JERSEY'S FISCAL POLICY PANEL

Annual Report

November 2022

Introduction

This is the fifteenth 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 global macroeconomic outlook remains weak. Global growth forecasts have been revised down amidst rising inflation.
- Jersey has, so far, been somewhat insulated from much of this shock. This is due to the positive impact of rising interest rates on some parts of the financial sector and the robust growth that was underway before the shock hit. Inflation remained muted for much of the year but has risen in recent months.
- The Panel's forecasts for economic growth remain broadly similar to those produced in July 2022 with a near-term period of stronger growth mainly attributable to accelerated growth in financial services profits reflecting higher interest rates. Inflation is forecast to peak in early 2023 but to remain high through 2023.
- Evidence from the labour market and businesses suggests that the economy recovered well from the Covid-19 pandemic. The number of people registered as actively seeking work, a measure of unemployment, remains at the lowest levels seen since comparable figures began in 2008, the number of jobs is back to pre-covid levels and vacancy rates are high. This points to a labour market at, or close to, full employment.
- A lack of spare capacity has become a pervasive feature of Jersey's economy. Several sectors are likely to be constrained over the Government Plan period. The construction sector faces a shortfall of workers and materials, while accommodation and restaurant operators report difficulties in recruiting staff.
- Business activity in the non-finance sector is currently strong but optimism has waned since June.
- Overall, it appears that Jersey's labour market has been resilient to the global shocks and the economy overall remains in a good position to weather them. These shocks represent a short-term risk to the economic recovery and have had an uneven impact on different households.
- Looking further ahead, there are several important risks to be mindful of including: an ageing population, productivity challenges and the impact on households of interest rate rises. These face the Jersey economy over a range of time horizons.
- Lack of affordable housing poses a risk to economic growth and productivity. There is a risk of reduced migration of key workers as the high cost of housing makes the island less attractive to potential migrants.

Public Finances

- Higher interest rates and earnings growth will likely lead to an upwards revision to the income forecasts. On the basis of current spending commitments, there will be a surplus in all years of the Government Plan. Given the strong labour market, and evidence of low spare capacity, it is currently appropriate to run significant surpluses over the 2023-2026 period. Though a worsening in the global economic background remains a risk.
- Across the board additional spending and tax cuts pose a concern to the future sustainability of Government finances and will limit the ability of the Government to provide targeted support or fiscal stimulus quickly should the economic outlook deteriorate.
- Jersey's net asset position as a percentage of Gross Value Added (GVA) has declined since the last Government Plan, falling from 167% of GVA in 2020 to 119% of GVA by the final year of the plan.
- The Stabilisation Fund is much depleted, and the Strategic Reserve balance is forecast to decline as a share of GVA and is well below the level recommended to meet a major crisis.
- The Social Security Reserve Fund is strong although this will be put under pressure by an ageing population, particularly if a zero or low migration target is pursued.
- A wide range of risks to Jersey's fiscal position remain including uncertainty around future financial investment returns and challenges around an ageing population.

Summary of recommendations

1. Fiscal Strategy. The economy has grown strongly but global conditions are clearly worsening. The fiscal strategy needs to steer a careful course between avoiding a sharp downturn and not overheating the economy. Such a course is not easy to judge but the current strong fiscal position provides an opportunity for the Government to rebuild reserves and to provide targeted support for those most affected by the changing economic conditions. Capital projects should go ahead as planned. Government should ensure that other spend undergoes economic impact appraisal and that it is appropriately scheduled to minimise the risk of overheating the economy.
2. Fiscal spending. The economy remains strong with little spare capacity and unemployment at historically low levels. The Medium-Term Report argued that this was not the time for significant across the board additional spending or tax cuts. This remains the case. It would be prudent to reduce "growth" expenditure in the early years of the Plan to strengthen reserves which may be required in future years.
3. Inflation. Alongside the overall picture, some households will be more adversely affected from high and rising inflation and from rising interest rates. Government should prepare to react quickly again to provide additional targeted support should it be needed and to offset any short-term risk to consumption.
4. Funds. Looking further ahead, long-term risks remain and Government should increase the balances of both the Stabilisation Fund and the Strategic Reserve. The Panel re-iterates its recommendation from the summer: with the Covid debt being paid off this year, it would be prudent to allocate surpluses and receipts from Prior Year Basis liabilities to increase the Funds' balances.
5. Objectives of Funds. The Government should ensure objectives for the Funds are clear and should adjust policies in line with objectives. This will be particularly relevant after the actuarial review of the Social Security Funds.
6. Housing. The cost of housing remains a risk to economic growth. This should be addressed as a priority and consistent with the Government's strategic aims. Interventions which boost short-term housing demand and support prices artificially are not desirable.
7. Capital programmes. The Government Plan addresses the historic tendency to submit overly-ambitious timetables for capital projects. 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.

8. **Value for Money.** The Government Plan includes Value for Money targets for 2023 and 2024 that look are realistic and achievable. However unspecified measures have been included for future years. Speculative measures should not be included in the Government Plan. They may lead to pressures in later years if they are subsequently not found.
9. **Net zero.** The Climate Emergency Fund will not be sufficient to finance the transition to net zero which will require the careful use of both taxes and expenditure to create the right economic incentives. The government should consider the strategy for financing these challenges.

The Economic Outlook

1.1 International outlook

1.1.1 World Growth

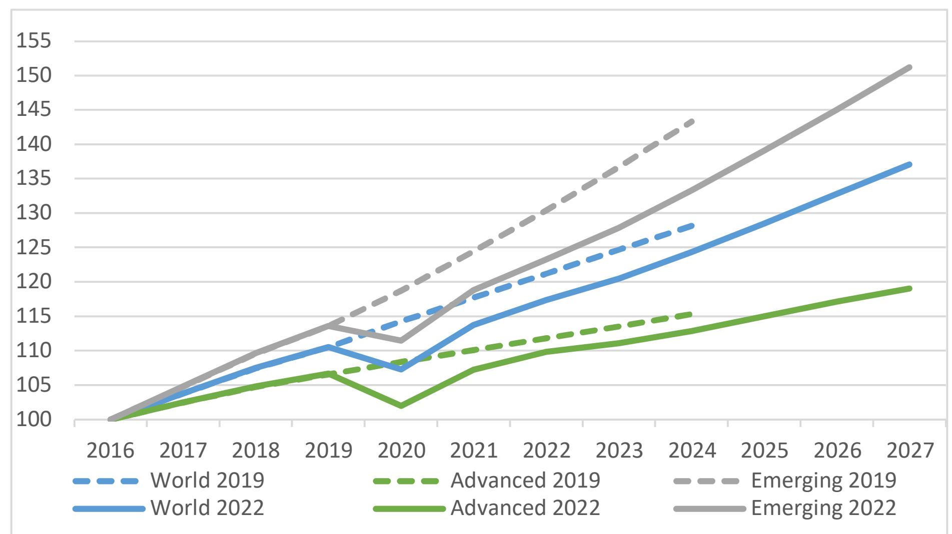
Since the Medium-Term Report in July 2022, the outlook for global growth has worsened. Whilst most countries experienced strong growth in 2021 as their economies recovered from the pandemic (**Figure 1.1**), growth has begun to slow in most major economies

Figure 1.1

Real GDP, 2016 - 2022, 2016 = 100

Index of real GDP, 2016 - 2022, October 2019 estimates/forecasts and October 2022 estimates - dotted lines show October 2019 estimates/forecasts

Sources: International Monetary Fund World Economic Outlook



Rising inflation, driven by the ongoing conflict in Ukraine and supply chains that remain disrupted by Covid is reducing household consumption and affecting business investment. Together with reduced demand from China, this is set to have a continued negative impact on global growth. Growth in the US is expected to continue to slow in 2022 and 2023, due to a range of factors including inflation (which is leading to a tightening of monetary policy) and supply chain disruptions. The impacts of President Biden's 'Inflation Reduction Act' are yet to be seen but will likely stimulate US domestic growth.

Growth in both the Eurozone and the UK is slowing. Rising energy prices (because of the conflict in Ukraine) are feeding through to inflation. This, coupled with monetary policy tightening to control inflation, is affecting growth.

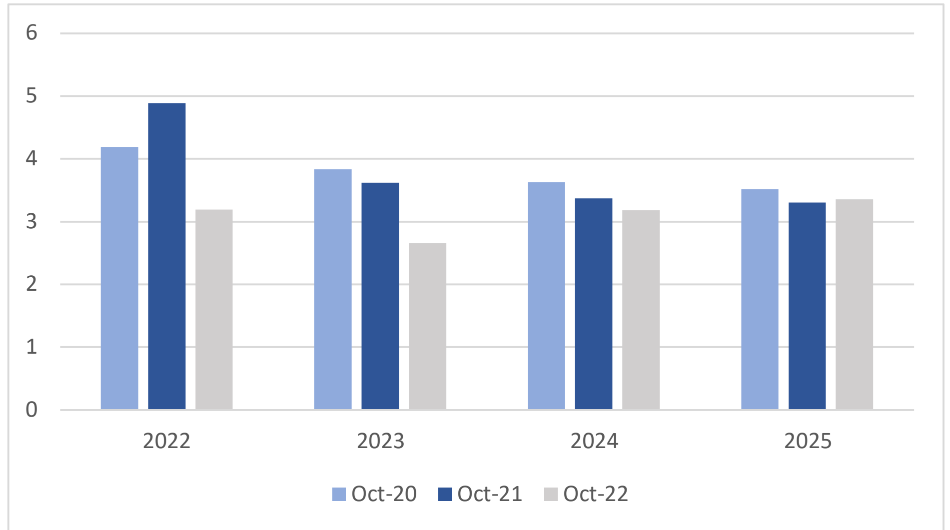
In light of these challenges, the International Monetary Fund (IMF) has revised down its forecasts for global economic growth in the coming years. **Figure 1.2** below shows the forecasts for rate of growth of the world economy (in terms of real Gross Domestic Product (GDP) for the years 2022-2024 in successive IMF forecasts. After being revised up from 4.2% to 4.9% between October 2020 and October 2021, the forecast for growth in 2022 was reduced to 3.2% in October 2022. The forecast for 2023 was also revised downwards.

Figure 1.2

Forecasts of global real GDP growth, 2022 - 2024

Forecasts of global real GDP growth, 2022 - 2024, October 2020, October 2021 and October 2022 projections

Sources: International Monetary Fund World Economic Outlook



1.1.2 UK Growth

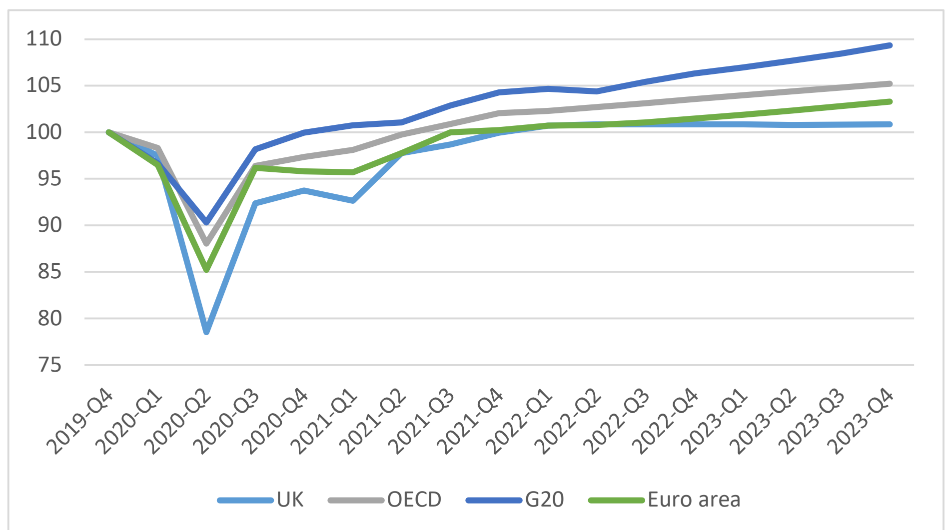
The UK economy experienced a larger hit from the Covid-19 pandemic than other members of the G7 group of advanced industrial economies, and the UK economy's recovery to end-2023 is forecast to be the weakest in the G7 by the OECD. According to the OECD's latest forecast, by the end of 2023 the UK's real GDP will be (**Figure 1.3**), only 0.8% higher than it was at the end of 2019. Contributing factors include high inflation and its effects on consumer confidence and disposable income; tightening of monetary policy and an expected tightening of fiscal policy; and supply shortages. The weak 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.

Figure 1.3

Real GDP estimates/forecasts, Q4 2019 - Q4 2023, Q4 2019 = 100

OECD Real GDP estimates/forecasts, June 2022 projection, Q4 2019=100 for each group of countries, Q4 2019 - Q4 2023

Sources: OECD Economic Outlook: Statistics and Projections



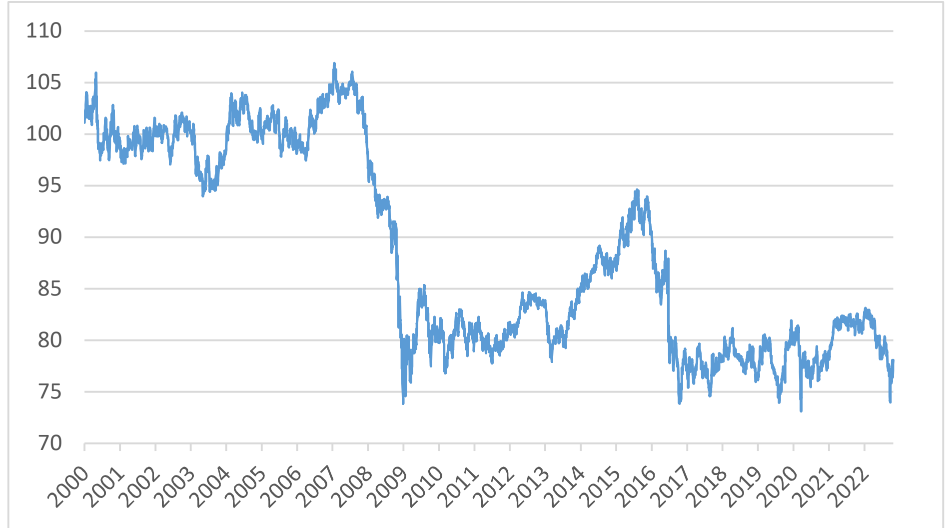
The value of Sterling declined in early 2022, partly due to a global lack of confidence in the UK economy. Its value slipped sharply after the UK Government's "Fiscal Event" in late September, but policy reversals and a new Government have helped reverse this (**Figure 1.4**).

Figure 1.4

Sterling's trade weighted index, Jan 2005 - Oct 2022, Jan 2005 = 100

Effective exchange rate index, Sterling (Jan 2005 =100), Jan 2005 - Oct 2022

Sources: Bank of England



The price of crude oil has risen to almost four times the pandemic low, as seen in **Figure 1.5**. The price of gas rose considerably during summer 2022 eclipsing the pandemic low by over 15 times. More recently the futures price of Natural Gas has fallen back (**Figure 1.6**). The UK's energy price cap will insulate UK households and businesses from some of the impact of rising wholesale prices.

Figure 1.5

Crude Oil and Natural Gas Prices 2000-2022

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: BEIS, IMF

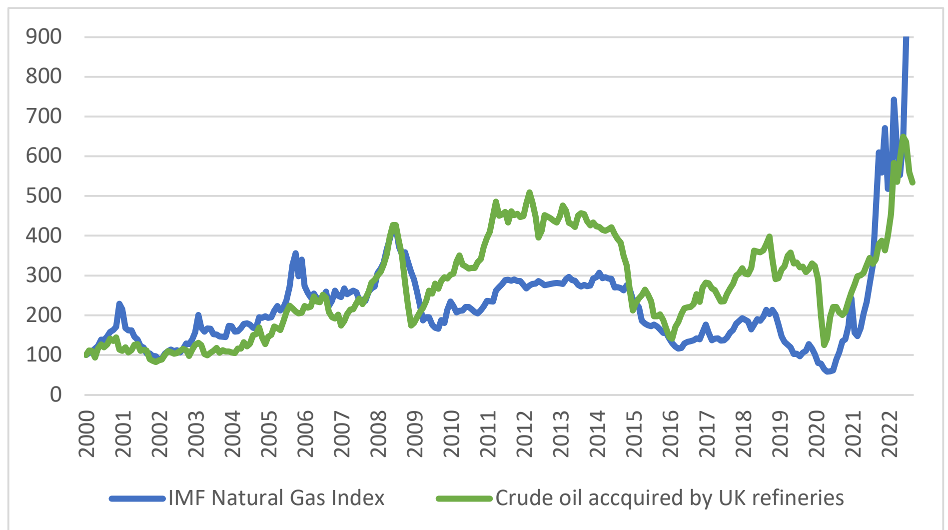


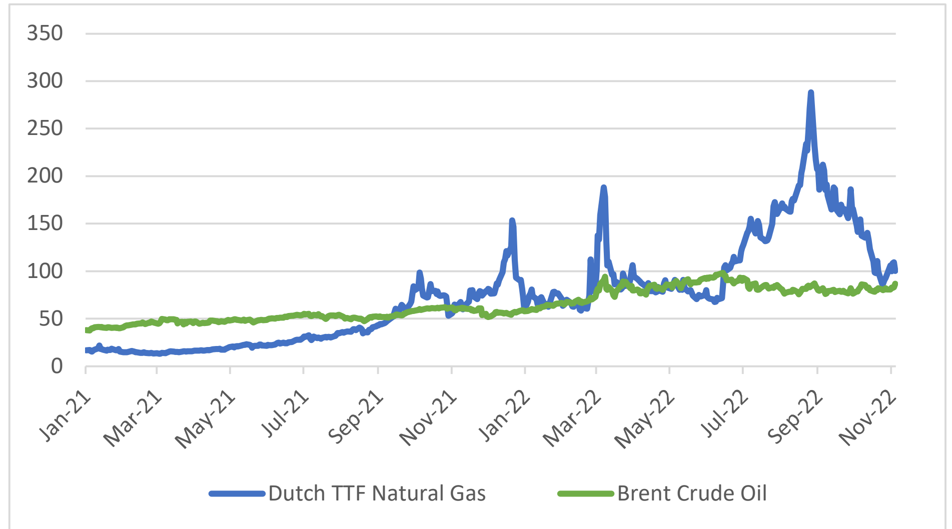
Figure 1.6

Futures price of Crude Oil and Natural Gas Jan 2021 - Nov 2022

Futures price of Dutch TTF Gas (£ per MWh)

Futures price of Brent Crude Oil (£ per barrel)

Sources: ICE



1.1.3 UK Inflation and close trading partners inflation

The UK has recently been experiencing the highest levels of inflation seen since the 1980s. CPI was 10.1% in September and the Bank of England is expecting inflation, as measured by CPI, to peak at around 11% by the end of 2022 and then to fall to around 5% by the end of 2023. Inflation remains above target in the US and the Eurozone and is expected to peak around the end of 2022 before falling back to target rates from 2025

1.1.4 Interest Rates

The Bank of England base rate is now at 3%, having been increased eight times since December 2021. The Bank of England has signalled that rates may not need to rise much further to bring inflation back to its 2% target, and expectations are that rates could peak at 4.4% in 2024.

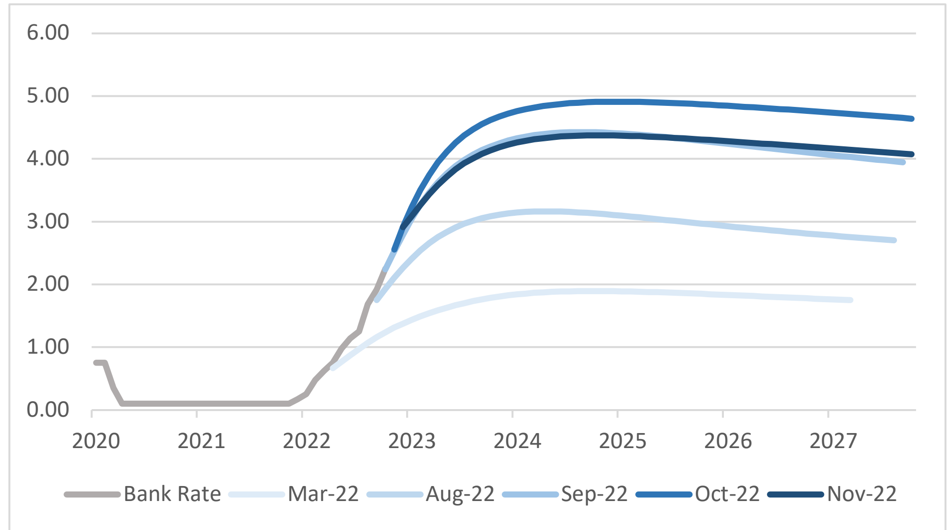
Interest rates have increased in the US and the Eurozone too, with the Federal Reserve Bank increasing rates to 3.75%-4.0% in November (+0.75 ppt) and the European Central Bank increasing the deposit rate (it's main interest rate) to 1.5% last month (+0.75 ppt). These rate rises are generally good for the Jersey banking sector which has a strong reliance on bank deposits. Rate rises will benefit households with savings but will increase costs for mortgage holders on flexible and tracker mortgages (and those with fixed rates ending).

Figure 1.7

Future UK Bank Rate expectations

Average monthly expectations for the future UK bank rate, and the actual value for the UK bank rate

Sources: Bank of England



1.2 Jersey economic developments

The most recent GVA data available shows that the economy grew by 9.2% in 2021 real terms. This was faster than other advanced economies, and followed a GVA contraction of 9.6% in 2020, driven by falls in consumption (because of Covid restrictions) and Bank Rate cuts. Around half of the economic contraction in 2020 was due to reduced profits in the financial services sector.

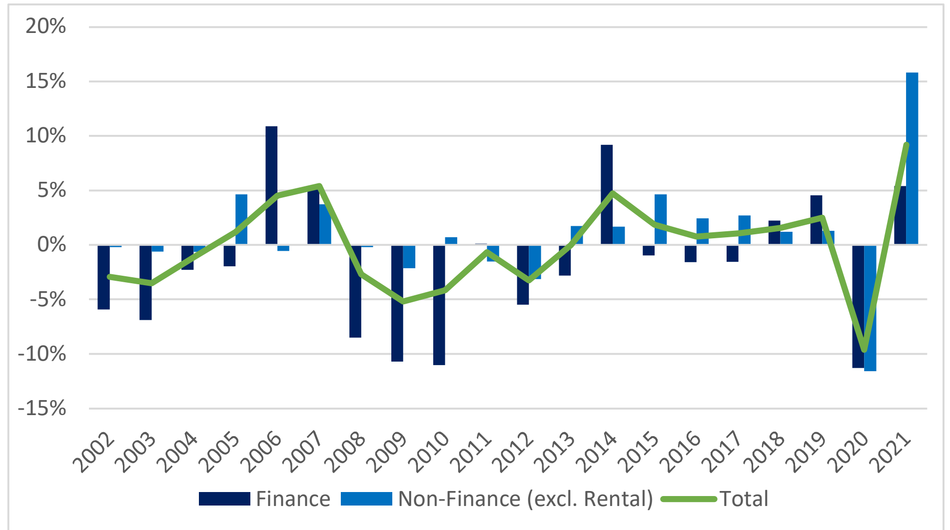
The decline in GVA varied by sector, and likewise the recovery has not been uniform across all sectors. Some sectors have grown and now are larger than they were in 2019; others have been slower to bounce back. In 2021 hotels, restaurants and bars grew by 56%, the strongest growth of all sectors. This followed a 47% decline in 2020. Other sectors seeing strong growth in 2021 were construction (34%), agriculture (19%), transport, storage and communication (17%), other business activities (17%) and manufacturing (15%). Weaker growth occurred in financial services (5%), public administration (4%) and wholesale and retail (2%). The only sector in which real GVA fell was the electricity, gas and water sector that shrank by 5%.

Figure 1.8

Jersey GVA growth

Annual percentage real terms change

Source: Statistics Jersey



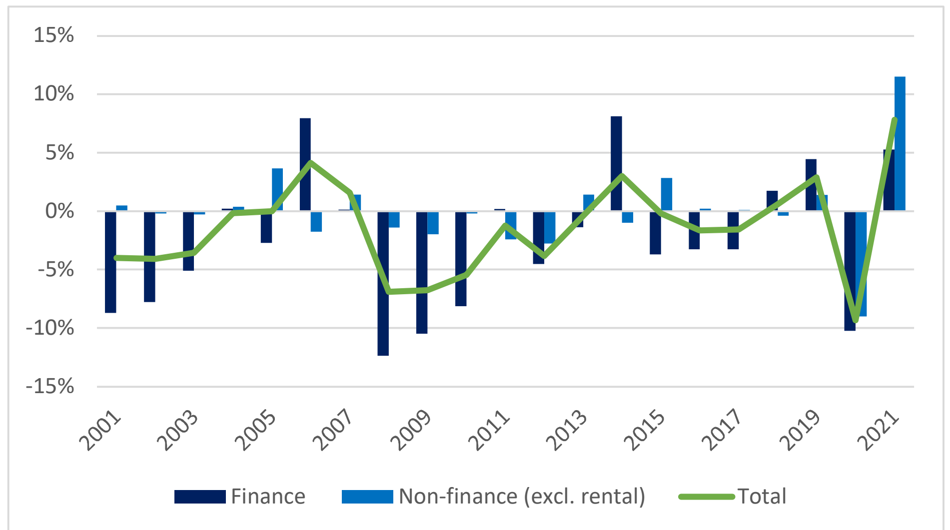
Economic growth is expected to continue driven by higher expected profits in the financial sector both from higher interest rates and as a result of past efficiency improvements.

Figure 1.9

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 5% growth in real terms GVA in 2021. Financial services profits, particularly the banking sector, are a significant driver of GVA in Jersey and grew by 10% in 2021, after a fall of 20% in 2020. Profits in the financial services sector are partly determined by short-term interest rates – particularly those in the UK. UK Bank Rate remained at a record low 0.1% throughout the majority of 2021, consequently this sector has seen a slower recovery than the non-finance sectors.

Figure 1.10

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

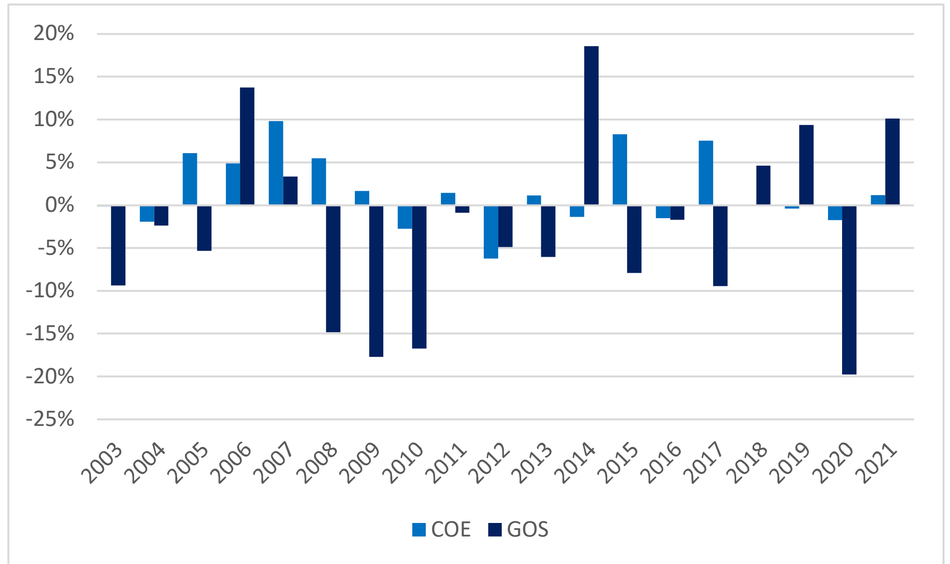


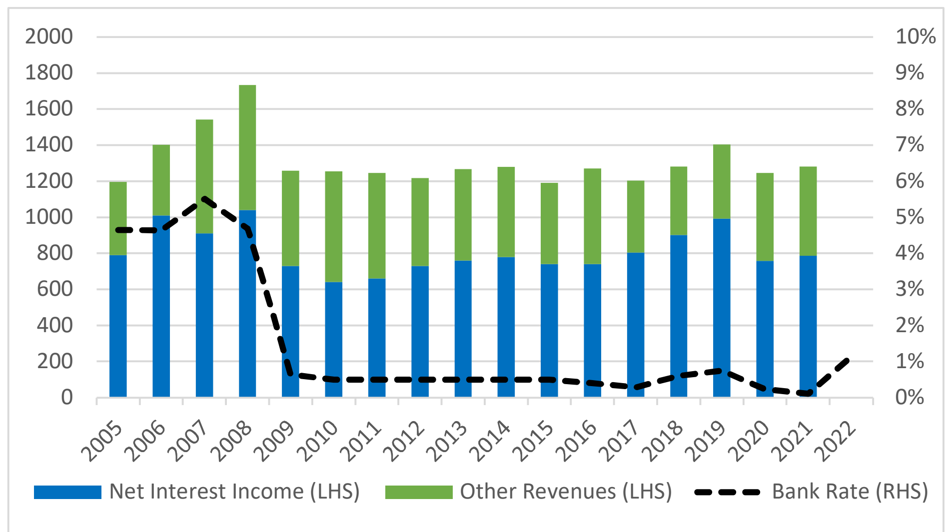
Figure 1.11 below shows the recent annual history of financial services revenues. Net interest income grew by 3.7% in nominal terms in 2021, recovering slightly from the 23.6% fall in 2021.

Figure 1.11

Banking revenues

Source of revenue (£m, current prices - left hand scale) and annual average for Bank of England Official Bank Rate (percentage - right hand scale, 2022 until end October)

Sources: Statistics Jersey, Bank of England



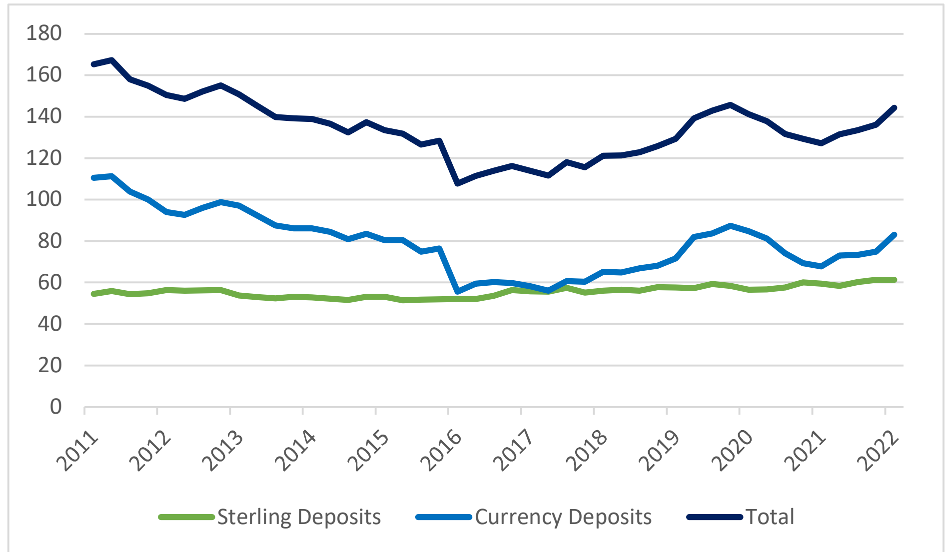
Although the value of sterling deposits remains stable, deposits of foreign currencies ("currency deposits") have begun to rise slowly, following the sharp decline from their six-year peak in March 2020. These deposits are mainly held in US dollars, though Euro deposits are important and mean that both US and Euro interest rates affect the profitability of Jersey's banking sector.

Figure 1.12

Banking deposits

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

Sources: Jersey Financial Services Commission



Whilst the size of banking sector deposits has been relatively stable throughout the pandemic, the value of funds administered in Jersey has continued to increase. The total value of funds administered has risen 103% since June 2015 to total £458bn in the most recent data in June 2022.

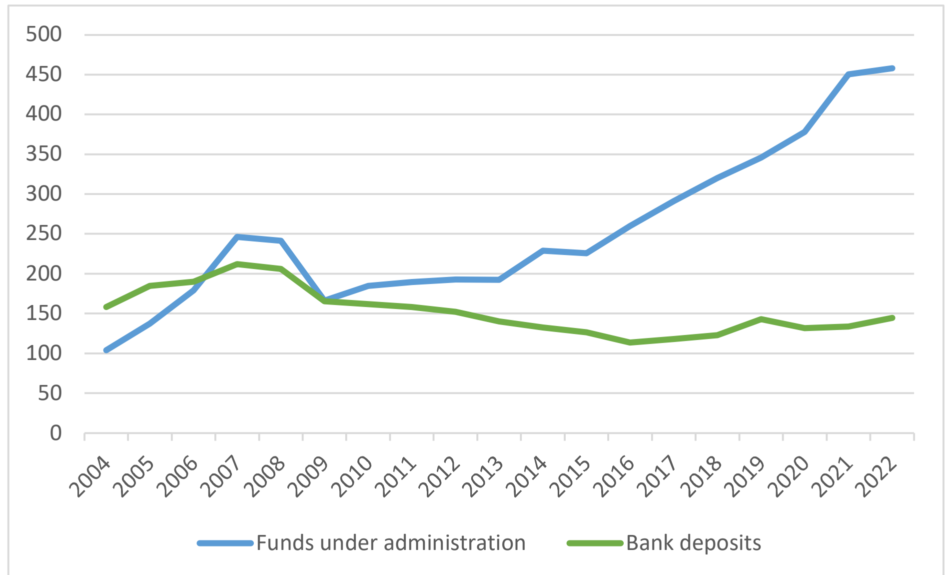
When the Panel met with representatives from the funds industry, they reported strong growth against a backdrop of increasing global uncertainty. Sector representatives concluded that Jersey was likely to be able to retain market share in a growing market, but that growth would likely be limited by staff and skills shortages.

Figure 1.13

Deposits and funds

£bn, total banking deposits held in Jersey (red line) and net asset value of regulated funds under administration (blue line); 2004-2021 is year-end; 2022 is June

Sources: Jersey Financial Services Commission



The **Business Tendency Survey (BTS)** from September 2022 suggests that business sentiment continues to be weighted towards the upside and closely reflects the results from the pre-pandemic period. The headline business activity indicator has remained positive with the weighted net balance of firms

reporting an increase in business activity outweighing those who reported a decrease by 10 percentage points.

Figure 1.14 presents a summary indicator produced from the weighted responses to the BTS. Overall responses to the BTS are continuing to be optimistic.

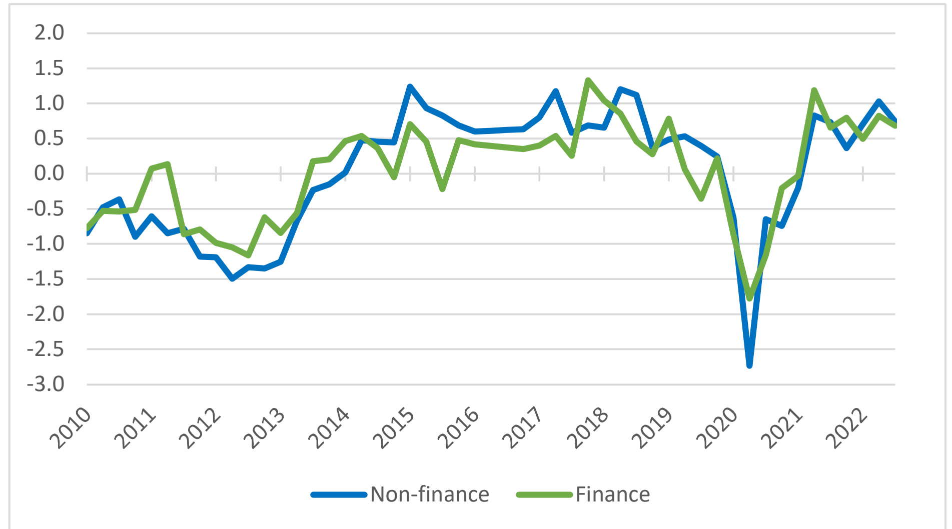
Figure 1.14

BTS summary indicator

Summary indicator incorporating responses from finance and non-finance sectors to the BTS

Note: Results for future employment in September 2021 in the financial services are averaged from June and December observations

Sources: Statistics Jersey, Panel calculations



During the Panel's June factfinding meetings, representatives from banks reported the potential for increased profitability due to rising interest rates, although profits are likely to pick up with a lag, delayed by previous hedging.

Representatives across the finance sector highlighted their difficulties in recruiting to key positions in their organisations. Businesses in this sector are beginning to relocate some elements of their activities to the UK as competition for staff and the high cost of living in the island make local recruitment more difficult.

1.2.2 Rest of the economy

The non-finance sector saw a period of accelerated growth in 2021, growing by 16%.

The headline Business Activity indicator for the non-finance section was moderately positive in the September 2022 BTS. New business and future business activity were also positive, although optimism has waned since June. Business activity is currently strong, but the survey indicates ongoing concerns about rising costs and thus, future profitability.

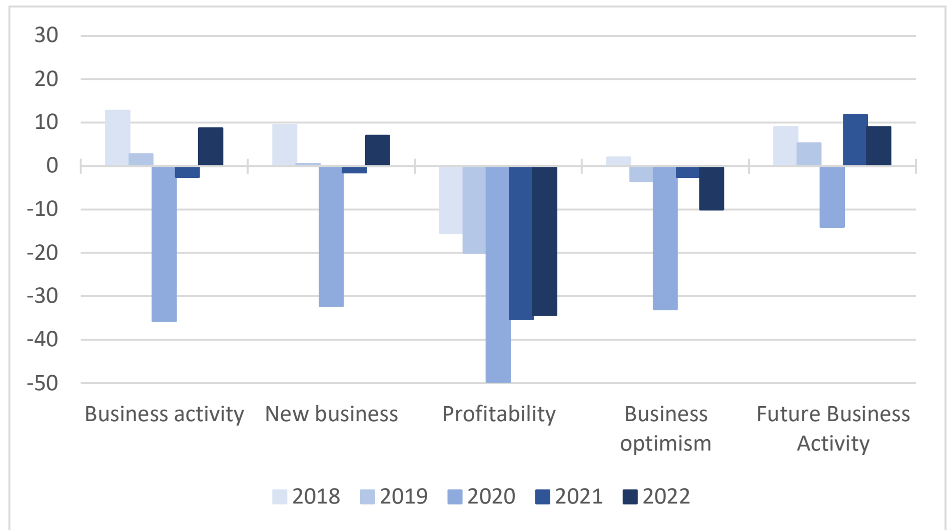
Figure 1.15

Non-finance business tendency

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

Note: 2022 covers March, June and September.

Sources: Statistics Jersey, Panel calculations



1.2.3 Sectoral performance of the non-finance economy

The Wholesale and retail sectors saw growth of 2% in 2021, the strongest growth since 2015. The challenges faced by the sector pre-pandemic still remain such as the threat to high street stores from online retailers. Nonetheless, the commercial vacancy rate in the St Helier (7.9%) is significantly lower than the UK average (14%).

Responses to the September BTS from this sector were slightly negative, particularly with respect to input costs, profitability and optimism.

The **hotels, restaurants and bars** sector saw the strongest growth among any sector rising by 56%. However, it remains 18% smaller in real terms than in 2019. The sector continues to face significant staffing issues in the wake of Brexit and the Covid-19 pandemic with reported difficulties in attracting seasonal staff and consequential wage pressures across the sector. Rising input costs have also affected this sector with every respondent to the June BTS reporting a rise in input costs compared to the previous quarter.

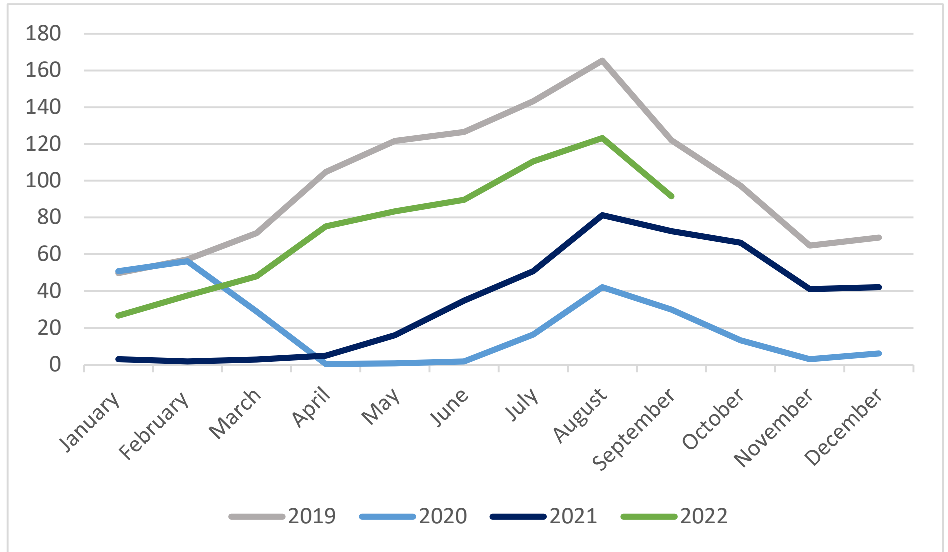
In August 2022, air and sea departures recovered to around 75% of the peak numbers in August 2019. The removal of all travel restrictions for the 2022 summer season has supported the tourism sector. Traveller numbers may not return to pre-pandemic levels as hotel room capacity has fallen over the past three years.

Figure 1.16

Port departure numbers

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

Sources: Ports of Jersey



The **construction** sector grew by 34% in 2021, continuing the strong growth the sector saw during the final months of 2020. In real terms, the sector has grown 11% since 2019, one of only a few sectors to be larger now than pre-Covid. This sector has cited recruitment difficulties in recent months. Despite this, average earnings in the sector rose 5% in 2022, below the whole economy average of 6.2%.

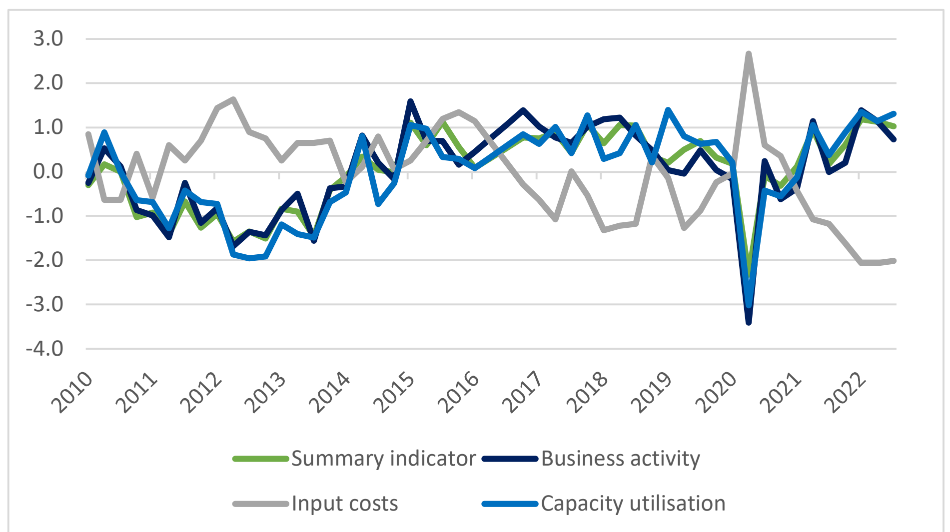
The potential impact of Government's proposed capital programme on the construction sector is explored in more detail in **Section 2.2.6**.

Figure 1.17

BTS results for the construction sector

Summary indicator for the construction sector and mean and variance adjusted series for the business activity, future business activity and input costs

Sources: Statistics Jersey, Panel calculations



1.3 Labour Market

Labour market data for 2021 and 2022 highlighted the acute pressures that were felt in some sectors. Low numbers of people actively seeking work, coupled with high vacancy rates made recruitment difficult, and this, coupled with rising inflation has contributed to wage pressures. In June 2022 average

earnings were 6.2% higher than in June 2021 and this increase, whilst lower than inflation, was the fastest growth in earnings since 2001.

Jersey has seen a full return to pre-pandemic levels of employment with total employment standing at 63,720 in June 2022. Over the period between the 2011 and 2021 Census' net migration has averaged around 330 per year, less than half of the 680 annual average in the prior decade.

During the Panel's factfinding visit, industry representatives gave reports of strong competition for staff. Pressures were cited across most sectors, but were more pronounced in certain roles, such as compliance in financial services and chefs in hospitality.

As discussed in the Panel's recent Medium-Term Report, the old age dependency ratio has risen to 28%. The total population grew by 5.5% over the ten-year period to 2021 but the working age population grew by only 1.3%.

Looking ahead, weaker economic growth forecasts for the UK, the decline in sterling and Brexit are likely to pose challenges for employers looking to recruit from Europe. Low net migration and lower fertility pose a challenge for the Island and the Common Population Policy needs to address both short-term pressures and long-term sustainability.

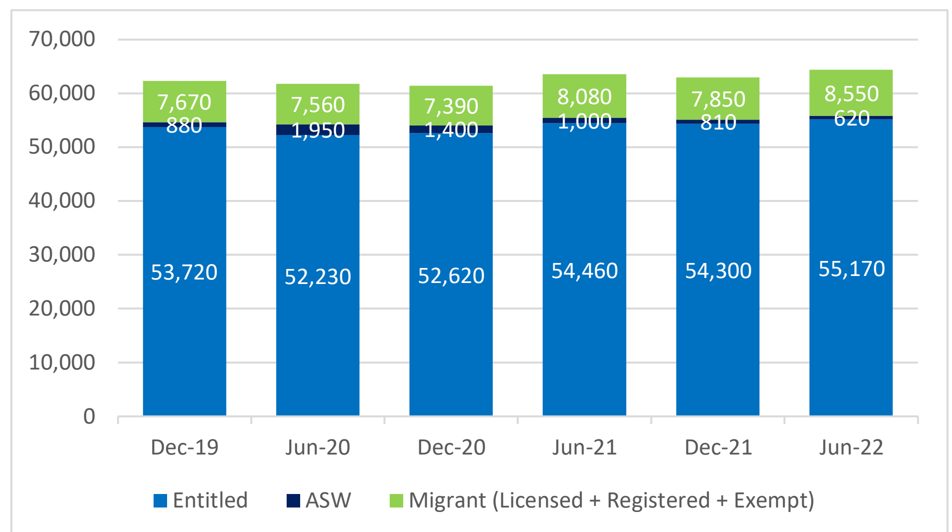
Figure 1.18

Labour force composition

Total numbers of workers registered as entitled, actively seeking work and migrant (includes those in the licensed, registered and exempt categories).

Note: ASW includes some underemployed individuals, and some unemployed individuals will not register with CLS. This calculation is therefore only ever an approximation of changes in the labour force.

Sources: Statistics Jersey



High frequency data, such as the numbers of those registered as 'Actively Seeking Work' (ASW) is useful to assess the short-term movements of the labour market. The number of those who are registered as ASW fell to 620 in June 2022, the lowest level since records began. ASW data contains information about the sector of previous employment for 90% of those registered, providing an indication of sectoral labour market changes which may also indicate skills shortages or surpluses in the economy. The percentage of total ASW attributed to each sector of previous employment has returned to a similar distribution to before the pandemic. This suggests that

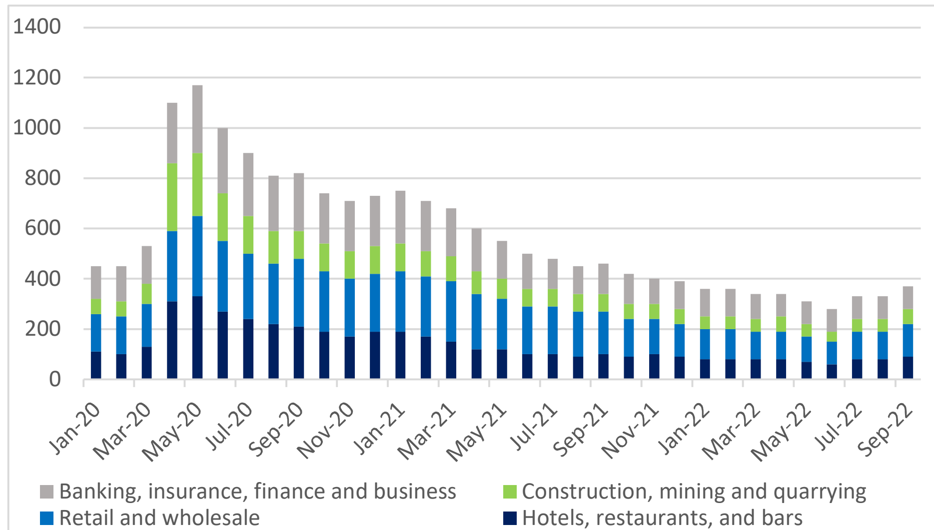
whilst there are acute pressures in some sectors, a widespread mismatch of skills is not present.

Figure 1.19

Actively Seeking Work by industry of last employment

Number of those registered as Actively Seeking Work on the last calendar day of each month, for construction, financial services, wholesale, and retail, and hotels, restaurants and bars sectors.

Sources: Statistics Jersey / Customer and Local Services



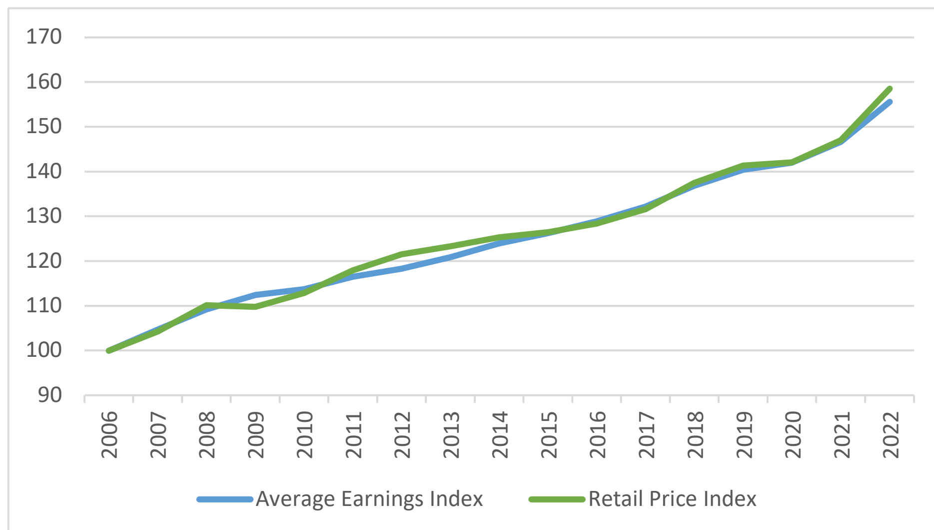
In June 2022, average weekly earnings per full-time equivalent employee (FTE) were 6.2% higher than in June 2021. This latest annual increase compares to 3.3% in the twelve-month period to June 2021, the largest rise since 2001. Average earnings in the private sector increased by 6.7%, whilst the increase for the public sector was only 3.1%. High inflation erodes real earnings and with inflation at 7.9% in June 2022, real-term all-sector average earnings were 1.6% lower than in June 2021 (1.1% lower in the private sector, and 4.4% lower in the public sector). All-sector average earnings have increased in real terms by only 0.8% since 2012.

Figure 1.20

Average earnings and inflation

Index (2006 = 100) of average earnings (blue line) and retail price index (green line)

Sources: Statistics Jersey



Monthly online job vacancy data are a useful indicator of the health of the labour market and of changes in demand for labour. Vacancy data has been taken from the Government of Jersey website and whilst this does not cover all job vacancies on the Island, it is still useful to compare trends.

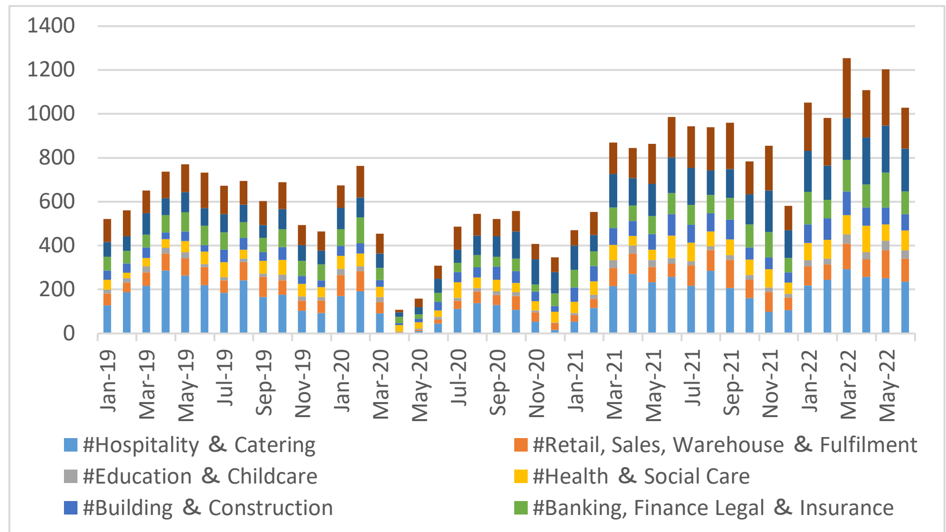
Private sector vacancies have been rising steadily throughout the last year, whilst still exhibiting the expected seasonal variation. Most sectors have seen monthly vacancies rise compared to 2019.

Figure 1.21

Vacancies in Jersey

Number of public sector vacancies and 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



Section 2.2.6 sets out the significant capital programme planned by government and its subsidiaries over the coming years, in particular the hospital. The Government's Future Population Policy will need to consider the resource requirement needed to successfully deliver this significant increase in construction. This resource includes not just availability of funding but also internal resource capacity to manage projects, and capacity in the supply chains to deliver.

1.4 Inflation

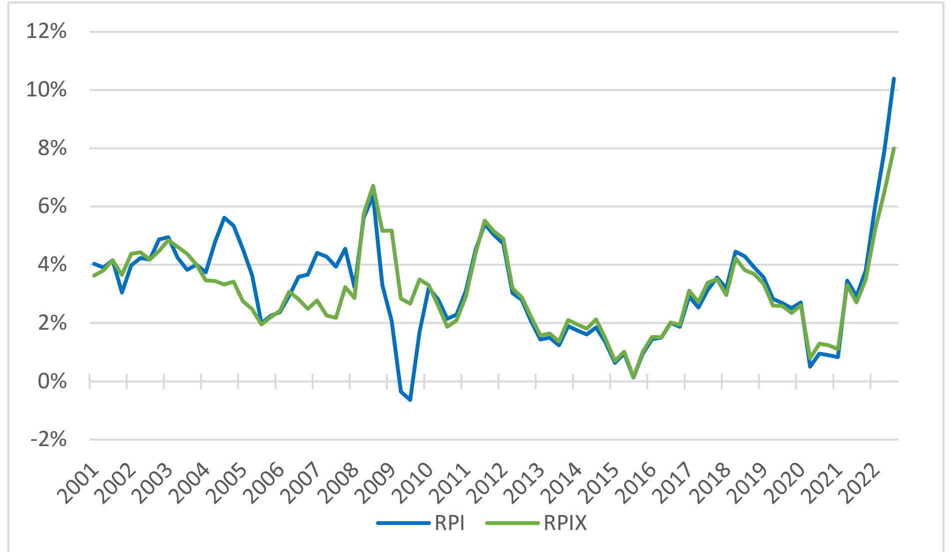
Jersey's headline measure of inflation, the Retail Price Index (RPI) increased by 10.4% in the year to June 2022. This was the largest twelve month increase in prices since September 1990. Following a period of very low inflation during the Covid-19 lockdown, inflation started to pick up in the second quarter of 2021 because supply chains, disrupted by covid, were unable to match increased demand from consumers as lockdowns were lifted. The more recent and sharper rise in inflation is due to increases in fuel & light (+ 25.1% in the year to June 2022) as global energy prices have risen sharply because of the conflict in Ukraine.

Figure 1.22

Inflation in Jersey

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

Sources: Statistics Jersey



1.5 The housing market

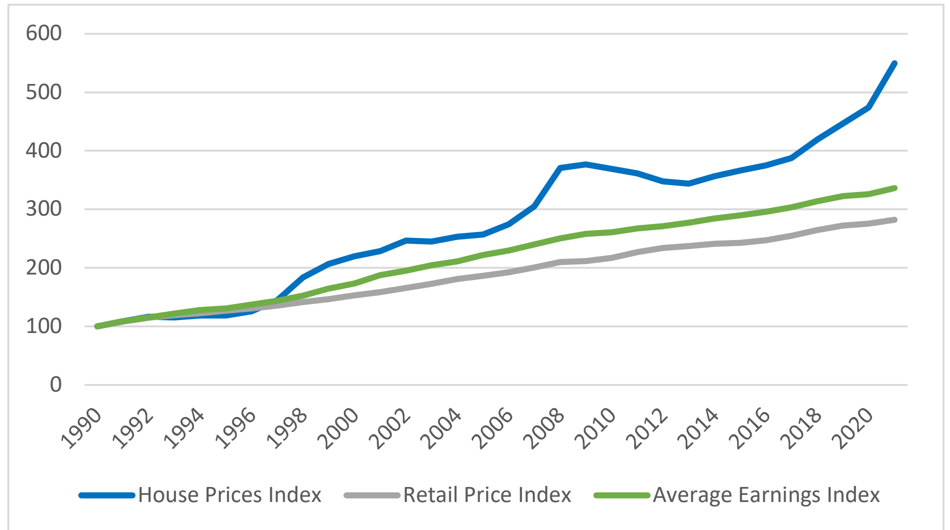
House price growth in Jersey has far exceeded both RPI and Average Earnings growth since the late 1990s. A number of factors have contributed to this including limited supply of land and low interest rates.

Figure 1.23

House Prices, Retail Prices and Average Earnings Indices

Index 1990 = 100

Sources: Statistics Jersey



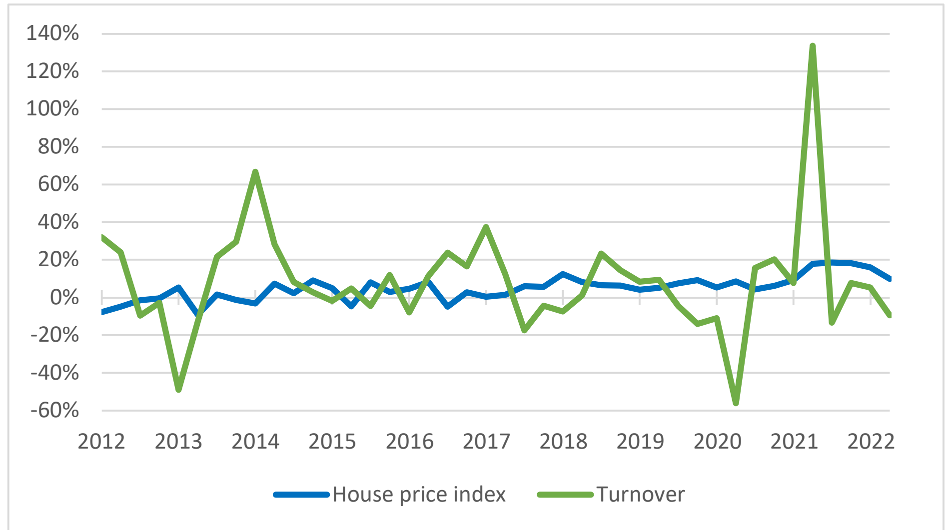
During 2021, the Jersey property market grew strongly, and this has continued into 2022. Transaction numbers reached a 10-year high in Q4 2021 with almost 500 properties transacted through the Royal Court during the quarter.

Figure 1.24

Housing market

Annual change in House Price Index and transaction numbers

Sources: Statistics Jersey



The increases in Bank Rate already introduced, and the further rises expected are likely to supress activity in the housing market and to slow down the growth in house prices but are unlikely to resolve the risk that high housing costs pose to growth and productivity. The rate rises are likely to affect households via higher mortgage payments (and via rent increases), but the scale and timing of this is uncertain. Available information suggests that the majority of mortgages are on 5-year fixed rates, and so many mortgage holders won't feel the effects of interest rate rises for some time, though the difference between monthly mortgage repayments on older fixed rates and probable new rates will be significant. Conditions in the housing market will need careful monitoring and targeted support for the most severely affected households may be needed.

1.6 Output gap

The output gap represents the difference between the current level of output in the economy and the potential level it 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 with significant swings in both demand and supply caused by the global pandemic

creating unprecedented levels of disruption. For the UK, the Office of Budget Responsibility (OBR) recommends that even less weight than usual be placed on output gap estimates.

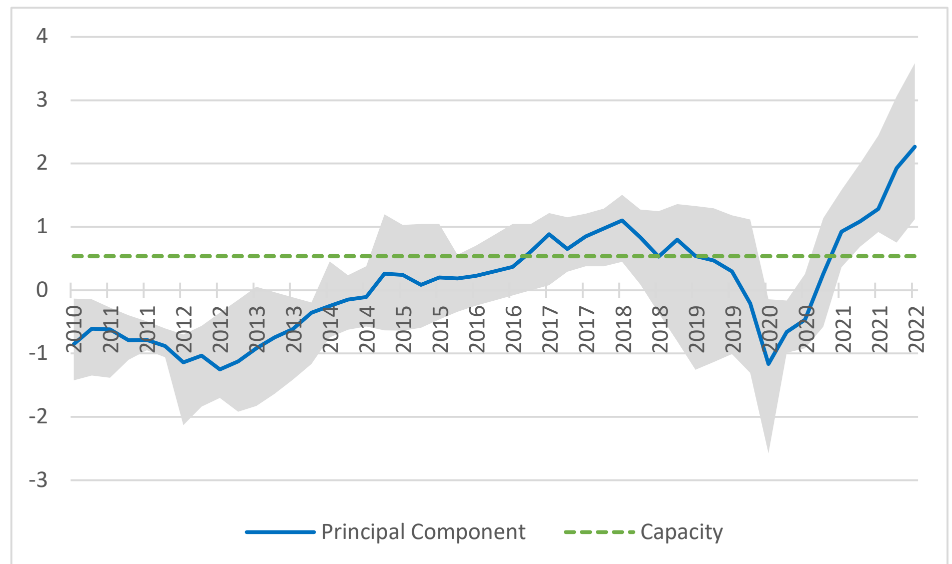
Figure 1.25 shows the results of the PCA output gap estimate. This demonstrates that the onset of the pandemic resulted in a significant degree of spare capacity as unemployment increased, job vacancies fell, and business sentiment became strongly negative. In the first half of 2021, spare capacity was used up and the output gap is estimated to have been more than fully closed. 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. This is particularly true in the construction sector as capital programmes are likely to use a significant portion of the sector's capacity.

Figure 1.25

Output Gap estimate based on PCA

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

Sources: Statistics Jersey, Government of Jersey, Panel calculations



1.7 Economic growth forecast

The Panel has updated its economic assumptions since the Medium-Term Report in July 2022.

The updated economic assumptions present a mixed economic outlook. A sustained period of high inflation will cause those whose income does not rise with inflation to see their real income fall. At the same time rising interest rates used by the Bank of England to combat UK inflation will be positive for banking profits and, so, for government revenues. However, since falling real incomes are caused by Jersey's longer term higher expenditure on imports (especially fuel) and not weak demand it is not appropriate for Government spending to attempt to offset the entire impact of the supply side shock.

At the end of October, financial markets expected rates to peak at almost 4.5% in 2024. This forecast has been used in the Panel's updated economic

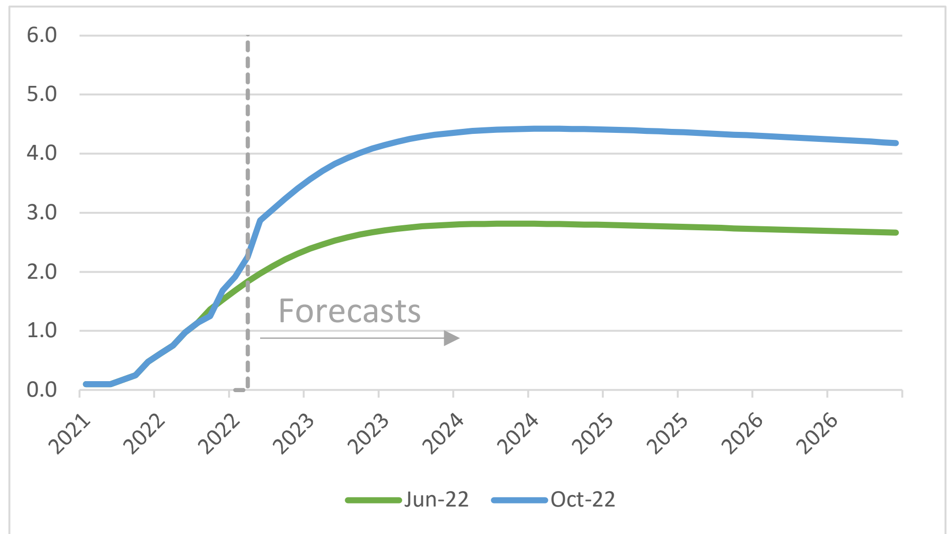
assumptions and whilst it predates the Bank of England's November Monetary Policy report (which signalled that interest rates may not need to rise as much as markets were expecting) it is not dissimilar to the most recent market expectation of 4.4% interest rates.

Figure 1.26

Interest rates forecast

Interest rates forecast used in the Panel's Economic Assumptions, taken from the final five days of the month.

Sources: Bank of England



Inflation projections for Jersey have also increased. The headline measure of inflation is expected to peak at 12% in Q4 2022, and remain high for a protracted period, before slowly falling back to a long-run trend of 2.4% over the forecast horizon.

The higher expected interest rate profile (compared to the forecast in the June Medium-Term Report) drives the differential between RPIX, the closest comparator to UK CPI used to forecast Jersey's inflation, and RPI, the headline measure of inflation in the Island. RPI includes both indirect taxes and an estimation of mortgage interest payments. RPIX excludes mortgage interest payments and RPIY excludes indirect taxes and mortgage interest payments. RPIX and RPIY track very closely and are assumed to be equal in this forecast in the absence of any new indirect taxes.

The differential between RPI and RPIX becomes smaller in the later years of the forecast as interest rates are expected to settle at 4.3%.

Figure 1.27

Inflation forecast (RPI and RPIX)

Blue line is Jersey RPI, green line is Jersey RPIX, grey line is UK CPI. Dotted lines indicate forecasts. The UK CPI forecast is produced by the MPC.

Sources: Statistics Jersey, Bank of England, Panel calculations

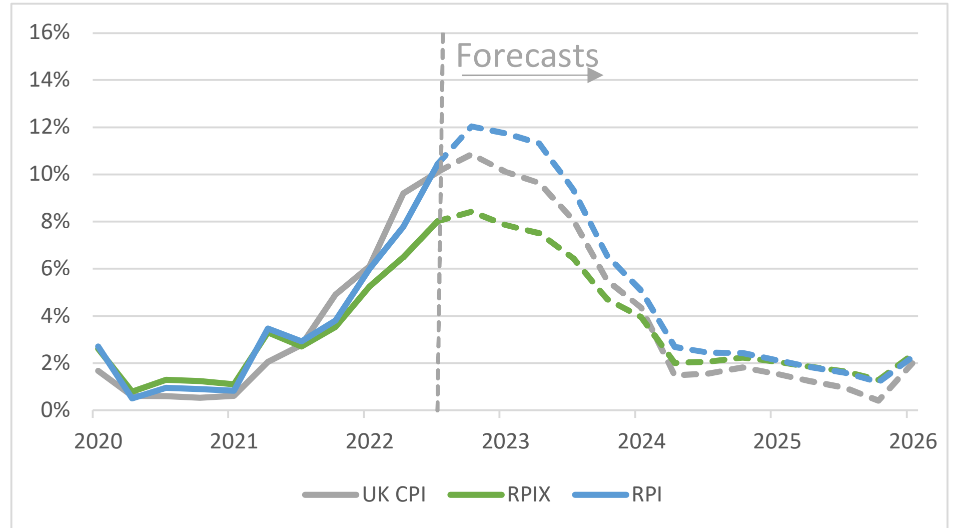


Figure 1.28 shows the Panel's latest forecast. GVA growth in early years of the forecast period is slower than previously forecast. This is mostly due to higher inflation eroding real terms growth and changes to the shape of the financial services profit expectations.

Financial services profits are forecast in part using the expected changes in the Bank Rate. In light of evidence from the sector, the Panel has adjusted the profits profile and is now forecasting some of the expected profits into later years (and less in 2023). This revised forecast includes an expectation that Banks are likely to make larger impairment provisions (as interest rates rise) which will reduce profits. Also, many financial service businesses will have hedged a proportion of their interest rate exposure and therefore will see profits grow more steadily over the forecast period. Average earnings are expected to rise almost in line with inflation during the forecast period. Across the economy real terms earnings are now expected to fall slightly by 0.5% in both 2022 and 2023, rising in line with inflation from 2024 onwards. Public sector inflation related pay increases are lagged by one year resulting in real terms falls in 2022 and 2023. This pushes any increase in real terms average earnings into 2025.

Employment is unchanged from the July 2022 publication and is assumed to rise consistently in the financial services sector, whilst non-finance will see a period of above trend growth. This reflects a strong post-pandemic recovery in the labour market.

The forecast for house prices and transactions remains unchanged from the July 2022 assumptions.

Figure 1.28

Central Economic Assumptions

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 RPIY, 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	Trend 2026+
Real GVA	-9.6	9.2	2.5	5.9	3.1	0.3	0.5
RPI	1.3	2.7	9.1	9.7	3.1	1.7	2.4
RPIY	1.2	2.7	7.1	6.6	2.6	1.7	2.4
Nominal GVA	-8.1	12.1	9.5	12.6	6.0	2.2	2.9
Gross operating surplus (including rental)	-16.4	19.2	13.4	19.3	8.4	2.2	2.9
Financial services profits	*-18.8*	*13.1*	*20.0*	*35.0*	*12.0*	*1.0*	*3.2*
Compensation of employees (CoE)	-0.8	6.8	6.3	6.7	3.6	2.2	2.9
Financial services CoE	*-0.5*	*3.9*	*4.8*	*6.5*	*3.0*	*2.1*	*3.4*
Non-finance CoE	*-4.4*	*8.7*	*8.5*	*6.9*	*3.2*	*2.1*	*2.7*
Employment	-2.4	2.9	0.7	0.6	0.5	0.3	0.1
Average earnings	1.1	3.3	6.2	6.2	3.1	1.8	2.8
Interest rates (%)	0.2	0.1	1.4	3.9	4.4	4.4	4.3*
House prices	6.1	16.0	6.0	5.0	4.0	3.0	2.9
Housing transactions	-3.8	15.1	3.5	3.0	2.5	2.5	4.0

*Trend interest rates represent market expectations for 2026

Figure 1.29 shows the changes since the July 2022 forecast. Note revisions to the prior year GVA data are a regular feature of the national accounting report.

Figure 1.29

Change in economic assumptions from previous forecast

Percentage point difference between the November 2022 and July 2022 forecasts

Sources: Statistics Jersey, Panel calculations

% change unless otherwise specified	2020	2021	2022	2023	2024	2025	Trend 2026+
Real GVA	-0.9	+3.8	-1.6	-2.7	+1.8	+0.2	0.0
RPI	0.0	0.0	+1.4	+3.0	-0.8	-1.0	0.0
RPIY	0.0	0.0	+0.9	+1.4	-1.1	-1.0	0.0
Nominal GVA	-0.9	+3.9	-1.0	-1.5	+1.1	-0.6	0.0
Gross operating surplus (including rental)	-0.9	+8.2	-3.1	-5.0	+2.8	-0.3	0.0
Financial services profits	*-0.7*	*-6.4*	*-6.2*	*-7.3*	*+5.8*	*-0.6*	*0.0*
Compensation of employees (CoE)	-1.0	+0.7	+0.5	+1.3	-0.7	-1.0	0.0
Financial services CoE	*-0.8*	*+0.3*	*-1.3*	*+1.4*	*-1.1*	*-1.0*	*0.0*
Non-finance CoE	*-4.3*	*+0.7*	*+1.8*	*+1.4*	*-1.1*	*-1.0*	*0.0*
Employment	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Average earnings	0.0	0.0	+0.9	+1.3	-0.7	-1.1	0.0
Interest rates (%)	0.0	0.0	+0.2	+1.4	+1.7	+1.7	+1.7
House prices	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Housing transactions	0.0	0.0	0.0	0.0	0.0	0.0	0.0

The remainder of this section sets out a number of economic risks to the Jersey economy over a longer time horizon.

1.8 Risks to growth

Data on GVA, jobs and ASW show that the Jersey economy has recovered well from the shock caused by the Covid pandemic. One factor behind lower unemployment in most developed economies is falling labour market participation. It is unclear whether this applies in Jersey as participation rate data are not available.

The pandemic led to significant disruption for the visitor economy. Whilst recent data suggests that visitor numbers are recovering, they remain below pre-pandemic levels. Changing travel patterns, including lower demand for business travel because of the much-increased use of online conferencing, are a continuing downside risk for the visitor economy.

1.9 Other economic risks

There are several risks to Jersey's economy in the coming years in addition to those discussed in previous sections.

The economic effects of the conflict in Ukraine could continue into the medium term. In particular, protracted supply chain issues may bear down on production and investment. The impacts of climate change also present a risk to the economy of Jersey, although there are also significant opportunities associated with decarbonising the economy. The States Assembly has approved a Carbon Neutral Roadmap for Jersey, which focuses on the actions that need to be taken for decarbonisation from 2022 to 2026.

The emergence of a new more transmissible and/or more virulent strain of Covid-19, or of a new pandemic of another pathogen, could have a significant negative impact on the economy of Jersey and its trading partners.

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 will increase financial sector profits, and there is potential for improved growth in other sectors.

The Fiscal Outlook

2.1 Introduction

This section considers the proposed Government Plan for 2023-26 ('the Government Plan') and assesses the extent to which it follows the fiscal framework guidelines. The Government Plan was lodged on 4 October 2022 and will be debated by the States Assembly on 13 December 2022.

The Jersey economy has recovered well from the shock caused by Covid and has experienced strong, above trend growth. Whilst the outlook for global economies remains uncertain, Jersey's economy is in a good position. The outlook for public finances also appears positive as rising interest rates and a prolonged period of high inflation will likely increase government revenues (though inflation may place additional pressures on expenditure in the early part of the period).

Thus, although the global economic outlook is uncertain, the current position of the Jersey economy (strong revenue coupled with an economy operating close to full capacity) points to an ideal opportunity to rebuild government new worth through contributions to the Stabilisation Fund and the Strategic Reserve.

Proposed Government Plan 2023-26

The proposed Government Plan sets out:

- An operating surplus of £20m in 2023 and small surpluses across all years of the Plan
- Capital expenditure of £1.1bn over four years including £695m for Our Hospital
- New revenue-raising measures of £5m, with the commitment to set out a total of approximately £10m for implementation in 2024
- The repayment of all Covid-19 borrowing during 2022
- £61m of growth funding to support the delivery of ministerial priorities during 2023
- Inflation allocation of £53m in 2023, recognising the impact of inflation on government expenditure
- A Value for Money programme to deliver £10m in efficiencies 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 under times 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 depreciation being included in the operating balance as it reduces the incentives to cut required capital spending in order to achieve a balanced budget.

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

1. It includes an adjustment for the economic cycle (i.e. it is a structural balance, which aims to remove any cyclical component in expenditure and revenue). This relies on the judgement of the Panel, as set out in Section 1.

2. It excludes investment returns and borrowing costs whereas the operating balance includes both borrowing costs (for the revolving credit facility, refinancing pension liabilities, Our Hospital and the housing bond) and some investment returns (on the Consolidated Fund and Currency and Coinage Fund).

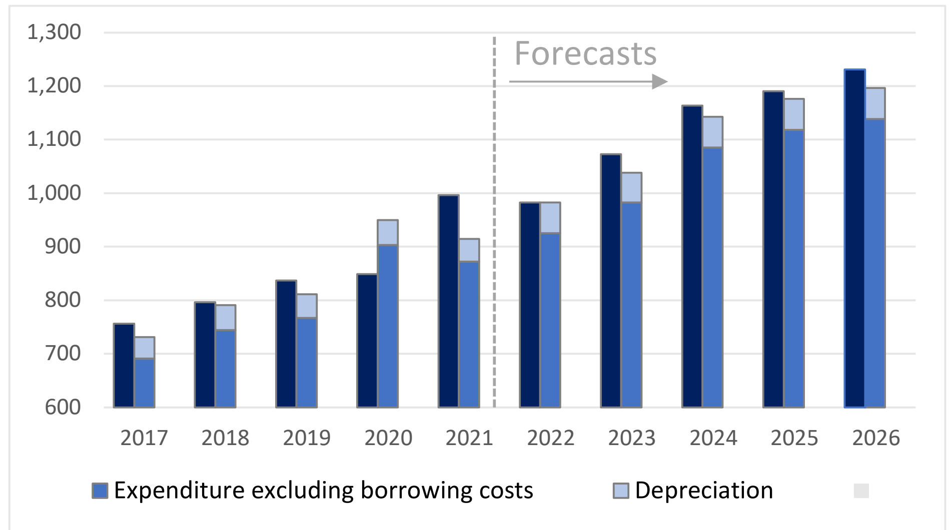
While the structural budget balance adjustment is more of a question of judgement, it is possible to produce the primary budget balance (i.e. the operating balance with the exclusions in 2 above) directly using figures in the Government Plan. Figure 2.1 sets out recent outturns and a forecast to 2026 for the primary balance / primary budget position. This has been calculated as revenue (excluding investment returns) minus expenditure (excluding borrowing costs) minus depreciation.

Figure 2.1

Income and expenditure forecasts

£m (current prices)

Source: Treasury and Exchequer



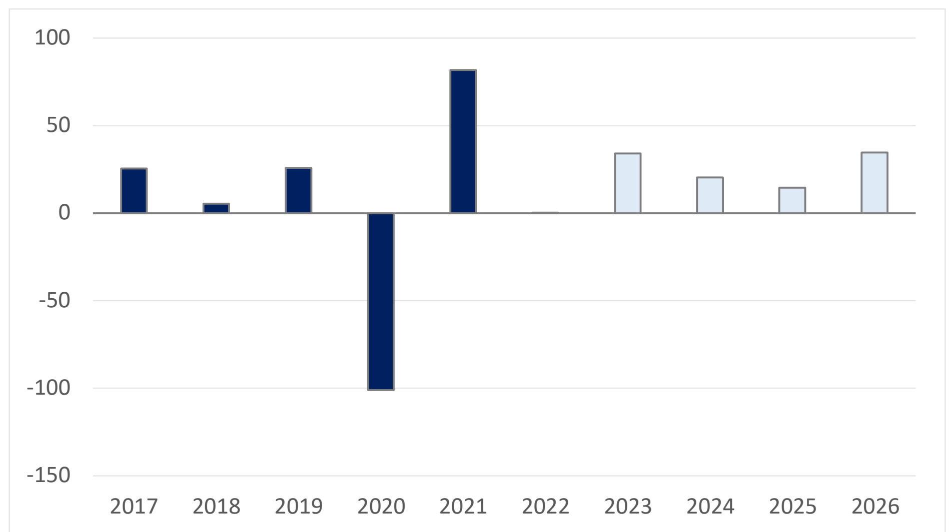
The primary budget was in surplus during 2021 of £82m following the previous deficit of £101m in 2020. The primary budget is forecast to be balanced in 2022. From 2023 onward, the primary budget is forecast to be small in surplus. Two one-off dividends agreed with Jersey Telecom provide an additional £20m in 2023 and 2024.

Figure 2.2

Primary surplus / deficit

Primary budget surplus - £m (current prices). Outturn (dark blue bars) and forecast (light blue bars)

Source: Treasury and Exchequer



The 'States Grant' is an annual transfer to the Social Security Fund from the Consolidated Fund to support old age pensions and some working age benefits. The Social Security Fund receives this grant, in addition to the 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 for 2020-2022. This year's Government Plan proposes to re-instate the States Grant in 2024, with a £82m transfer.

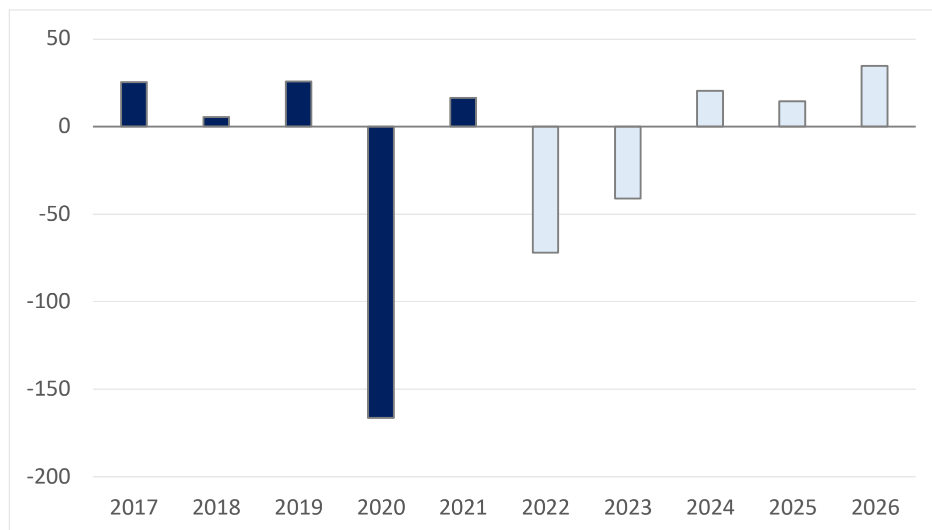
Figure 2.3

Primary surplus / deficit if the States Grant was not withdrawn

Primary budget surplus - £m (current prices).

Outturn (dark blue bars) and forecast (light blue bars)

Source: Treasury and Exchequer



The surpluses (Figure 2.2) and likely upwards revisions should be set in the context of the economic forecasts from Section 1 which include an increase in government income throughout the period. The Panel's central forecast is for continued economic growth, despite some global headwinds, which is driven by pandemic recovery and improved financial sector profits.

Based on the Panel's analysis, the Government of Jersey should plan to run significant surpluses over the 2023-2026 period. **The economy is currently strong with little spare capacity and historically low levels of unemployment. This is not the time for a fiscal stimulus.**

The large projected inflation rises outlined in Section 1 are likely to be challenging for some, but not all, households. Although a broad fiscal stimulus should be avoided some highly **targeted support to those most affected may be justified.**

In the main though, surpluses generated should be used to improve the Government of Jersey balance sheet. This should be through rebuilding the Stabilisation Fund which seeks to enable fiscal policy to be more counter-cyclical or improving the Strategic Reserve balance. The Stabilisation Fund and Strategic Reserve are considered further in following sections.

The Government Plan also sets out a forecast of the "Government of Jersey Group' surplus, which includes the income and expenditure of all funds. This shows that the balance of income and expenditure improves rapidly from a deficit of £50m in 2022 to £204m in 2026. However, this compares to a surplus of £324m in 2019.

The level of investment returns in individual years, and over the long term, is highly uncertain and while the assumptions used in the Government Plan appear prudent there is a risk that investments could perform significantly differently, in either direction, from past performance.

Figure 2.4

Government of Jersey Group forecast

£m

Source: Treasury and Exchequer

	2020	2021	2022	2023	2024	2025	2026
Operating surplus	-113	68	-13	20	7	3	23
Trading operations surplus	0	2	4	4	5	5	5
Special Funds surplus	-54	-72	-75	-75	-4	-6	3
Group operational surplus	-168	-2	-83	-50	8	2	31
Investment returns	241	326	-169	0	200	174	173
Group surplus	73	324	-253	-50	208	176	204

2.2.1 Expenditure related to Covid-19

Expenditure related to Covid-19 is expected to fall to £25m in 2023, with recurring costs of £2m annually throughout the plan period. This is reduced from the previous Government Plan allocation of £11m and £9m in 2024 and 2025 respectively. It is anticipated that all borrowing for the impacts of Covid-19 will be repaid in full by the end of 2022.

Figure 2.5

Covid-19 expenditure

£m

Source: Treasury and Exchequer

	2020	2021	2022	2023	2024	2025	2026
Nightingale field hospital	10	3	0	0	0	0	0
Cofunded Payroll Scheme	98	30	0	0	0	0	0
Borrowing costs	2	2	7	0	0	0	0
Income support costs	6	1	1	0	0	0	0
Economic recovery	12	12	10	0	0	0	0
Education costs	4	4	2	2	0	0	0
Test and tracing programme	16	42	20	11	0	0	0
Vaccine	0	5	7	3	0	0	0
Other	43	10	39	8	2	2	2
Total Covid costs	**190**	**109**	**86**	**25**	**2**	**2**	**2**
Covid-19 costs as a proportion of GVA	**4%**	**2%**	**2%**	**0%**	**0%**	**0%**	**0%**

2.2.2 Value for Money

The Government Plan reduces previous 'rebalancing' targets under a new Value for Money programme. The Value for Money programme aims to drive a cultural change in which all colleagues act on their responsibility to ensure that there is always a focus on the elimination of wasteful process and improving service delivery.

The programme delivery will be overseen by a Political Oversight Group, chaired by the Minister for Treasury and Resources and aims to deliver through the following approaches:

1. Cashable Savings Targets and delivery plans for each Department
2. A Productivity Improvement Programme
3. A series of Best Value Reviews

4% of non-pay expenditure has been allocated directly to departments (after allowing for inflation on departmental income capped at 2.5%). 2.7% has been held centrally to contribute to the Value for Money programme savings target in 2023. The restraint of non-pay expenditure allocates efficiencies across

departments instead of targeting certain departments to deliver significant efficiencies. As proposed in the previous Government Plan, zero-based budgeting has been used across departments to build budgets as part of the Value for Money programme.

The Panel's previous recommendation to build detailed, realistic and timebound targets for all years of the Government Plan has been met in part. The Value for Money represents a lower risk detailed plan with more achievable targets over a longer time period. However, unallocated future savings of £10m in 2024-2026 do not have detailed plans to achieve the targets. **The Panel understands that efficiencies can be difficult to predict, especially in uncertain economic times and recommends that detailed, realistic and timebound targets for all years should be built into the four-year Government Plan as it moves forward.**

The impact of high inflation, and rising interest rates on government revenues and expenditure remains uncertain. **The FPP recommends that efficiencies should be sought regardless of the stage of the economic cycle and the government should continue to search for efficiencies in future years**. A change in economic conditions should not result in any divergence from the efficiencies programme.

2.2.3 Revenue Forecast

The Government Plan is based on a revenue forecast that is around £85m higher for 2023 than forecast in the previous Government Plan. There are also further increases in the revenue forecast beyond 2023. The revenue forecast is conditioned on the FPP economic forecast from July and therefore follows the upward revisions to the forecast, published in the Medium-Term Report.

Much of the increase in revenue in 2025 comes from an additional £98m from income tax (personal and corporate), and smaller increases in GST (+£2.5m), stamp duty (+£15m), impôts (+£9m) and other income (+£2m). The Government measures announced in September 2022's Mini-Budget reduce the increase in revenue by £19m in each year

Since the publication of the IFG summer forecast, an additional planned special dividend payment has been agreed with Jersey Telecom. This is funded through the retained proceeds of the sale of the Internet of Things (IoT) element of the company and increases revenue forecasts by £20m in both 2023 and 2024.

Figure 2.6

General revenue income forecast

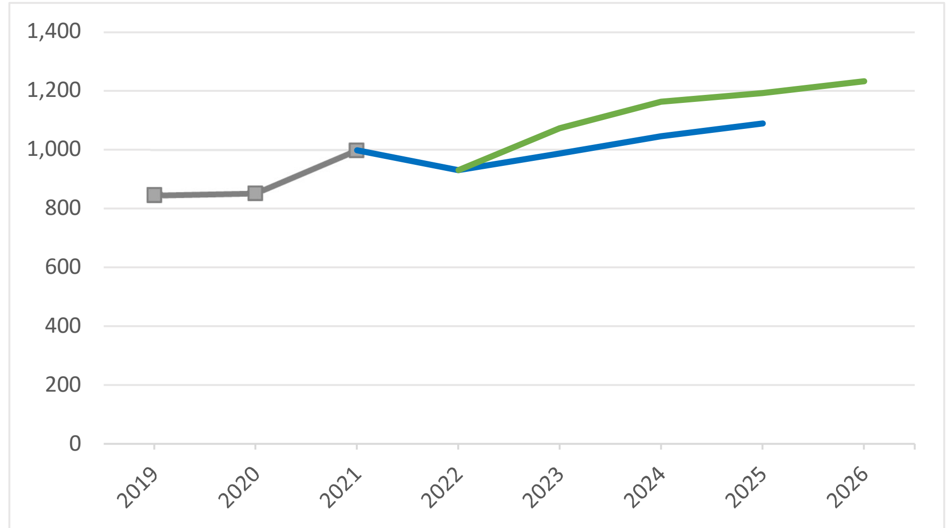
£m

Green line is Government Plan 2023-26

Blue line is Government Plan 2022-25

Grey line is outturn

Source: Treasury and Exchequer



2.2.4 Revenue measures

The Government Plan includes additional revenue measures proposed for 2023 onwards. These are forecast to raise £5m annually through changes to the High Value Residency contribution, increases to Vehicle Emissions Duty and a higher rate of Stamp Duty on buy-to-let, second and holiday homes. The freeze on alcohol and fuel duties will cost approximately £4m, reducing the additional revenue to £1m in 2023.

Future revenue measures are proposed to raise taxation of approximately £10m from 2024. £3.4m of this is proposed to be raised by changes to the HVR scheme and Stamp Duty, the remaining £6.7m are unallocated with further measures to be considered. The proposed revenue raising measures are targeted and designed to drive behavioural changes and follow the Panel's previous recommendations.

Figure 2.7

Government Plan revenue forecast and measures in 2023-2026

£m, total revenue

Source: Treasury and Exchequer

	2023	2024	2025	2026
Income Tax	751.0	826.0	866.0	900.0
GST	108.2	110.6	112.5	114.3
Impôt duties	79.1	81.3	82.8	83.6
Stamp duty	56.9	57.6	59.9	62.9
Other income	62.2	63.8	67.7	68.8
Central scenario - IFG	**1,057.4**	**1,139.3**	**1,189.0**	**1,229.6**
Mini Budget	- 19.9	- 19.1	- 19.1	- 19.1
Domestic Compliance	14.0	15.5	15.5	15.5
One-off Dividend Income	20.0	20.0	-	-
Budget measures	0.9	0.9	0.9	0.9
Future tax measures	-	6.7	6.7	6.7
General Tax Revenue	**1,072.5**	**1,163.3**	**1,193.0**	**1,233.6**

The next years' Government Plan should set out how the £6.7m of "future tax measures" will be raised. Future Government Plans should also consider other revenue raising streams, or possibly alter the amount raised to ensure

taxation rates have a clear strategic rationale rather than be solely focussed on raising a specific amount of revenue.

2.2.5 Hypothecation

Hypothecation is where the government commits to spend a revenue stream, usually taxes, on a specific objective or policy issue. The Panel has previously recommended that hypothecation should only be introduced where revenue and spending are likely to be justifiably related. No new separate funds are proposed in the Government Plan. The Panel is pleased that their previous recommendation that the proliferation of separate funds is undesirable has been followed. Thorough consideration should be given towards the consolidation of funds and no further funds should be proposed without strong rationale.

2.2.6 Capital

The Government Plan sets out a plan for £1.1bn of capital spending over the four-year period, including a £695m allocation to the Our Hospital project. The Government has recently published its review of the Our Hospital project and its preferred option now awaits Assembly approval. A funding strategy will then follow. It is worth noting that the interest and bond market environment is less favourable to large scale borrowing than it was a few months ago.

Excluding Our Hospital, capital spending is largest in 2023 at £155m (including trading funds) and decreases gradually to £62m in 2026. The main areas of spending in 2023 relate to Estates (£52m), Information Technology (£36m) and Infrastructure (£30m). The largest individual areas of spending / projects include:

- Infrastructure Rolling Vote and Regeneration Including St. Helier (£14.7m in 2023)
- Upgrades to the CYPES estates (£13.6m in 2023) of which £5.9m relates to school improvements
- Sewage Treatment Works (£12m in 2023)
- Integrated Technology Solution (£12m in 2023)

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

Figure 2.8

Capital spending

£m

Source: Treasury and Exchequer

Capital programme area	2021	2022	2023	2024	2025	2026	Total 2023 - 2026
Feasibility	-	-	2	1	1	1	3
Estates	-	-	52	44	33	28	158
Infrastructure	-	-	30	20	18	18	85
Information Technology	-	-	36	10	3	2	50
Replacement Assets and Minor Capital	-	-	12	10	13	10	45
Community Fund	-	-	1	2	2	2	7
Reserve for Central Risk and Inflation	-	-	8	2	2	2	14
Funds	-	-	15	12	3	3	33
Total exc. Hospital	**78**	**131**	**155**	**100**	**75**	**65**	**395**
Our Hospital	52	25	80	190	241	183	695
Total with Hospital	**130**	**156**	**235**	**290**	**316**	**248**	**1090**

Capital spending for 2023 is estimated to be £235m including Our Hospital. This represents a 50% increase from 2022, where capital spend is estimated to have been £156m.

Excluding Our Hospital and trading funds, capital spend in 2023 is forecast at £141m, this represents an increase of £40m from the previous Government Plan's allocation. The majority of this increase is due to delays in spending during 2022. Delays to the Our Hospital project have moved a significant portion of the capital spending into later years of the Plan.

Figure 2.9

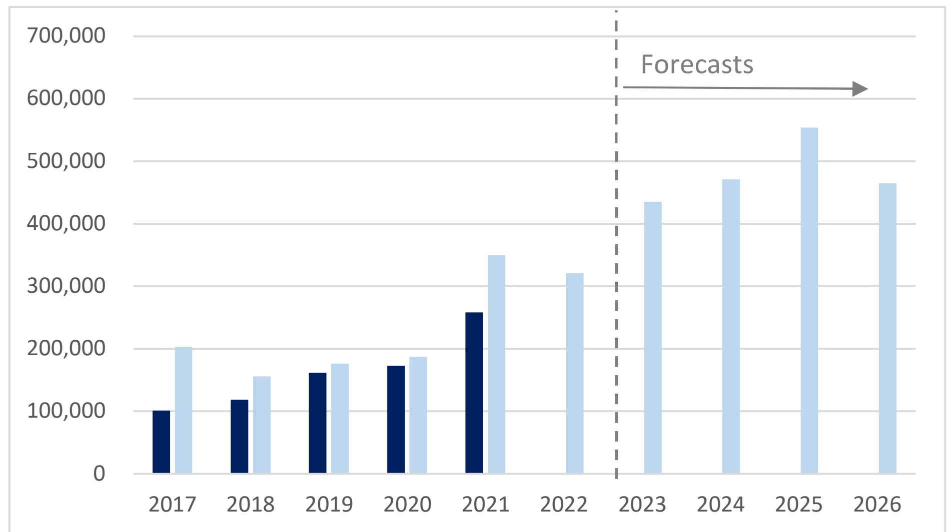
Capital spending - outturn and forecast

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

Light blue bar is outturn and GP 2023-26 forecast

Dark blue bar is most recent forecast before outturn from previous GPs and Budgets

Source: Treasury and Exchequer



In their 2019 Annual Report, the Panel set out a recommendation for Government to undertake further work to set out how the capital programme can be delivered without exacerbating capacity constraints in the local construction industry.

The proposed capital programme establishes Project Gateways to mitigate the inherent risk and uncertainty involved in project planning and delivery. This restructures the capital programme to include a three-stage project approval which should enable better forecasting. Previously, funding for feasibility has been held in a Reserve Head of Expenditure, this is replaced by a grouped head of expenditure within the Capital Programme. Emerging projects can receive feasibility funding in year, subject to the approval of a Strategic Outline

Business. This also allows funding to be reallocated where projects progress faster or slower than forecast.

Previously the Panel have recommended that capital projects are timed to support the economy during economic downturn. This is difficult to achieve in practice and the Panel welcomes the balance that the new structure of the capital programmes brings. **Major capital projects should go ahead, however care should be taken to ensure that multiple major projects do not overlap and that the capacity of the construction sector to deliver the projects is monitored. Small, non-time sensitive projects should also be identified which can be quickly implemented or withdrawn to support the economy as needed.**

2.3 The adjusted fiscal position

The Panel's reports also set out an indication of how supportive the overall fiscal position is to 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, government is continuing to provide significant support to the economy through capital spend on Our Hospital and through subsidiary companies – in particular Andium Homes and the States of Jersey Development Company.

The £61m of planned growth expenditure in 2023 may cause capacity pressures in some sectors and has the potential to crowd-out private sector investment and/or be diverted to off-Island expenditure. It also reduces the budget surplus that could be used to strengthen reserves and resilience to future downturn. The economic assumptions detailed in Section 1.7 anticipate that economic growth will begin to slow during 2025 and 2026. This means that fiscal policy will be pro-cyclical during later years of the plan as government net spending is expected to fall in 2026. Counter-cyclical fiscal policy is advisable and can be achieved through the transfer of surpluses to the Stabilisation Fund and Strategic Reserve.

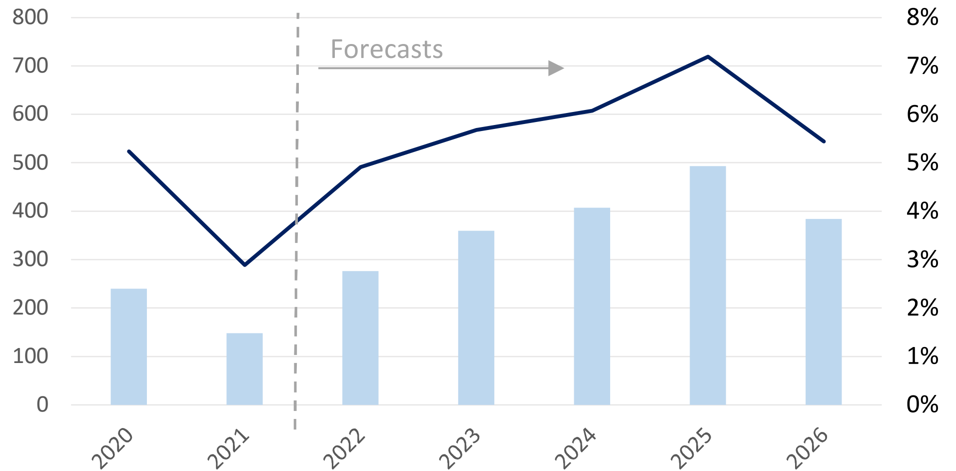
Figure 2.10

Adjusted fiscal position

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

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).

The Panel believes that the currently projected fiscal stimulus is larger than required given the current state of the economy. The Panel's central forecast predicts that inflation rates will return to trend during 2025, with interest rates also beginning to settle during this period. High and continued inflation resulting primarily from supply shocks should not be seen as a reason for significant fiscal consolidation, e.g. increased taxes, in order to reduce demand in the economy, but neither should the government aim to offset totally the impact of this shock. **In the event of a downturn more severe than presently expected, Government may want to consider additional contingency plans for supporting the most vulnerable households with the higher cost of living.** However, on current projections a large fiscal stimulus is not justified. On the other hand, if revenue surpasses current forecasts, then it would be sensible to avoid introducing new stimulus measures and any extra revenue should be used to strengthen the balance sheet.

The Panel recommends that flexibility is retained with regards to fiscal stimulus in this Government Plan period. The small surpluses identified in the Government Plan do not allow flexibility to increase expenditure without running budget deficits should the economic outlook deteriorate in later years

of the Plan. It would be prudent to reduce growth expenditure in the early years of the Plan to strengthen reserves which may be required in later years.

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. The revisions to the economic assumptions will ease some of the pressures of public finances but the economy is still expected to be smaller in the long run that was forecast in the pre-Covid-19 period.

Figure 2.11 sets out how the net asset position will change over the 2022-25 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 2.11

Net asset position

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

Source: Treasury and Exchequer

	2020	2021	2022	2023	2024	2025	2026
Physical assets	4.0	4.2	4.4	4.7	5.0	5.3	5.5
Net financial assets	3.6	4.1	3.9	3.5	3.2	3.1	3.0
Total	7.6	8.1	7.9	7.9	8.1	8.3	8.5
as % of GVA	**167%**	**158%**	**141%**	**125%**	**121%**	**121%**	**120%**

As a proportion of the economy, i.e. Gross Valued Added (GVA), the net asset position is forecast to decline sharply throughout the Government Plan period. Whilst States funds are growing over the plan period, net financial assets decline as borrowing increases. This is largely driven by financing of capital investments for Our Hospital and within the subsidiary companies. Physical assets rise steadily from 2023-2026, driven largely by the construction of the hospital. Net assets as a percentage of GVA was temporarily high in 2020 and 2021 as net assets remained stable whilst GVA was lower due to the pandemic. This trend is reversed from 2023 as net assets remain stable in nominal terms, but expectations are for significant nominal GVA growth. The net asset position is expected to decline from over 167% of GVA in 2020 to 120% in 2026.

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. **The Panel is concerned that Government is not adequately building the public sector net worth during a period of above trend growth. The**

expected surpluses in the medium term should be used to strengthen reserves and build resiliency to future economic shocks.

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 significantly reduced when compared to the position at the end of 2019.

Figure 2.12

Reserves

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

Source: Treasury and Exchequer

	2019	2020	2021	2022	2023	2024	2025	2026
Consolidated Fund	479	326	55	59	15	6	0	25
Strategic Reserve	906	968	1,032	1,006	1,003	1,057	1,094	1,125
Stabilisation Fund	50	1	1	1	1	1	1	1
Social Security Reserve Fund	1,983	2,093	2,264	2,072	1,983	2,119	2,240	2,361
Social Security Fund	92	76	66	73	76	66	65	60
Health Insurance Fund	108	108	100	86	77	71	75	80
Long Term Care Fund	37	37	41	46	53	61	71	82
Total	**3,655**	**3,609**	**3,558**	**3,342**	**3,207**	**3,381**	**3,545**	**3,734**
Total as % of GVA	73%	79%	69%	59%	51%	50%	52%	53%

2.5.1 Stabilisation Fund

The Stabilisation Fund was created in 2006 to help smooth the economic cycle. It should receive transfers in when the economy is performing well (when it is 'above trend'), and then use these resources 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 fund.

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

The Panel recommended in its Medium-Term Report that future surpluses should be prioritised to rebuild the Stabilisation Fund. The Panel previously estimated that given the expected positive output gap at least £7m should be transferred to the Stabilisation Fund in 2023. Our new projection indicates a minimum of £14m should be transferred with the strong growth in revenues suggesting an even larger transfer should be considered. The Government Plan 2023-26 does not commit to any transfers to the Stabilisation Fund but acknowledges that if surpluses of £7m are available, it should be transferred to the Fund. **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 Government Plan 2022-2025 approved using investment returns and capital appreciation from the Strategic Reserve to finance long-term borrowing (including the repayment of Our Hospital debt at £756m and pension debt at £480m). No principal repayment is expected to be due on debt until 2052.

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 latest projection is that the Strategic Reserve will remain below 30% for the next forty years (it is projected to be equivalent to 15-20% of GDP based on a 4.4% nominal return rate). Under a high return scenario, the Strategic Reserve will remain below 30% of GVA,

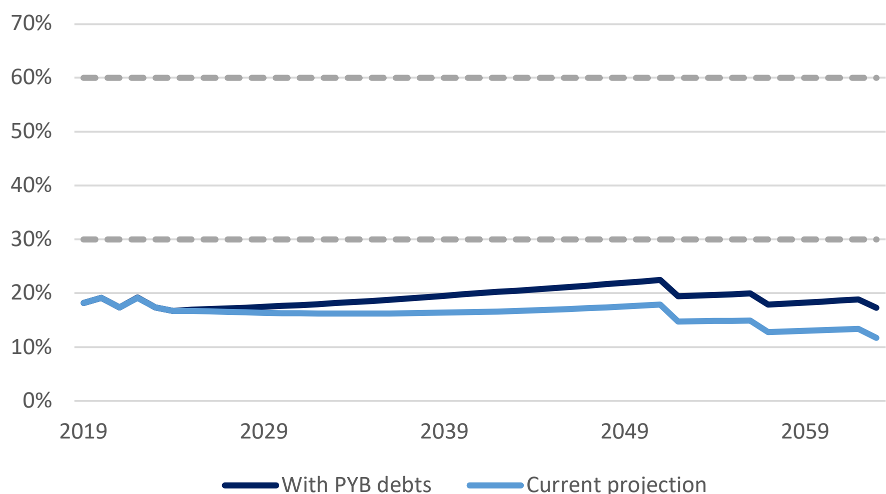
Borrowing and transfers relating to the Our Hospital funding strategy are taken from the current Assembly approved option and are reflected in the Strategic Reserve forecasts in Figure 2.13. The proposed project funding strategy is discussed in further detail in Section 2.6 and if agreed will alter the profile of the fund.

Figure 2.13

Strategic Reserve

Strategic Reserve as % of GVA. Current projections include the Our Hospital funding strategy

Source: Treasury and Exchequer



The Government should consider different options for building up the Strategic Reserve. On current plans the Covid-19 debt will be fully repaid in 2022 and so it would be advisable to **use the one-off payments from receipts from the Prior Year Basis to build up the Strategic Reserve and improve the Government's balance sheet.**

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 had a combined value of over £2bn at the end of 2020 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 £12.5m and £8.3m in 2023 and 2024is expected to be required for the new transformational benefits system. The project was started in 2021 and is expected to be completed in 2024.

The Panel published a detailed view of Social Security Funds in their Medium-Term Report. The updated actuarial review is due to be published during 2023, therefore the advice from the Panel remains the same and is summarised below.

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 pursue a reduction in net migration. The most recent actuarial review of the Fund concluded that based on the position at the end of 2017, contribution rates would need to rise to 14.5% by 2047 (from 10.5% currently) to meet the expected expenditure of the fund (under a +325 net migration scenario). **After the actuarial review, the Government should consider the future funding for the Social Security Fund and the use of the Reserve Fund. Any policy decisions should consider a range of different population scenarios and the impact these may have on the ability to pay future pensions.**

Further, the government should consider the overall composition of the States key Funds (particularly the Social Security Fund and Strategic Reserve) once the actuarial reviews have been completed and objectives of the Funds have been agreed. Government will want to ensure that the balances of the Funds are appropriate for the stated objectives. For instance, if the objective of the Social Security Reserve is to smooth the impacts of the ageing population and if contribution rates are increased to break-even for the steady state, then any surplus balances could be used to support the Strategic Reserve. **The Government should ensure objectives for the Funds are clear and adjust policies in line with objectives. This will be particularly relevant after the actuarial review of the Social Security Funds.**

Figure 2.14

Social Security Fund income and expenditure

£m, excludes transfers to/from Social Security Reserve

Source: Treasury and Exchequer

	2023	2024	2025	2026
Contribution income	228	237	244	250
States Grant	-	82	89	91
Benefit expenditure	- 301	- 321	- 334	- 346
Capital investment	- 13	- 8	-	-
Surplus	**- 86**	**- 10**	**- 1**	**- 4**

2.6 Borrowing

This Government Plan proposes no new borrowing. It plans to use underspends from 2021 and 2022 to fully repay the Covid-19 borrowing by the end of 2022.

The previous Government Plan approved borrowing to repay existing pension liabilities and for the Our Hospital project. Whilst the outcome of the review in the Our Hospital project was pending at the time of publication, the Government Plan carries forward the existing borrowing approval of £756m.

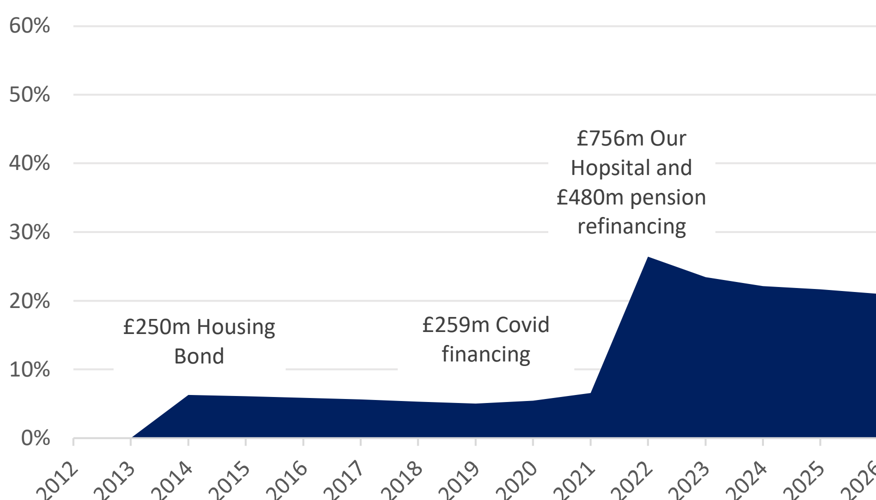
The Our Hospital review was published on 1 November 2022. The Government preferred two site option reduces the investment requirement and considers a phased approach to construction which broadly aligns with the economic cycle. The potential funding strategy discussed in the review follows broadly the same principles as P.80/2021, with the Strategic Reserve financing the annual costs and repaying the debt. However, the new proposed approach would be better matched to the projects spending profile, involving shorter-term debt being replaced by longer-term funding.

The Panel agrees that the proposed funding strategy is better suited to the current volatility in financial markets and the economic outlook. The Panel will review the finalised funding strategy when it becomes available – which won't be until the project has been approved by the Assembly.

Figure 2.15

Debt as a proportion of GDP

Borrowing highlighted in the chart Source: Treasury and Exchequer



2.7 Debt Strategy

In May 2022, the Government's debt framework and debt strategy were updated. The key aims remain the same. The Panel has previously assessed the debt framework aims and concluded that they are sensible and should be built upon in future iterations. **The government should modify the coverage ratio and debt-to-GDP to apply across the business cycle such that not achieving the aims during economic downturn won't be unduly scrutinised. The Strategic Reserve risk profile should give due consideration to the forecast debt position**

A full assessment of the individual aims can be found in Section 2.7 of the 2021 Annual Report.

2.8 Panel's previous recommendations

The Panel made several recommendations in November 2021's Annual Report and has given further advice in letters to the Minister for Treasury and Resources in March 2022. Longer-term recommendations were made in the Panel's Medium-Term Report published in July 2022. The Panel is concerned that the Government Plan does not adequately address some of their previous recommendations.

The Panel previously advised that across-the-board additional spending or tax cuts are not appropriate during periods of above trend growth. Jersey's economy is currently at or more likely above trend. The mini-budget, already been approved by the Assembly, contains broad tax cuts and the Government Plan proposes £61m of growth spending. The combination of these means the fiscal policy is looser than the Panel would recommend at this point in the economic cycle, risking overheating in the economy and prolonged higher inflation.

The recommendation to build reserves through transfers to the Stabilisation Fund or Strategic Reserve has not been followed. The Panel has also previously recommended that a long-term plan is needed to increase the size of the Strategic Reserve which has not been addressed in this Government Plan.

Several of the Panel's recommendations have been addressed earlier in the report:

- The recommendation to only include rebalancing measures in the Government Plan if it is clear how they will be achieved is covered in **Section 2.2.2.**
- The Panel recommended surpluses should be transferred to the Stabilisation Fund which is covered in **Section 2.5.1**

- Construction capacity constraints may place pressure on the achievability of the capital programme and is covered in **Section 2.2.6**
- In their 2022 Medium Term Report, the Panel recommended that the PYB debts be transferred to the Strategic Reserve to strengthen reserves has not been followed and is discussed in **Section 2.5.2.**
- The recommendation that some of the projected surpluses could be used to provide targeted support and offset a short-term risk to consumption is addressed in **Section 2.4**

2.9 Future fiscal considerations

The Government Plan 2023-2026 sets out several fiscal considerations for 2023. It is one of the Panel's key principles that fiscal policy needs to be focussed on the medium term and it is prudent to consider these issues. For the other issues, the Panel analyses the proposed approach below.

2.9.1 Long-term sustainability of the Jersey Teachers Superannuation Fund

The repayment of the Jersey Teachers Superannuation Fund (JTSF) Pension Increase Debt (PID) in 2022 has supported the long-term sustainability of the final salary pension scheme. However, the contributions currently being paid into the JTSF are unlikely to be sufficient to pay for the future accrual of benefits. An Actuarial Review is expected to be completed in early 2023.

It remains appropriate not to implement any additional revenue measures but **detailed plans to ensure the long-term sustainability of the JTSF will be needed following the completion of the Actuarial Review in early 2023.**

2.9.2 Technology Accelerator Fund

As part of the previous Government Plan, half of the £40m extraordinary dividend from JT transferred to the Technology Accelerator Fund. An initial grant of £230k will be paid to Digital Jersey in 2022 to design a detailed programme for the fund. The fund is expected to be fully used by 2025.

2.9.3 Coastal Management Strategy / Shoreline Management

The previous Government Plan committed to considering long-term funding requirements in 2022 and make recommendations. No such recommendations have been included in this Plan.

2.9.4 Actuarial review of Social Security Funds / Health Insurance Fund

The outcome of the actuarial reviews of the Social Security Funds and Health Insurance Fund will be published during the course of 2023. The Panel awaits the outcome of these reviews to provide further comment.

2.10 Long-term fiscal considerations

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

- Carbon Neutral Roadmap and associated costs and loss of incomes associated. Expert analysis produced for the States Assembly in 2019 suggests achieving net zero by 2030 would cost between £60m and £360m. The funding strategy 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.**