JERSEY'S FISCAL POLICY PANEL

Annual Report

November 2023

Introduction

This is the sixteenth annual report of the Fiscal Policy Panel (FPP). The current members of the Panel are:

Dame Kate Barker (Chair, appointed 2014),

Professor Francis Breedon (appointed 2016),

Professor Richard Davies (appointed 2018).

The Panel was placed on a statutory basis in 2014. The FPP's statutory role was reiterated in the Public Finances Law (2019), which requires the Panel to comment on Jersey's fiscal policy with reference to:

a. the strength of the economy in Jersey;
b. the outlook for the economy in Jersey;
c. the outlook for world economies and financial markets;
d. the economic cycle in Jersey;
e. the medium-term and long-term sustainability of the States' finances and the States' financial assets and liabilities; and
f. the advisability of transfers to or from the Strategic Reserve Fund and Stabilisation Fund.

The Panel's work is guided by five key principles. These are:

1. Economic stability is at the heart of sustainable prosperity;
2. Fiscal policy needs to be focused on the medium term;
3. Policy should aim to be predictable, with flexibility to adapt to economic conditions to assist in creating a more stable economic environment;
4. Supply in the economy is as important as demand; and
5. Low inflation is fundamental to the competitiveness of the economy.

In making its recommendations, the Panel is guided by its understanding of the preferences of Islanders. The Panel feels that Islanders want government to be prudent and create the conditions for economic growth while respecting the Island's cultural heritage, maintaining the competitiveness of the economy and keeping inflation low.

In preparation of its reports the Panel has discussions with policymakers, business owners and managers, and representatives of public and private sector workers. The Panel is also grateful for the invaluable support provided by the staff of the Government of Jersey, in particular the Economics Unit and Treasury and Exchequer. More information about the Panel, including previous reports, can be found at www.gov.je/FiscalPolicyPanel.

Executive Summary

Economic Outlook

- The outlook for global growth over the next few years has weakened slightly with ongoing geopolitical tensions creating risk and uncertainty. Global inflation is declining more slowly than previously expected.
- Rising interest rates have subdued global growth but have had a positive effect on profits and growth for Jersey's banks. This sector accounts for 20% of Jersey's economy, and its strong performance enabled the economy to grow by 6.7% in 2022. However, the rest of Jersey's economy saw no change in GVA in 2022.
- Jersey's economy is at full employment. The number of people registered as actively seeking work, a measure of unemployment, remains low, whilst vacancy rates are high. In 2022, the number of people in employment increased by 1,600 (full-time equivalent workers) compared to 2021.
- Low productivity growth has become a pervasive feature of Jersey's economy. Economic growth has depended on a growing workforce. Inflation has peaked and is forecast to fall steadily throughout 2024. However, a lack of spare capacity means that elevated inflation is an ongoing risk for Jersey.
- As well as low productivity growth, an ageing population will put increasing pressure on Jersey's fiscal position. The Future Economy Programme has been established to tackle these issues, which we welcome.
- Despite a slowing of housing market activity in 2023, the high cost of housing continues to be a potential drag on economic growth and productivity and is also likely to be contributing to difficulties in recruiting and retaining workers.

Public Finances

- On the basis of current spending commitments and forecast tax revenues, there will be a primary budget deficit in 2024 and 2025, with spend on the public sector boosting demand further. Given the strong addition to revenues from banking profits and evidence of overheating in the economy this is an inappropriate fiscal stance. This forces demand offshore, carries risks to inflation and does not allow for the Government to build up its reserves, increasing its vulnerability to shocks.
- Jersey's net asset position as a percentage of Gross Value Added (GVA) has declined since the last Government Plan from 168% of GVA in 2020 to 135% in 2022. The net asset position is projected to fall further to 122% of GVA by 2027. The Panel is concerned that the projected net asset position remains lower than pre-pandemic levels.

- The Stabilisation Fund is much depleted. The Strategic Reserve balance is forecast to decline as a share of GVA. In 2027, it is forecast to stand at £1,206 million, roughly half the minimum level recommended by the Panel. The Strategic Reserve is unlikely to be sufficient to meet a major crisis. It is disappointing not to see stronger commitment to add to the reserves, given the current and recent past strength of government revenues.
- Whilst the actuarial review for the Social Security Funds show that they are in a good position under high migration scenarios, other health-related funds such as the Health Insurance and Long-Term Care Funds are likely to be exhausted by the 2040s, well before the end of the demographic transition that they are designed to mitigate. The review into the future of health and care funding is of critical importance.

Summary of recommendations

1. **The Government's long-run goals.** The Government's Strategy for Sustainable Economic Development sets out Jersey's fundamental economic challenges in the coming decades: to maintain living standards for all as the population ages, and to reverse the trend of declining labour productivity. The FPP agrees that meeting these long run challenges via the Future Economy Programme is vital.
2. **Reserves.** In the shorter term, renewed policy action is needed. Both the Stabilisation Fund and the Strategic Reserve as a proportion of GVA have shrunk and have not been replenished despite strong economic growth and exceptionally strong government revenues. The Strategic Reserve is about half the minimum value recommended by the Panel. The low values of both mean that Jersey is increasingly vulnerable to a serious economic downturn. The FPP recommends that the Government takes urgent action to replenish these funds. The FPP has previously recommended that the Strategic Reserve should be between 30% and 60% of GVA. The Panel recommends that all Prior Year Basis receipts should be ringfenced and transferred to the Strategic Reserve as they arise.
3. **Housing.** Following strong growth in both transactions and prices in recent years the market has cooled: while prices have held up, the number of transactions has dropped sharply. The high cost of housing (and land) is likely to be a drag on productivity on Jersey and as such a risk to economic growth. The Panel are currently undertaking a review into Jersey's housing market, which will be published in due course.
4. **Fiscal Strategy and Spending.** Jersey's economy grew strongly in 2022. Growth was driven by higher profits in the banking sector as a result of higher interest rates; the rest of the economy saw no growth. The improved fiscal position should be used to rebuild reserves and not to fund further expenditure growth, though the Panel welcomes the Government's extensive capital programme. It recommends that the primary balance should move to a surplus as soon as possible, but that this shouldn't be achieved through cuts to the capital programme.
5. **Inflation.** Inflation has peaked and is forecast to fall steadily. However, higher prices are affecting households who face an elevated cost of living. With many mortgage holders protected by fixed rates the full effect of the interest rate rises has not been felt yet but will materialise as these fixed deals come to an end. There is a risk of worsening the inflation outlook if the Government's fiscal stance adds too much demand into the economy.

6. **Health-related funds.** Recent actuarial reviews have established that the Health Insurance and Long-Term Care Funds will be exhausted before the end of the demographic transition that they are designed to mitigate. It is important that in the context of Jersey's future health and care financing needs, the sustainability of these Funds is considered.

SECTION 1

The Economic Outlook

1.1 International outlook

1.1.1 World Growth

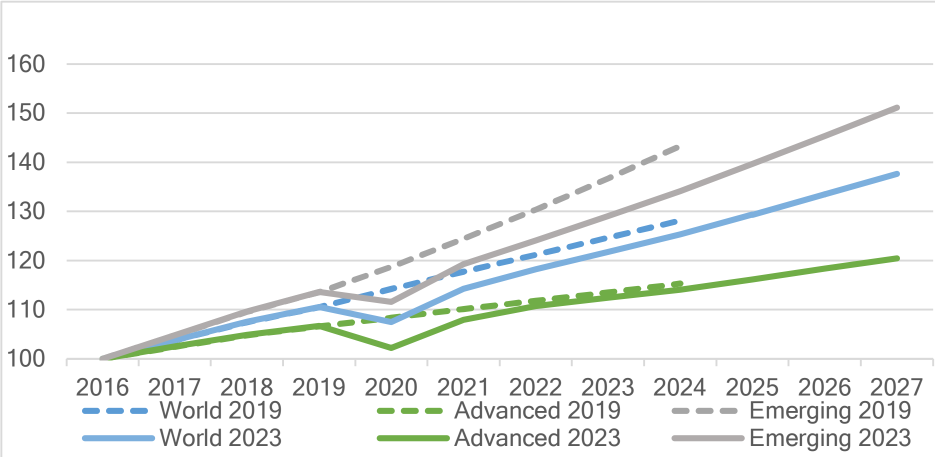
Despite several economic shocks in recent years, the global economy has been resilient and continues to grow slowly. However, the outlook for global growth in the medium term remains well below the pre-pandemic projected path, mainly for emerging market and developing economies (**Figure 1.1**).

Figure 1.1

Real GDP, 2016 - 2027, 2016 = 100

Index of real GDP, October 2019 (dotted line) and October 2023 (solid line) estimates/forecasts

Sources: International Monetary Fund World Economic Outlook



Over the course of 2022 and 2023, major economies tightened monetary policy to decelerate inflation as the conflict in Ukraine and sanctions placed on Russia placed pressure on energy and commodity prices. The effects of higher interest rates are dampening the prospects for global growth. Although conflict in the Middle East has created another source of economic instability, at the moment, market expectations are that further monetary tightening is less likely.

The International Monetary Fund (IMF)'s latest forecasts show a modest upside revision to global growth in 2023 but small downward revisions in subsequent years. **Figure 1.2** shows the forecasts for rate of growth of the world economy (in terms of real Gross Domestic Product (GDP)) for the years 2023-2027 in successive IMF forecasts. Global growth is forecast to remain below the 2000-2019 average growth rate of 3.8%.

The slowdown in the Chinese economy and the exposed fragility of its financial markets from the real estate crisis there pose a risk for global growth. However, there are some upside risks to global growth. Throughout 2023, US economic performance has surpassed expectations with strong consumer spend and investment and is on track to return to its pre-pandemic trend growth path.

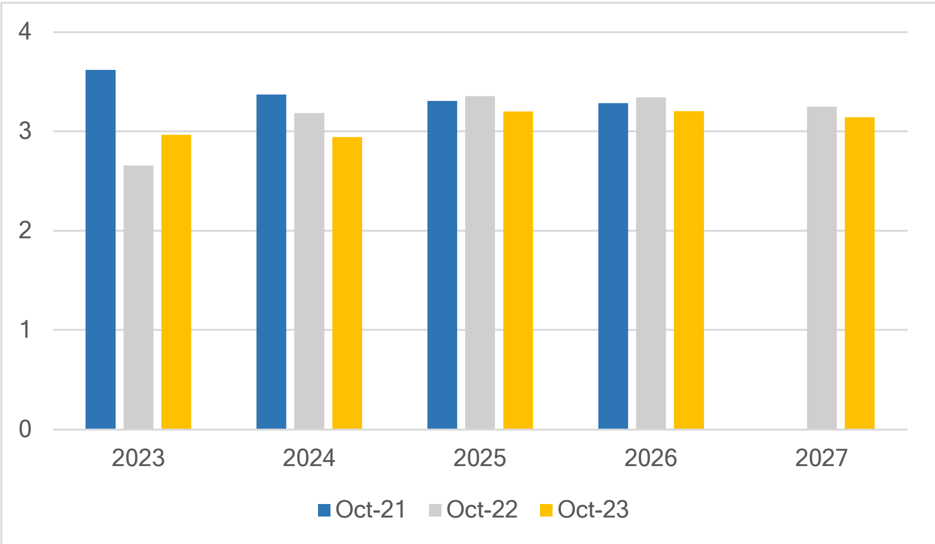
Although inflation in most economies has peaked, it remains elevated; the IMF has advised continued resolve by central banks to bring inflation down to target levels. Fiscal resources in many countries are depleted as government support has been used to mitigate the recent course of crises (in particular, Covid) leaving many governments in a vulnerable position in managing future shocks. Other developing risks to the global economy include increased geopolitical tensions in the Middle East, which could lead to price volatility in energy and commodities.

Figure 1.2

Forecasts of global real GDP growth, 2023 - 2027

Forecasts of global real GDP growth, percentage (%), 2023 - 2027, October 2021, October 2022 and October 2023 projections

Sources: International Monetary Fund World Economic Outlook



1.1.2 UK Growth

Revised data shows that the UK economy recovered more strongly from the Covid-19 pandemic than previously thought. However, the energy price shock and a tight labour market have resulted in high inflation and a tightening of monetary policy by the Bank of England.

According to the IMF's latest forecast, the UK's real GDP will have grown by 0.5% in 2023, with growth prospects in 2024 now revised downward to 0.6%. The sluggish performance of the UK economy relative to that of other advanced industrialised economies may be of particular significance for Jersey since the UK is our major trading partner.

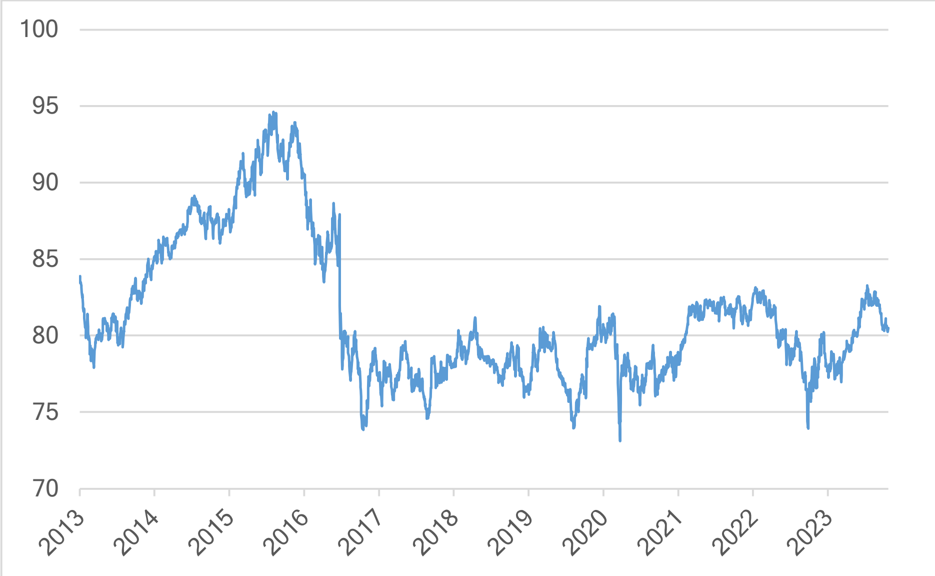
The value of sterling (**Figure 1.3**) has recovered from the sharp depreciation experienced in September 2022. Whilst this appreciation should contribute to bringing down inflation, further macroeconomic shocks or any divergence in monetary policy could affect market confidence and the exchange rate.

Figure 1.3

Sterling's trade weighted index, Jan 2013 - Oct 2023, Jan 2005 = 100

Effective exchange rate index, Sterling (Jan 2005 =100), Jan 2013 - Oct 2023

Sources: Bank of England



From its peak in August 2022 (**Figure 1.**), the price of gas fell by over 80% by August 2023 and price of crude oil also fell by over 20%, over the same period. This fall has benefited UK consumers through a lower energy price cap. However, since then energy prices have begun to rise again, although only modestly, meaning that energy bills are set to rise.

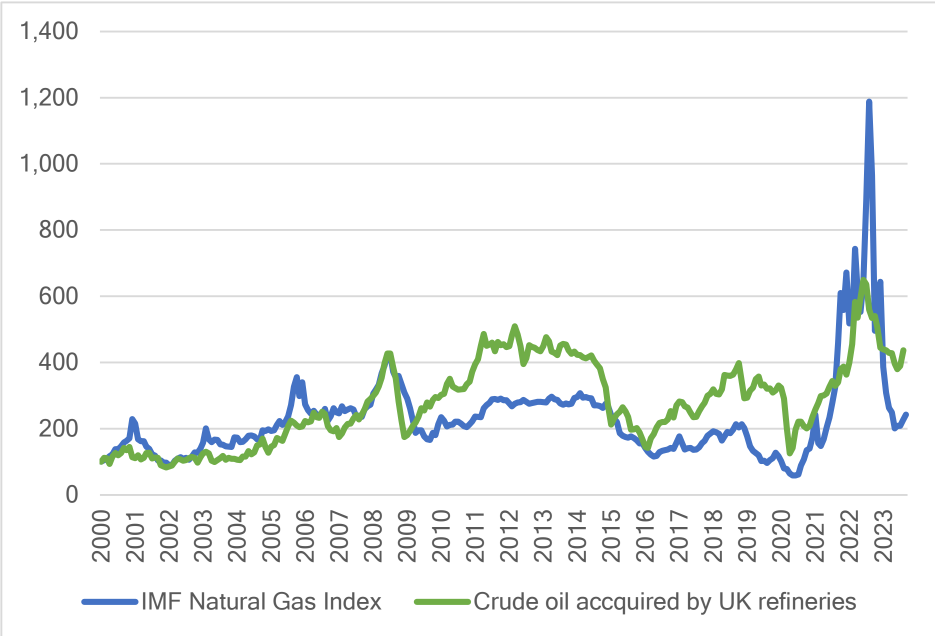
Figure 1.4

Crude Oil and Natural Gas Prices 2000-2023

The price of crude oil acquired by UK refineries measured monthly (Jan 2000 = 100)

IMF Commodity Prices index for natural gas (Jan 2000 = 100)

Sources: DESNZ, IMF



1.1.3 UK Inflation and close trading partners inflation

High inflation has recently been the dominant challenge for the UK economy and most other advanced economies. The UK's key measure for inflation, CPI, peaked at 11.1% in October 2022 and has since been falling slowly. It stood at 6.7% in September 2023 and is forecast to fall to around 4.5% by the end of 2023. Inflation has also peaked in the US and the Eurozone but remains above target.

1.1.4 Interest Rates

The Bank of England base rate is now at 5.25%, having been increased six times since November 2022. The Bank of England has signalled its commitment to further tighten monetary policy as necessary in order to bring inflation back to its 2% target. Market expectations are that rates could peak at 5.3% at the end of 2023. **Figure 1.5** sets out the changing market expectations for the Bank Rate at various points from November 2022 to November 2023.

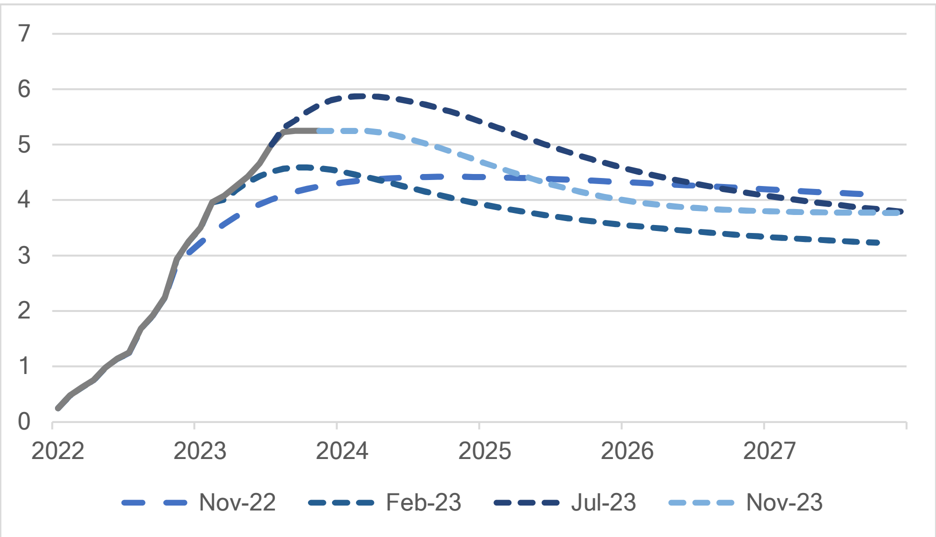
Interest rates have continued to increase in the US and the Eurozone too, with the Federal Reserve Bank increasing rates to 5.25%-5.50% (+1.25 percentage points, pp) and the European Central Bank increasing the deposit rate (its main interest rate) to 4.0% (+3.5 pp). Although these rises are dampening economic activity, Jersey's banking sector has benefited due to increased profits from bank deposits. Rate rises will benefit households with savings to some extent but will increase costs for mortgage holders on variable and tracker mortgages (and those with fixed rates ending).

Figure 1.5

Future UK Bank Rate expectations

Average monthly expectations for the future UK Bank Rate (percentage), and the actual value for the UK Bank Rate (solid grey line)

Sources: Bank of England



1.2 Jersey economic developments

The most recent GVA data[1] available shows that the economy grew by 6.7% in 2022 in real terms and at basic prices (**Figure 1.6**). This was faster than other advanced economies. The driver of growth was profits in the financial services sector – specifically in the banking sub-sector – due to the increases in interest rates throughout 2022.

Following strong growth in 2021, hotels, restaurants and bars continued their recovery from Covid-19 and the sector grew by 20% in 2022. Financial services saw the second fastest growth (19%) and is the largest sector of the economy.

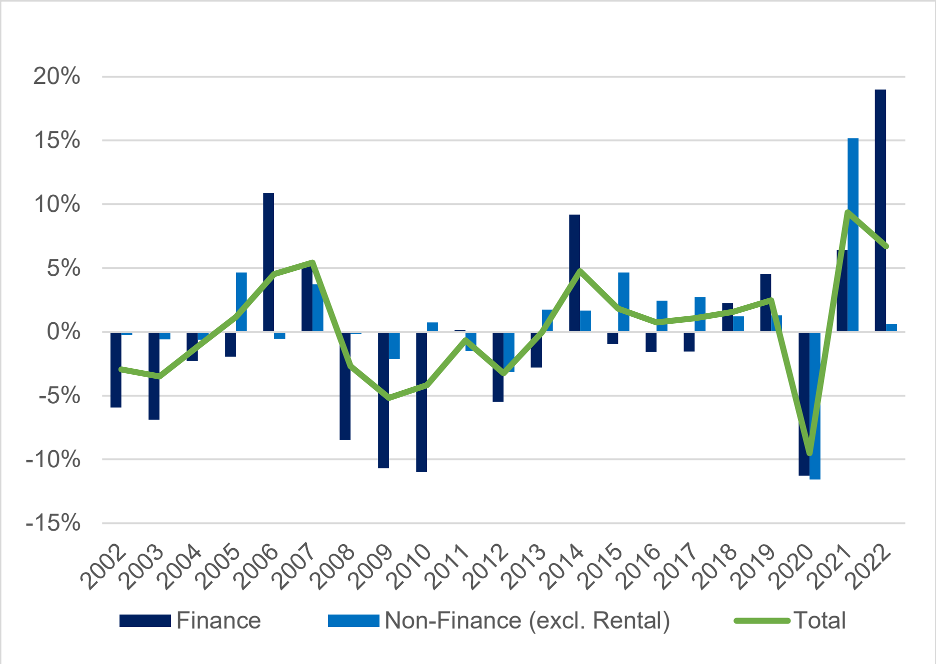
The rest of the economy saw more mixed results. Transport, storage and communication grew (6%), whereas construction, other business activities and public administration saw no change. A number of sectors shrank in value – electricity, gas and water (-11%), agriculture and fishing (-8%), manufacturing (-7%), wholesale and retail (-7%) and rental income of private households (-5%).

Figure 1.6

Jersey GVA growth

Annual percentage real terms change

Source: Statistics Jersey



[1] Statistics Jersey published their report on 'Measuring Jersey's economy: GDP and GVA - 2022' on 4 October 2022. The publication introduced changes to the methodology and the headline measure of GVA. Changes include updating the classification of businesses into relevant sectors to the UK standard industrial classification 2007 system and presenting the values in market prices (previously in basic prices). For continuity, the FPP has presented the information under the "old" methodology, unless otherwise specified, to allow for an easier comparison to previous reports and economic assumptions. The FPP will move to reporting under the "new" methodology in future publications.

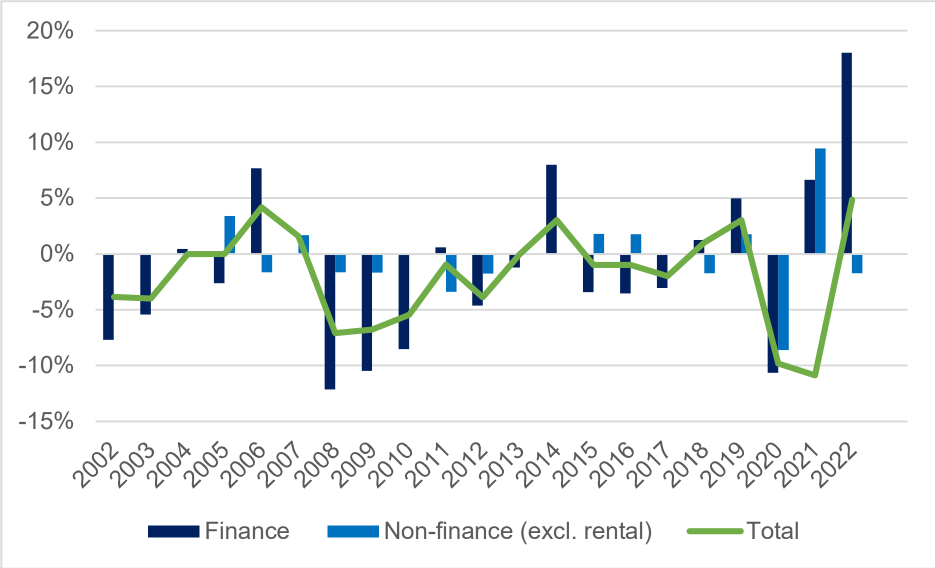
Strong profits in the banking sub-sector contributed to the real productivity growth in 2022 (**Figure 1.7**). The non-finance sector saw productivity fall by 1.7%.

Figure 1.7

Productivity growth

Annual percentage change in GVA per FTE in real terms

Source: Statistics Jersey



1.2.1 Finance Sector

The financial services sector saw a 39% growth in profits (**Figure 1.8**) and 19% growth in real GVA in 2022. Strong growth in profits from higher net interest margins has helped the banking sub-sector, which represents the largest portion of the financial services sector. It should be noted that other sub-sectors within financial services did not benefit directly from the increase in interest rates.

Figure 1.8

Financial services profit and employment costs

Annual real terms percentage change in gross operating surplus, GOS (dark bars) and compensation of employees, COE (pale bars).

Sources: Statistics Jersey

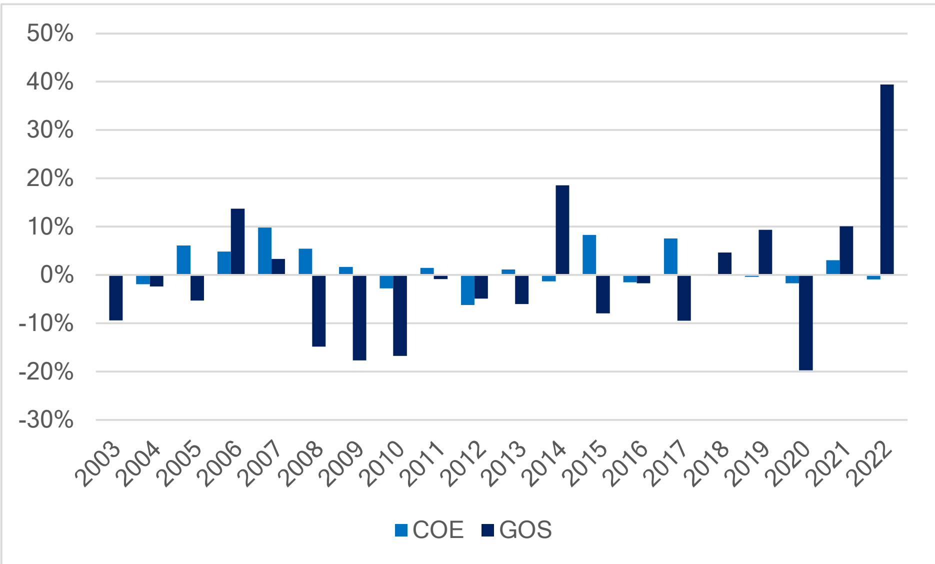


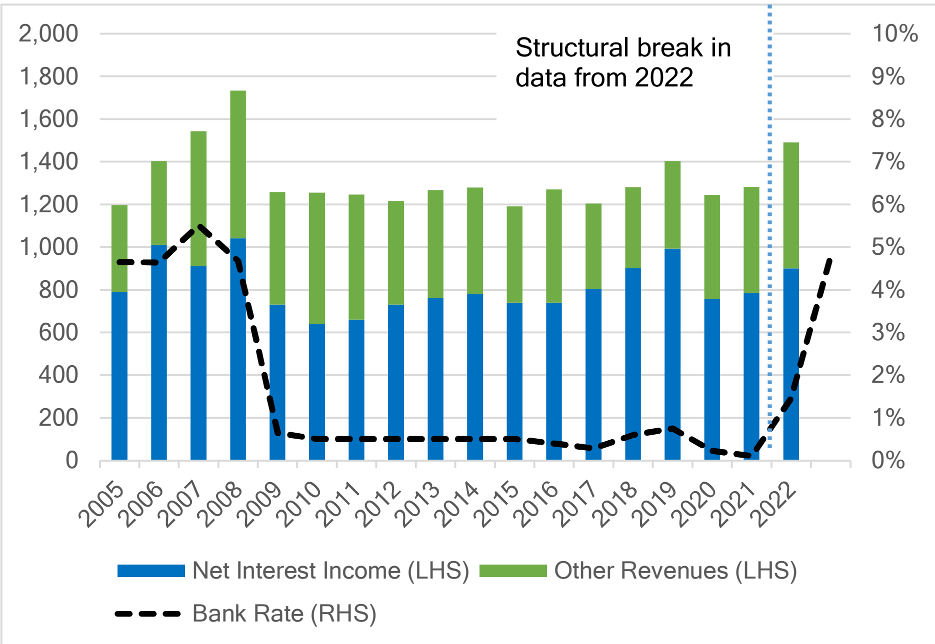
Figure 1. shows the recent annual history of financial services revenues. It should be noted that data for 2022 is not directly comparable with previous years due to a structural break, changing how businesses are classified for economic statistics[1]. Banking revenues reached £1,490 million, of which £900 million was net interest income.

Figure 1.9

Banking revenues

Source of revenue (£ million, current prices - left hand scale) and annual average for Bank of England Official Bank Rate (percentage - right hand scale, 2023 is the forecast annual average)

Sources: Statistics Jersey, Bank of England



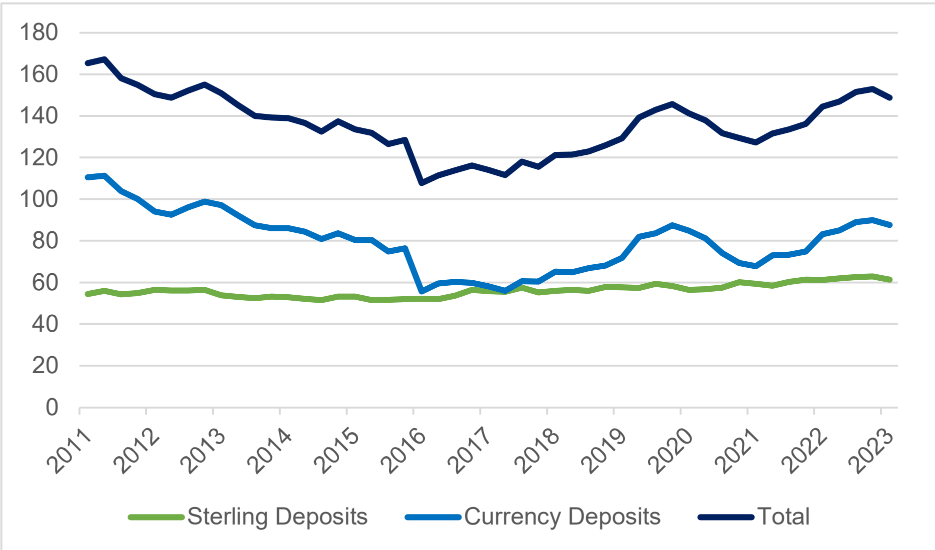
The total value of deposits (**Figure 1.10**) held by Jersey banks stood at just under £150 billion at the end of June 2023, of which £88 billion is held as currency deposits. These deposits are mainly held in US dollars, though euro deposits are important and mean that both US and Eurozone interest rates affect the profitability of Jersey's banking sector.

Figure 1.10

Banking deposits

Total bank deposit values (£ billion current prices) in sterling and foreign currencies ("Currency Deposits")

Sources: Jersey Financial Services Commission



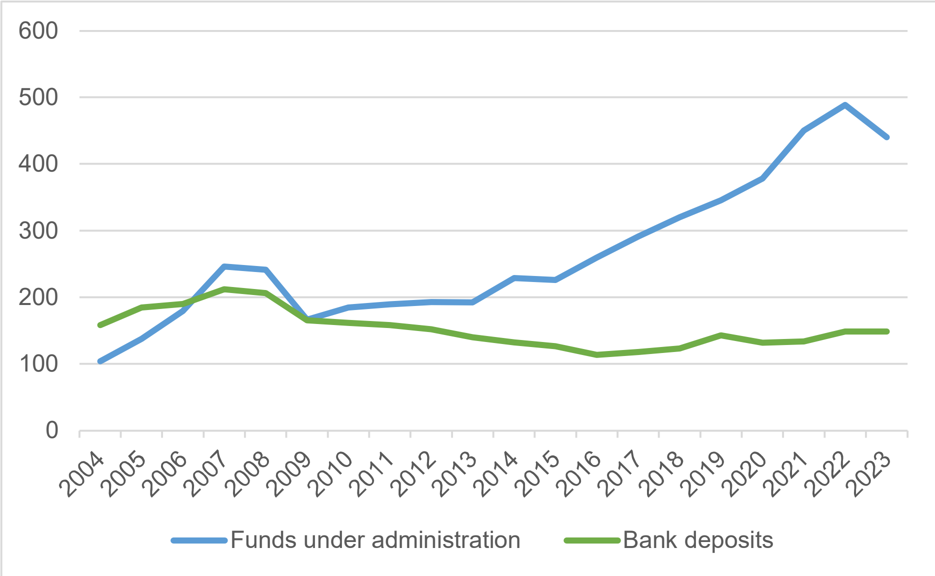
Following strong year-on-year growth in the value of funds administered in Jersey since 2015, there was a fall of 10% in the first half of 2023 (**Figure 1.11**).

Figure 1.11

Deposits and funds

£ billion, total banking deposits held in Jersey (green line) and net asset value of regulated funds under administration (blue line); 2004-2022 is year-end; 2023 is June

Sources: Jersey Financial Services Commission



The **Business Tendency Survey (BTS)** from September 2023 suggests that business sentiment within the finance sector continues to be weighted towards the upside. The headline business activity indicator has remained positive with the weighted balance of firms reporting an increase in current business activity outweighing those who reported a decrease by 15 pp, and by 47 pp for future business activity, by 47 pp.

When the Panel met with representatives from the financial services sector it was noted that further increases in interest rates may not boost profitability as significantly. Further, representatives across the finance sector highlighted existing difficulties and competition in recruiting to key positions in their organisations, citing a "war for talent". Others cited the higher cost of living as an additional factor that made recruitment more difficult. Other challenges reported included the pace of change with respect to regulatory changes introduced to support Jersey's Moneyval mutual evaluation.

1.2.2 Rest of the economy

The non-finance sector saw a period of subdued growth in 2022, growing by 0.6%. Employment, measured by Full Time Equivalents (FTE), grew by 3%. Productivity fell by 1.7%.

The headline business activity indicator for the non-finance sector was moderately negative in the September 2023 BTS (**Figure 1.12**). New business and business optimism were negative. Future business activity, which covers the period to Q4 2023, showed a moderately positive response. With a weakened outlook for business activity, the survey indicates continued concerns about rising costs and thus, future profitability.

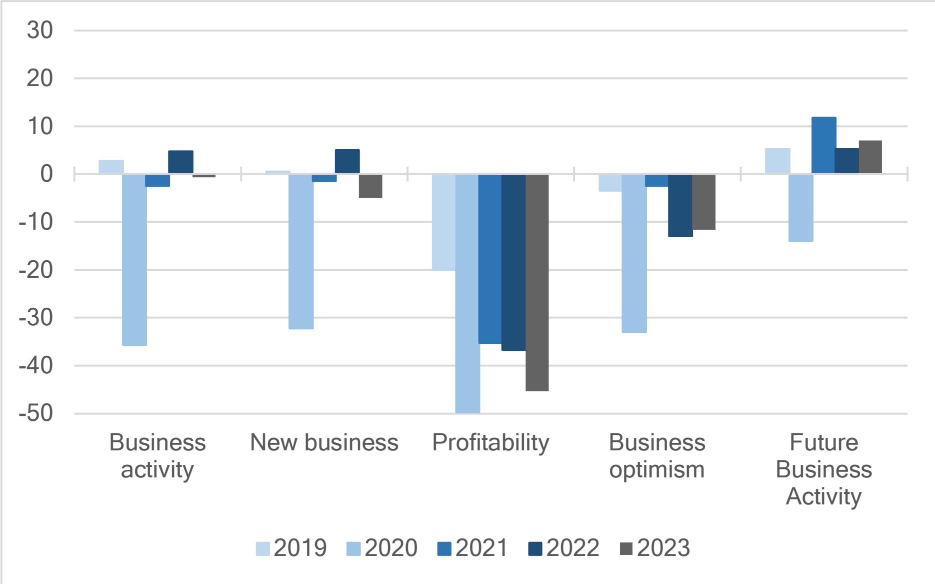
Figure 1.12

Non-finance business tendency

Percentage net balance of respondents reporting an increase (weighted by employment). Average of quarterly results

Note: 2023 covers March, June and September.

Sources: Statistics Jersey, Panel calculations



1.2.3 Sectoral performance of the non-finance economy

The wholesale and retail sector saw growth fall by 7% in 2022. Responses to the September BTS from this sector were largely negative, particularly with respect to input costs, profitability and business activity. Continuing challenges to the sector include increased competition from online retailers as well as the cost-of-living pressures on consumers, which may have impacted discretionary spend.

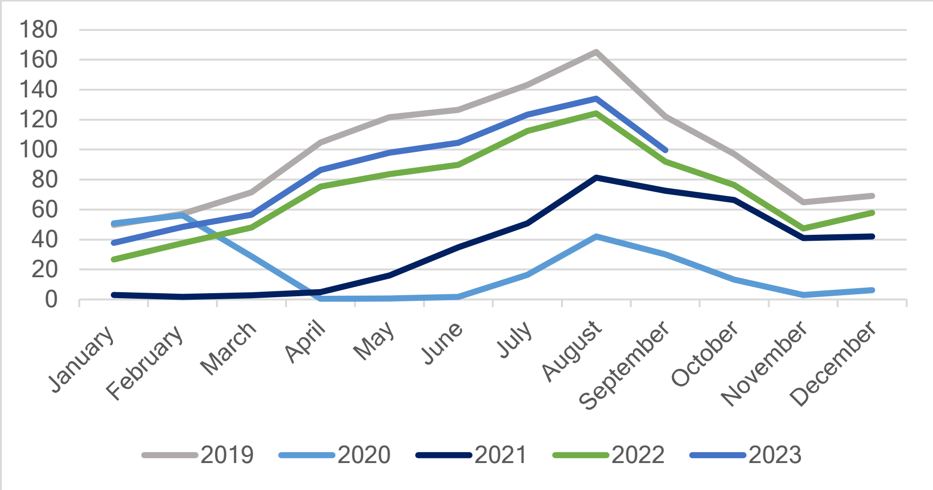
The **hotels, restaurants and bars** sector continued its bounce back from Covid-19 and grew by 20% in 2022, to be just 2% smaller in value compared to 2019. Sentiment in 2023 appears to be less positive, with the September BTS showing negative business optimism throughout the year and high input costs. Further, at the Panel's factfinding visit, industry representatives noted lower spending power domestically and inbound visitors with disposable incomes being squeezed. Data on departures captured by Ports of Jersey (**Figure 1.13**), shows that departures are rising year-on-year but still remain below pre-pandemic levels.

Figure 1.13

Port departure numbers

Number of departures from Jersey air and sea terminals (thousands)

Sources: Ports of Jersey



The **construction** sector did not grow in 2022. Further, the sector saw the collapse of two construction companies in 2023 because of firm-specific reasons. The sector has been buffeted by rising costs of materials and a slowdown in the housing market (see **Section 1.5**). The sector expressed concern about the future pipeline of work as a result of changes to the plans for the New Healthcare Facilities and delays in the planning process for a number of proposed developments.

1.3 Labour Market

Jersey continues to operate at full employment as evidenced by the high employment rates and low level of unemployment. The number of jobs (**Figure 1.14**) grew from just over 61,000 (December 2019) to 65,000 (June 2023), the highest number on record. Since 2019 the increase in jobs has been evenly distributed between jobs filled by entitled workers, and migrant workers. But over the last 12 months, around 70% of the increase has come from jobs filled by migrant workers.

Figure 1.14

Labour force composition

Total numbers of jobs filled by workers registered as entitled and migrant (includes those in the licensed, registered and exempt categories)

Sources: Statistics Jersey

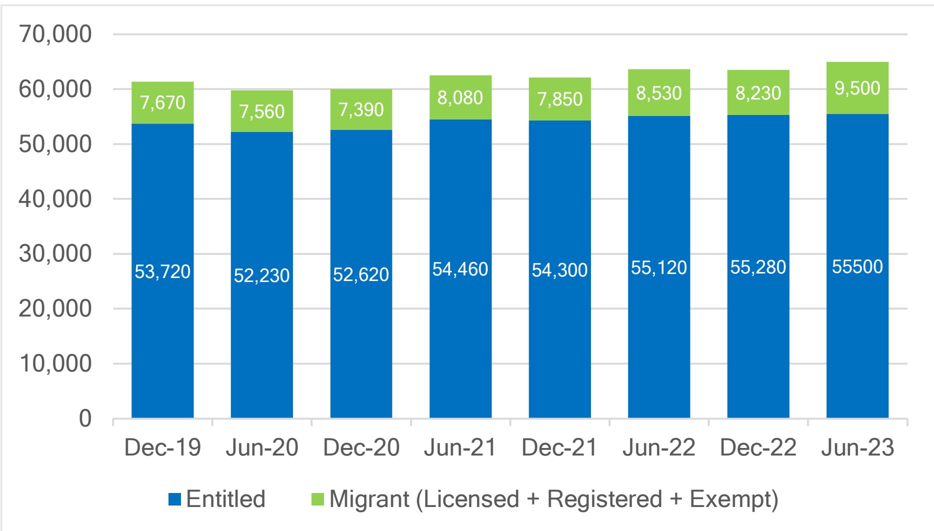


Figure 1.15 breaks down the growth in jobs by industry. Between June 2022 and June 2023, growth in jobs was mostly driven by the public sector (particularly "core" headcount – though the public sector as a share of total jobs has returned to about the same share as in June 2014), hospitality (recovering from a pandemic low) and private sector health and social care. Over the last 5 years, the latter two areas have both driven jobs growth, as has the construction sector. Only agriculture and fishing and wholesale and retail have experienced sustained decreases in headcount.

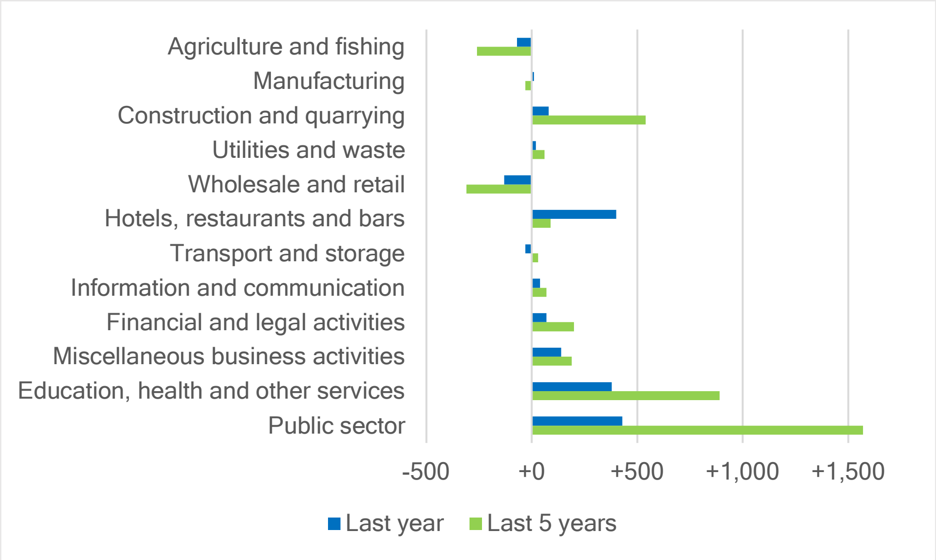
It is too early to say if this constitutes a return to the pre-pandemic rate of net migration, or a new trend. The Government published its first annual report on the Common Population Policy in June 2023, which sets out Jersey's future demographic challenges from an ageing population and an objective of economic growth without "unrestrained" population growth.

Figure 1.15

Change in jobs by industry

Change in total jobs by sector, June 2022-June 2023 and June 2018-June 2023; "education, health and other services" covers private sector education and health only

Sources: Statistics Jersey



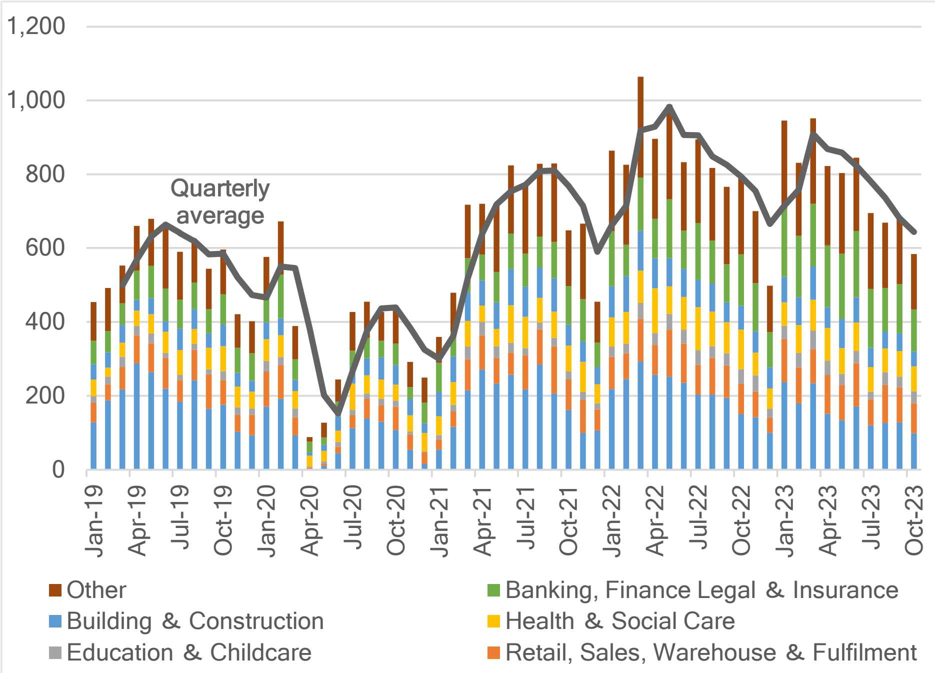
Evidence of an expanding and tight labour market is supported by vacancies posted on the Government of Jersey website for private sector jobs, in Figure 1.16. The pandemic and post-pandemic trend in Jersey has been similar to the UK – with job vacancies falling to record lows during the pandemic and rising to record highs in 2021 and 2022. In 2023, job vacancies have remained well above pre-pandemic levels, but below the levels seen in 2022 – total job postings from January to October 2023 were 11% lower than over the same period last year.

Figure 1.16

Vacancies in Jersey

Number of private sector vacancies by sector posted on the Government of Jersey website. Postings on the site can be given three sector categories; for this chart, vacancies are assigned to the first sector listed. Postings with no sector listed are excluded

Sources: Customer and Local Services



The breakdown of job postings across sectors now broadly resembles the picture before the pandemic, with some notable changes. In 2019 hospitality job postings made up 40% of all vacancies during the seasonal peak, but this fell to around 20% of the total in the 2023 peak. Conversely, roles in financial services now make up around 20% of all postings, compared to a little over 10% in 2019. This may reflect changes in the composition of demand for labour in Jersey, or simply changes in recruitment practices.

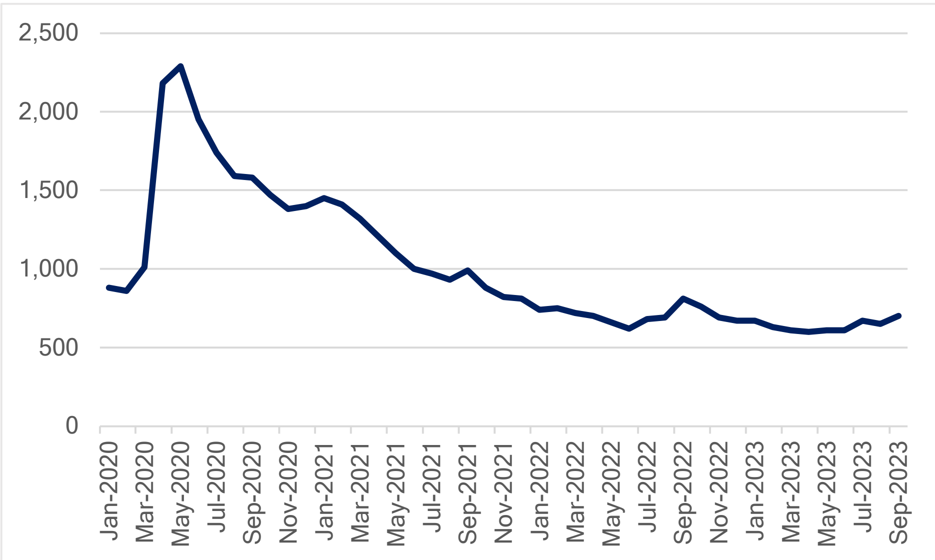
Alongside this growth in jobs, unemployment has remained low following Jersey's economic recovery, as shown in **Figure 1.17**.

Figure 1.37

Individuals Actively Seeking Work

Number of those registered as Actively Seeking Work on the last calendar day of each month

Sources: Statistics Jersey / Customer and Local Services



Low unemployment and high inflation have contributed to strong nominal earnings growth (**Figure 1.18**). Average earnings in the private sector rose by 7.8% in the year to June 2023, while average public sector earnings rose by 7.4% (below the headline pay award of 7.9%, as some pay groups had not accepted the offered pay award). Despite this, in real terms average earnings fell by 2.8% and 3.2% respectively, after a decade of essentially zero real earnings growth. The increase in the minimum wage from £9.22 in January 2022 to £10.50 in November 2022 (13.9%) will however have particularly helped lower earners. Around 40% of workers in agriculture and fishing, wholesale and retail and hospitality earned below the living wage of £12.19 in June 2023.

Figure 1.18

Average earnings and inflation

Index (2008 = 100) of average earnings (blue line) and retail prices index (green line)

Sources: Statistics Jersey

1.4 Inflation

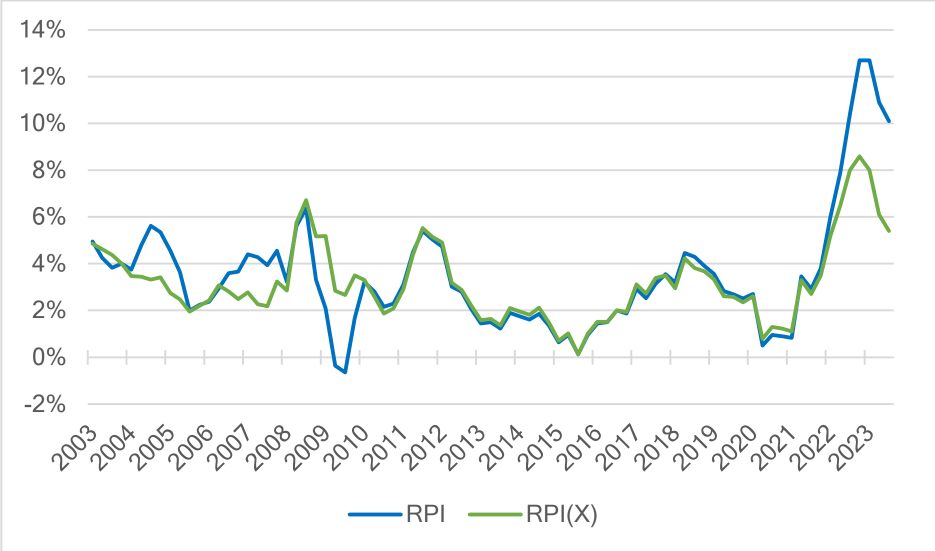
Jersey's headline measure of inflation, the Retail Prices Index (RPI), was 10.1% (September 2023). 2022 saw inflation reach its highest levels since 1990, peaking at 12.7% in December 2022. RPI(X), which excludes mortgage interest payments, also peaked at 8.6% in December 2022 (**Figure 1.19**). The increases in inflation have largely been attributed to the imported inflationary pressures from the UK and increases in the Bank Rate, the latter affecting housing costs for those households with mortgages.

Figure 1.19

Inflation in Jersey

Annual percentage change in retail prices index (RPI) and retail prices index excluding mortgage interest payments (RPI(X))

Sources: Statistics Jersey



1.5 The housing market

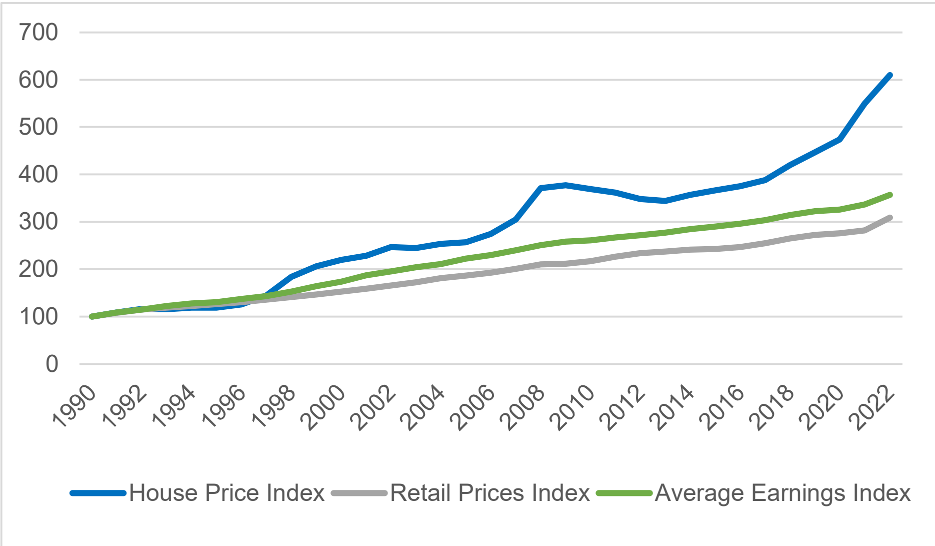
Since the late 1990s, house price growth in Jersey has far exceeded both RPI and average earnings growth (**Figure 1.20**), driven by factors including limited supply of land and historically low interest rates in the period following the financial crisis. However, increases in interest rates throughout 2022 and into 2023 are now contributing to a slowing in the housing market.

Figure 1.20

House Price, Retail Prices and Average Earnings Indices

Index 1990 = 100

Sources: Statistics Jersey



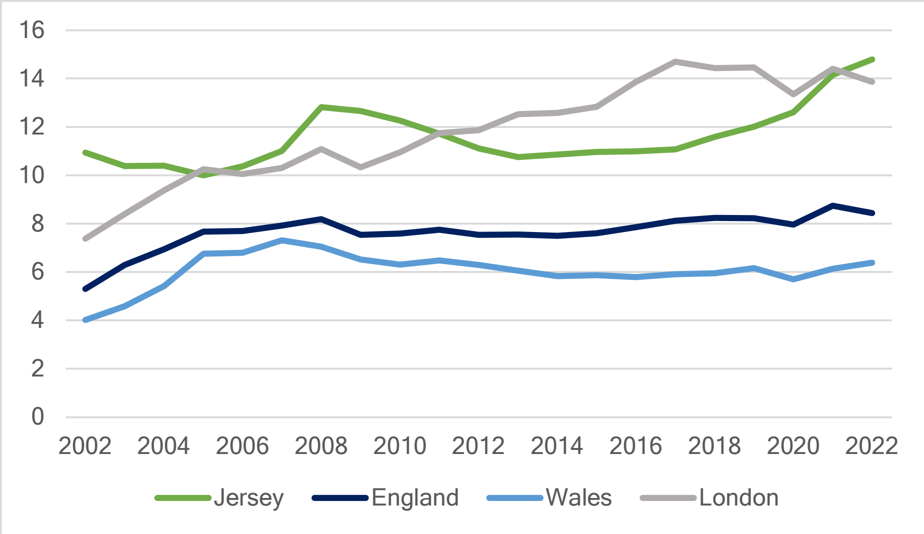
In 2022, the house price to income ratio worsened slightly, with the average property price in Jersey equal to nearly fifteen times average household income, shown in **Figure 1.21.** The house price to income ratio in Jersey is significantly worse than many areas of the UK, with ratios of 8.4 in England and 6.4 in Wales, and surpassed London at 13.9 in 2022.

Figure 1.21

House price to income ratio - comparison with the UK

Ratio of median property price to equivalised median net household income, 2002-2022

Sources: Statistics Jersey, UK Office for National Statistics



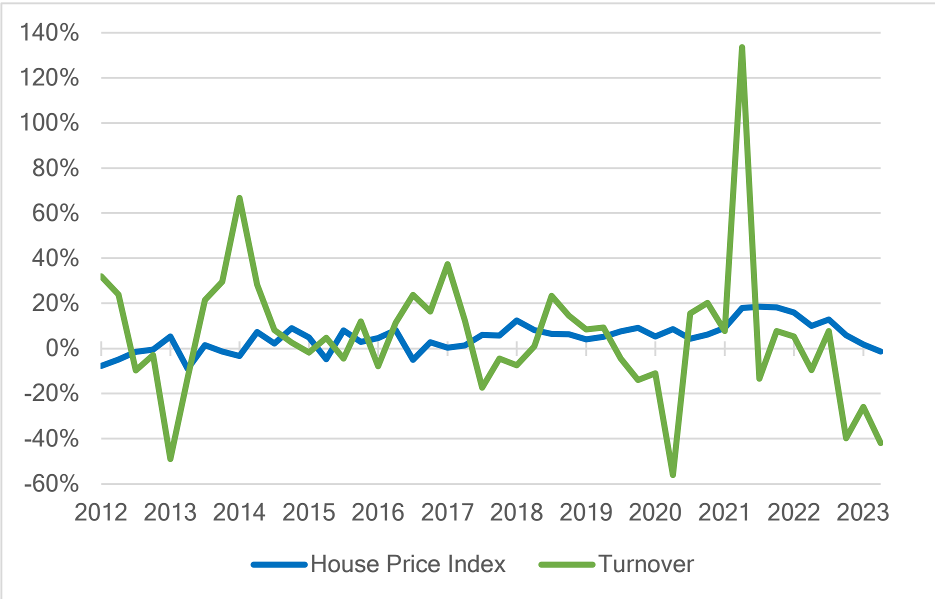
Strong growth in the Jersey property market in the first half of 2022 has been followed by a period of slowdown. Latest quarterly data indicates a decrease in turnover of 42% in Q2 2023 compared to Q2 2022 (**Figure 1.22**). Almost half of all transactions in Q2 2023 (45%) were the result of completions occurring in new developments. Excluding new builds, turnover would be 62% lower compared to Q2 2022. The slowdown in transactions is in line with the Panel's July 2023 assumptions.

Figure 1.22

Housing market

Annual change in House Price Index and transaction numbers

Sources: Statistics Jersey



In contrast to the significant fall in housing transactions, house prices have reduced only slightly, falling by 1% annually in Q2 2023. Reduced activity in the housing market has been driven by the increases in Bank Rate, and market activity is likely to remain suppressed whilst interest rates remain high. However, this period of reduced housing market activity is unlikely to resolve the risk posed by high housing costs to growth and productivity. The Panel is undertaking a review into Jersey's housing market, which will be published in due course.

Interest rate rises will affect households via higher mortgage payments (and via rent increases), but this effect is likely to be gradual, as according to the latest household expenditure survey, 73% of mortgages held by households in 2021/22 were on fixed rates. This suggests that many mortgage holders may not yet have felt the effects of interest rate rises, though for mortgage holders on new rates (whether fixed or variable) the difference is significant. For example, according to Bank of England data, the interest rate on a standard 5-year fixed rate mortgage with a 75% loan-to-value ratio has increased from 2% in Sep 2018 to 5.2% in Sep 2023.

The Government Plan includes a £10 million shared equity pilot scheme to help first-time buyers. Under the scheme, eligible buyers will be able to access a government contribution of up to 40% of the purchase price, subject to certain criteria. The scheme involves funding allocated in a previous Government Plan and is expected to be available from Spring 2024. The relatively small scale of the pilot scheme is unlikely to materially impact the housing market but may help some first-time buyers into home ownership. **However, the impact of the pilot scheme on the housing market should be carefully monitored before the Government considers whether to extend the scheme.**

In January 2023, the Government introduced a new higher rate of stamp duty on transactions where the property is not the main residence of one or more of the purchasers, such as when the property is a buy-to-let, second home or holiday home. The latest quarterly data (Q2 2023) indicates that 28% of properties transacted were not purchased to be the main residence of the purchaser. It is difficult to isolate the impact of the tax on the market from increasing interest rates which are also impacting purchasing decisions. With data only available since the start of 2023 on these transactions, the Panel needs further data to assess the impact of this measure on the wider housing market.

1.6 Future Economy Programme

Following the publication of an Outline Economic Strategy last year, in October 2023 the Government published a Strategy for Sustainable Economic Development outlining the structural economic challenges Jersey faces - low productivity and maintaining living standards with an ageing population. The Strategy is accompanied by a Delivery Framework containing actions the government will take to achieve sustainable economic growth. **The FPP agree that addressing the twin challenges set out in the Strategy should be a priority for the Island.**

To provide the tax revenues to support a much larger older population, to maintain Jersey's competitiveness as a jurisdiction and to mitigate and adapt to a changing climate, economic growth needs to come through higher productivity, rather than continued population growth. The FPP welcomes the commitment the Strategy and Framework make to a "holistic approach" to Government decision-making in this regard, with aligned economic thinking across Government and the private sector, clear policy priorities (like the "themes" set out by the Strategy) and a consistent understanding of the short- and long-term trade-offs inherent in Jersey's economy.

1.7 Economic growth forecast

Since the FPP's last update of economic assumptions in July 2023 (**Figure 1.24**), Statistics Jersey released outturn data for GVA in 2022. This showed real GVA growth of 6.7% and nominal GVA growth of 14.7%, both of which were 2 pp lower than forecast. Outturn data show finance sector profits (in nominal terms) grew by 49.4%; this compares very closely to the FPP's forecast of 50%. The FPP has not been asked to update the economic assumptions.

The economic assumptions suggested a mixed outlook for the Jersey economy in 2023. The FPP forecast that the annual inflation rate for RPI would reach 10.8% (**Figure 1.23**), highlighting the gradual fall from its peak in December 2022. The forecast for the quarterly inflation rates for 2024 also factors in the different energy price changes expected in the UK and Jersey.

Further, the FPP forecast that real GVA growth would fall to below 2% in 2023, reflecting waning growth of finance profits as the industry settles into a period of higher interest rates when compared to the previous decade (which saw the Bank Rate fall to a low of 0.1% during the pandemic). The FPP noted a sharp fall in the number of housing transactions for 2023; this too is driven by higher interest rates.

Figure 1.23

Inflation forecast (RPI and RPI(X)), July 2023

Blue line is RPI, green line is RPI(X). Dotted lines indicate forecasts.

Sources: Statistics Jersey, Panel calculations

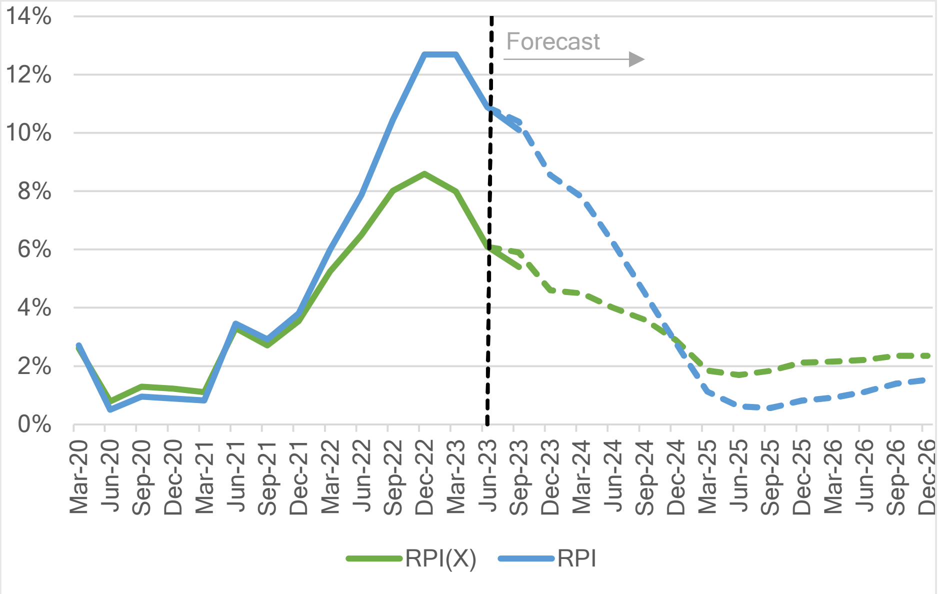


Figure 1.24

Central Economic Assumptions, July 2023 with updated GVA outturn for 2022

Percentage change year on year unless otherwise stated, light blue indicates outturn data.

Note: changes in profits, earnings, employment costs and house prices are in nominal terms.

Real GVA is deflated with RPI(Y), however, the rental component of GVA is deflated with a separate rental deflator.

Sources: Statistics Jersey, Panel calculations

% change unless otherwise specified	2020	2021	2022	2023	2024	2025	2026	Trend 2027+
Real GVA	-9.6	9.2	6.7	1.7	2.6	-0.2	-0.5	0.5
RPI	1.3	2.7	9.3	10.8	5.3	0.8	1.2	2.4
RPI(X)=RPI(Y)	1.2	2.7	7.1	6.2	3.8	1.9	2.3	2.4
Nominal GVA	-8.1	12.1	14.7	8.3	6.5	1.8	1.8	2.9
Gross operating surplus (including rental)	-16.4	19.2	23.8	8.9	8.0	0.4	0.7	2.9
Financial services profits	*-18.8*	*13.1*	*49.4*	*9.0*	*11.0*	*-2.0*	*-2.0*	*3.2*
Compensation of employees (CoE)	-0.8	6.8	7.2	7.7	5.0	3.1	2.9	2.9
Financial services CoE	*-0.5*	*3.9*	*6.1*	*9.0*	*5.4*	*3.4*	*3.4*	*3.4*
Non-finance CoE	*-4.4*	*8.7*	*7.8*	*6.8*	*4.1*	*2.6*	*2.6*	*2.7*
Employment	-2.4	2.9	2.9	0.7	0.5	0.4	0.4	0.1
Average earnings	1.1	3.3	6.2	6.7	4.2	2.6	2.4	2.8
Interest rates (%)	0.2	0.1	1.5	4.8	5.9	5.1	4.4	4.0*
House prices	6.1	16.0	11.0	-2.0	0.0	4.0	3.0	2.9
Housing transactions	-3.8	15.1	-12.9	-50.0	20.0	25.0	35.0	4.0

*Trend interest rates represent market expectations for 2027

1.8 Risks to growth

Immediate risks to economic growth in Jersey include possible persistent or lingering high inflation in the UK. This would affect Jersey directly via prices of imported goods and indirectly through tourism as it affects the number of inbound visitors and their spending power on Island. The BTS survey showed business concerns over higher current and future input costs and product prices. The FPP previously commented that Jersey's tight labour market could result in upward pressures on wage increases, which would keep inflation higher for longer; this still holds.

Despite the economic resilience seen in Jersey during and at the end of the pandemic, growth remains uneven across the economy. Growth has been confined to the banking sector within financial services. Non-finance sectors such as hospitality and construction are showing a less positive outlook and a continued lack of growth in the non-finance sector could cause further divergence in the economy – this is a risk to achieving sustainable growth. Other existing issues such as a skills shortage and the cost of housing may act as a drag to economic growth.

1.9 Other economic risks

The outlook for the global economy has weakened and there is a risk that any slowdown may spill over into Jersey. This includes the risk that any further geopolitical tensions such as the conflicts in Ukraine and the Middle East may introduce prolonged inflationary pressures to Jersey.

If left unimproved in the medium to long term, low and falling productivity will continue to weigh down on the Jersey economy. It will erode business and investor confidence and ultimately Jersey's economic competitiveness. However, as noted, the Future Economy Programme proposes some mitigating solutions for this.

Finally, upside risks to the economy are still present despite the dampened global forecasts. The outlook for the Island is positive in some respects: higher interest rates may continue to benefit the banking sector, although the marginal gains may be smaller than recently experienced.

SECTION 2

The Fiscal Outlook

2.1 Introduction

This section considers the proposed Government Plan for 2024-27 ('the Government Plan') and assesses the extent to which it follows the fiscal framework guidelines. The Government Plan was lodged on 19 September 2023 and will be debated by the States Assembly on 12 December 2023.

Jersey's economy had, by 2021, largely recovered from the shock caused by Covid-19. It then grew quite strongly in 2022. Whilst the outlook for global economy remains uncertain, Jersey's economy is in a relatively good position. The outlook for public finances also appears positive as high interest rates are expected to lead to higher tax revenues. This presents an ideal opportunity to rebuild Government reserves through contributions to the Stabilisation Fund and Strategic Reserve.

Proposed Government Plan 2024-27

The proposed Government Plan sets out:

- A forecast operating deficit of £8 million in 2023 with operating surpluses across all forward years of the Plan.
- Capital expenditure of £454 million over four years; this excludes as yet unapproved funding for the New Healthcare Facilities.
- £47.5 million of growth funding to support the delivery of ministerial priorities during 2023.
- A continuation of the Value for Money programme set to deliver £10m in efficiencies annually in 2024 to 2026.
- Increased collection from domestic tax compliance activities of £31.5 million annually.

The Panel has assessed the extent to which the Government Plan follows the fiscal framework guidelines to:

- seek to increase the Strategic Reserve and public sector net worth, while following the advice of the Fiscal Policy Panel on borrowing and net financial assets.
- run a primary structural current balance or surplus in the long term until the Strategic Reserve is judged large enough to meet its mandate.
- borrow only to finance investment (or refinance liabilities), except during periods of economic duress, and monitor the impact on net financial assets.

2.2 Income and expenditure

The headline metric in the Government Plan is the 'operating balance', which includes current spending and income and excludes capital spending. This metric includes depreciation as the cost of the capital stock 'used up' to deliver public services. The Panel supports the idea of depreciation being included in the operating balance as it reduces the incentives to cut required capital spending in order to achieve a balanced budget, however the adjustment is relatively small and so does not truly cover the cost of maintaining a modern public capital stock. The Government Plan forecasts operating deficit of £8 million in 2023 with operating surpluses across all forward years (**Figure 2.1**). When comparing to last year's Government Plan, revenues are £31 million higher in 2024 and £135 million cumulatively across 2024 to 2027. Despite growing revenue projections, the operating balance has deteriorated by £21 million across 2024 to 2027 (**Figure 2.2**). This deterioration is driven by high expenditure growth. **The strong growth in revenues should have enabled the Government to rebuild its reserves.**

Figure 2.1

Operating balance

£ million (current prices)

Dark blue is outturn, blue is projected balance and light blue is forecasts from GP2024-2027P

Source: Treasury and Exchequer

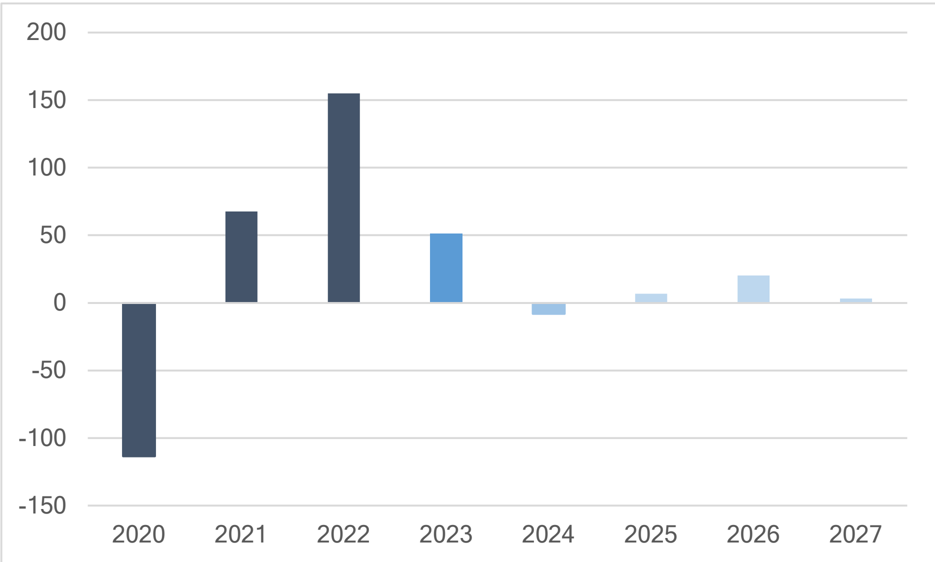


Figure 2.2

Revenue income, revenue expenditure and operating and primary balances, Government Plan 2023-2026 versus Government Plan 2024-2027

£ million (current prices)

Source: Treasury and Exchequer

	2023	2024	2025	2026	2027
General Revenue Income					
GP23	1,076	1,163	1,193	1,234	
GP24		1,194	1,247	1,283	1,329
Difference		**31**	**54**	**50**	
Revenue Expenditure					
GP23	985	1,091	1,133	1,153	
GP24		1,146	1,183	1,206	1,268
Difference		**56**	**50**	**52**	
Operating balance					
GP23	35	15	2	22	
GP24		-8	7	20	3
Difference		**-24**	**5**	**-2**	
Primary balance (excluding Our Hospital and NHF)					
GP23	-65	-22	-3	28	
GP24		-53	-27	12	1
Difference		**-31**	**-24**	**-16**	

The measure differs from the 'primary balance', which is used in the fiscal framework. The primary balance differs from the operating balance in two ways:

1. It includes capital spending and excludes depreciation, thus it includes a better estimate of the true cost of maintaining a modern public capital stock.
2. It excludes investment returns and borrowing costs whereas the operating balance includes both borrowing costs (for the revolving credit facility, refinancing pension liabilities, any borrowing for the New Healthcare Facilities and the housing bond) and some investment returns (on the Consolidated Fund and Currency and Coinage Fund).

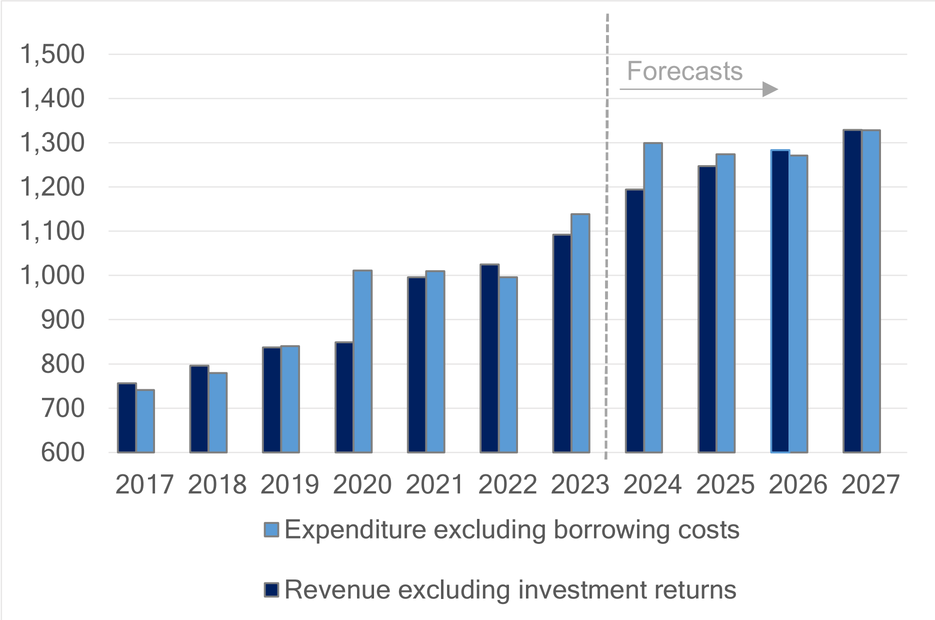
Overall, the primary balance is a better measure of fiscal stance since capital spending is a necessary part of the government budget and must be financed. **Figure 2.** sets out recent outturns and a forecast to 2027 for the primary budget position. This has been calculated as revenue (excluding investment returns) minus current and capital expenditure (excluding borrowing costs) and excludes depreciation.

Figure 2.3

Income and expenditure forecasts (primary budget)

£ million (current prices)

Source: Treasury and Exchequer



The primary budget balance is expected to be in deficit in 2024 and 2025. The primary budget deficits have been, and will continue to be, financed from a mixture of existing reserves and borrowing. Once the New Healthcare Facilities financing plan is developed, this is likely to widen the primary budget deficit, if growth in revenue expenditure is not reduced. The Panel is disappointed that the primary budget balance is expected to be in deficit in spite of strong growth in revenues and recommends a move to a primary balance surplus. This move should not be achieved through cuts to the capital programme.

The 'States Grant' is an annual transfer to the Social Security Fund from the Consolidated Fund to support the funding of old age pensions and some working age benefits. The Social Security Fund receives this grant as well as contributions received from employers, employees and the self-employed. The aggregate value of this transfer is calculated using a formula set out in law, though the States Assembly suspended this from 2020 to 2023. This year's Government Plan proposes to re-instate the States Grant. However, it will be phased in and supplemented by injections worth £40 million over 2024 and 2025 from the Social Security Reserve Fund. The Social Security Reserve Fund will then be repaid in 2027 when the public finances are expected to be in a better position.

Whilst the Government Plan identifies some cashable savings (discussed in Section 2.2.1) in 2024, it includes growth in revenue expenditure of £47.5 million above the additional £70 million provided for inflation to maintain departmental budgets in real terms. This excludes capital spending.

The Panel's central forecast is for Jersey's economy to continue to grow, with growth driven by sustained financial sector profits. Jersey's economy continues to operate at full capacity and so **the Panel continues to advise that the Government should run a primary surplus with surpluses generated being used to improve the Government of Jersey balance sheet.**

Any surpluses should be used to pay off short-term debt, rebuild the Stabilisation Fund (to enable fiscal policy to be more counter-cyclical if needed) or improve the Strategic Reserve balance (in that order). Whilst the Government Plan allows for some transfers to the Stabilisation Fund, these are not formally included in the Government Plan. Instead, any transfers to the Stabilisation Fund are predicated on the availability of funds through additional income or unspent approvals at the end of 2023 and 2024. **The Government should include a commitment to generate surpluses and make these transfers**. The Stabilisation Fund and Strategic Reserve are considered further in following sections.

2.2.1 Value for Money

The Government Plan continues its Value for Money programme through the following:

1. Cashable Savings Targets and delivery plans for each department.
2. A continuous improvement framework.
3. A series of focussed thematic reviews and best value deep-dives.

The Government Plan includes a detailed departmental breakdown for £10 million of cashable savings for 2024 with further savings of £10 million in 2025 and 2026 included but not identified. The Panel's previous recommendation to maintain realistic and timebound targets for all savings and to not include unspecified future savings still holds.

2.2.2 Revenue Forecast

The Government Plan is based on a revenue forecast that is around £30 million higher for 2024 than forecast in the previous Government Plan (**Figure 2.4**). There are also further increases in the revenue forecast beyond 2024. The revenue forecast is conditioned on the FPP economic forecast from July 2023.

Much of the increase in revenue in 2024 comes from income tax (personal and corporate) (+£17 million), and GST (+£10 million) and other income (+£26 million), with downward revisions to stamp duty (-£18 million) and impôts (-£8 million).

Figure 2.4

General revenue income forecast

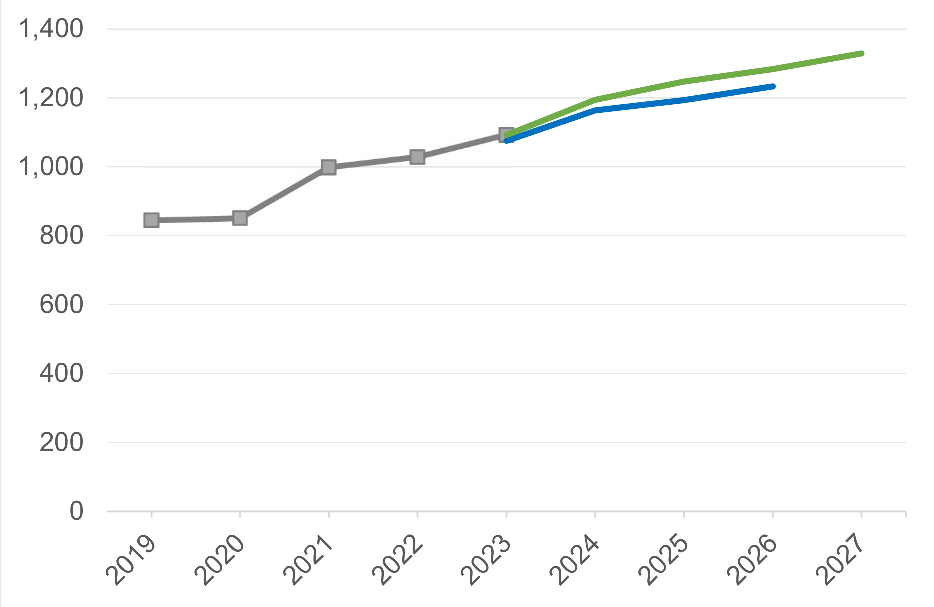
£ million

Green line is Government Plan 2024-27

Blue line is Government Plan 2023-26

Grey line is outturn

Source: Treasury and Exchequer



2.2.3 Budget proposals

The Government Plan includes additional budget proposals from 2024 onwards. These are forecast to reduce the initial revenue forecast by under £4 million in 2024. However, the Plan also more than doubles the value of collections from domestic compliance from £15 million to £31.5 million. No further detail is provided. The Panel's view is that the Government should ensure that the proposed increase in these collections is feasible and realistic before being incorporated in the spending profile.

Figure 2.5

Government Plan revenue forecast and measures in 2024-2027

£ million, total revenue

Source: Treasury and Exchequer

	2024	2025	2026	2027
Income Tax	843.0	884.0	916.0	957.0
GST	121.0	124.0	127.0	131.0
Impôt duties	73.2	75.6	75.1	74.7
Stamp duty	39.8	45.6	55.5	58.0
Other income	89.6	89.8	80.9	78.8
Central scenario - IFG	1,166.6	1,219.0	1,254.5	1,299.5
Domestic Compliance	31.5	31.5	31.5	31.5
Budget measures	- 3.7	- 3.2	- 2.6	- 2.1
General Tax Revenue	1,194.3	1,247.3	1,283.4	1,328.9

2.2.4 Capital

The Government Plan sets out a plan for over £400 million of capital spending over the four-year period, excluding any spend on the New Healthcare Facilities. The Government presented the Council of Minister's preferred option to deliver new health and care facilities under a phased approach in July 2023. The spending profile is expected to cost no more than £710 million, with £52 million in borrowing for 2024 included in the current Government Plan for approval. A funding strategy for the full costs of the acute facility under phase 1 of the project will be presented in a proposition to the States Assembly in summer 2024. It is anticipated that any borrowing will be held in the Strategic Reserve with disbursements made to the Consolidated Fund as required. It is worth noting that the interest and bond market environment is now less favourable to large scale borrowing than two years ago.

Capital spending is largest in 2024 at £123 million (including trading funds) and decreases gradually to £80 million in 2027 (**Figure 2.6**). The Panel notes that this profile of spend remains within the range that the Government considers feasible to deliver. Capital spend is important as it addresses long-term challenges, though the Government should recognise the risk to delivery that Jersey's tight labour market poses. The scale and profile of capital spending will inevitably change depending on the scale of recovery needed following Storm Ciarán and also as plans for the proposed New Healthcare Facilities are developed. As explored in **Section 1.2**, greater certainty of the scale and pipeline of construction projects should benefit the construction sector.

The main areas of spending in 2024 relate to Estates (£45 million), Infrastructure (£30 million) and Information Technology (£20 million). The largest individual areas of spending / projects include:

- Infrastructure Rolling Vote and Public Realm (£19 million in 2024)
- Upgrades to the CYPES estates (£10.7 million in 2024, of which £5.8 million relates to school improvements)
- Jersey Opera House (£5.5 million in 2024)
- Digital Care Strategy (£5.3 million in 2024)
- Liquid Waste Key Infrastructure (£5.2 million in 2024)

The majority of these have been designated as 'major projects' and therefore will span multiple years.

Figure 2.6

Capital spending

£ million

Source: Treasury and Exchequer

Capital programme area	2023	2024	2025	2026	2027	Total 2024 - 2027
Feasibility	-	2	1	1	1	4
Estates	-	46	48	33	32	159
Infrastructure	-	30	33	24	23	110
Information Technology	-	20	10	10	8	48
Replacement Assets and Minor Capital	-	11	13	10	10	44
Community Fund	-	0	0	0	0	0
Reserve for Central Risk and Inflation	-	5	1	1	0	7
Funds	-	10	7	7	6	29
Total exc. New Healthcare Facilities	120	123	113	86	80	402
New Healthcare Facilities	52	52	0	0	0	52
Total with New Healthcare Facilities	172	175	113	86	80	454

Figure 2.7

Capital spending - outturn and forecast

£ million (current prices) including trading operations and subsidiary companies

Dark blue bar is outturn

Light blue bar is most recent forecast before outturn from previous GPs and Budgets and GP2024-2027 forecasts

Source: Treasury and Exchequer

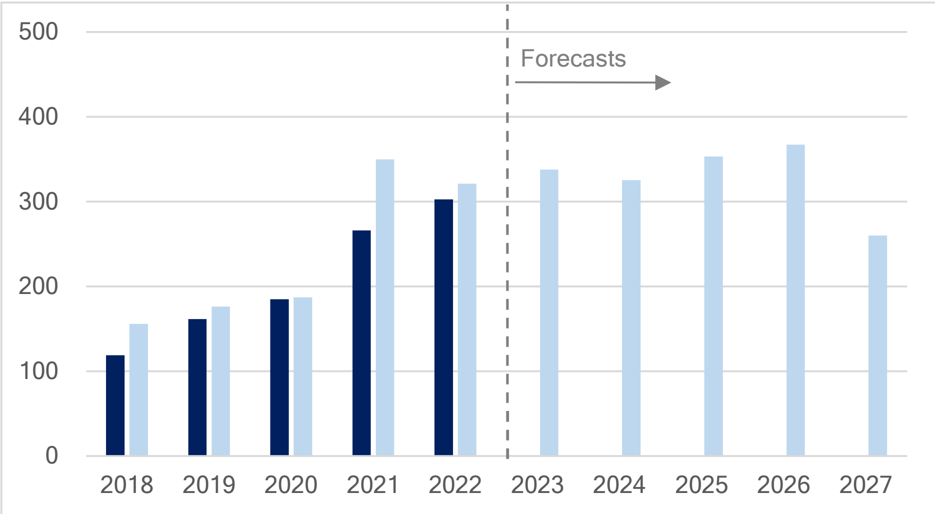


Figure 2.7 considers the performance of forecast versus outturn for capital spending for the Group, which includes capital spending by Andium Homes, Ports of Jersey and the States of Jersey Development Company. In 2022, capital spending across the Group was £302.5 million, of which Andium Homes was £105 million. The outturn is slightly lower than the forecast of £321.2 million. It is important to note that approval for capital spending by Andium Homes, Ports of Jersey and the States of Jersey Development Company sit outside of the Government Plan approval.

2.3 The adjusted fiscal position

The Panel's reports also consider whether the overall fiscal position supports the economy, i.e. how much demand government is putting 'into the economy' through current and capital expenditure; and how much government is 'taking out' of the economy in taxes and contributions.

Overall, as outlined in the previous sections, the Government is continuing to provide significant further stimulus to an already overheating economy. This carries with it the risk of creating or exacerbating capacity pressures in some sectors, the crowding out of private sector investment and/or the risk of diverting expenditure off-Island. This expenditure also reduces the budget surplus that could be used to strengthen reserves and improve resilience to future downturns.

The economic assumptions detailed in **Section 1.7** anticipate that real economic growth will begin to slow from 2025 to 2026. This means that fiscal policy may need to be procyclical during later years of the Plan as government net spending starts to plateau in 2025 before falling in 2027 (**Figure 2.8**), and a further reason why it would be prudent for the Government to pursue a counter-cyclical fiscal policy now. The Panel would have expected the

Government to be making significant transfers to the Stabilisation Fund, which is Jersey's main tool for counter-cyclical fiscal policy.

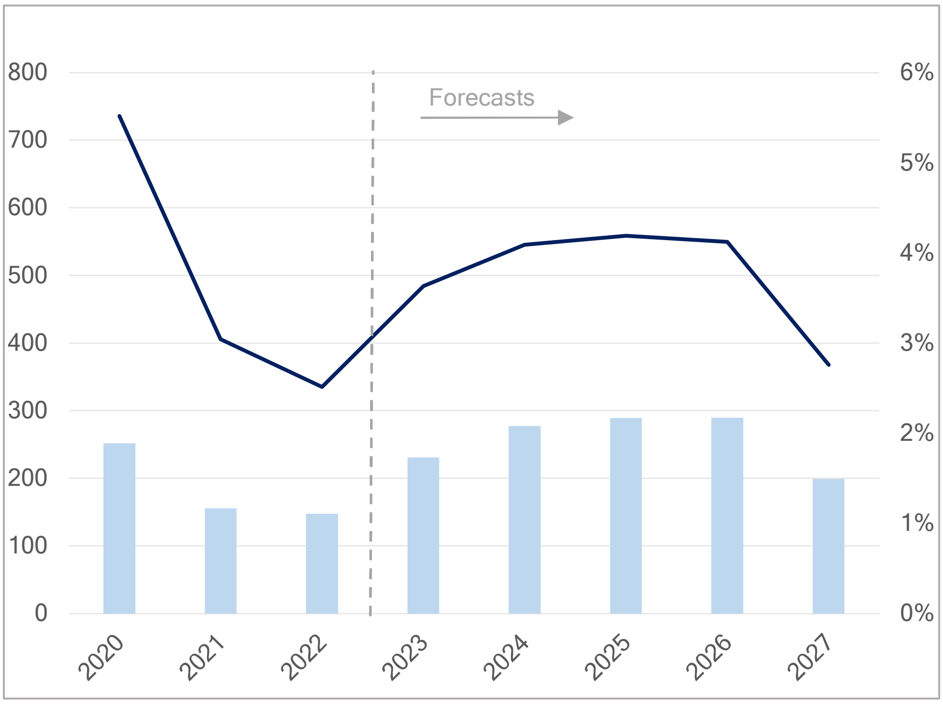
Figure 2.8

Adjusted fiscal position

Light blue bars represent total government net spending into the economy including expenditure and Group capital subtracting receipts (£ million)

Dark blue line is spending as % of GVA

Source: Treasury and Exchequer



2.4 Flexibility

The Government of Jersey does not have an independent monetary policy and so can only use fiscal policy – government spending and taxation – to manage overheating (and conversely sluggish growth) in the economy. Government should in the first instance allow the automatic fiscal stabilisers to work. However, these are smaller than other countries due to Jersey's relatively low marginal tax rates and because Jersey's personal tax base is less cyclical than other jurisdictions (see **Section 3.2.1** of the Panel's 2022 Medium-Term Report).

Together with the recommendation for the Government to pursue a counter-cyclical fiscal policy, **the Panel advises the Government to avoid protecting spending or creating binding spending targets for certain policy areas. This will reduce the Government's ability to deliver public services that are value for money, to build up reserves or respond to any further economic or fiscal shocks.**

2.5 Net asset position

The Fiscal Framework guidelines state that government should seek to increase public sector net worth, i.e. the overall net asset position including both physical assets and net financial assets. This is a key objective for achieving fiscal sustainability in the long term. Further, the Public Finances Law requires the Panel to comment on the sustainability of public finances in light of the States' financial assets and liabilities.

Figure 2. sets out how the net asset position will change over the 2024-27 Government Plan period. The forecast includes balance sheet forecasts for the subsidiary companies (Andium Homes, Ports of Jersey and States of Jersey Development Company).

Figure 2.9

Net asset position

£ billion (current prices) and as a percentage of GVA

Source: Treasury and Exchequer

	2020	2021	2022	2023	2024	2025	2026	2027
Physical assets	4.0	4.2	4.5	4.6	4.8	4.8	4.8	4.8
Net financial assets	3.7	3.9	3.5	3.5	3.5	3.5	3.8	4.0
Total	**7.6**	**8.1**	**7.9**	**8.1**	**8.2**	**8.4**	**8.6**	**8.8**
as % of GVA								
Physical assets	88%	83%	76%	73%	70%	70%	69%	67%
Net financial assets	80%	76%	59%	55%	51%	51%	54%	55%
Total	**168%**	**159%**	**135%**	**127%**	**121%**	**122%**	**122%**	**122%**

The net asset position is forecast to stabilise at around 120% of GVA. In 2019, net assets as a percentage of GVA were around 150%; it was temporarily higher in 2020 as net assets remained stable whilst GVA was lower due to the pandemic. In 2022, the value of net financial assets fell due to unrealised investment revaluation losses. From 2023, the value of net assets continues to grow, but does not keep up with nominal GVA growth. The net asset position may change in the future if borrowing is required for the New Healthcare Facilities project or indeed, for capital spending.

Financial principle 7.1 commits the Government to preserving the net asset value. This should be considered not only in terms of the nominal value of net assets, but in terms of their real value and in relation to the size of the economy.

Financial assets are held in funds including the Strategic Reserve, Consolidated Fund, Stabilisation Fund and a number of 'Social Security Funds'. Over the Government Plan period, the aggregate value of these funds as a percentage of GVA is growing but will remain low (Figure 2.10) compared to the position at the end of 2019 where the size of reserves stood at 74% of GVA.

Figure 2.10

Reserves

Size of selected funds, balance at end of year (£ million)

Source: Treasury and Exchequer

	2023	2024	2025	2026	2027
Consolidated Fund	95	38	3	9	2
Strategic Reserve	1,032	1,071	1,113	1,158	1,206
Stabilisation Fund	1	1	1	1	1
Social Security Reserve Fund	2,047	2,136	2,230	2,351	2,520
Social Security Fund	89	95	109	120	129
Health Insurance Fund	111	108	105	103	103
Long Term Care Fund	56	61	68	76	86
Total	3,430	3,509	3,628	3,817	4,047
Total reserves as % of GVA	*54%*	*52%*	*53%*	*54%*	*56%*
Debt as % of GVA	*13%*	*13%*	*13%*	*12%*	*12%*

2.5.1 Stabilisation Fund

The Stabilisation Fund was created in 2006 to help smooth the economic cycle. The Fund should receive transfers in when the economy is performing well (when it is 'above trend'), and then "pay out" to support government spending when economic conditions are worse, or when the economy is 'below trend'.

In 2020, given the prevailing economic conditions and protracted period below trend, the Government transferred nearly all of the balance of the Stabilisation Fund to the Consolidated Fund. Just £0.6m was left in the Stabilisation Fund.

The ability to draw on the £50 million of past surpluses in 2020 was valuable and demonstrates the importance of the Stabilisation Fund in supporting countercyclical policy in Jersey.

The Government Plan does not commit to any transfers to the Stabilisation Fund but seeks approval for up to £25 million in 2024 to be transferred to the Fund, subject to the availability of funds. As such, this has not been incorporated into the forecast for the Fund's balance. **The Panel strongly recommends that this commitment is strengthened and incorporated into the Government Plan.**

2.5.2 Strategic Reserve

The Strategic Reserve is governed by legislation setting out that it may only be used in exceptional circumstances to insulate the Island's economy from severe structural decline such as the sudden collapse of a major Island industry or from major natural disaster. The devastation caused to parts of the Island from Storm Ciarán has highlighted the importance of maintaining these fiscal buffers in the event of a disaster. The frequency and scale of such events may become more acute with climate change.

In 2019, the Panel assessed that a Strategic Reserve of between 30% and 60% of GVA would be prudent to enable the Strategic Reserve to meet its objectives. This was based on the experience of similar crises in other countries. The Strategic Reserve is forecast to remain significantly below this over the Government Plan period. The Panel calculates that the Strategic Reserve should sit at £2,900 to £4,300 million by 2027 compared to the current forecast balance of £1,206 million or 17% of GVA (**Figure 2.11**).

The Government Plan includes no plans to rebuild the Strategic Reserve. The Panel has previously recommended to the Government to explore options to rebuild the Strategic Reserve, including using receipts from the Prior Year Basis (PYB) debt, to build up the Strategic Reserve and improve the Government's balance sheet. However, this alone would not be sufficient to the meet the 30% to 60% threshold. The Government estimates that £305 million of the PYB debt is outstanding with taxpayers offered a choice of payments plans.

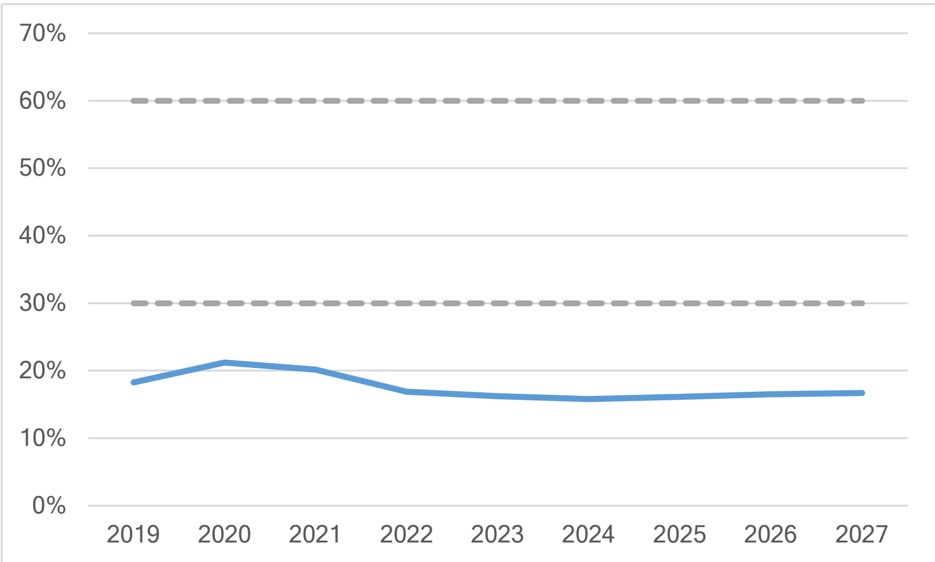
Indeed, the Panel notes that PYB income is currently incorporated into the Consolidated Fund's balance and used to partially finance capital spending and has not been allocated to the Strategic Reserve.

Figure 2.11

Strategic Reserve

Strategic Reserve as % of GVA (blue line). Dotted lines represent the FPP's recommended levels.

Source: Treasury and Exchequer



2.5.3 Social Security Fund / Social Security Reserve

The Social Security Fund and Social Security Reserve Fund have been built up over the last 20 years with the intention of smoothing the impact of future pension needs. They are expected to have a combined value of over £2.1 billion at the end of 2023 and represent the majority of Jersey's financial assets. The reserve has been built up predominately through returns on investment and surpluses in the Social Security Fund – due to contributions being collected at a rate higher than the 'break-even' rate.

Capital investment of £9.4 million for the new transformational benefits system will be completed in 2027.

The actuarial review for the Social Security Fund was completed in May 2023. It concluded that the Fund remains in good health under higher migration scenarios and under the current contribution rates and States Grant provision. Migration scenarios such as net nil migration and +325 net migration will cause the Funds to be exhausted in 40 to 60 years, as the pensioner population is expected grow faster than working-age individuals. It is likely that the Government will need to increase the retirement age and/or social security contribution rates in the future if it continues to see low levels of net migration.

The objective of the Social Security Fund will, according to the Government Plan, be considered in the future.

Figure 2.12

Social Security Fund income and expenditure

£ million, excludes transfers to/from Social Security Reserve

Source: Treasury and Exchequer

	2024	2025	2026	2027
Contribution and other income	253	262	270	277
States Grant	58	69	89	130
Transfer from Social Security Reserve	20	20		-40
Benefit expenditure	- 320	- 335	- 345	- 357
Capital investment	- 4	- 2	- 2	- 1
Surplus	6	14	11	9

2.5.4 Health Insurance and Long-Term Care Funds

The actuarial reviews for the Health Insurance Fund and Long-Term Care Fund were completed in May 2023.

The Health Insurance Fund mainly subsidises services provided through GP surgeries and community pharmacies and provides for free prescriptions and is currently funded through allocations from social security contributions and to a lesser extent investment income. It is expected to hold £111.4 million at the end of 2023. The actuarial review for the Fund showed that without any policy changes, it will be exhausted by the late 2030s but subsequent policy changes mean that the Fund is likely to be exhausted by mid-2030s.

The Long-Term Care Fund provides universal and means-tested benefits to individuals with long-term care needs and is currently funded through taxpayer contributions and supplemented by an annual States Grant. It is expected to hold £55.6 million at the end of 2023. The actuarial review for the Fund concluded that the Fund will be able to fund the current long-term care scheme until the late 2030s.

The actuarial reviews for the Health Insurance Fund and Long-Term Care Fund show that the exhaustion of the Funds is projected to occur well before the end of the demographic transition that they are designed to mitigate.

The Panel understands that following a review of Jersey's health and care system, a Public Health Strategy will be published in 2024 with options being developed to consider the future funding and financing options for Jersey's health and care needs by 2027. Given the outcomes of the actuarial reviews of the Health Insurance and Long-Term Care Funds, the Public Health Strategy will be critical in determining a sustainable future for these Funds.

2.5.5 Consolidated Fund

The Consolidated Fund can be considered as the Government's current account to which all tax revenues are received and from which all expenditure is paid out. The Government Plan partially finances capital spending using balances in the Consolidated Fund. The balance is forecast to fall to a low of £1.8 million at the end of 2027 (**Figure 2.13**).

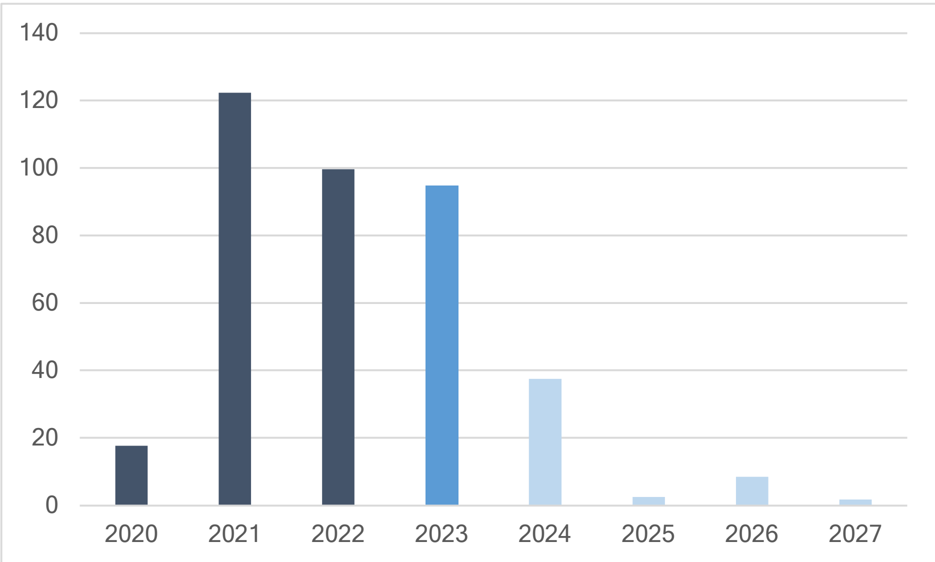
Figure 2.13

Consolidated Fund end of year closing balance

£ million

Dark blue is outturn, blue is projected balance and light blue is forecasts from GP2024-2027

Source: Treasury and Exchequer



2.6 Borrowing

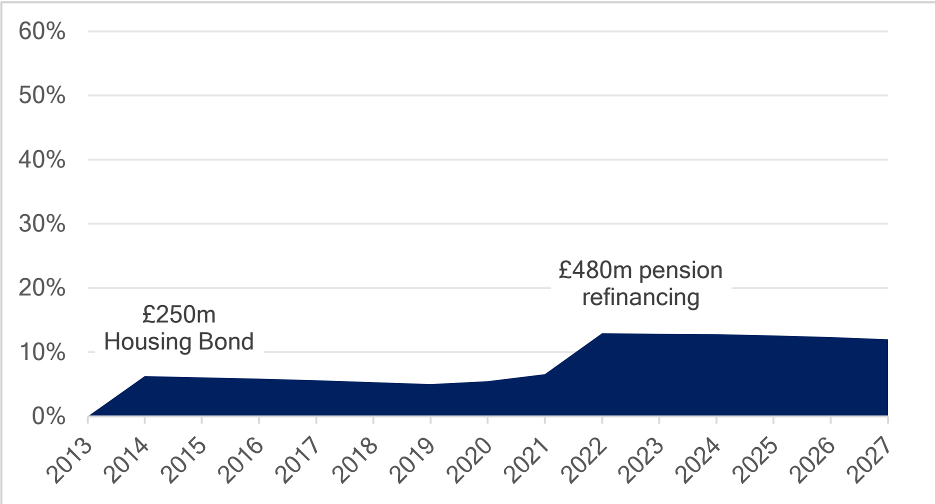
Since the Panel's 2022 Annual Report, the Government has repaid the Covid-19 borrowing, reducing the Government's debt portfolio to £762 million or 13% of GDP. The previous Government Plan approved borrowing for £90 million for healthcare facilities in 2023; further approval is sought in the current Plan for £52 million, under the Revolving Credit Facility, for the New Healthcare Facilities project. Although it is anticipated that the project will not cost more than £710 million, the funding strategy is due to be developed in 2024 and is not accounted for in the forecast for Jersey's debt-to-GDP ratio in **Figure 2.14**.

Figure 2.14

Debt as a proportion of GDP

Borrowing highlighted in the chart

Source: Treasury and Exchequer



2.7 Panel's previous recommendations

The Panel made several recommendations in November 2022's Annual Report. The Panel is pleased that a number of these recommendations have been adopted and encourages progress against the rest.

However, the recommendation to build reserves through transfers to the Stabilisation Fund or Strategic Reserve has not been followed. The Panel has reiterated this recommendation in this report.

1. **Fiscal Strategy**. The Panel previously advised that fiscal strategy needs to steer a careful course between avoiding a sharp downturn and not overheating the economy. The Panel is supportive of targeted support for those most affected by the changing economic conditions but had recommended that the revenues from strong growth were also used to build up reserves. The Panel also recommended that capital projects should go ahead as planned, however, greater certainty in the capital spending pipeline will benefit the wider economy, in particular, the construction sector. The Panel looks forward to the publication of 25-year capital investment outlook in 2024.

2. **Fiscal spending**. The economy has performed well with little spare capacity and unemployment at historically low levels. The Panel advised reductions to "growth" expenditure and a strengthening of reserves. Together with inflation-driven increases to departmental budgets, the Government Plan includes further "growth" expenditure of £47.5 million in 2024. Further growth expenditure is undesirable.
3. **Inflation.** The Panel previously noted the impacts of the package of measures introduced in Jersey's mini-budget. The Panel also advised the Government to prepare to react quickly again to provide additional targeted support. Inflation has peaked and is forecast to fall steadily. However, prices will be higher than they were, affecting some households more than others. With many mortgage holders remaining on low fixed rates the full effect of the interest rate rises has not been felt.
4. **Funds.** The Panel notes that the outstanding Covid debt was paid off in 2022 and further work will be done to consider how Prior Year Basis liabilities can be used to increase the Funds' balances. However, the Government should not delay any decision to the approach and delivery of such a transfer beyond 2024.
5. **Objectives of Funds.** The Government has noted further work will be done to ensure objectives for the Funds are clear and that policies are adjusted in line with objectives. The Panel looks forward to reviewing the outcomes of this exercise.
6. **Capital programmes**. The Panel previously noted that care should be taken to ensure that major capital projects do not overlap, and consideration should be given to identifying smaller projects which could be paused or implemented quickly to support the economy. The Panel advises that these considerations are taken into account when designing the 25-year outlook for project investment.
7. **Value for Money.** The Government Plan includes Value for Money targets for 2024 that look are realistic and achievable. However, unspecified measures have been included for 2025 and 2026. As these savings are netted against high growth and inflation expenditure, it remains the advice to the Government that including unspecified savings is unwise as they may lead to pressures in later years if the savings are not found.

8. **Net zero.** The Panel noted that the Climate Emergency Fund would not be sufficient to finance the transition to net zero, and that careful use of both taxes and expenditure will be required to create the right economic incentives. The Panel looks forward to seeing the proposals for the Carbon Neutral Roadmap Long-Term Financing Strategy in 2024.

In addition to the above recommendations, the Panel commented on the long-term sustainability of the Jersey Teachers Superannuation Fund. The Panel notes the actuarial review's findings into the health of the Fund and has no further comments.

The Panel also notes the update made to the Technology Accelerator Fund. The Fund was created in 2022 with an endowment of £20 million from the £40 million extraordinary dividend from Jersey Telecom. The programme, now called Impact Jersey, launched with its first Open Programme awarding grants in 2023. Working with Digital Jersey, a revised spend profile was agreed and enables some monies to be transferred into the Consolidated Fund to fund investment in the Government Digital Services Platform. A 3-year programme of £12.5 million expenditure is now forecast with a review in 2026 to assess the next phase of the programme.

2.8 Future fiscal considerations

The Government has set out several areas for consideration in 2024 that could affect public finances. These include the long-term financing strategy for the carbon neutral roadmap, liquid waste changes and taxing vaping products. The Government plans to conduct a stamp duty review and to consider policies on fuel duty replacement in 2024. A 25-year outlook for project investment will be published in 2024. The Panel looks forward to reviewing these in due course.

2.9 Long-term fiscal considerations

There are other fiscal considerations over the long-term which the Government should consider. These are:

- Expert analysis produced for the States Assembly in 2019 suggests achieving net zero by 2030 would cost between £60 million and £360 million. The funding strategy for the Carbon Neutral Roadmap will be included in the next Government Plan. **The Climate Emergency Fund will not be sufficient to finance the transition to net zero. The Funding Strategy will need to consider careful use of both taxes and expenditure to create the right economic incentives to deliver net zero.**

- Ageing demographics will likely lead to higher expenditure on health and may require more financial support where individuals have not saved sufficient money into a pension or through other means. **The Government should consider the future impacts of the ageing population on fiscal expenditure.**
- High inflation and rising interest rates will provide increased revenue but also place pressure on pay and non-pay expenditure. In the medium-term the Bank Rate is unlikely to return to the historic lows seen over the past decade and will therefore increase Government's borrowing costs. **The Government should consider the funding strategy of major capital projects over the medium and long-term.**

Appendix

Output gap

The output gap represents the difference between the current level of output in the economy and the potential level the economy could sustain without putting upward or downward pressure on inflation. Trend output depends on the levels of labour, capital and productivity and is commonly used to measure spare capacity or overheating in the economy.

Whilst the output gap is not directly observable, it can be estimated using a range of data. Principal Component Analysis (PCA) identifies a common determinant among several cyclical indicators including earnings data, vacancies data, employment and ASW rates, and BTS indicators. The Panel uses this common determinant as an indicator of the degree of spare capacity in the economy and therefore the output gap.

The interpretation of output gaps continues to be particularly difficult and the Panel has not updated its approach to the output gap in light of the current financial conditions. Figure A.1 shows the results of the PCA output gap estimate and shows that capacity within Jersey's economy remains tight. Whilst there is some uncertainty around this analysis, the Panel's view is that Jersey should plan on the basis of limited spare capacity across the next Government Plan period.

Figure A.1

Output Gap estimate based on PCA

Blue line is Principal Component, green line represents the zero line and grey swathe is the minimum and maximum of the scaled series used in PCA.

Sources: Statistics Jersey, Government of Jersey, Panel calculations