Bank of England has stated that rate rises are not a priority, given the UK's low level of inflation.

Figure 14

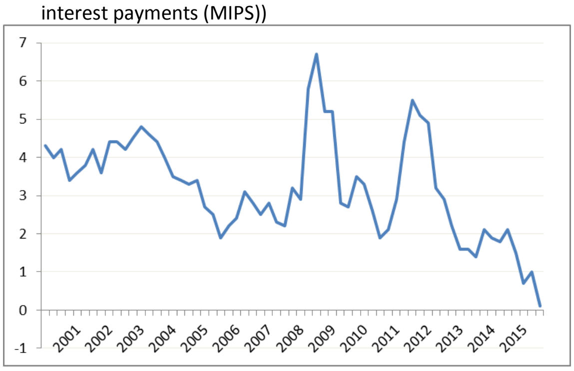
(a) RPI inflation

(% change from a year earlier - all items)



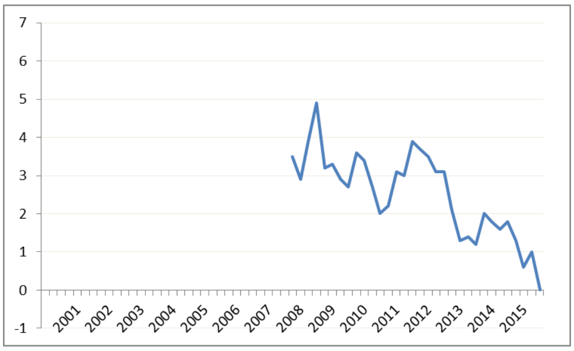
(b) RPIX inflation

(% change from a year earlier - all items, excluding mortgage interest payments (MIPS))



(c) RPIY inflation

(% change from a year earlier - all items, excluding MIPs and indirect taxes)



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