States of Jersey

IFG UPDATE REPORT ON DRAFT FORECASTS OF STATES INCOME FROM TAXATION AND DUTY FOR THE PREPARATION OF MTFP 2016-2019

AS PRESENTED TO THE COUNCIL OF MINISTERS 18TH JUNE 2015

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States of Jersey

Council of Ministers Report

18 June 2015

IFG Update Report on Draft Forecasts of States Income from Taxation and Duty for the preparation of MTFP 2016-2019

Executive Summary

1. Purpose

To provide draft forecasts of States income from taxation and duty for the Council of Ministers to inform the preparation of the next MTFP 2016-2019.

2. Background

The forecasts for all States income derived from taxation and duty were reviewed by the new Income Forecasting Group (IFG) in March 2015 and these forecasts were included in the Resource Statement as an Addendum to the Strategic Plan P27/2015.

The IFG recommended that a further review be carried out and presented to the Council of Ministers in May 2015, to ensure the MTFP 2016-2019 would be based on the most up to date information.

This report provides the recommended update on the forecasts of States income from taxation and duties as at May 2015.

The IFG forecasts represent a large proportion of States income but exclude other States income from the Island Rate, dividends and returns from States Investments and other fees which are produced and reported separately.

3. Summary of Draft Forecasts of States Income from Taxation and Duty

The IFG is presenting the current forecast range in line with the agreed timetable and to inform the proposals for the MTFP.

There is much uncertainty in the economic outlook, as commented by the Fiscal Policy Panel in its Pre-MTFP Report in January. For this reason, while a central scenario has been produced by the IFG using best estimates of the variables on which the income forecast is based, it is essential that appropriate flexibility is built into the proposals for the MTFP 2016 – 2019 to recognise that uncertainty.

The IFG emphasises to Ministers that within the range identified there are a number of risks to the downside due to –

- The uncertainty in the forecast period with respect to changes in taxpayer behaviour as a result of the taxation of 0% company profits only on distribution. The changes in behaviour which could occur include: (i) the enveloping of personally held income bearing assets within corporates; and (ii) the adoption of a non- or lower-distribution policy by those taxpayers who do not need to distribute all their corporate profits on an annual basis.

- The impact on the banks, who are a major contributor to corporate and individual taxable income, of the UK banking reform programme.

- Uncertainty about the combined impact of future changes in fiscal policy such as public sector reform and future capital expenditure.

- The impact on business decisions of the uncertainty of the outcome for Jersey of any referendum on the UK's future relationship with the EU.

- High level of uncertainty in general terms and in particular around prospects for the global economy and Eurozone.

Although there is significant uncertainty around these downside risks and therefore the likely scale of impact, if a number of these were to come to fruition they could cause the forecasts to trend towards the lower range of the forecasts. This is why the Group is recommending that the Council must identify appropriate contingency plans for the MTFP period.

There are however, potential benefits which could offset these downside influences arising out of the general recovery of the economy supported by the jobs and growth policy.

<u>Movement in forecasts since MTFP 2013-2015</u>

In early 2012, when the original MTFP economic assumptions and forecasts were prepared, while the euro crisis had begun to unfold, the extent and depth of the consequences were not fully apparent. This meant that forecasts at this time did not fully anticipate the fallout from the euro crisis, that recovery in the international economy was delayed and that the low interest rate environment would be maintained for longer than expected. This had direct and indirect implications for the Jersey economy which ultimately meant that it was weaker for much longer and that growth in average earnings and employment more subdued than originally anticipated. The biggest impact was on the forecasts of income tax revenues.

The forecasts of States income in the Budget 2015 identified a reduction compared to MTFP forecasts of £35 million in 2014 and £50 million in 2015.

The 2015 Budget proposed measures to manage the deficits in 2014 and 2015 and the indications were that these reductions in income forecasts were not temporary and would need to be addressed with sustainable measures over the period of the next MTFP 2016-2019.

<u>Draft MTFP forecasts 2016-2019 (March 2015)</u>
The **March 2015 update**, reported in the Resources Statement (P27/2015 Add), was based on the provisional 2014 outturn and economic assumptions from the FPP Pre-MTFP Report in **January 2015** and showed a further reduction in States income forecasts. The reduction was primarily due to:

- A reduction in the 2014 outturn for income tax relative to the Budget 2015 forecast.
- A smaller reduction in income forecasts from 2016 to 2018 reflecting slightly lower assumptions for average earnings, employment, inflation and financial services profits growth (as a result of new information from financial services companies)

- A further reduction in income from 2018, with all economic assumptions from 2018 being based on the long-term trend rate of economic growth of 0% in real terms.

Draft MTFP Forecasts 2016-2019 (May 2015)

The **latest update**, which is to be used as the basis for the draft MTFP, is based on further revised economic assumptions **as at April 2015**, which have been endorsed by the FPP: There are three key changes to the assumptions – lower financial services profit growth, slightly higher inflation in 2015 and 2016 and interest rates are expected to be very slightly lower in 2015 and 2016 and very slightly higher in 2017. As a result:

- The forecast models for income tax and impôts duties have been recast for the new economic assumptions.
- The forecasts for GST are based on past trends related to the overall direction of the economy and are therefore not affected by the minor changes in economic assumptions.
- Stamp duty forecasts are based on assumptions for house prices and market turnover which are unchanged since the last update and there is no additional data to affect the future forecasts.
- The 2015 stamp duty forecast has increased based on improved in-year information.

Further information is also available which has been taken into account in re-modelling the income tax forecasts this relates to:

- New employment data for December 2014, which shows stronger than expected employment growth in the last half of 2014.
- Analysis of Business Tendency Survey data from December 2014 influencing the central financial services profits assumptions. [The March 2015 BTS has subsequently been published with key indicators generally more positive than the December 2014 survey].
- Updated information on company income tax assessments for 2014 following the formal appeal period, these figures affect the starting point of the company income tax forecast for 2015 and specific information relating to future years expected tax liability.

Figure 1 Draft MTFP forecasts for 2016-2019 for States income from taxation and duty

	Draft MTFP 2 forecasts				
States Income from Taxation and Duty	**2015 £'000**	**2016 £'000**	**2017 £'000**	**2018 £'000**	**2019 £'000**
- Income Tax	438,000	458,000	475,000	499,000	519,000
- GST	81,740	83,334	84,968	85,779	86,609
- Impôt Duties	55,323	55,367	55,444	55,615	55,820
- Stamp Duty	26,890	26,357	28,802	30,946	31,800
Higher Scenario	*612,786*	*645,639*	*675,646*	*717,678*	*755,503*
Central Scenario	601,953	623,058	644,214	671,340	693,229
Lower Scenario	*592,162*	*600,611*	*613,123*	*624,660*	*633,044*
		3.5%	*3.4%*	*4.2%*	*3.3%*
MTFP2 Forecast (March 2015)	605,483	627,789	656,939	685,093	708,011
Variation	(3,530)	(4,731)	(12,725)	(13,753)	(14,782)
Budget 2015 (May 2014) Forecast as amended	615,137	640,476	668,592	700,456	737,682
Variation	(13,184)	(17,418)	(24,378)	(29,116)	(44,453)

4. Recommendation

The IFG presents it forecasts for the period 2015-2019 as a range around a central scenario. In light of the uncertainties in the outlook, the IFG would recommend it is imperative that the Council of Ministers builds sufficient flexibility into the plans for the draft MTFP 2016-2019 particularly given the IFG's view that the risks to the central forecast are to the downside.

Main Report

1. Purpose

To provide draft forecasts of States income from taxation and duty for the Council of Ministers to inform the preparation of the next MTFP 2016-2019.

2. Background

The forecasts for all States income derived from taxation and duty were reviewed by the new Income Forecasting Group (IFG) in March 2015 and these forecasts were included in the Resource Statement as an Addendum to the Strategic Plan P27/2015.

The IFG recommended that a further review be carried out and presented to the Council of Ministers in May 2015, to ensure the MTFP 2016-2019 would be based on the most up to date information.

This report provides the recommended update on the forecasts of States income from taxation and duties as at May 2015.

The IFG forecasts represent a large proportion of States income but exclude other States income from the Island Rate, dividends and returns from States Investments and other fees which are produced and reported separately.

3. Income Forecasting Group (IFG)

The forecasts of States income are a critical component of the States medium and long term financial planning. They are also required as part of an annual Budget and MTFP, alongside forecasts of States expenditure, to assess the projected balance on the Consolidated Fund. This is a requirement of the Treasury and Resources Minister as part of the Public Finances (Jersey) Law.

The largest single component of States income is income tax revenue. For several years an Income Tax Forecasting Group (ITFG) has been responsible for advising the Treasurer in respect of the forecast for income tax revenues.

The format and remit of this group has been reviewed and the Treasury and Resources Minister has approved the Terms of Reference of a new Income Forecasting Group (IFG).

The new group has been established to improve and formalise the process by which the Minister for Treasury and Resources and the Council of Ministers are provided with robust forecasts of States income from taxation and duty. The Terms of Reference are attached as **Appendix A**. This will become a part of the updated Fiscal Framework to be prepared alongside the next MTFP.

The Group will report at least twice a year, no later than March and no later than September to inform the annual Budget. In an MTFP year, such as 2015, a further update will be prepared between the March update and the lodging of the MTFP, as appropriate.

4. Summary of Draft Forecasts of States Income from Taxation and Duty

This latest forecast has been prepared by officers and reviewed by the IFG.

There is much uncertainty in the economic outlook, as commented by the Fiscal Policy Panel in its Pre-MTFP Report in January. For this reason, while a central scenario has been produced by the IFG using best estimates of the variables on which the income forecast is based, it is essential that appropriate flexibility is built into the proposals for the MTFP 2016 – 2019.

The IFG emphasises to Ministers that within the range identified there are a number of risks to the downside within the forecast range due to –

- The uncertainty in the forecast period with respect to changes in taxpayer behaviour as a result of the taxation of 0% company profits only on distribution. The changes in behaviour which could occur include: (i) the enveloping of personally held income bearing assets within corporates; and (ii) the adoption of a non- or lower-distribution policy by those taxpayers who do not need to distribute all their corporate profits on an annual basis.

- The impact on the banks, who are a major contributor to corporate and individual taxable income, of the UK banking reform programme.

- Uncertainty about the combined impact of future changes in fiscal policy such as public sector reform and future capital expenditure.

- The impact on business decisions of the uncertainty of the outcome for Jersey of any referendum on the UK's future relationship with the EU.

- High level of uncertainty in general terms and in particular around prospects for the global economy and Eurozone.

Although there is significant uncertainty around these downside risks and therefore the likely scale of impact, if a number of these were to come to fruition they could cause the forecasts to trend towards the lower range of the forecasts. This is why the Group is recommending that the Council must identify appropriate contingency plans for the MTFP period.

There are however, potential benefits which could offset these downside influences arising out of the general recovery of the economy supported by the jobs and growth policy.

<u>Movement in forecasts since the MTFP 2013-2015</u>
The March 2012 forecast used in the MTFP 2013-2015 was based on analysis conducted largely in February 2012 and in particular drew on the most up to date forecasts by the FPP for the Jersey economy, by the OBR for the UK economy and by the IMF and other forecasters for the global economy.

In early 2012 while the euro crisis had begun to unfold, the extent and depth of the consequences were not fully apparent. This meant that forecasts at this time did not fully anticipate the fallout from the euro crisis, that recovery in the international economy was delayed and that the low interest rate environment would be maintained for longer than expected. This had direct implications for the financial services sector in Jersey, particularly the banking sector. In addition, the resultant weaker demand within the Jersey economy and in our export markets impacted on other sectors and resulted in the economy overall being weaker for much longer than originally anticipated. As a consequence of these trends the labour market underperformed with growth in average earnings and employment more subdued than had been expected. The biggest impact was on the forecasts of income tax revenues.

By the time of the modelling for the March 2013 forecast the extent of the euro crisis and its impact on the global economy was much more apparent and it was clear that the Jersey economy was not performing as well as expected. GVA growth was below expectations and quite crucially for income tax forecasts earnings and employment trends also significantly weaker than expected. This also led to reductions in future economic assumptions for these variables as expectations of recovery were pushed back. This delay in economic recovery meant that personal income tax growth was revised down by about £25m in 2014 and £30m in 2015 and was the sole reason for the downgrading of forecasts at that time (and partially offset by expectations of higher corporate tax from in year forecasting).

When the forecasts were updated in March 2014 leading to the Budget 2015 forecasts the economic assumptions were revised in the light of the latest economic developments locally and internationally and based on the most recent FPP forecasts. The revisions to the forecast due to economic assumptions were not significant and included slightly weaker growth in earnings and employment in 2013, 2014 and 2015. In addition, overall economic growth was revised up slightly in 2015-17 as interest rates were expected to rise sooner (in line with market expectations) and that this could have led to stronger growth in financial services profits.

Other factors also contributed to the further weakening of the 2015 Budget forecasts, particularly in income tax:

- A reduction in 2013 outturns causing a revision of the 2013 tax base by £5 million,
- In year company tax information for 2014 resulting in an adjustment of £5 million,
- The combined impact of 2014 Budget measures, including the reduction in the marginal rate from 27% to 26%, amounted to £5 million.

The overall reduction in the 2015 Budget forecasts relative to the original MTFP forecasts amounted to £35 million in 2014 and £50 million in 2015.

The 2015 Budget proposed measures to manage the deficits in 2014 and 2015 and the indications were that these reductions in income forecasts were not temporary and would need to be addressed on a sustainable basis over the period of the next MTFP 2016-2019.

<u>Draft MTFP forecasts 2016-2019 (March 2015)</u>

The **March update**, reported in the Resources Statement (P27/2015 Add), was based on the provisional 2014 outturn and economic assumptions from the FPP Pre-MTFP Report in **January 2015** and showed a further reduction in States income forecasts. The reduction was primarily due to:

- A reduction in the 2014 outturn for income tax relative to the Budget 2015 forecast.
- A smaller reduction in income forecasts from 2016 to 2018 reflecting slightly lower assumptions for average earnings, employment, inflation and financial services profits growth (as a result of new information from financial services companies).
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<u>Draft MTFP Forecasts 2016-2019 (May 2015)</u>

The **latest update**, which is being used as the basis for the draft MTFP, is based on revised economic assumptions **as at April 2015** which have been endorsed by the FPP. There are three key changes to the assumptions – lower financial services profit growth, slightly higher inflation in 2015 and 2016 and interest rates are expected to be very slightly lower in 2015 and 2016 and very slightly higher in 2017. As a result:

- The forecast models for income tax and impôts duties have been recast for the new economic assumptions.
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Further information is also available which has been taken into account in re-modelling the income tax forecasts this relates to:

- New employment data for December 2014, which shows stronger than expected employment growth in the last half of 2014.
- Analysis of Business Tendency Survey data from December 2014 influencing the central financial services profits assumptions. [The March 2015 BTS has subsequently been published with key indicators generally more positive than the December 2014 survey].
- Updated information on company income tax assessments for 2014 following the formal appeal period, these figures affect the starting point of the company income tax forecast for 2015 and specific information relating to future years expected tax liability.

A summary of the draft forecasts for the MTFP 2016-2019 are shown in Figure 2, together with a comparison with the Budget 2015 forecast and previous forecasts in Figure 3.

Figure 2 Draft MTFP forecasts for 2016-2019 for States income from taxation and duty

	Draft MTFP 2 forecasts				
States Income from Taxation and Duty	**2015 £'000**	**2016 £'000**	**2017 £'000**	**2018 £'000**	**2019 £'000**
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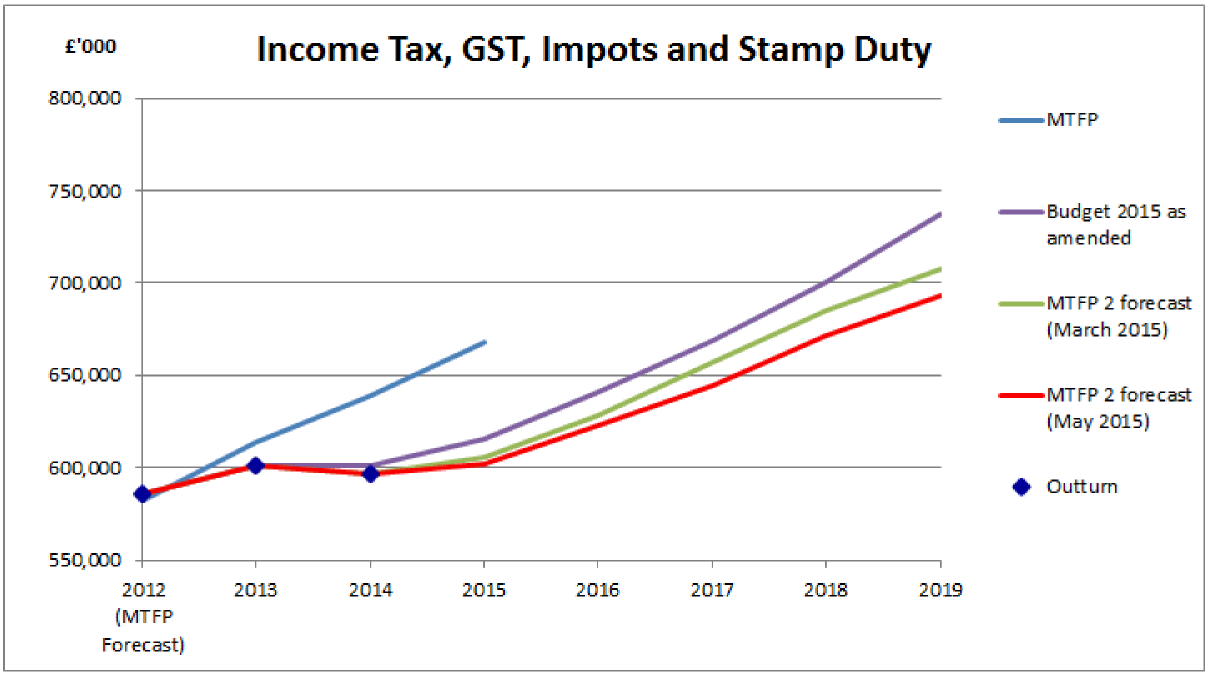
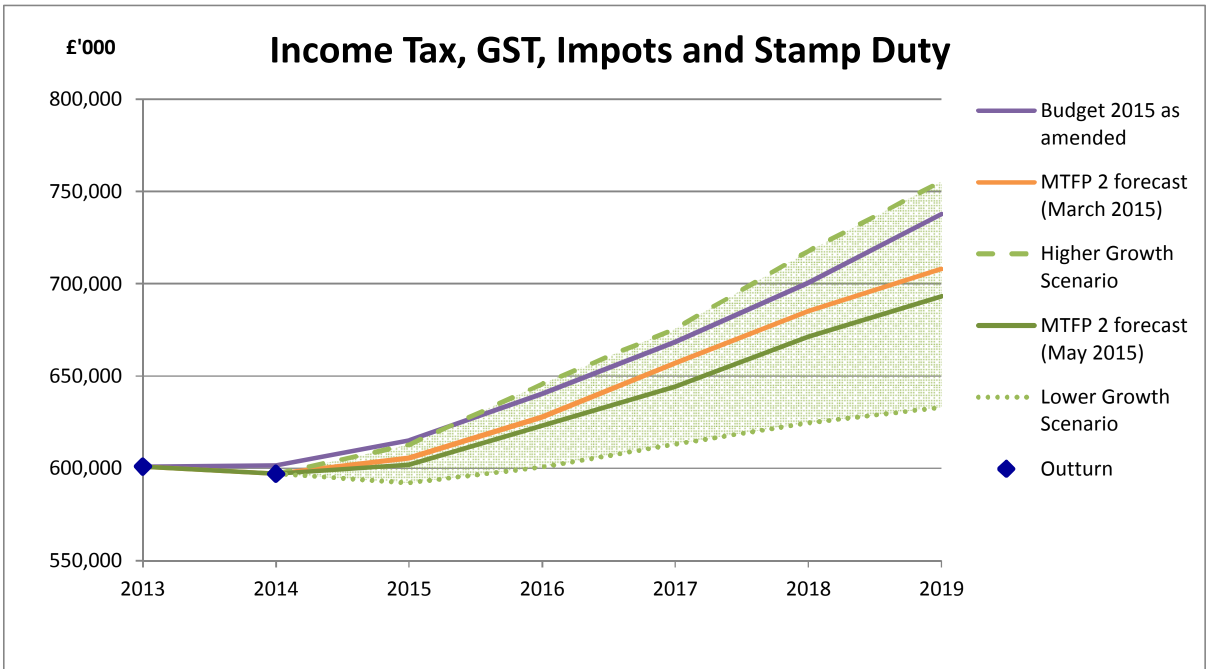
Figure 3 - Movement in Forecasts of States income from taxation and duty for 2013-2019 – Amend to MTFP, Budget 2015 and May 2015 forecasts only



<u>Overall range of forecasts</u>
The economic assumptions from the FPP Pre-MTFP report provide a range of assumptions higher, lower and central. These assumptions are used within the modelling of the different types of States income along with some other factors to provide an illustrative range within which the central forecast sits. The forecast range will provide an indication of the likely risk in the income forecasts and can be used to establish a degree of flexibility within the forward plans.

Figure 4 – Range of Income Forecasts from Taxation and Duty (May 2015)



The Graph illustrates the movement from the 2015 Budget forecast (as amended) to the draft MTFP2 Forecasts from May 2015.

5. Economic Assumptions 2014-2019

R102/2014 'Updating the Fiscal Framework' recommended the involvement of the FPP in the preparation of economic assumptions to be used for financial forecasting. In the Panel's first Pre-MTFP Report, economic assumptions have been produced for 2014-2019 and endorsed by the Panel for use in the preparation of the financial forecasts.

IFG has considered the latest economic assumptions endorsed by the Fiscal Policy Panel (FFP) in April 2015 and agreed that these assumptions be used as the basis for the draft income forecast modelling for the MTFP 2016-2019.

The economic assumptions factor in the latest local and international developments. A detailed report has been prepared for IFG (see **Annex 2**) and is summarised here.

Changes in assumptions 2015 Budget to FPP Pre MTFP Report (January 2015)
The main features of the economic assumptions when compared to the Budget 2015 are:

- Real economic growth is expected to be slightly stronger in 2014 and 2015 but slightly weaker in 2016 and 2017. For 2018 and beyond the FPP advised that the States should plan on the basis of a trend rate of real growth of 0%.
- Inflation (as measured by RPI and RPIY, for example) is expected to be lower until 2017, recognising the recent sharp falls in oil prices and lower market expectations for interest rate increases.
- Financial services profits are expected to grow more slowly following information obtained through a series of interviews with financial services companies in November and December 2014. This is a key assumption for the company income tax forecast.
- Employment is expected to grow more quickly in 2014 and 2015 rather than in 2016 and 2017.
- Average earnings growth is expected to be weaker in 2015 and 2016.
- Interest rates are now expected to increase later and more slowly, according to financial markets expectations.

Changes in assumptions FPP Pre MTFP Report (January 2015) to April 2015
There are three key changes to the latest assumptions relative to the assumptions made in January:

1. Financial services profit growth – is now expected to be slower in 2015, 2016 and 2017.
2. Inflation – is now expected to be slightly higher in 2015 and 2016.
3. UK policy interest rates – are now expected to be very slightly lower in 2015 and 2016 and very slightly higher in 2017.

Figure 5 draft Economic Assumptions for MTFP 2014-2019 (April 2015)
(numbers in red show figure that have changed)

Central scenario - updated 14 April 2015					Return to trend	
	2014	2015	2016	2017	2018	2019
Real GVA	1.6	1.2	1.1	1.4	0.0	0.0
RPI	1.6	1.6	3.1	3.1	3.3	3.3
RPIY	1.6	1.8	2.6	2.6	3.0	3.0
Nominal GVA	3.2	3.0	3.7	4.0	3.0	3.0
Company profits(a)	2.5	2.4	3.3	3.7	3.0	3.0
Financial services profits	1.8	1.1	3.1	3.3	3.0	3.0
Compensation of employees(b)	3.7	3.5	4.0	4.3	3.0	3.0
Employment	1.0	1.0	0.5	0.5	0.0	0.0
Average earnings	2.6	2.5	3.0	4.0	3.0	3.0
Interest rates (%)	0.5	0.5	1.1	1.6	2.0	2.5
House prices	3.3	3.0	4.0	5.0	3.0	3.0

OUTTURNS

(a) Gross profits for all companies, including traders.

(b) The number of employees multiplied by the costs of employment (wages, bonuses, pensions).

Range in Economic Assumptions

The economic assumptions from the FPP (April 2015) have been expanded to provide an upper and lower range of assumptions. The range of assumptions will inform the MTFP planning in terms of the levels of risk in States income and the scale of flexibility that may need to be considered and provided for over the four year period.

The economic assumptions and the range in the assumptions are discussed further in **Annex 2** to the main Income Tax Update Report (attached).

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6. Draft Income Tax Forecasts 2015-2019 from IFG

The Taxes Office have provided data on the personal and company income for the year of assessment 2013 (YOA 2013) together with the values of exemptions and allowances.

The model is tested by running the actual tax data through it and checking the results against the 2014 outturn. Any amendments to the model can be made to improve the forecasting model going forward.

There were several new sources of information between the Budget 2015 and the March 2015 forecast:

- The Taxes Office had new information on personal and company tax assessments for YOA 2013.
- The Statistics Unit had published data on economic variables, such as for economic growth, employment and average earnings.
- The Fiscal Policy Panel (FPP) published their pre-MTFP report[1] which contains a new economic growth forecast for Jersey and the underlying economic assumptions, these have subsequently been updated in April 2015 and further endorsed by the FPP.
- The latest market expectations for interest rates, for example, those published in the Bank of England's Inflation Report.
- 2014 ITIS data providing information on employment income trends.
- Initial information from tax agents and interviews with major financial institutions

Further information has been included in the latest update (May 2015):

- Updated Fiscal Policy Panel economic assumptions for 2015-2017. In particular, slightly lower financial services profits growth expectations and slightly higher inflation expectations compared to the last set of economic assumptions (end of January 2015).
- New employment data for December 2014, which shows stronger than expected employment growth in the last half of 2014.
- Updated information on company income tax assessments for 2014 following the formal appeal period, these figures affect the starting point of the company income tax forecast for 2015 and specific information relating to future years expected tax liability.

The latest economic assumptions are summarised in Section 5 and described in detail at **Annex 2** the main Income Tax Update Report (attached).

[1] Fiscal Policy Panel Pre-MTFP Report 2015, http://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/R%20Fiscal%20Policy%20Panel%202015%20annual%20report%2020150130%20JE.pdf

Variations in Income Tax Forecast from Budget 2015

The variations in income tax forecast since the Budget 2015 are shown in the two updates March 2015 and May 2015.

Figure 6 shows the differences between the March 2015 forecasts and those at Budget 2015 and Figure 7 shows the further variations between the latest May 2015 forecasts and the March 2015 update.

Figure 6 – Variations in Income Tax from Budget 2015 to March 2015

	Actual	Forecast					
	2013	2014	2015	2016	2017	*2018*	*2019*
	£m	£m	£m	£m	£m	*£m*	*£m*
Personal tax							
Budget 2015 forecast	**357**	**364**	**373**	**386**	**404**	**425**	**452**
2014 outturn		-8	-8	-8	-8	-8	-8
2015 Budget measures				2	2	2	2
2015 in-year estimate of employment income			-4	-4	-4	-4	-4
Updated economic assumptions			0	0	3	4	-5
Current provisional forecast	**357**	**356**	**360**	**376**	**397**	**419**	**437**
Company tax							
Budget 2015 forecast	**98**	**84**	**85**	**91**	**97**	**103**	**109**
2014 outturn		-1	-1	-1	-1	-1	-1
2015 in-year estimate of top 100 taxpayers			2	2	2	2	2
Updated economic assumptions			0	-3	-5	-7	-10
Current provisional forecast	**98**	**83**	**86**	**89**	**93**	**97**	**100**

Note: the 2013 outturn included a one-off £10 million tax receipt.

At the time of the March 2015 forecast, income tax revenues were expected to be £12 million lower from 2015 than expected in the forecast for the 2015 Budget.

Figure 7 – Variations in Income Tax from March 2015 to May 2015

	Forecast				
Budget year	**2015**	**2016**	**2017**	**2018**	**2019**
	£m	**£m**	**£m**	**£m**	**£m**
Provisional forecast	360	376	397	419	437
Higher exemption thresholds	-1	-1	-2	-2	-3
Updated central forecast	**359**	**375**	**395**	**417**	**434**
Company income tax					
	Forecast				
Budget year	**2015**	**2016**	**2017**	**2018**	**2019**
	£m	**£m**	**£m**	**£m**	**£m**
Provisional forecast	86	89	93	97	100
2015 in year estimate - YOA 2014 assessments	-2	-2	-2	-2	-2
Repayment on past assessments	-1	0	0	0	0
2015 in-year news on YOA 2016 for 2017	0	0	-5	-5	-5
Lower financial services profits growth	0	-2	-4	-5	-5
Updated central forecast	**82**	**85**	**82**	**85**	**88**
Net change to income tax forecast	-5	-5	-13	-14	-15

Summary Forecasts

Figure 8 – Updated Income Tax Forecast 2015-2019

March 2015:	Forecast				
Budget year	**2015**	**2016**	**2017**	**2018**	**2019**
	£m	**£m**	**£m**	**£m**	**£m**
Personal	360	376	397	419	437
Companies	86	89	93	97	100
Bad debts	-3	-2	-2	-3	-3
	443	**463**	**488**	**513**	**534**
Annual growth	6	20	24	26	21
Annual growth, %	1%	4%	5%	5%	4%

May 2015:	Forecast				
Budget year	**2015**	**2016**	**2017**	**2018**	**2019**
	£m	**£m**	**£m**	**£m**	**£m**
Personal	359	375	395	417	434
Companies	82	85	82	85	88
Bad debts	-3	-2	-2	-3	-3
	438	**458**	**475**	**499**	**519**
Annual growth	1	19	17	24	21
Annual growth, %	0%	4%	4%	5%	4%

The May 2015 forecast shows a further reduction in income tax forecasts of £5 million in 2015, compared to the March 2015 update.

<u>Forecast range</u>

The Group also considered the suggested range around the forecasts which had been calculated using the range in relevant economic assumptions. However, the Group felt that a more significant variation was required in the early years 2015 and 2016 and this is reflected in Figure 9.

Figure 9 – Range of income tax forecasts

Budget year	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Upper		447	476	499	535	568
Central	**437**	**438**	**458**	**475**	**499**	**519**
Lower		430	440	451	462	471
Range as a % of central, +/-		2%	4%	5%	7%	9%

The detailed income tax forecasting note from IFG providing an update for May 2015 is attached as **Appendix 1** and the initial income forecasting note from March 2015 is attached as **Annex1.**

7. Draft GST and ISE Forecasts 2015-2019 from IFG

There are three components of the GST forecast:

- GST on purchases of goods and services on Island,
- GST on imports, and
- International Service Entity Fees (ISE) fees paid by businesses exempt from GST.

GST on purchases on Island

Good & Services Tax (GST) was introduced in 2008 and is collected by the Taxes Office. GST is collected from duty paid on purchases of goods and services on the Island. Initially introduced at 3% the GST rate was increased to 5% in 2011.

In year GST forecasts are usually modelled using the previous increases in actual GST income as a base to project forward. MTFP1 GST forecasts were based on the economic assumptions at the time (March 2012) which were for economic growth and inflation. During the last 3 years the actual GST income has been lower than forecast in MTFP1.

The Group asked for information on the trends in GST over the period since 2008 and the average increase has been 0.5% over the period. However, in 2014 the increase has been stronger at 2%, probably reflecting the improving economic conditions.

The Group asked if similar trends could be identified by sector to provide more detail on individual trends about which forward assumptions could be made. Detailed trends for the various sector where subsequently provided but there were no obvious correlations identified that would help improve the forward forecast.

The proposal is that for 2015 to 2017, while economic growth is forecast to continue, to use the recent 2% trend. For 2018 and 2019 the longer term average of 0.8% is used.

GST on imports

Import GST has increased gradually in recent years. Over the last 3 years it has increased by an average 6% per annum reflecting an increase in on-line sales. The MTFP2 forecast has been developed based on this trend growth. The Group has no reason to believe this trend will not continue.

ISE Fees

ISE Fees are a relatively stable income stream for the States and have consistently been around £9 million per annum.

The 2014 outturn was £9.04 million in line with the November 2014 provisional forecast and the Budget 2015. The MTFP2 forecast assumes £9 million of ISE fees per annum.

Variations between Budget 2015 and May 2015 forecasts

In the 2015 Budget the emerging trend in 2014 was used to forecast forward over the MTFP2 period. At the time economic growth was assumed to continue through to 2019, rather than the trend % real growth now assumed from 2018.

The main difference in the forecasts since the 2015 Budget arises out of the different economic assumptions beyond 2017.

The changes in economic assumptions and additional information on in-year 2015 figures between the March and May 2015 updates have not affected the forecasts proposed for the draft MTFP 2016-2019.

Figure 10 – Summary GST draft forecasts 2015-2019 (May 2015)

		Draft MTFP2 Forecasts				
Budget Year	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
GST	67,904	69,262	70,647	72,060	72,637	73,218
Import GST	3,281	3,478	3,687	3,908	4,142	4,391
ISE Fees	9,042	9,000	9,000	9,000	9,000	9,000
Total GST	**80,227**	**81,740**	**83,334**	**84,968**	**85,779**	**86,609**
Annual Growth %		*1.9%*	*2.0%*	*2.0%*	*1.0%*	*1.0%*
Budget 2015 Forecast	79,107	80,650	82,584	84,571	86,460	89,171
Variation	1,120	1,090	750	397	- 681	- 2,562

Note: These forecasts are unchanged from those presented to CoM in March 2015

<u>Forecast Range</u>

Following proposals from the Economics Unit to the IFG the recommendation is that:

- A lower range 1% below the central assumption and a higher range 1% above the central assumptions is used for MTFP2 for forecasting net GST.
- A wider 2% range above and below the central forecast is proposed for import GST reflecting the higher trend growth assumption for this income stream.
- ISE fees are relatively stable between years, and a 0.5% range above and below the central forecast is proposed.

The overall effect of the range of forecasts is shown in Figure 10.

Figure 11 – GST draft forecast range (May 2015)

		Draft MTFP2 Forecasts				
Budget Year	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Higher	80,227	82,530	84,911	87,379	88,897	90,460
Central	**80,227**	**81,740**	**83,334**	**84,968**	**85,779**	**86,609**
Lower	80,227	80,995	81,818	82,652	82,800	82,953
Range £'000	-	1,535	3,093	4,727	6,097	7,507
Range %	0%	2%	4%	6%	7%	9%

Note: The forecast range is unchanged from those presented to CoM in March 2015

8. Draft Impôts Duty Forecasts 2015-2019 from IFG

Impôts duties are levied on a range of commodities imported to the Island. The duties on the various commodities, principally alcohol, tobacco and fuel are reviewed at the annual Budget. The duty increases for alcohol and tobacco are influenced by the strategies for particular Health improvement and reduction in consumption policies rather than a policy to raise additional revenues.

The policies in that regard can be considered fairly successful based on the importation trends. These show that for most alcohol and tobacco commodities the long-term trend is for reduced importation. There is evidence to suggest an increase in duty free consumption but this is actively policed by customs.

The basis of the impôts duty forecasts is to take the latest 2014 outturn and to apply the last 10 year average importation figures and then to forecast the future duty rates.

<u>10 year importation trend</u>
Customs maintain records going back a number of years and on statistical advice use a 10 year average of importation trends to forecast future levels.

The average 10 year trends by commodity are:

Spirits	98%
Wines	101%
Cider	103%
Beer	98%
Tobacco	94%
Fuel	100%

<u>Increases in Impôts duty rates</u>

The Group discussed the appropriate uprating of impôts duty rates and requested information from customs on the impact of above and below RPI increases in duty on the following year's importation. The information showed that there was no real correlation and the Customs Director confirmed that this had been looked at previously with a similar outcome.

The Group therefore concluded that it was appropriate to assume that recent policies in annual Budgets would continue, particularly as updates to both the Tobacco and Alcohol and Licensing Strategies were not due ahead of the next MTFP. Analysis of recent budgets showed that broadly RPI increases for tobacco and alcohol were common and that increases to fuel and other commodities were less likely.

The forecasts use the current 2015 Budget rates and assume RPI increases in future years for alcohol and tobacco only.

From 2014 a new bonded warehouse scheme has been introduced by customs to deter profiteering around budget announcements for the following year. This reduced tobacco taken to duty in 2014 but correspondence with the tobacco wholesalers suggests that this will be a one-off effect and future forecasts should not be affected.

Figure 12 - Draft MTFP forecasts for impôts duties (May 2015)

		Draft MTFP2 Forecasts (May 2015)				
Budget Year	*2014*	2015	2016	2017	2018	2019
	£'000	£'000	£'000	£'000	£'000	£'000
Impôts on Spirits	*4,801*	4,703	4,752	4,802	4,861	4,921
Impôts on Wine	*7,615*	7,527	7,838	8,161	8,515	8,883
Impôts on Cider	*988*	1,061	1,127	1,196	1,273	1,355
Impôts on Beer	*5,285*	5,365	5,420	5,477	5,544	5,612
Impôts on Tobacco	*13,788*	14,142	13,705	13,283	12,897	12,524
Impôts on Fuel	*20,708*	21,589	21,589	21,589	21,589	21,589
Impôts on Other Goods	*161*	175	175	175	175	175
Vehicle Emissions Duty	*760*	761	761	761	761	761
Total Impôts Duties	***54,102***	**55,323**	**55,367**	**55,444**	**55,615**	**55,820**
Annual Growth %		*2.3%*	*0.1%*	*0.1%*	*0.3%*	*0.4%*
Budget 2015 Forecast	*55,613*	55,649	55,587	55,558	55,566	55,602
Variation £'000	*(1,511)*	(326)	(220)	(114)	49	218
March 2015 Forecast	*54,102*	55,219	55,098	55,169	55,368	55,602
Variation £'000	-	104	269	275	247	218

Variation from March 2015 to May 2015

The forecasts have been revised to reflect the in-year information for 3 months actuals for 2015 and also the small variation in RPI assumptions which affect the duty rate increase assumptions from 2016 onwards.

Forecast range

An approach to providing a range around the impots duty forecast was accepted by the Group and this uses the variation around the RPI assumptions compounded by a +/-1% variation on future importation assumptions. The impact on the central forecasts is shown in Figure 13.

Figure 13 – Impôts draft forecast range (May 2015)

		Draft MTFP2 Forecasts (May 2015)				
Budget Year	*2014*	2015	2016	2017	2018	2019
	£'000	£'000	£'000	£'000	£'000	£'000
Higher	*54,102*	55,875	56,968	58,121	59,399	60,748
Central	***54,102***	**55,323**	**55,367**	**55,444**	**55,615**	**55,820**
Lower	*54,102*	54,770	53,799	52,880	52,064	51,295
Range £'000	-	1,105	3,169	5,241	7,335	9,453
Range %	*0%*	2%	6%	9%	13%	17%

9. Draft Stamp Duty Forecasts 2015-2019 from IFG

Stamp duty is charged on property, equity and share transfer transactions according to the value of the transaction. It is also collected on Wills, Probate and Obligations. The Stamp duty forecasts are separated into general stamp duty, stamp duty on probate and stamp duty on share transfer property transactions.

General Stamp Duty
The main component is duty on property and in addition the forecasts allow for a relatively fixed forecast of stamp duty on Obligations and Wills.

The duty on property transactions has been particularly volatile over the last five years, falling from over £14 million in 2009 to £10.7 million in 2013, a fall of 25% and then increasing to over £17 million in 2014, an increase of 64%.

The last MTFP was based on the actual stamp duty in 2011 of £13.3 million and an assumption for an economic recovery from 2012 and 2013. The lack of economic growth and depressed conditions in the property market for 2012 and 2013 have meant that stamp duty income has been well below the MTFP forecast in those years.

The current draft forecast for the next MTFP 2016-2019 has been based on a considerable analysis of the past years data. This has identified some key trends which informed the assumptions by the Group for the forward forecast, in particular to identify an approach which separates the forecasts for higher value properties over £2 million.

2014 Outturn – establishing a base for the MTFP forecasts 2015-2019
The reasons for the significant increase in 2014 were examined and have been identified as:

- a general increase in activity and increase in the average value of transactions
- an unusually large number of high value properties transacted in 2014 which were linked to the relocation of high net worth individuals to Jersey.
- the effect of the 2015 Budget announcing an increase in Stamp Duty rates for properties above £1m. This is thought to have led to an acceleration of high value property transactions leading up to the end of 2014 where purchasers looked to transact before rates increased. (A similar pattern of activity was seen in the first half of 2011 when Stamp Duty rates were also raised for properties over the value of £1m on 1st July 2011.)

The Group asked for information to be sought on potential high net worth activity and forecasts of high net worth residency applications in future years. As a result of this work with the High Net Worth Residency team, the Group has been able to identify that the activity in over £2 million property transactions in 2014 was unusual and based on latest information is unlikely to recur at a similar level in future years. However, there is sufficient evidence to suggest an increase in the assumption for the average number of high value residential transaction in future years. Information was also provided which suggests a further number of significant receipts in the first quarter of 2015 for which a one-off adjustment has been included, but not affecting future years.

The Group agreed to reduce the 2014 outturn figure to be used as the basis of the forward forecast. A positive adjustment was then agreed for the improved assumptions for high value properties.

The 2015 Budget measures were discussed with the conclusion that the net effect of these measures should be broadly neutral. The Group was not aware of any further changes in rates or policy that would affect the forward forecasts.

Economic Assumptions

The general stamp duty forecasts are modelled using economic assumptions for the forecast movement in house prices and the forecast level of housing market turnover. These are derived by the economics unit from the forecasts provided in the FPP report.

These assumptions, like the economic assumptions generally, are slightly more buoyant in the short term and less so from 2017 onwards compared to those used in the 2015 Budget forecasts. The market turnover assumptions forecast a return to pre downturn levels at about the point the economy is forecast to return to capacity in 2018/2019.

Stamp Duty on Share Transfer – Land Transaction Tax (LTT)

The majority of share transfer property transactions are for flats and apartments, and therefore likely to be lower value properties (on average) than non-share transfer property transactions. Therefore they are less likely to be subject to the anomalies and volatility seen on general property transactions.

The draft MTFP forecasts are based on an adjusted 2014 outturn and the same economic assumptions have been applied as for general stamp duty.

Probate duty

Probate duty is extremely difficult to forecast. It is the result of duty payable from individuals who die and are domiciled in Jersey, or where the individual is not so domiciled but have Jersey moveable property. Between 2009 and 2014 however, transactions have remained steady at around 2,000. Anomalies in income were seen in 2009 and 2012 due to one-off large transactions, but changes in the 2013 Budget have capped probate duty to £100,000 per estate as a competition measure to attract greater investment in the Island, so these anomalies will not be seen in future.

There are no economic assumptions applied to this forecast and a flat £2.5 million forecast is assumed based on the long term trend.

Draft MTFP Forecasts for 2015-2019 (May 2015)

The resulting draft MTFP forecasts in Figure 14 show an improvement in the early years and a slight deterioration by 2018 and 2019 compared to the 2015 Budget forecasts.

There is also a small improvement in 2015 relative to the forecasts presented to Council of Ministers in March 2015, due to actual results in the first three months of 2015. These are due to two significant over £2 million property transactions which are not considered to be a change in trend which would affect forward forecasts.

Figure 14 - Draft MTFP forecasts for Stamp Duty (May 2015)

		Draft MTFP2 Forecasts				
Budget Year	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Stamp Duty	21,988	23,075	22,376	24,669	26,680	27,481
Probate	2,735	2,500	2,500	2,500	2,500	2,500
Stamp Duty on Share Transfer (LTT)	1,254	1,315	1,481	1,633	1,766	1,819
Total Stamp Duty	**25,977**	**26,890**	**26,357**	**28,802**	**30,946**	**31,800**
Annual Growth %		*3.5%*	*-2.0%*	*9.3%*	*7.4%*	*2.8%*
Budget 2015 Forecast	22,730	23,838	25,605	27,763	31,730	33,209
Variation £'000	*3,247*	3,052	752	1,039	(784)	(1,409)

The 2014 and 2015 stamp duty is adjusted to reflect the high volume of >£2 million property transactions, as a result this skews the forecast profile of growth in stamp duty in the years to 2016. In 2017 to 2019 the annual growth in stamp duty, excluding probate duty, reflects the economic assumptions for the increase in market turnover and house prices for these years.

Forecast range

An approach to providing a range around the Stamp Duty forecast was accepted by the Group and this uses the variation around the economic assumptions on house prices. The impact on the central forecasts is shown in Figure 15.

Figure 15 – Stamp Duty draft forecast range (May 2015)

		Draft MTFP2 Forecasts				
Budget Year	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Higher	25,977	26,161	27,760	31,146	34,382	36,295
Central	**25,977**	**26,890**	**26,357**	**28,802**	**30,946**	**31,800**
Lower	25,977	24,888	24,994	26,591	27,796	27,796
Range £'000	-	1,273	2,766	4,555	6,586	8,499
Range %	0%	5%	10%	16%	21%	27%

10. Recommendation

The IFG presents it forecasts for the period 2015-2019 as a range around a central scenario. In light of the uncertainties in the outlook, the IFG would recommend it is imperative that the Council of Ministers builds sufficient flexibility into the plans for the draft MTFP 2016-2019 particularly given the IFG's view that the risks to the central forecast are to the downside.

APPENDIX A

Terms of Reference for an Income Forecasting Group

Purpose

The group is established as an advisory function on the forecasts of all States income from taxation and social security contributions which will be informed by economic assumptions produced by the Fiscal Policy Panel.

Objectives

To produce an absolute minimum of two forecasts each year

- A full review of states tax, social security contributions and duty revenue forecasts will take place following the provisional outturn and no later than March of each year.
- A further forecast to inform the Budget debate, no later than September, including any revised economic assumptions and experience form the current year actual revenues.
- In an MTFP year, a further update will be considered between the full review in March and the actual lodging of the MTFP.

To produce reports on the forecasts of states income from taxation and social security contributions, including:

- Forecasts for income tax revenues
- Forecasts for goods and services tax and ISE Fees
- Forecasts for impots duties
- Forecasts for stamp duties
- Forecasts for social security contributions
- Economic assumptions used; and
- Factors and risks that should be considered

The forecasts will cover a period of at least four years and include a range within which a central forecast can be applied

Reporting

The reports will be presented to the Treasury and Resources Minister in advance of the Council of Ministers consideration.

Once a report is approved by the Treasury and Resources Minister it will be published alongside the Medium Term Financial Plan and the Budget.

Other reports can be prepared on the request of the Treasury and Resources Minister.

Administration

All meetings will be minuted with agreed actions.

Quarterly review meetings will also be held.

Quorum – at least six of the nine members be present for the meetings to be considered quorate.

Any variations to the group membership once established to be agreed by the Treasury and Resources Minister or Chief Minister.

It will be the responsibility of the Chief Executive and Treasurer of the States to ensure that the group has sufficient resources to fulfil its responsibilities.

Group Membership

The members of the group are:

- Treasurer of the States of Jersey (Chair)
- Comptroller of Taxes
- Director of Financial Services
- Chief Officer, Economic Development
- Chief Officer, Social Security
- Adviser, International Affairs
- Deputy Director of Tax Policy
- States Economic Adviser
- An external person appointed by the Treasury and Resources Minister

The meetings of the group will be attended by the following officers in a supporting role

- Head of Financial Planning (Secretary)
- Finance Director, Income Tax
- Economist

The group will invite other officers and external advisers to attend as appropriate which will be documented.

The group will operate independent of any political influence.

States of Jersey

Economics Unit

May 2015

INCOME TAX FORECAST UPDATE NOTE FOR THE INCOME FORECASTING GROUP

AS PRESENTED TO THE COUNCIL OF MINISTERS 18TH JUNE 2015

States of Jersey
Economics Unit
May 2015

Income tax forecast update note for the Income Forecasting Group

1. Introduction

This note updates the provisional income tax forecast paper that was presented to, and discussed with, the Income Forecasting Group (IFG) in February and March 2015. The provisional income tax forecast paper and detailed economic assumptions paper are included as Annexes 1 (page 18) and 2 (page 48) to this note.

Since the IFG meeting on 16 March 2015, there have been a few developments which have been included in the updated income tax forecast:

1. **Updated Fiscal Policy Panel economic assumptions** for 2015-2017 (April 2015). In particular, slightly lower financial services profits growth expectations and slightly higher inflation expectations compared to the last set of economic assumptions (end of January 2015).
2. **New employment data** for December 2014, which shows stronger than expected employment growth in the last half of 2014.
3. **Updated information on company income tax assessments** for YOA 2014, which affects the starting point of the company income tax forecast for 2015.

The rest of the note is set out as follows:

Section 2 describes the Fiscal Policy Panel's (FPP) final economic assumptions that have been used to update the income tax forecast and the reasons for any changes. It also includes an analysis of the December 2014 employment data which was published after the FPP finalised their economic assumptions in January 2015.

Section 3 describes the updated information on company income tax assessments and how this affects the income tax forecast.

Section 4 shows the updated provisional income tax forecast and forecast range on the basis of the FPP's economic assumptions, the latest employment data and new information on company income tax assessments.

Section 5 includes an updated sensitivity analysis of variations in the inflation assumptions.

2. Final economic assumptions

The Fiscal Policy Panel's final updated economic assumptions have been used in the tax model to update the income tax forecast (Figure 1). These were updated as late as possible (14th April 2015) to fit in with the timescales to update and finalise the income forecasts for the next Medium Term Financial Plan.

The economic assumptions that have been updated by the FPP are marked in **red**.

There are three key changes to these assumptions relative to the assumptions made in January:

1. **Financial services profit growth** – is now expected to be slower in 2015, 2016 and 2017.
2. **Inflation** – is now expected to be slightly higher in 2015 and 2016.
3. **UK policy interest rates** – are now expected to be very slightly lower in 2015 and 2016 and very slightly higher in 2017.

Since the FPP finalised their assumptions, **employment data** for December 2014 has also been published. These are described in more detail next.

The changes in these assumptions have had knock-on effects on the nominal and real economic growth (GVA) assumptions. There are no changes to the trend assumptions for any of the economic variables in 2018 and 2019.

A comparison between these assumptions and the previous assumptions from the FPP's Pre-MTFP report in January 2015 can be found in Appendix 1, and the updated central, optimistic and pessimistic economic assumptions can be found in Appendix 2.

Figure 1: Final economic assumptions used (% change, unless otherwise stated)

numbers in red show figures that have changed

					Return to trend	
	2014	2015	2016	2017	2018	2019
Real GVA	1.6	1.2	1.1	1.4	0.0	0.0
RPI	1.6	1.6	3.1	3.1	3.3	3.3
RPIY	1.6	1.8	2.6	2.6	3.0	3.0
Nominal GVA	3.2	3.0	3.7	4.0	3.0	3.0
Company profits(a)	2.5	2.4	3.3	3.7	3.0	3.0
Financial services profits	1.8	1.1	3.1	3.3	3.0	3.0
Compensation of employees(b)	3.7	3.5	4.0	4.3	3.0	3.0
Employment	1.0	1.0	0.5	0.5	0.0	0.0
Average earnings	2.6	2.5	3.0	4.0	3.0	3.0
Interest rates (%)	0.5	0.5	1.1	1.6	2.0	2.5
House prices	3.3	3.0	4.0	5.0	3.0	3.0

OUTTURNS

(a) Gross profits for all companies, including traders.

(b) The number of employees multiplied by the costs of employment (wages, bonuses, pensions).

Financial services profit growth

The central financial services profits assumption for 2015 has been updated to +1.1% growth on the basis of a weighted average of the finance sector's profit expectations recorded in the Business Tendency Survey December 2014 (BTS).

The slightly lower central financial services profit assumptions of +3.1% for 2016 and +3.3% for 2017 are based on updated finance sector interview expectations (April 2015). The finance sector executives were asked to provide updated profit and employment expectations for 2015-2018.

The optimistic and pessimistic scenarios include finance sector profit assumptions +/- 3% around the central assumption, which captures the inherent uncertainty in trying to forecast the financial services sector's profit growth.

The updated financial services profit growth assumptions now mean that the nominal value of economic activity (GVA) is expected to grow by 0.5% less in 2015 and 0.4% less in 2017.

Inflation

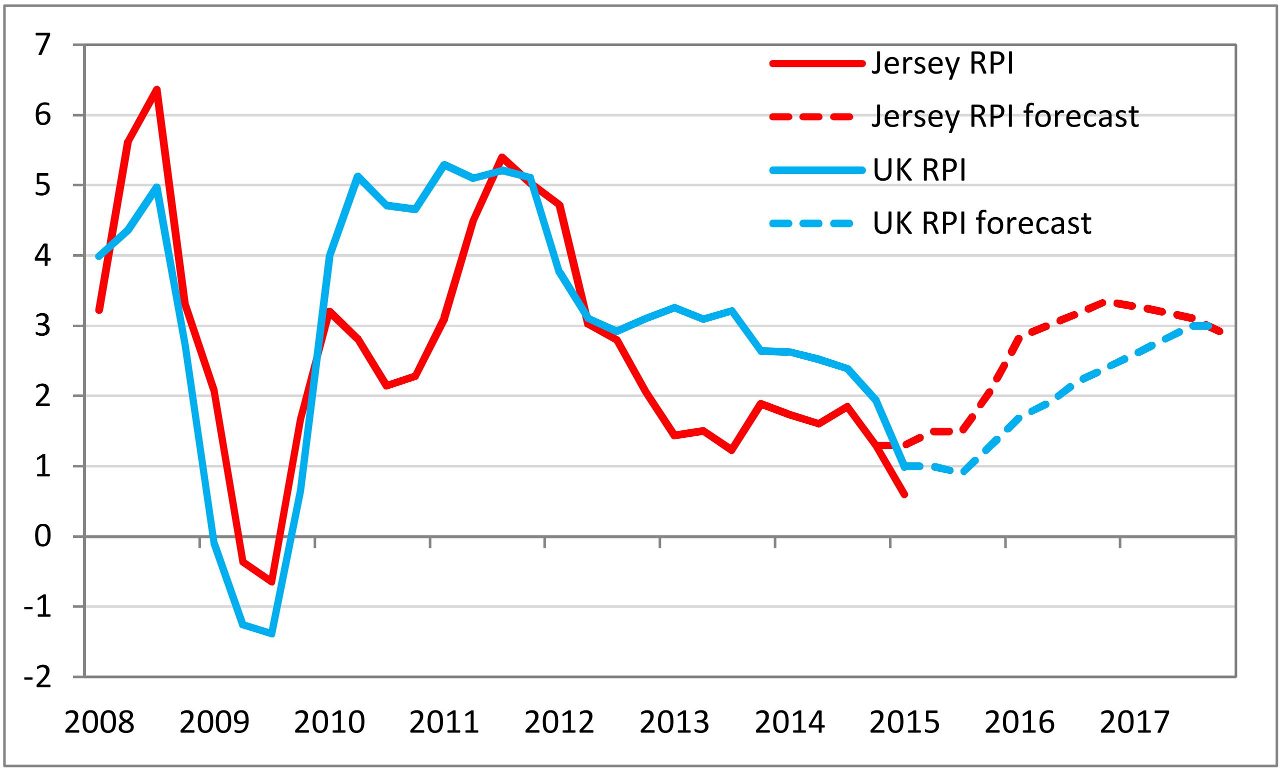
The inflation assumptions have been updated to reflect the outturn for December 2014, the effect of lower oil prices (and lower expected oil prices in the future), and the latest UK policy interest rate assumptions. As a result, the RPI inflation assumption is now slightly higher in 2016 and RPIY inflation higher in 2015 with other years largely unchanged on both measures.

The changes in the inflation assumptions have been reflected in the real GVA assumptions, rather than the nominal GVA assumptions and any of its components (e.g. profit or wages).

Jersey and UK RPI inflation have moved together in recent years but at times can be significantly different (and are measured on a slightly different basis), but the profile of the inflation assumptions are consistent with the latest OBR UK's inflation outlook, given that there are some common factors, such as lower oil prices, affecting both (Figure 2).

Since the FPP set the inflation assumptions out to 2019, the actual rate of inflation for March 2015 turned out to be lower than expected. This suggests that the average rate of inflation for 2015 which is used in the income tax forecast might turn out to be lower than currently expected. Adjusting for this would not have a significant impact on the income tax forecast. This is covered in more detail in Section 5 (page 14) which provides a sensitivity analysis for the inflation assumptions.

Figure 2: Jersey and UK inflation (RPI by quarter, % change on previous year)



Sources: UK: ONS RPI quarterly (CHAW series) up to March 2015, UK Office for Budget Responsibility forecast thereafter (March 2015 Economic and Fiscal Outlook); Jersey: Jersey Statistics Unit RPI quarterly to March 2015 and FPP forecast thereafter.

UK policy interest rate

The FPP's updated interest rate assumptions, the "adjusted" profile line (Figure 3), are based on the financial market's expectations published alongside the Bank of England's February 2015 Inflation report and more recent independent forecasts[1] which expect the interest rate to increase sooner (more along the lines of the November 2014 profile).

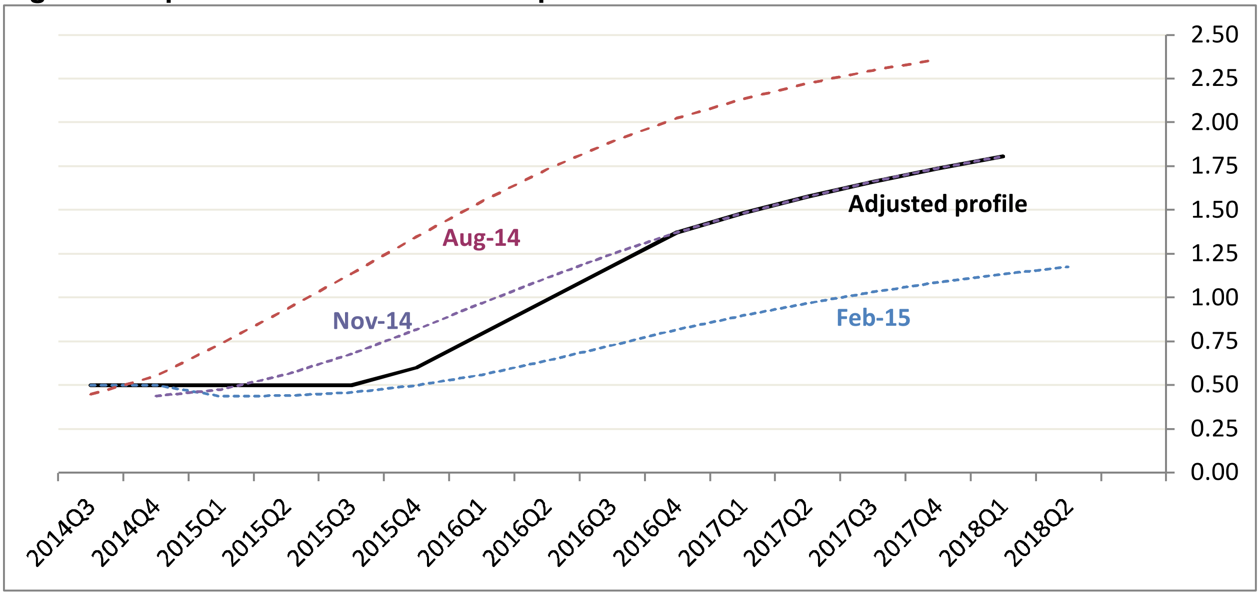
The previous interest rate assumptions were based on the November 2014 profile. Therefore the updated interest rate assumptions are fairly similar to the previous assumptions.

These slight changes are not material enough to affect the company income tax forecast which is based on the information gained from the finance sector executives. These changes do not have a material impact on the investment income growth and mortgage interest relief claims in the personal income tax forecast, either.

The Bank of England's next inflation report was published mid-May 2015. The interest rate expectations have moved forwards since February, as expected, and the May profile has moved closer to the 'adjusted' profile than the February 2015 assumptions.

[1] Those included in the summary of independent forecasts of various forecasting organisations, published by UK HM Treasury. https://www.gov.uk/government/collections/data-forecasts#2015

Figure 3: Updated interest rate assumptions



Sources: Bank of England Inflation Reports (August 2014, November 2014 and February 2015), 'Adjusted profile': The FPP based on HM Treasury summary of independent forecasts and February 2015 Inflation report.

Employment in 2014

The Jersey Labour Market report for December 2014 was published shortly after the FPP finalised the economic assumptions. It showed that total employment increased by about 2,000 staff (by about 3.5%) between December 2013 and December 2014, mostly in the private sector, and most sectors saw increased levels of employment.

The level of employment at the end of 2014 was higher than expected. In particular, the average employment level for 2014 was +1.3% higher (compared to +1% higher assumed in the previous forecast). The higher than expected rate of employment growth at the end of 2014 is likely to feed through into higher than expected employment growth in 2015 but it is too soon to determine whether this will have significantly different implications for tax revenue. Given the nature of the employment (focused on the lower 'value added' sub-sectors of finance and non-finance) any improvement is likely to be small.

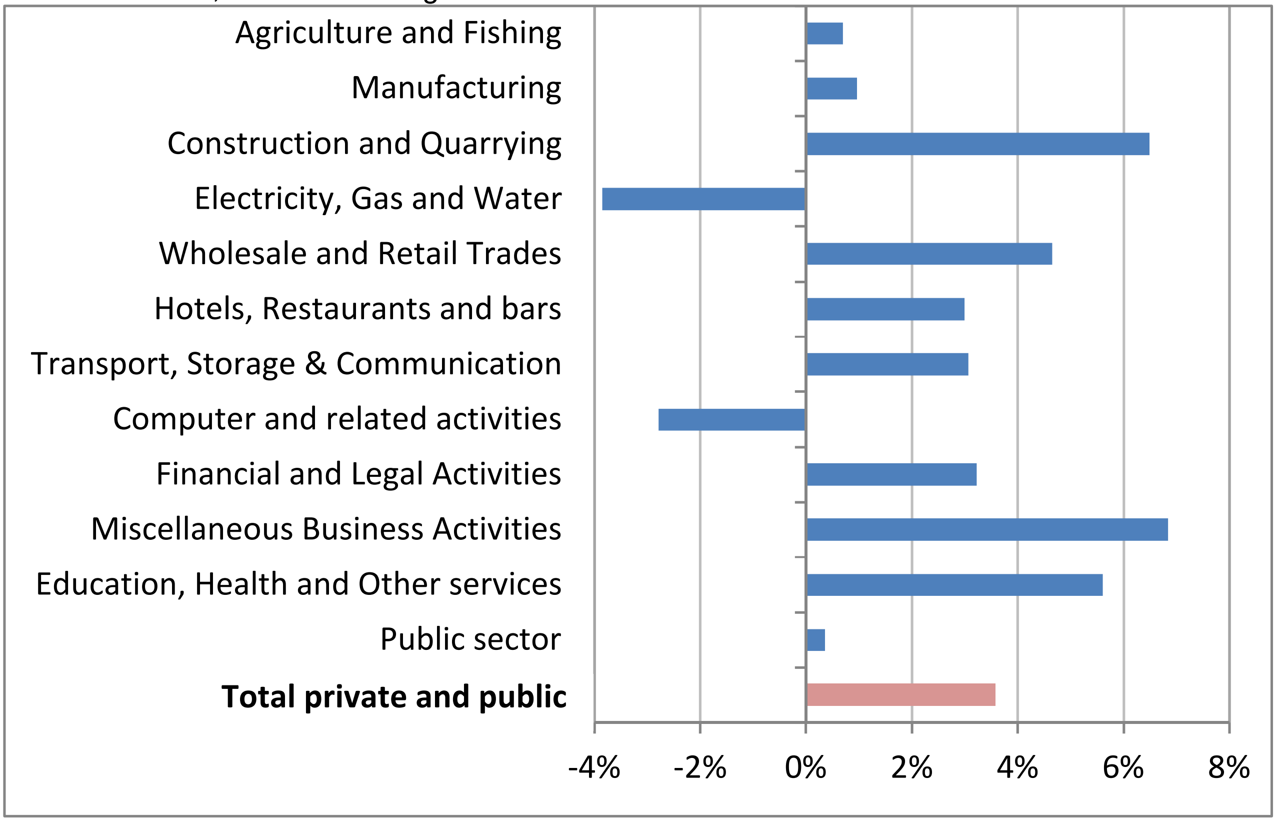
The extent to which the increase in employment is using up spare capacity in the economy (for example, by increasing employment in the resident population) or building new capacity (for example, by increasing the size of the working age population through inward migration), will determine whether the small improvement to the public finances would be just in 2016, or every year from 2016.

The makeup of future changes in employment

In December 2014, the total employment level (as measured by the number of jobs filled) was 3.6% higher than in December 2013. However, some sectors, such as 'Construction' and

'Miscellaneous business activities' saw larger % increases whilst others, such as 'Agriculture' and 'Electricity, Gas and Water' saw smaller % increases or even % decreases (Figure 4).

Figure 4: Increase in employment by sector
December 2014, annual % change



Source: Jersey Labour Market December 2014, Jersey Statistics Unit

In the forecast, the assumption is that future changes in employment are spread across all sectors of Jersey's economy in proportion to their size. So a 1% increase in employment means a 1% increase in employment in each sector of the economy.

A high level analysis of the employment increases during 2014 and ITIS data, suggests that if employment increased by 1% in 2015 (the central assumption) in a similar makeup to 2014 (rather than being spread evenly across the economy) then this could reduce the expected growth in income tax revenue by less than £0.5m a year.

Conversely, if future employment increases were focused more in sectors which pay above the economy average, then this would lead to slightly higher income tax revenue growth than expected.

The latest information from Social Security on contributions suggests that the numbers of contributors and the value of their contributions are both increasing at similar rates.

It is not clear at this early stage in what is anticipated will be the growth phase of the economic cycle what the make-up of employment growth will be going forward. However, given the low levels of employment growth forecast over the period any moderate variations in the make-up of employment growth is not deemed significant for the forecast.

The impact of the public sector reform agenda on the forecast

The Resources Statement to the Draft Strategic Plan 2015-2018 (P27Add/2015)[2] sets out the Council of Ministers' approach to balance States' tax revenues and current expenditure by 2019. In summary, there are three parts:

1. Secure the economic recovery and lay the foundations for future productivity growth.
2. Focus on a programme of savings, efficiencies and expenditure constraint, and consider the level of benefits, and charges for services.
3. After the measures have been agreed, consider taxes and contribution changes.

The target for the spending review at the time of the report is £60m staff related savings and £35m savings on non-staff expenditure (including benefit changes and user pays charging). The reduction in staff costs will be managed by not replacing people as they leave the States, strictly managing vacancies, stronger performance management and redesigning services. Natural turnover and voluntary redundancy will be used to minimise the number of compulsory redundancies.

Public sector pay growth may also be kept below that in the economy as a whole although this could simply be offset by trends in other sectors where earnings growth is above the average. If public sector earnings growth was 1% in 2016 and 2017 and everything else stayed the same this would reduce tax revenue in the region of £2-3m by 2018 which is within the sensitivity of the forecast range.

It is not clear what the overall impact of these reforms would be on tax revenue. Firstly, there is not enough detail to the reforms at this stage. Secondly, consideration would need to be given as to what alternative fiscal measures would be put in place if savings had to be achieved or revenue raised in another way. Thirdly, the economy could adjust to the changes, for example through the supplyside, which could partly, or more than offset, the initial impacts of the public sector reforms over the next few years.

In addition to public sector reform there is also uncertainty about the scale of potential positive impacts from public sector capital expenditure in the forecast period. Given the uncertainty about the nature, timing and scale of the combined impact of future changes in fiscal policy the income tax forecast has not been adjusted either way to reflect changes in the overall fiscal stance.

Uncertainty regarding shareholder income and tax payer behaviour

[2] http://www.statesassembly.gov.je/AssemblyPropositions/2015/P.27-2015Add.pdf

The note that accompanied the provisional forecast highlighted the uncertainty around shareholder income and taxpayer behaviour. Since then more detailed data has been made available regarding the investment income taxed on individuals for the years of assessment 2010-2013, in particular bank interest and dividend income. A review of this data does not indicate a clearly identifiable trend towards the enveloping of significant bank deposits and shareholdings by the 2013 year of assessment, however the incentive to envelop such assets has only existed for a short period of time and hence similar reviews will need to be undertaken in each subsequent year to determine whether such a trend is developing and the corresponding impact on the personal income tax forecast.

It should be highlighted that bank interest and dividend income (excluding distributions from Jersey companies) constitutes approximately 5% of the “total income” reported by individual taxpayers for the 2013 year of assessment. Furthermore although difficult to anticipate changes in taxpayer behaviour, it is unrealistic to assume that all individual taxpayers will envelop assets in this way. For many taxpayers:

- no significant tax deferral would be achieved as they are not in a financial position to defer the receipt of income;
- the costs of establishing and maintaining the required company would negate the benefit of the tax deferral; and
- the “hassle factor” of maintaining a company and complying with the distribution rules would act as a disincentive to envelop assets.

3. Updated company tax information

Updated information for YOA 2014 affecting the forecast for 2015

During April 2015, the Taxes Office received written declarations from the top 100 company taxpayers[3] and their agents for the 2014 year of assessment. This is more up to date and reliable information than the initial estimates provided by the company taxpayers and their agents in February and March 2015.

This section updates the analysis contained in the previous detailed IFG paper (included in annex 1 page 18). The agents’ estimates for the top 20 are significantly different to the next top 80, so each group has been estimated separately. Overall, this means that company income tax revenue is expected to grow by £0.8m or 1% for YOA 2014 (received by the States in 2015).

This suggests an updated estimate for company income tax of £84m in YOA 2014/Budget year 2015 and this has been used in the updated forecast. This is £3m lower than the initial estimate the IFG received in March 2015. However, relative to the Budget 2015 forecast, this is £1m lower.

[3] The top 100 company tax payers on the basis of the 2013 (YOA) assessments.

The most up to date information form the Taxes Office confirms that this is an accurate base to use in the updated forecast.

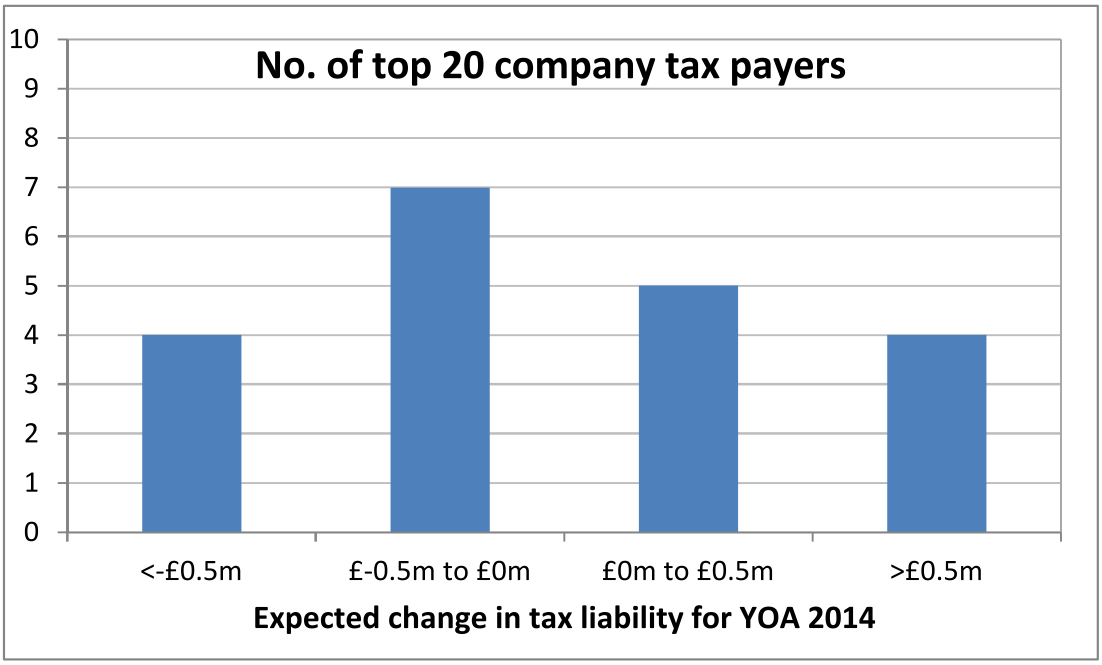
Note that the expected 0.5% increase for company income tax revenue for YOA 2014 cannot be compared directly with the economic assumption for financial services profit growth of 1.8% for 2014 because:

- Company tax revenue is collected on non-financial services activities such as those carried out by utility companies.
- Profits may be offset by past losses and capital allowances before arriving at tax revenue.

Figure 5 shows the size of the expected changes in the YOA 2014 tax liabilities for the top 20 companies compared to their YOA 2013 tax liabilities. The number of companies that expect an increase are fairly similar to the number of companies that expect a decrease, which is why, overall, tax revenue from the top 20 is only expected to grow slightly for YOA 2014.

This also shows how company tax can be volatile and hard to predict amongst the top 20 companies even in the short-term and that they can have a significant impact on the overall company tax forecast.

Figure 5: Expected changes in the top 20 companies' income tax liabilities for YOA 2014 compared to YOA 2013



There has been a further significant development since the provisional forecast, regarding profits in YOA 2016 and affecting the forecast for 2017. A £5m downward adjustment has been made to company income tax in 2017 as a result of confidential information received regarding a financial services business restructure which will impact on corporate profits in 2016. There will be minimal (if any) impact on jobs. There has also been a £1m downward adjustment in 2015 in respect of a repayment of tax for assessments from previous years (up to YOA 2013).

4. Updated income tax forecast and the forecast range

Income tax forecast

The changes in the financial services profits growth and inflation assumptions, the employment outturn for 2014 and the updated company information have been updated in the income tax model. The resulting changes to the March 2015 provisional central forecast are shown in Figure 6.

Figure 6: Impact of the updates on the provisional income tax forecast

Personal income tax

	Forecast				
Budget year	**2015**	**2016**	**2017**	**2018**	**2019**
	£m	**£m**	**£m**	**£m**	**£m**
Provisional forecast	360	376	396	419	437
Higher exemption thresholds	-1	-1	-2	-2	-2
Updated central forecast	**359**	**375**	**395**	**417**	**434**

Company income tax

	Forecast				
Budget year	**2015**	**2016**	**2017**	**2018**	**2019**
	£m	**£m**	**£m**	**£m**	**£m**
Provisional forecast	86	89	93	97	100
2015 in year estimate - YOA 2014 assessments	-2	-2	-2	-2	-2
Repayment on past assessments	-1	0	0	0	0
2015 in-year news on YOA 2016 for 2017	0	0	-5	-5	-5
Lower financial services profits growth	0	-2	-3	-5	-5
Updated central forecast	**82**	**85**	**82**	**85**	**88**
Net change to income tax forecast	-5	-5	-12	-14	-14

Note: some columns do not appear to sum due to rounding.

Higher exemption thresholds are a consequence of two factors:

1. **Higher inflation** - the higher inflation assumptions (relative to February) result in slightly higher assumptions for the growth in personal exemption thresholds claimed by income taxpayers, thereby reducing the expected increases in personal income tax.
2. **Higher employment** – The higher employment level in 2014 has resulted in an increase in the expected total value of exemption thresholds being claimed in the model for Budget year 2015.

The impact of higher employment on earned income was already included in the provisional central income tax forecast because this was based on ITIS data which includes all earned income during the year and therefore takes account of changes in employment. However, it is not possible to identify what the changes in employment or average wages have been from the ITIS data – just what the combined impacts of the two are on earned income.

The lower financial services profit growth assumptions are due to less positive finance sector profit expectations in the Business Tendency Survey December 2014 and less positive profit expectations from the finance executives that were originally interviewed by the States Economics Unit in November 2014. The majority of the expectations remained the same, but a small number of them are now less positive. This has reduced the expected growth rate in company income tax revenues from financial services companies.

The provisional March central forecast and the updated May central forecast is shown in Figure 7.

Figure 7: Updated income tax forecast

March 2015: Provisional central forecast

			Forecast		
Budget year	**2015**	**2016**	**2017**	**2018**	**2019**
	£m	**£m**	**£m**	**£m**	**£m**
Personal	360	376	397	419	437
Companies	86	89	93	97	100
Bad debts	-3	-2	-2	-3	-3
	443	**463**	**488**	**513**	**534**
Annual growth	6	20	24	26	21
Annual growth, %	1%	4%	5%	5%	4%

May 2015: Updated central forecast

			Forecast		
Budget year	**2015**	**2016**	**2017**	**2018**	**2019**
	£m	**£m**	**£m**	**£m**	**£m**
Personal	359	375	395	417	434
Companies	82	85	82	85	88
Bad debts	-3	-2	-2	-3	-3
	438	**458**	**475**	**499**	**519**
Annual growth	1	19	17	24	21
Annual growth, %	0%	4%	4%	5%	4%

Forecast range

During the IFG's meetings in February and March 2015, the IFG agreed an appropriate forecast range as being a funnel starting at 2% either side in 2015 and growing to 9% either side by 2019. The forecast range around the new central forecast has been updated accordingly (Figure 8).

Figure 8: Updated forecast range

Budget year	2014 £m	2015 £m	2016 £m	2017 £m	2018 £m	2019 £m
Upper		447	476	499	535	568
Central	**437**	**438**	**458**	**475**	**499**	**519**
Lower		430	440	451	462	471
Range as a % of central, +/-		2%	4%	5%	7%	9%

Charts of the forecast are shown in Figure 12 (page 15)

Comparison with the Budget 2015 forecast

The updated forecast includes new information since the Budget 2015 forecast was carried out a year ago (Figure 9).

Looking at the personal tax changes:

1. **Lower than expected 2014 income tax revenue outturns** has resulted in a £8m decrease in the starting personal tax base.
2. **ITIS records show that earned employment income did not grow as quickly as expected in 2014**, which reduces the personal tax forecast by £4m each year from 2015.
3. **The 2015 Budget measures are expected to increase personal tax revenue** relative to the Budget 2015 forecast by about £2m a year from 2016.
4. **New data and revised assumptions for the economic variables have a broadly neutral effect for 2015 to 2018**.

Looking at the company tax changes:

1. **New data and revised assumptions for the economic variables has resulted in lower expected profit growth in the financial services sector** which reduces the expected growth in company tax revenue from 2016 onwards (£5m in 2016 and £8m in 2017).
2. **Lower than expected 2014 income tax revenue outturns** has resulted in a £1m decrease in the starting company tax base.
3. **Agents' written estimates of company tax for the top 100 taxpayers** suggest that company tax revenue in 2015 will be similar to 2014.

Figure 9: Updated income tax forecast compared to the Budget 2015 forecast

Budget year	Actual 2013 £m	Forecast 2014 £m	2015 £m	2016 £m	2017 £m	2018 £m	2019 £m
Personal tax							
Budget 2015 forecast	**357**	**364**	**373**	**386**	**404**		
2014 outturn		-8	-8	-8	-8		
2015 in-year estimate of employment income			-4	-4	-4		
2015 Budget measures				2	2		
Updated economic assumptions			-1	-1	1		
Updated central forecast	**357**	**356**	**359**	**375**	**395**	**417**	**434**
Company tax							
Budget 2015 forecast	**98***	**84**	**85**	**91**	**97**		
Updated economic assumptions			0	-5	-8		
2014 outturn		-1	-1	-1	-1		
Repayment on past assessments			-1				
2015 in-year news on YOA 2016 for 2017					-5		
Updated central forecast	**98***	**83**	**83**	**85**	**82**	**85**	**88**

Actual ; Forecast

* Includes a one-off £10m tax receipt in 2013.

Figure 10: Central forecast growth in personal and company income tax

Budget year	Forecast 2015 £m	2016 £m	2017 £m	2018 £m	2019 £m
Personal	4	16	20	22	17
Company	0	2	-2	3	3
Bad debts	-1	1	0	-1	0
Change on previous year	**3**	**19**	**18**	**23**	**20**

Figure 11: Summary of the differences between the updated central forecast and the 2015 Budget forecast

Budget year	Actual 2014 £m	Forecast 2015 £m	2016 £m	2017 £m
Personal	-8	-13	-11	-9
Companies	-1	-3	-6	-14
Bad debts	1	0	0	0
Change since Budget 2015	**-8**	**-16**	**-17**	**-23**

5. Updated sensitivity analysis for the inflation assumption

The inflation assumptions affect the income tax forecast through the value of the exemption thresholds that are expected to be set in future Budgets over the forecast period (unless they impact on the expected growth in the nominal components of GVA).

The central expectation is that the exemption thresholds will increase by the rate of inflation. This is based on past Budget policy which, over the longer term, has tended to either freeze the thresholds, or increase them in line with average earnings. Assuming that they will increase by the rate of inflation provides a middle ground between the two. More recently, the level of inflation has been a factor in the exemption threshold increases as well.

If future Budget policy sets the exemption thresholds with reference to the rate of inflation, and inflation turns out to be higher or lower than expected, this will have an impact on the amount of income tax revenue collected compared to the forecast.

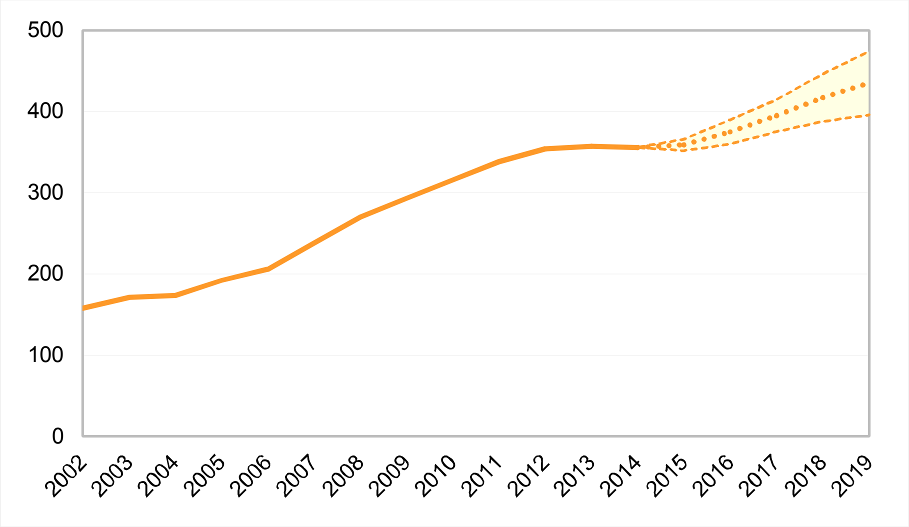
Similarly, if Budget policy is set independently of the rate of inflation, this will have an impact on the forecast.

For example, if the average rate of inflation in 2016 is 0.5% lower than currently expected, then this would mean that the exemption limits grow by 0.5% less than expected resulting in about £0.7m more income tax revenue than forecast from 2017 onwards.

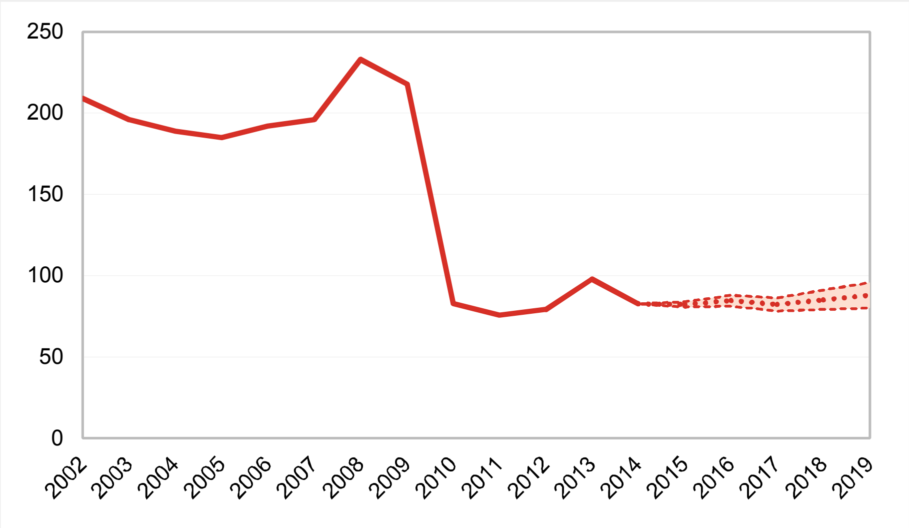
Likewise the opposite is true if the average rate of inflation in 2016 is 0.5% higher than currently expected.

Figure 12: Forecasts by taxpayer type

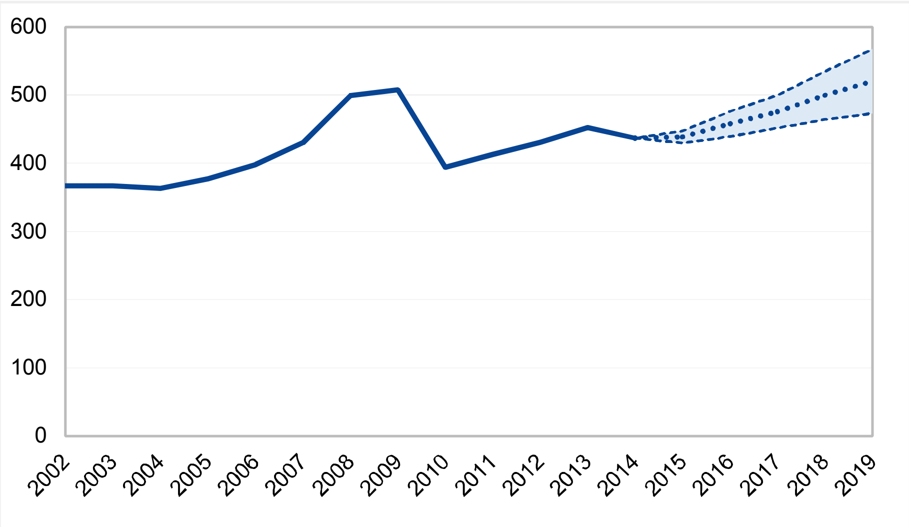
Personal, £m



Company, £m



Total income tax, £m



Appendix 1 - Final economic assumptions compared to the provisional assumptions

Central scenario - updated 14 April 2015

	2014	2015	2016	2017	Return to trend 2018	2019
Real GVA	1.6	1.2	1.1	1.4	0.0	0.0
RPI	1.6	1.6	3.1	3.1	3.3	3.3
RPIY	1.6	1.8	2.6	2.6	3.0	3.0
Nominal GVA	3.2	3.0	3.7	4.0	3.0	3.0
Company profits(a)	2.5	2.4	3.3	3.7	3.0	3.0
Financial services profits	1.8	1.1	3.1	3.3	3.0	3.0
Compensation of employees(b)	3.7	3.5	4.0	4.3	3.0	3.0
Employment	1.0	1.0	0.5	0.5	0.0	0.0
Average earnings	2.6	2.5	3.0	4.0	3.0	3.0
Interest rates (%)	0.5	0.5	1.1	1.6	2.0	2.5
House prices	3.3	3.0	4.0	5.0	3.0	3.0

Central scenario - previous 30 January 2015

	2014	2015	2016	2017	Return to trend 2018	2019
Real GVA	1.6	2.0	1.2	1.7	0.0	0.0
RPI	1.6	1.5	2.5	3.0	3.3	3.3
RPIY	1.6	1.5	2.5	2.7	3.0	3.0
Nominal GVA	3.2	3.5	3.7	4.4	3.0	3.0
Company profits(a)	2.5	3.4	3.9	4.5	3.0	3.0
Financial services profits	1.8	3.3	4.3	5.1	3.0	3.0
Compensation of employees(b)	3.7	3.5	4.0	4.3	3.0	3.0
Employment	1.0	1.0	0.5	0.5	0.0	0.0
Average Earnings	2.6	2.5	3.0	4.0	3.0	3.0
Interest rates (%)	0.5	0.6	1.2	1.5	2.0	2.5
House prices	1.0	3.0	4.0	5.0	3.0	3.0

Difference

	2014	2015	2016	2017	Return to trend 2018	2019
Real GVA	0.0	-0.8	-0.1	-0.3	0.0	0.0
RPI	0.0	0.1	0.6	0.1	0.0	0.0
RPIY	0.0	0.3	0.1	-0.1	0.0	0.0
Nominal GVA	0.0	-0.5	0.0	-0.4	0.0	0.0
Company profits(a)	0.0	-1.0	-0.6	-0.8	0.0	0.0
Financial services profits	0.0	-2.2	-1.2	-1.8	0.0	0.0
Compensation of employees(b)	0.0	0.0	0.0	0.0	0.0	0.0
Employment	0.0	0.0	0.0	0.0	0.0	0.0
Average Earnings	0.0	0.0	0.0	0.0	0.0	0.0
Interest rates (%)	0.0	-0.1	-0.1	0.1	0.0	0.0
House prices	2.3	0.0	0.0	0.0	0.0	0.0

OUTTURNS

(a) Gross profits for all companies, including traders.

(b) The number of employees multiplied by the costs of employment (wages, bonuses, pensions).

Appendix 2 – The economic assumptions for the optimistic and pessimistic scenarios

FPP central scenario

	2014	2015	2016	2017	Return to trend 2018	2019
Real GVA	1.6	1.2	1.1	1.4	0.0	0.0
RPI	1.6	1.6	3.1	3.1	3.3	3.3
RPIY	1.6	1.8	2.6	2.6	3.0	3.0
Nominal GVA	3.2	3.0	3.7	4.0	3.0	3.0
Company profits(a)	2.5	2.4	3.3	3.7	3.0	3.0
Financial services profits	1.8	1.1	3.1	3.3	3.0	3.0
Compensation of employees(b)	3.7	3.5	4.0	4.3	3.0	3.0
Employment	1.0	1.0	0.5	0.5	0.0	0.0
Average earnings	2.6	2.5	3.0	4.0	3.0	3.0
Interest rates (%)	0.5	0.5	1.1	1.6	2.0	2.5
House prices	3.3	3.0	4.0	5.0	3.0	3.0

FPP central scenario - upper range

	2014	2015	2016	2017	Return to trend 2018	2019
Real GVA	2.6	2.7	2.6	2.9	1.5	1.5
RPI	1.6	3.1	4.6	4.6	4.8	4.8
RPIY	1.6	2.8	3.6	3.6	4.0	4.0
Nominal GVA	4.2	5.5	6.2	6.5	5.5	5.5
Company profits(a)	4.1	3.8	5.2	5.1	4.0	4.0
Financial services profits	4.8	4.1	6.1	6.3	4.0	4.0
Compensation of employees(b)	5.2	7.1	7.1	8.1	6.6	6.6
Employment	2.5	2.5	2.0	2.0	1.5	1.5
Average Earnings	2.6	4.5	5.0	6.0	5.0	5.0
Interest rates (%)	0.5	1.2	1.8	2.3	2.7	3.2
House prices	3.3	6.0	7.0	8.0	6.0	6.0

FPP central scenario - lower range

	2014	2015	2016	2017	Return to trend 2018	2019
Real GVA	0.6	-0.3	-0.4	-0.1	-1.5	-1.5
RPI	1.6	0.1	1.6	1.6	1.8	1.8
RPIY	1.6	0.8	1.6	1.6	2.0	2.0
Nominal GVA	2.2	0.5	1.2	1.5	0.5	0.5
Company profits(a)	0.9	1.1	2.1	2.5	1.5	1.5
Financial services profits	-1.2	-1.9	0.1	0.3	1.5	1.5
Compensation of employees(b)	2.1	0.0	0.0	1.0	-0.5	-0.5
Employment	-0.5	-0.5	-1.0	-1.0	-1.5	-1.5
Average Earnings	2.6	0.5	1.0	2.0	1.0	1.0
Interest rates (%)	0.5	0.5	0.5	0.9	1.3	1.8
House prices	3.3	0.0	1.0	2.0	0.0	0.0

OUTTURNS

(a) Gross profits for all companies, including traders.

(b) The number of employees multiplied by the costs of employment (wages, bonuses, pensions).

States of Jersey
Economics Unit
May 2015

ANNEX 1

DRAFT INCOME TAX FORECAST NOTE FOR THE INCOME FORECASTING GROUP

AS PRESENTED TO THE COUNCIL OF MINISTERS 19TH MARCH 2015

ANNEX 1

States of Jersey
Economics Unit
March 2015

Draft income tax forecast note for Income Forecasting Group

1. Introduction

This note describes the provisional results of the income tax forecasting model for the Income Forecasting Group (IFG) for March 2015. The note is set out as follows:

- Section 2 covers how the forecast is carried out.
- Section 3 updates on the latest tax data (Year of Assessment 2013).
- Section 4 goes through the other new information and updates the assumptions used in the tax model.
- Section 5 shows the income tax forecast and forecast range suggested by the model.
- Section 6 provides a sensitivity analysis for the key economic assumptions.

There are also some appendices with reference information for the Income Forecasting Group.

- Appendix 1 describes the current economic assumptions and the economic assumptions used in the 2015 Budget forecast.
- Appendix 2 describes optimistic and pessimistic economic scenarios.
- Appendix 3 discusses additional forecasting information that was used for Treasury's longer term planning in May 2014 and November 2014.

2. How the forecast is carried out

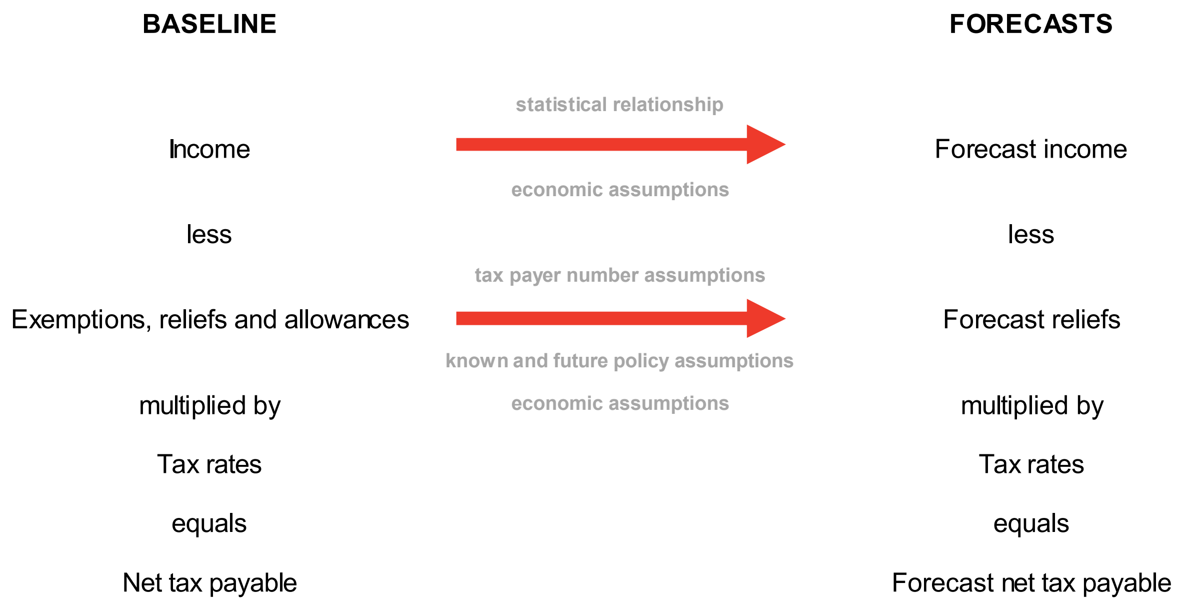
The Taxes Office provides data on personal income and company income, and the value of personal exemptions, reliefs and allowances for all years up to the last complete year of assessment (YOA) which was 2013.

An overview of the tax model is shown in Figure 5. There are two main parts to it – forecasting taxable income and forecasting the value of exemption thresholds, reliefs and allowances.

Taxable income is estimated over the forecast period by taking the data provided by the Taxes Office and using statistical relationships between income and various economic variables, in combination with assumptions about the economic variables going forward. The economic variables include economic activity (Gross Value Added (GVA)), company profits, employment, average earnings and interest rates, for example.

The value of exemptions, reliefs and allowances are estimated over the forecast period by taking the baseline data and using assumptions about future tax payer numbers, inflation, interest rates and Budget policy.

Figure 5: Model overview



Forecast net tax payable is adjusted for the expectation of the size of bad debts in the future to arrive at a final forecast for income tax revenue.

In order to reflect the fact that there is significant uncertainty in the forecast, a central forecast is produced with a range, with the emphasis on the range rather than the point estimates. The model can provide a range based on a set of optimistic and pessimistic economic assumptions. In recent forecasts, the IFG has set the range at +/- 5% of the central forecast for the forecast period.

The forecast is considered by the IFG and they use their judgement to decide what the final income tax forecast will be.

3. Updates on the latest tax data

The latest complete year of tax data (covering incomes in 2013 - Year of Assessment (YOA) 2013) shows that total income tax revenue was £437m for Budget year 2014[4].

The last central forecast (in the 2015 Budget) for income tax revenue in 2014 was £444m, and so actual income tax receipts were £7m lower than forecast (Figure 6).

The £437m income tax revenue for Budget year 2014 was £15m lower than the income tax revenue received in Budget year 2013.

[4] The income tax due on incomes and profits received in 2013 is recognised as States income tax revenue in 2014.

Figure 6: Actual 2014 income tax revenue compared to 2015 Budget forecast

	Actual £m	2015 Budget Forecast £m	Difference £m
Personal	356	364	-8
Companies	83	84	-1
Bad debts	-2	-3	1
	437	444	-7

Note: The forecast and difference columns do not sum due to rounding.

Income tax revenue growth was lower than expected mainly because personal incomes did not grow as quickly as expected. Weaker income growth (in particular in employment income and shareholder income) were the main contributors to the £8m shortfall. A higher yield than expected helped to partially offset the weaker income growth.

Variances in other forms of taxable income were individually worth less than £1m in income tax and acted to offset each other.

The Budget 2015 forecast was carried out between February and May 2014. During this time, the economic model was using actual 2013 economic data, and not economic assumptions, to forecast income tax revenue for 2014. Therefore any differences between forecasts and actual outturns were due to:

- the model's estimated relationships between economic variables and the tax base and yield (and therefore tax revenue)
- some of the other underlying assumptions made for forecasting purposes such as trends in shareholder income.

In this case, the relationship that tries to predict employment income growth overestimated it on the basis of the economic performance and variables in 2013. There is no economic relationship which tries to predict shareholder income – the other key difference between actual and forecast.

Figure 7 shows the differences between forecast and actual personal income tax and company income tax receipts outlined in Figure 6.

Figure 7: Breakdown of the difference between the 2015 Budget forecast and 2014 outturn

	£m	£m
Personal:		
Forecast		**364**
Income - lower than forecast:		-11
Employment income	*-6*	
Shareholder income	*-5*	
Yield - higher than forecast		3
Actual outturn		**356**
Company:		
Forecast		**84**
Other		-1
Actual outturn		**83**

The forecast for Budget 2015 did not include an adjustment for the impact of the final withdrawal of the deemed dividend rules, or any behaviour changes resulting from the taxation of shareholder income applying in YOA2013. This could have contributed to the fall in shareholder income seen. Employment income and shareholder income is considered in more detail later (page 16 onwards).

4. Assumptions for the new forecast

There are several new sources of information since the 2015 Budget forecast was carried out:

1. The Taxes Office has new information on personal and company tax assessments for YOA 2013 which relates to income tax revenue in Budget year 2014.
2. The Taxes Office has earned income data from the Income Tax Instalment System (ITIS) and company profit estimates from agents for YOA2014.
3. The Statistics Unit has published data on economic variables, such as for economic growth, employment and average earnings.
4. The Fiscal Policy Panel (FPP) has published their Pre-MTFP report[5] which contains a new economic growth forecast for Jersey and the underlying economic assumptions.
5. The latest market expectations for interest rates, for example, those published in the Bank of England's Inflation Report.

[5] Fiscal Policy Panel Pre-MTFP Report 2015,
http://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/R%20Fiscal%20Policy%20Panel%202015%20annual%20report%2020150130%20JE.pdf

Tax base assumptions

The provisional income tax forecast has been updated to include the latest information from tax assessments. **The main assumption is that all the changes seen in personal and company assessments last year remain in the tax base in future.** This means that:

- For the personal tax base, the forecast starts from the amount of taxable income and exemptions, reliefs and allowances seen in the most recent complete year of assessment (2013).
- For the company tax base, the forecast starts from the amount of profits seen in the 2013 year of assessment. The effective tax rate, or yield, on company profits is assumed to remain the same over the forecast period.

The starting tax base is £437m. There are currently no accounting adjustments or one-off receipts for 2014 that should be adjusted for in the income tax outturn figures.

News so far this year

The Taxes Office has received some provisional estimates for the top 100 company taxpayers from their tax agents, which give an indication as to the amount of company income tax they will pay in 2015.

The Taxes Office has also examined the amount of employment income recorded during 2014 through ITIS. This informs how much income tax revenue will be received in Budget year 2015.

Company income tax provisional assessments

The Taxes Office has received agents' estimates for the majority of the top 100 company income taxpayers for 2014 YOA.

The agents' estimates for the top 20 are significantly different to the bottom 80, so each group has been estimated separately.

It has been assumed that:

- The tax receipts for the top 20 will grow by 8% - the indication from the estimates received so far.
- The tax receipts for the next 80 will fall by 5% - the indication from the estimates received so far.
- The tax receipts for companies outside of the top 100 will grow by 2.5% in 2014, the current company profit assumption for all companies overall (as provided in the FPP report).

Figure 8: Company income tax estimate

Central	YOA 2013 £m	YOA 2014 £m	Change on year %	Number
Top 20 - estimates	45.1	48.6	7.8	17
Top 20 - not known	4.4	4.8	7.8	3
21-100 - estimates	12.8	12.1	-5.3	60
21-100 - not known	4.2	4.0	-5.3	20
Rest	16.2	16.6	2.5	
	82.7	86.1	4.1	

Note: Assumed increases are in red.

This suggests an estimate for company income tax of £86m in 2015 and this has been used in the provisional forecast. Relative to the Budget 2015 forecast, this is £2m higher.

However, there is some uncertainty involved extrapolating the estimated assessments across all company taxpayers. This could affect the estimate by up to £1m or £2m in either direction and it is possible the estimate could be out by more than this. There is also still the uncertainty inherent in using estimated assessments, rather than final assessments.

Employment income for 2014

The Taxes Office has looked at the ITIS returns to find out the amount of employment income earned during 2014. This shows that employment income increased by 2.9% compared to 2013 and this has been used in the model.

Relative to the Budget 2015 forecast which assumed a higher rate of employment income growth, the impact of this is to reduce the provisional personal income tax forecast by £4m a year from 2015. This estimate of employment income is robust and will not change significantly.

Unfortunately, only ITIS data for January 2015 was available at the time the forecast was prepared. Therefore there isn't enough information on earned incomes in 2015 yet to be able to compare with the model's forecast for earned incomes and come to any conclusions. This will be reviewed at the time of the April update to see if there is any useful indication of trends in 2015.

Economic assumptions

The Fiscal Policy Panel's economic assumptions have been used in the tax model. These assumptions factor in the local and international developments since the last forecast was carried out (Figure 9).

These assumptions are described in the FPP's pre-MTFP report. A summary of these, and some further analysis, is included in the accompanying paper to this note, "Income Forecasting Group -

Detailed analysis supporting the economic assumptions for the new income tax forecast, March 2015".

In this forecast (compared to the assumptions in the Budget 2015 forecast):

- Real economic growth is expected to be slightly stronger in 2014 and 2015 but slightly weaker in 2016 and 2017. For 2018 and beyond the FPP advised that the States should plan on the basis of a trend rate of real growth of 0%.
- Inflation (as measured by RPI and RPIY, for example) is expected to be lower until 2017, recognising the recent sharp falls in oil prices and lower market expectations for interest rate increases.
- Financial services profits are expected to grow more slowly following information gained through a series of interviews with financial services companies in November and December 2014. This is a key assumption for the company income tax forecast.
- Employment is expected to grow more quickly in 2014 and 2015 rather than in 2016 and 2017.
- Average earnings growth is expected to be weaker in 2015 and 2016.
- Interest rates are now expected to increase later and more slowly, according to financial markets expectations.

The changes since the last forecast are covered in Appendix 1 (page 24).

Figure 9: Economic assumptions used (% change, unless otherwise stated)

Central scenario

					Return to trend	
	2014	2015	2016	2017	2018	2019
Real GVA	1.6	2.0	1.2	1.7	0.0	0.0
RPI	1.6	1.5	2.5	3.0	3.3	3.3
RPIY	1.6	1.5	2.5	2.7	3.0	3.0
Nominal GVA	3.2	3.5	3.7	4.4	3.0	3.0
Company profits(a)	2.5	3.4	3.9	4.5	3.0	3.0
Financial services profits	1.8	3.3	4.3	5.1	3.0	3.0
Compensation of employees(b)	3.7	3.5	4.0	4.3	3.0	3.0
Employment	1.0	1.0	0.5	0.5	0.0	0.0
Average earnings	2.6	2.5	3.0	4.0	3.0	3.0
Interest rates (%)	0.5	0.6	1.2	1.5	2.0	2.5
House prices	3.3	3.0	4.0	5.0	3.0	3.0

Key:

OUTTURNS

Exemptions, allowances and reliefs assumptions

The assumptions about the future value of the exemption thresholds, allowances and reliefs (EARs) have been made bearing in mind the expected number of tax payers, past Budget decisions, a future Budget policy stance[6] and other economic variables, such as the rate of inflation (Figure 10).

Figure 10: Assumptions for exemptions, reliefs and allowances

Budget year Year of assessment (YOA)	2015 2014	2016 2015	2017 2016	2018 2017	2019 2018
	%	%	%	%	%
Exemption limits	1.5	1.7	2.5	3.0	3.3
Allowances and reliefs	0	0	0	0	0
Number of tax payers	1.0	1.0	0.5	0.5	0.0

Notes: Exemption limits, allowances and reliefs for YOA 2014 and 2015 have already been set in past Budgets. Other more specific measures affecting exemption limits, allowances and reliefs agreed in past Budgets have been included in the forecast but not detailed in the table above.

The main change in these assumptions since the Budget 2015 forecast is slower growth in the exemption limits (determined by lower RPI assumptions) and slower growth in the number of taxpayers (based on the assumption for future employment growth).

The effective tax rate, or yield, for personal tax payers is determined by these assumptions over the forecast period. The yield changes over time as personal incomes grow and the amount of EARs claimed by taxpayers change.

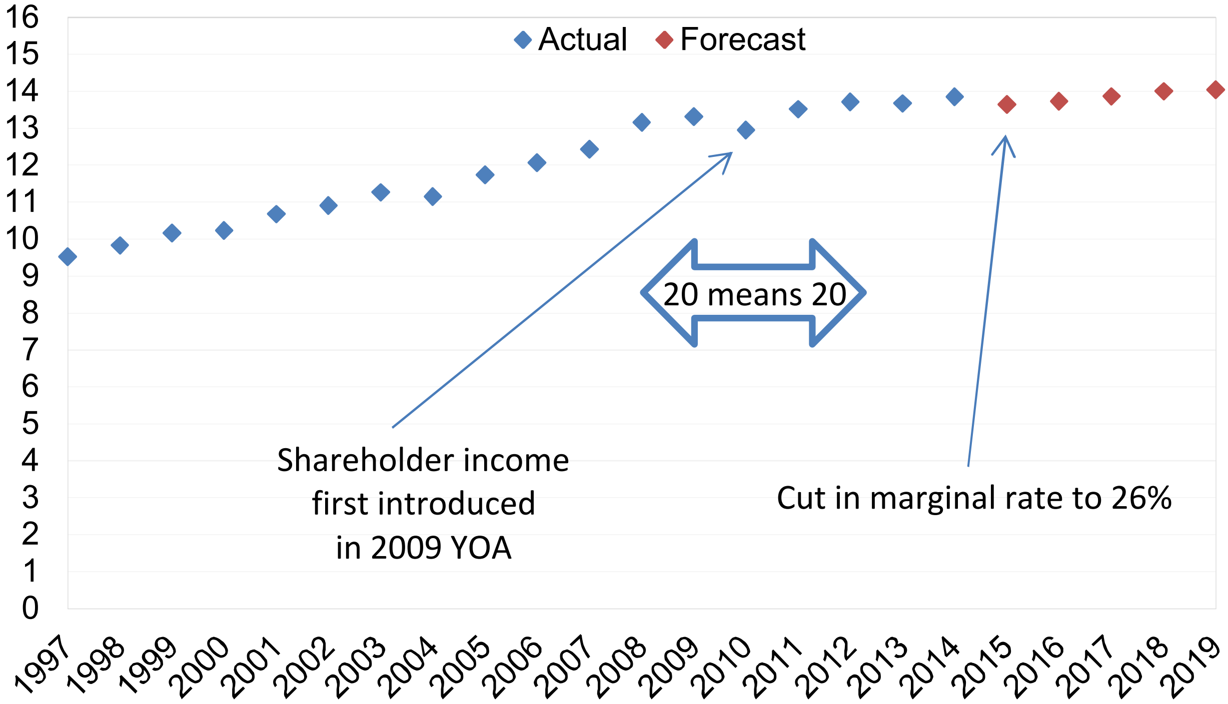
In this forecast, the yield increases from 13.6% in 2015 to 14.0% in 2019 because personal incomes are expected to grow more quickly (3.9% a year on average) than the value of EARs claimed (by 2.7% a year on average).

The yield in 2015 (13.6%) is expected to be slightly lower than the yield in 2014 (13.8%) because of the cut in the marginal income tax rate from 27% to 26% passed in the 2014 Budget (Figure 11).

Some uncertainty remains regarding the impact of higher interest rates on mortgage interest tax relief and the impact this will have on the yield.

[6] The baseline future Budget policy stance is assumed to be slight growth in exemption thresholds and no growth in allowances and reliefs. This is consistent with Budget policy in recent years.

Figure 11: Personal income tax yield
Total personal income tax as a % of total personal income, Budget year



5. Income tax forecast and the forecast range

Provisional central forecast

The provisional central forecast for income tax revenue is shown in Figure 12. There is a lot of uncertainty involved in forecasting income tax revenue and so the central forecast should not be used by itself, but as part of a range which is described later in this section (see Figure).

Figure 12: Provisional central income tax forecast

Budget year	Actual		Forecast				
	2013	2014	2015	2016	2017	2018	2019
	£m	£m	£m	£m	£m	£m	£m
Personal	357	356	360	376	397	419	437
Companies	98	83	86	89	93	97	100
Bad debts	-3	-2	-3	-2	-2	-3	-3
	452	**437**	**443**	**463**	**488**	**513**	**534**
Annual growth		-15	6	20	24	26	21
Annual growth, %		-3%	1%	4%	5%	5%	4%

Comparison with 2015 Budget forecast

This forecast includes new information since the last forecast was carried out (Figure 13):

4. New data on 2014 outturns has resulted in a £8m decrease in the starting personal tax base and a £1m decrease in the starting company tax base.

5. New in-year data on employment income from ITIS records.

6. New in-year data on agents' estimates of company tax for the top 100 taxpayers.

7. New data and revised assumptions for the economic variables has resulted in higher growth expectations for personal tax (+£3m in 2017) but lower growth expectations for company tax (-£5m by 2017).

8. The 2015 Budget measures overall are expected to increase personal tax revenue relative to the last forecast by about £2m a year from 2016.

Appendix 3 (page 26) discusses an extension to the 2015 Budget forecast out to 2019 which was provided to the Treasury in advance of the draft 2015 Budget to help with the development of the Long Term Revenue Plan.

Figure 13: Differences between the provisional central forecast and 2015 Budget forecast

	Actual	Forecast					
Budget year	**2013 £m**	**2014 £m**	**2015 £m**	**2016 £m**	**2017 £m**	**2018 £m**	**2019 £m**
Personal tax							
Budget 2015 forecast	357	364	373	386	404		
2014 outturn		-8	-8	-8	-8		
2015 Budget measures				2	2		
2015 in-year estimate of employment income			-4	-4	-4		
Updated economic assumptions			0	0	3		
Current provisional central forecast	357	356	360	376	397	419	437
Company tax							
Budget 2015 forecast	98*	84	85	91	97		
2014 outturn		-1	-1	-1	-1		
2015 in-year estimate of top 100 taxpayers			2	2	2		
Updated economic assumptions			0	-3	-5		
Current provisional central forecast	98*	83	86	89	93	97	100

Actual ; Forecast

* This includes a one-off £10m tax receipt in 2013.

As a consequence, overall revenues are expected to be lower than forecast in the 2015 Budget by about £12m a year from 2015 (Figure 14). The figures in this table tie in with those in Figure 13.

Figure 14: Summary of the differences between the provisional central forecast and the 2015 Budget forecast

Budget year	Actual 2014 £m	Forecast 2015 £m	2016 £m	2017 £m
Personal	-8	-13	-10	-7
Companies	-1	1	-2	-4
Bad debts	1	0	0	0
	-7	**-12**	**-12**	**-11**

The effects of the updated economic assumptions on the provisional forecast are as follows:

Figure 15: Impact of the changes in economic assumptions on the provisional forecast

Budget year	Forecast 2015 £m	2016 £m	2017 £m
Personal tax			
Compensation of employees	1	1	1
Lower RPI	0	1	2
Other	-1	-2	0
	0	**0**	**3**
Company tax			
Financial services profits and interest rates	**0**	**-3**	**-5**

Analysis of forecast growth in personal income tax

The growth in the provisional central income tax forecast is mainly expected from growth in personal income tax, rather than company income tax (Figure 16). The totals in this table relate to the annual growth summarised in Figure 12.

Figure 16: Central forecast growth in personal and company income tax

Budget year	Forecast 2015 £m	2016 £m	2017 £m	2018 £m	2019 £m
Personal	4	16	21	22	18
Company	3	3	4	5	3
Bad debts	-1	1	0	-1	0
Change on previous year	6	20	24	26	21

There are two reasons this growth in personal income tax is being forecast. Firstly, personal incomes are expected to grow over the forecast period. Secondly, the yield – the average amount of income tax paid per £1 of personal income – is expected to gradually increase as personal incomes grow faster than the amount of exemptions, reliefs and allowances claimed by taxpayers (Figure 17). This is known as 'fiscal drag'. Note that the fall in yield in Budget year 2015 is due to the cut in the marginal rate of income tax from 27% to 26%.

Figure 17: Central forecast growth in personal income tax – income and yield

	Forecast				
Budget year	**2015**	**2016**	**2017**	**2018**	**2019**
	£m	**£m**	**£m**	**£m**	**£m**
Change in incomes	10	14	17	18	17
Change in yield	-6	2	4	4	1
Change on previous year	4	16	21	22	18

The forecast growth in personal incomes is explained in more detail in Figure 18 in terms of their impacts on personal income tax revenue (assuming an average yield on this income). Most of the increase is due to forecasting an increase in employment income and to a lesser extent, increases in pension income and investment income.

Employment income is expected to increase as average earnings and employment are expected to increase over the forecast period. Pension income is expected to increase based on the long term trend seen over the last 18 years (this is not obvious in the table because the impact on income tax revenue is relatively small and rounded to the nearest £1m). Investment income (from bank interest, dividends and rental) is expected to increase as interest rates gradually increase and growth picks up generally in the global economy. Shareholder income is expected to grow in line with inflation (although there are particular risks to this income discussed later).

The forecast for employment income in 2015 is more certain because it is based on employment income information from ITIS returns in 2014, whereas the forecast increases from 2016 onwards are based on the model's relationship which is mainly based on the assumptions for earnings and employment growth. This relationship is considered further on page 17.

Figure 18: Central forecast growth in personal incomes – detail

	Forecast				
Budget year	**2015**	**2016**	**2017**	**2018**	**2019**
	£m	**£m**	**£m**	**£m**	**£m**
Employment income	7	10	12	14	11
Pension and other	2	2	2	2	2
Investment income	1	1	2	2	2
Shareholder income	0	0	1	1	1
Growth in personal incomes	10	14	17	18	17

Provisional forecast range

The size of the forecast range is a matter of judgement. It should be large enough so that actual income tax revenue is likely to be within the forecast range but small enough to be useful for planning purposes.

The income tax forecasting model can provide an indicative forecast range using different sets of economic assumptions.

The income tax forecast range shown in Figure 19 is based on the FPP's real economic growth forecast and the central range around it, which is 1% either side in 2014 and 1.5% either side from 2015 to 2017. The upper and lower range has been rounded to the nearest £5m.

Figure 19: Provisional forecast range based on central economic growth assumptions

Budget year	2014 £m	2015 £m	2016 £m	2017 £m	2018 £m	2019 £m
Upper		450	480	515	555	590
Central	**437**	**443**	**463**	**488**	**513**	**534**
Lower		440	450	465	475	485
Range as a % of central, +/-		1%	3%	5%	7%	9%

However, this range is particularly narrow in 2015 and 2016. The IFG has agreed that a wider range is more appropriate – 2% either side in 2015 and 4% either side in 2016, leading on to the range of 5%, 7% and 9% either side suggested by the model (Figure).

Figure 20: Provisional forecast range - adjusted

Budget year	2014 £m	2015 £m	2016 £m	2017 £m	2018 £m	2019 £m
Upper		455	485	515	555	590
Central	**437**	**443**	**463**	**488**	**513**	**534**
Lower		435	445	465	475	485
Range as a % of central, +/-		2%	4%	5%	7%	9%

Comparison with MTFP 2013-2015

Figure 21 illustrates the difference in the forecast of income tax revenue between the MTFP 2013-2015 (whose forecasts were agreed in 2012) and the current provisional forecast. The MTFP adopted a 10% range (5% either side) in each year. The £437m income tax revenue received in 2014 was below the MTFP forecast range (£450m - £495m) and the provisional forecast of between £435m and £455m for 2015 is also below the MTFP forecast range (£475m - £525m).

Income tax revenue has been, and is expected to be lower than forecast in the MTFP mainly due to weaker growth in personal tax revenue. The reasons for this weaker growth are:

- Lower than expected growth in average earnings and employment 2012-2014.
- The impact of changes to the taxation of shareholder income.
- The 2014 Budget measures, in particular the cut in the marginal rate to 26%.

Figure 21: Provisional forecast compared to previous MTFP 2013-2015 forecast

£m. Black line represents outturns. Blue lines represent the current provisional forecast range. Red lines illustrate the range of the forecast that informed the MTFP in 2012.

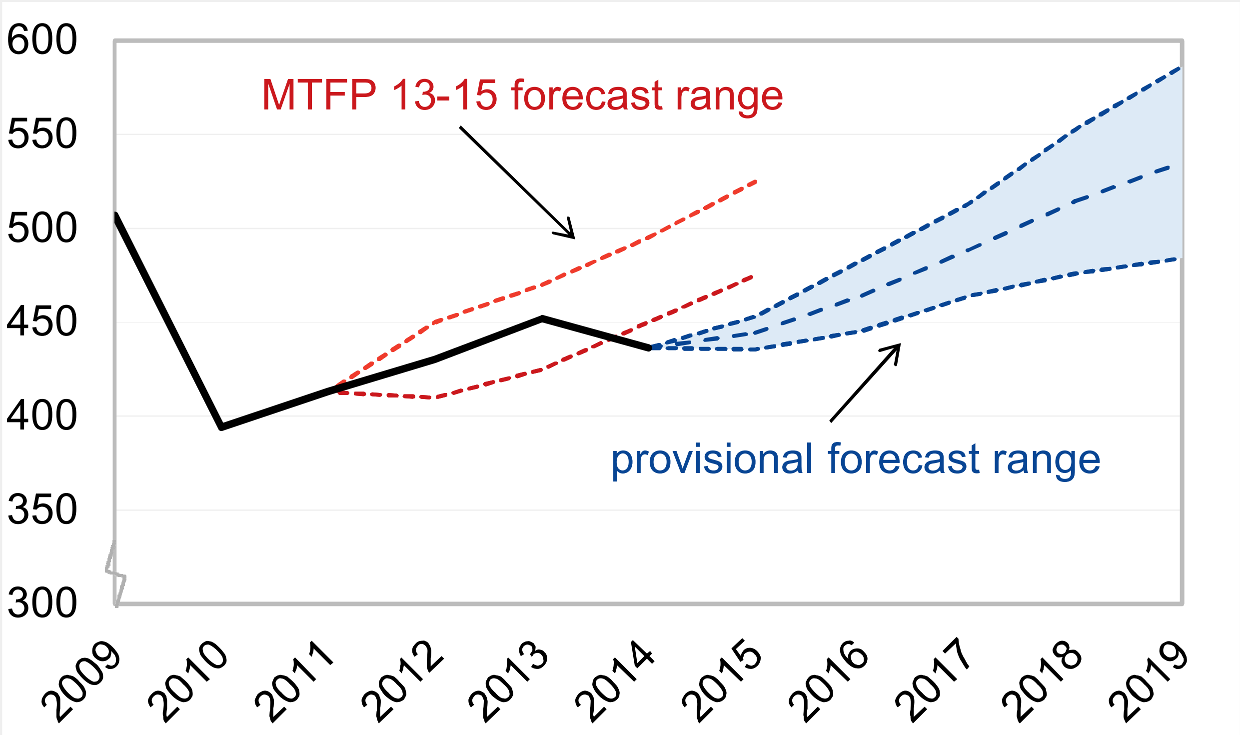
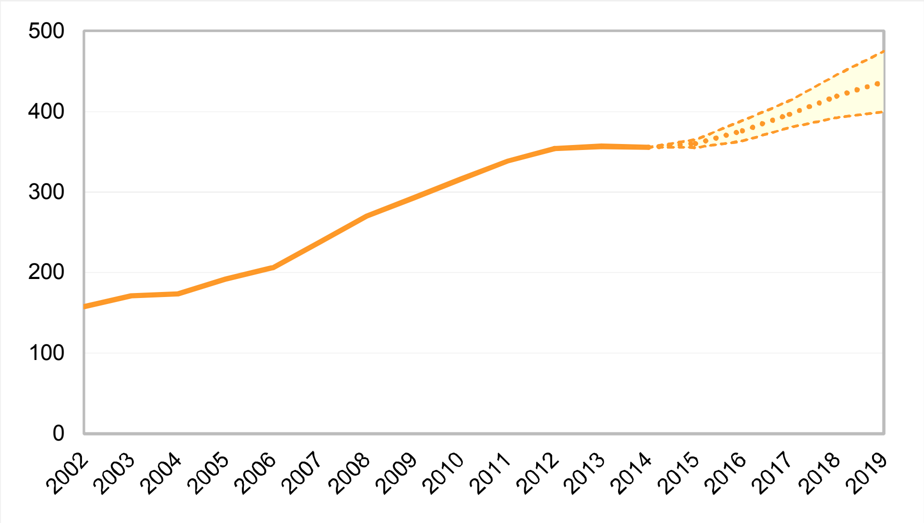
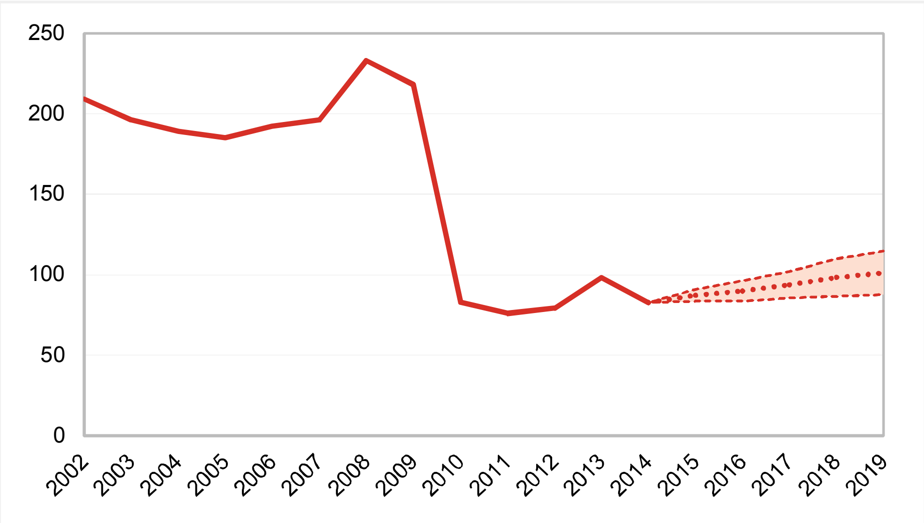


Figure 22: Forecasts by taxpayer type

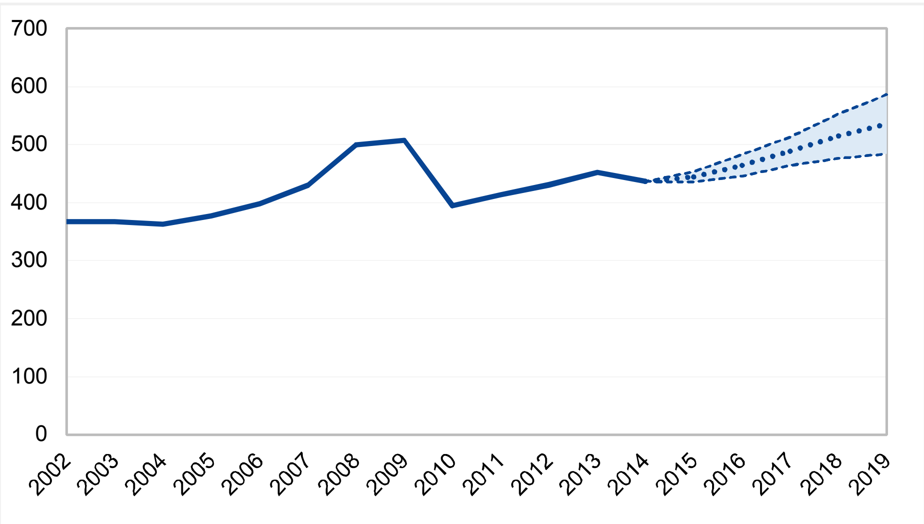
Personal, £m



Company, £m



Total income tax, £m



Recent developments

Recent developments in employment income, shareholder income, and financial services company profits are considered in this section.

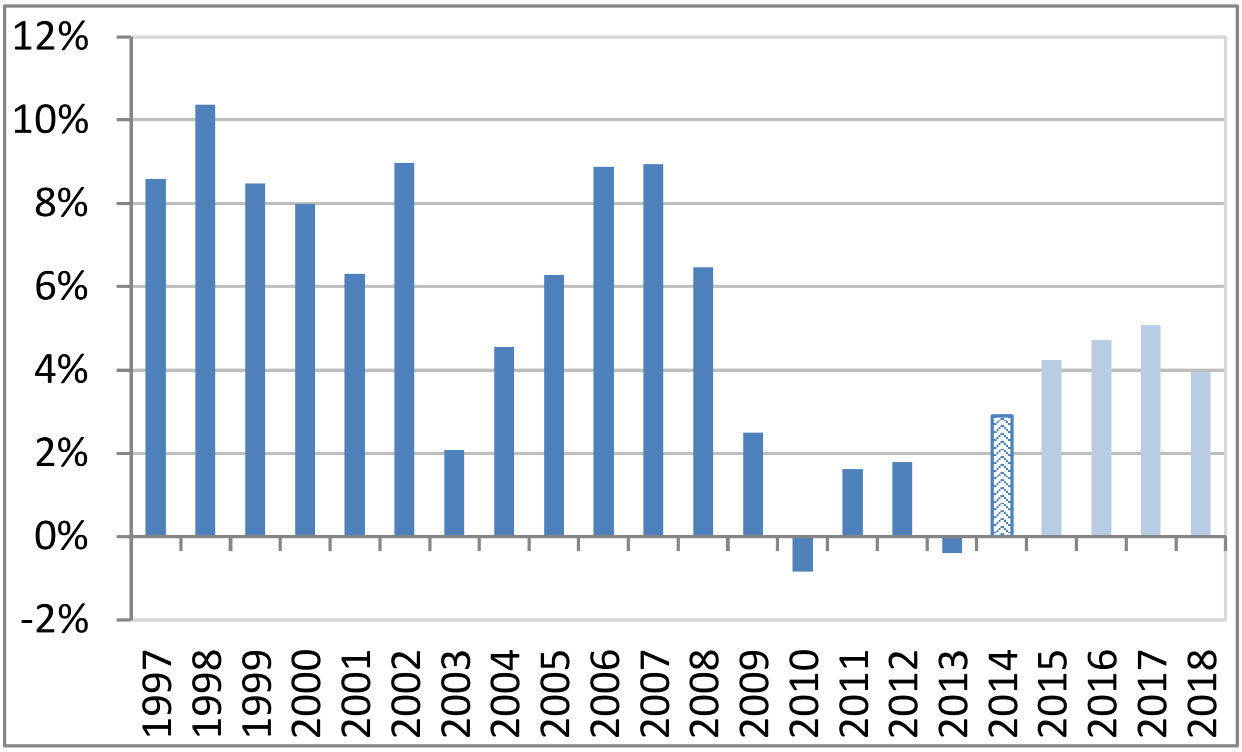
Employment income

Employment income makes up 65% of total personal income recorded on tax returns and is affected by changes in employment and average earnings. Employment income is forecast to grow as Jersey's economy recovers, and employment and earnings growth return to previous trends.

The chart below shows that growth in employment income has been relatively weak since 2008 and there is uncertainty as to how quickly and by how much this will grow in future.

The light blue bars show the model's forecast for employment income growth of about 4% each year (in nominal terms) (or about 2% a year in real terms) from 2015, using the central scenario assumptions.

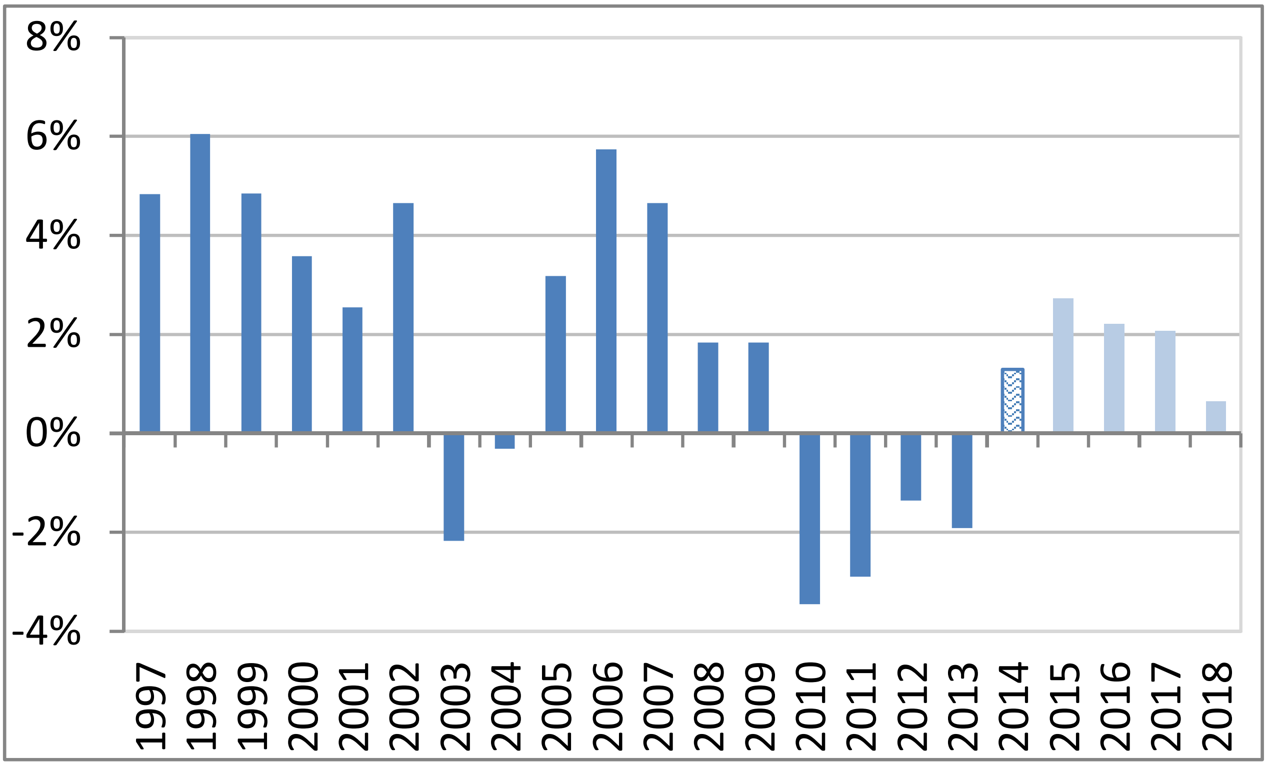
Figure 23: Employment income
annual % change (nominal) calendar year (impacts on income tax revenue the following year)



Note: 1997-2013 are actuals, 2014 is based on ITIS returns and 2015-2018 is the model forecast. Employment income in 2014 impacts on personal income tax revenue in 2015.

Employment growth is assumed to return to the previous trend of slight growth and this therefore assumes that there is no further shift from full-time to part-time employment or further declines in employment in the finance sector. Likewise, it does not assume that future employment growth includes a shift back to full-time employment or a greater share of employment in sectors such as finance where tax per person employed is higher than the average.

Figure 24: Employment income
annual % change (real). Deflated using RPI



Note: 1997-2013 are actuals, 2014 is based on ITIS returns and 2015-2018 is the model forecast. Employment income in 2014 impacts on personal income tax revenue in 2015.

<u>The model's relationship for employment income growth</u>

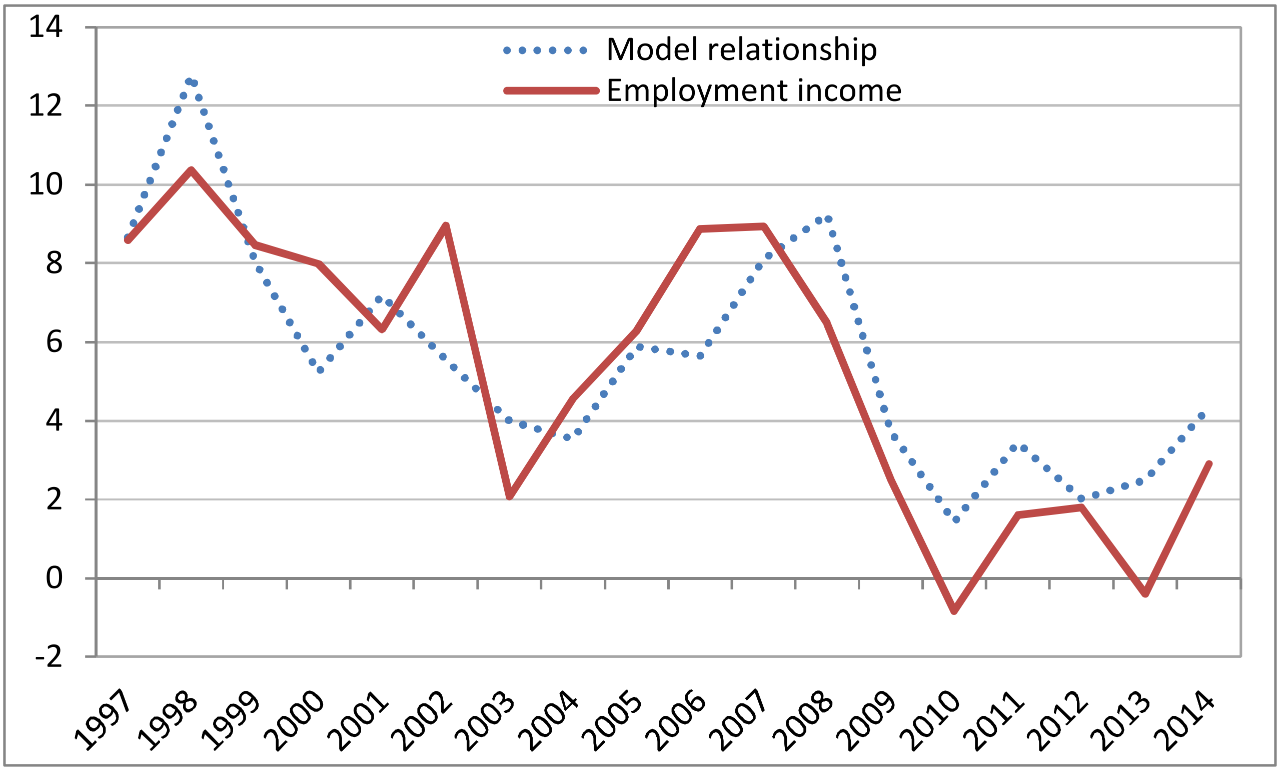
The model's estimated relationship for employment income growth is based on past changes in average earnings, employment and to a lesser degree house prices, and how they best fit with past changes in employment income growth.

Where there is no economic data, the model uses economic assumptions which at times are subject to significant uncertainty and may turn out to be too high or too low. This is another source of forecast error which could work in the same (or opposite) direction as the differences that result using the model's estimated relationships.

Figure 25 shows past changes in employment income and the model's relationship for employment income growth using actual data. The relationship is based on 18 years of income tax and economic data.

The estimated relationships are indicating that employment income has grown more strongly in 2014 than in the last few years. The latest ITIS data confirms what the model is indicating, although as would be expected not the precise % change.

Figure 25: The model's fitted relationship for employment income growth compared to actual employment income growth
Annual % increase



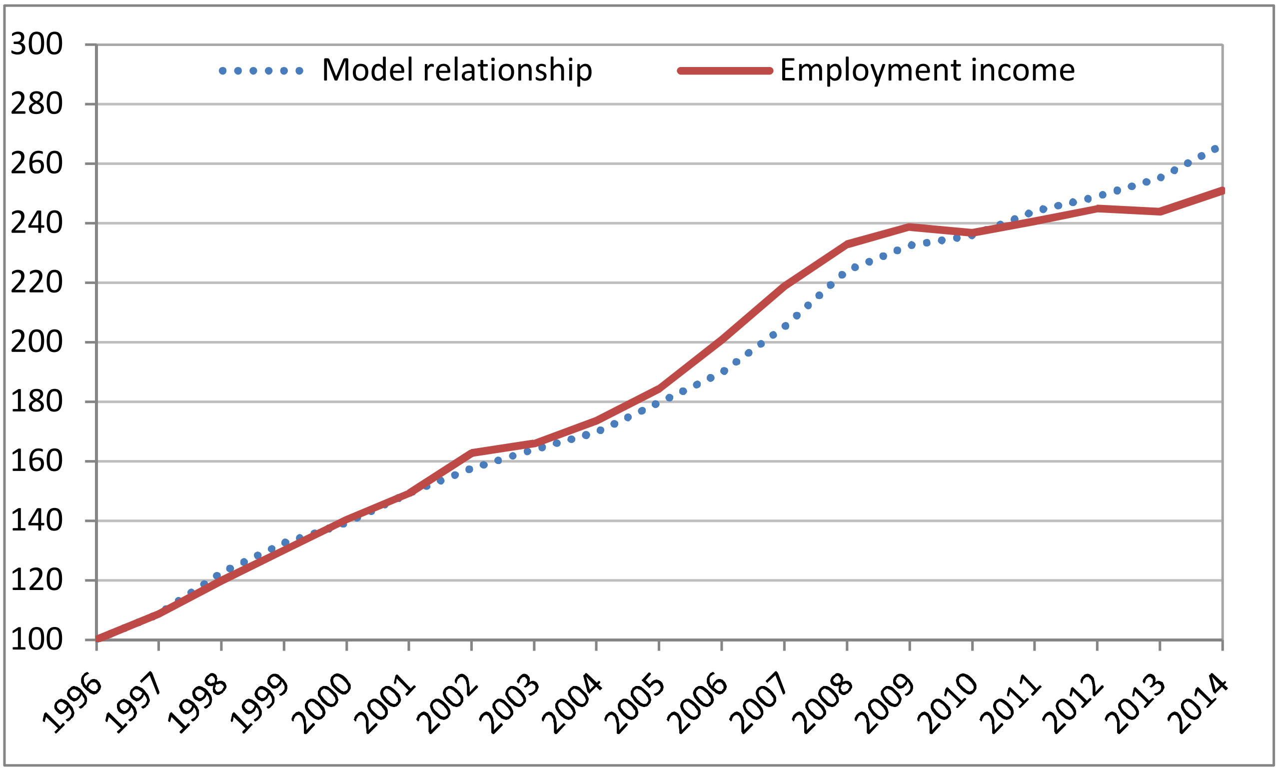
The model has overestimated actual employment income growth in 11 of those years and underestimated in the other 7 years. For the last 7 years – since the impact of the global financial crisis in 2008 – the model's relationship has overestimated employment income growth by an average of 1.8%. However, over the 18 year period the model has overestimated employment income growth by 0.3% on average.

Overall, with the hindsight of real economic data, the model will tend to overestimate employment income growth when Jersey's economy is performing poorly and employment income is growing weakly, and underestimate employment income growth in the upward phase of the economic cycle.

The FPP expects that Jersey's economy returned to growth in 2014 and that the economy will continue to grow more quickly (in nominal terms) in 2015, 2016 and 2017.

Although there is a risk that the model continues to overestimate actual employment income growth as it has done since 2008, there is also the risk that the model starts to underestimate employment income growth as it has done before when Jersey's economy performs more strongly (Figure 26).

Figure 26: The model's fitted relationship for employment income growth compared to actual employment income growth – cumulative growth
Index (1996=100)



As a guide, every 1% of employment income growth might raise about £2m in personal income tax. If the forecast overestimates or underestimates employment income growth by 1% each year in 2015, 2016 and 2017, then the forecast difference would grow by about £2m a year from Budget year 2016 to a total of £6m a year by Budget year 2018.

UK context

The UK's Office for Budget Responsibility published its 'Economic and Fiscal Outlook' in December 2014 which sets out their latest fiscal forecast for the UK's public finances, and the economic and market assumptions that underpin the forecast.

The OBR's income tax forecast is driven by assumptions for growth in the total wages and salaries in the UK economy, in nominal terms, which is made up of assumptions for employment growth and average earnings growth. The provisional forecast for personal income tax in this note is also driven by a similar assumption (changes in employment growth and average earnings growth drive employment income changes).

Figure 27 shows the OBR's assumptions for UK employment and average earnings growth compared to the assumptions for Jersey employment and average earnings growth. Between 2014 and 2017 the assumptions for both economies are fairly similar. In 2018 and 2019, the OBR's assumptions are about 1% higher altogether than the FPP's assumptions.

Figure 27: UK and Jersey forecast assumptions for average earnings and employment growth

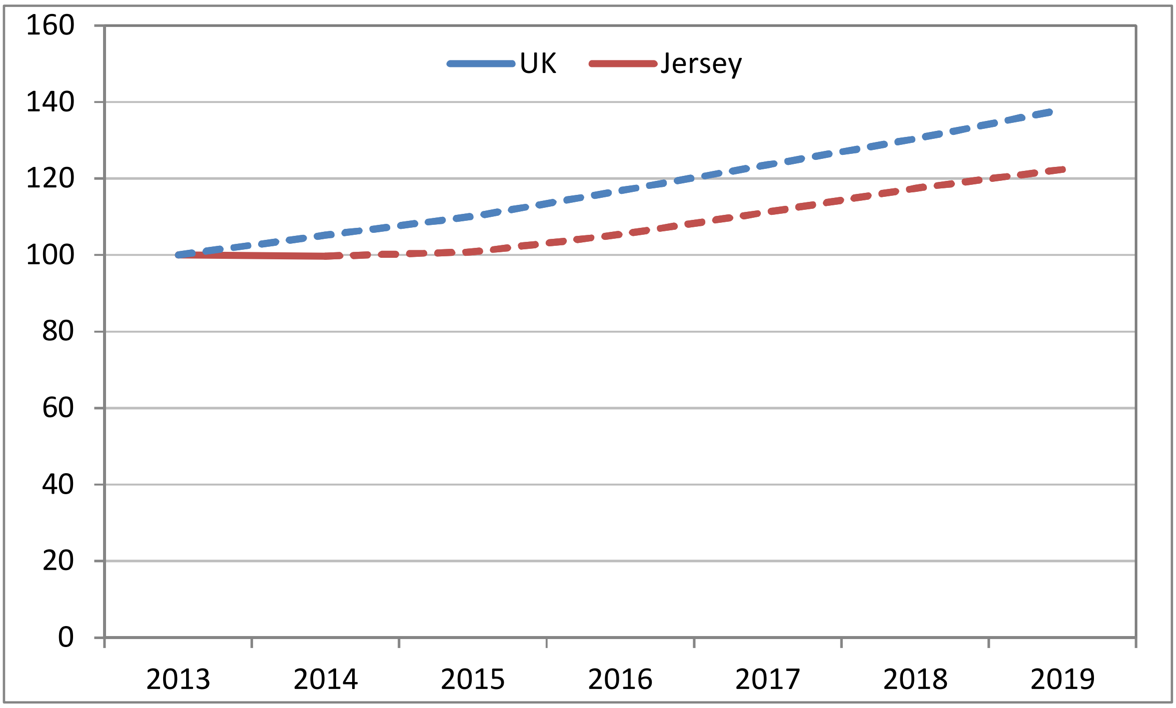
	%					
	2014	**2015**	**2016**	**2017**	**2018**	**2019**
UK						
Employment growth	2.3	1.6	0.6	0.3	0.3	0.3
Average earnings growth	1.8	2.0	3.1	3.9	3.9	3.8
Jersey						
Employment growth	1.0	1.0	0.5	0.5	0.0	0.0
Average earnings growth	2.6	2.5	3.0	4.0	3.0	3.0

Source: OBR Economic and Fiscal Outlook December 2014

On the basis of these economic assumptions, the OBR is expecting the UK's personal income tax revenue to grow from £155bn to £214bn between April 2013 and April 2020 (38% growth) (Figure 28, growth between 2013 and 2019). This is comparable with the provisional central forecast for Jersey's personal income tax revenue growing from £357m to £437m (22% growth) over a similar period.

The cut in the marginal rate of income tax from 27% to 26% also helps to explain why personal income tax revenue is expected to pick up more slowly than in the UK.

Figure 28: UK and Jersey personal income tax forecasts
Index 2013=100



Note: UK personal income tax years run from year beginning 6 April. For the UK line, 2013 = 6 April 2013 to 5 April 2014.

Source: OBR Economic and Fiscal Outlook December 2014.

Shareholder income

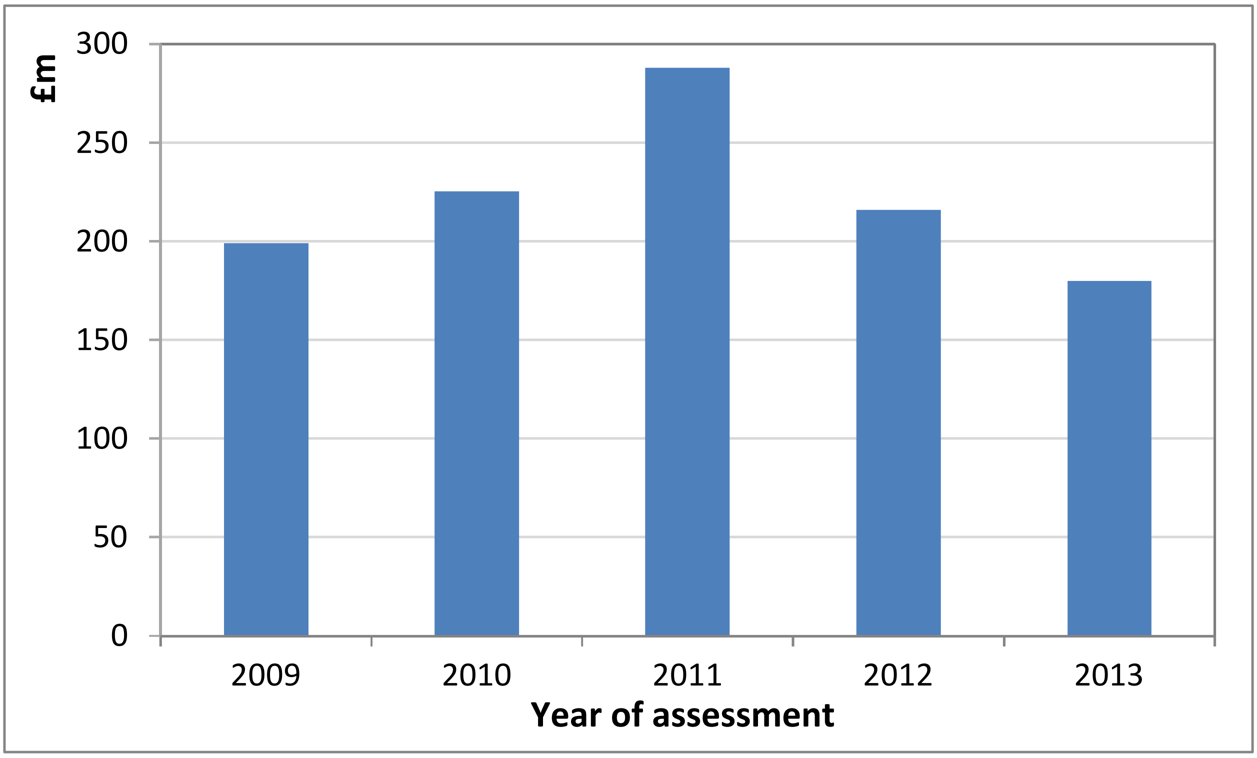
Broadly, the profits of Jersey companies (other than those companies taxed at 20%) are assessed on shareholders at the personal level under the heading of "shareholder income" (Figure 29).

There have been significant changes to the tax rules which affect the amount of shareholder income assessed on taxpayers. For each year of assessment (YOA) the shareholder income would have included the following:

YOA	Company profit assessed on shareholder
2009	Attributed investment holding company profits – accounts Y/E 09
2010	Attributed investment holding company profits – accounts Y/E 10 Deemed dividends minimum 60% trading profits – accounts Y/E 09
2011	Attributed investment holding company profit – accounts Y/E 11 plus profits to 31/12/11 Deemed dividends minimum 60 of trading profit - accounts Y/E 10
2012	Deemed dividends minimum 60% trading profits - accounts Y/E 11 plus minimum 60% profits to 31/12/11
2013	Company distributions only

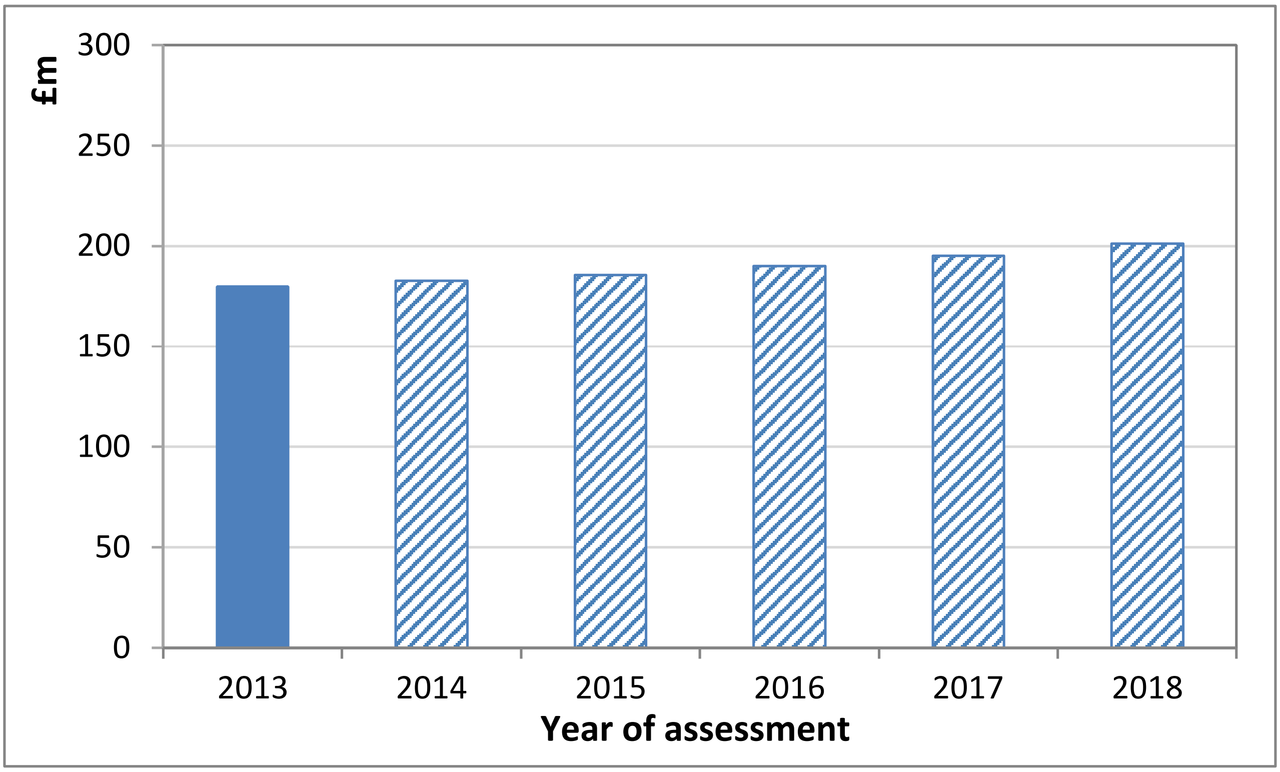
Forecasting shareholder income is particularly difficult because there is little information on which to estimate the profile going forward. Past experience is no guide to the future and there is a risk that some of this income recorded in YOA 2013 may not occur again in future years.

Figure 29: The amount of shareholder income declared by taxpayers



Note: Shareholder income in 2013 impacts on personal income tax revenue in 2014.

Figure 30: Shareholder income provisional central forecast



Note: Shareholder income in 2013 impacts on personal income tax revenue in 2014.

The starting point for the provisional central forecast is based on the most recent amount of shareholder income received for YOA 2013. The central assumption is that this income grows at the rate of inflation over the forecast period because there is no strong evidence to suggest that this income will grow either more quickly or slowly.

However, there is a risk that taxpayer behaviour may change such that shareholder income may fall, rather than grow, and it is not possible to gauge by how much it could fall by. Therefore, there is significant uncertainty and downside risk to this part of the forecast.

Company tax

Future growth in company tax revenue will be partly determined by when interest rates increase and how this positively affects the profits of the banking sector. Since the FPP provided their economic assumptions, the financial market expectations of when interests may go up has worsened. Should these expectations be founded, this would be a downside risk to the company tax forecast.

The impact of this might be that company profits, and therefore company tax revenue, grows at a similar rate to inflation. This is because a slower increase in interest rates would delay any pick up in finance sector profits that would have otherwise resulted from higher interest rates. Figure 31 illustrates that this risk could be around £6m less company tax revenue by 2019.

Figure 31: Illustrative impact of latest interest rate profile on company tax revenue

Budget year	2015 £m	2016 £m	2017 £m	2018 £m	2019 £m
No real growth	86	87	90	92	95
Central forecast	86	89	93	97	100
Difference in growth	0	-2	-3	-5	-6

Banking reform in the UK (the Vickers proposals) is another uncertainty that could impact on banking sector activity and profitability. Interviews with executives of Jersey banks suggested that there were risks and opportunities (and relatively evenly balanced) from the proposed reforms but some uncertainty still remains.

Other uncertainties

There is also some uncertainty about the impact of higher interest rates on mortgage interest relief claims towards the end of the forecast period, particularly since the introduction of the interest cap in 2015 Budget.

6. Sensitivity analysis

This section looks at how the central income tax forecast would change by changing some of the underlying key assumptions.

Economic growth rate

The impact of economic growth on income tax revenue depends on the exact nature of the economic growth and the extent to which it increases personal employment income and company profits.

A 1% increase in the economic growth assumption where employment income and profits in the economy increase by 1%, would result in a £2m-£3m increase in the income tax revenue forecast each year from 2015. A similar decrease in the economic growth rate assumption would have the opposite effect.

Growth that is more focused on earnings growth due to higher productivity, or employment growth in higher wage jobs, would bring in slightly more tax revenue than the estimate above (£3m-£5m) given its impact on the tax base.

Conversely, growth that is focused more on profit growth, particularly in the non-finance sectors of the economy, or employment growth in lower wage jobs, would result in a slightly lower increase in tax revenue (£0m-2m).

Interest rates

An interest rate profile that is 1% higher than the central assumption from 2015 onwards would impact on tax revenue from 2016.

There are two impacts on personal tax which work in opposite directions and are expected to largely offset each other:

1. An increase in investment income (£11m @ 13.5% yield)
2. An increase in mortgage interest relief (£5m @ 27%/26%).

The impact of the higher interest profile on financial services profits is uncertain, unlikely to be uniform and the subject of the ongoing work mentioned above. However, if the existing profile of corporate profits was adjusted to reflect a proportionate 1% increase in interest rates then it would increase tax revenue by approximately £2m by 2017. A slower increase in interest rates would delay the expected timing of the impact on financial services profits and therefore company income tax revenue.

Appendix 1

Economic assumptions: Current provisional compared to 2015 Budget forecast

CURRENT February 2015

	2013	2014	2015	2016	2017	Return to trend 2018	2019
Real GVA	0.0	1.6	2.0	1.2	1.7	0.0	0.0
RPI	1.5	1.6	1.5	2.5	3.0	3.3	3.3
RPIY	1.5	1.6	1.5	2.5	2.7	3.0	3.0
Nominal GVA	1.3	3.2	3.5	3.7	4.4	3.0	3.0
Company profits	tbc	2.5	3.4	3.9	4.5	3.0	3.0
Financial services profits	tbc	1.8	3.3	4.3	5.1	3.0	3.0
Compensation of employees	tbc	3.7	3.5	4.0	4.3	3.0	3.0
Employment	-0.3	1.0	1.0	0.5	0.5	0.0	0.0
Average Earnings	2.2	2.6	2.5	3.0	4.0	3.0	3.0
Interest rates (%)	0.5	0.5	0.6	1.2	1.5	2.0	2.5
House prices	-1.3	3.3	3.0	4.0	5.0	3.0	3.0

PREVIOUS May 2014 (Budget 2015)

	2013	2014	2015	2016	2017	2018+ averages 2018	2019
Real GVA	0.2	0.3	1.3	2.0	2.3	1.9	1.8
RPI	1.5	2.2	3.0	3.3	3.3	3.5	3.5
RPIY	1.5	2.2	2.7	2.7	2.7	3.0	3.0
Nominal GVA	1.7	2.5	4.0	4.7	5.0	4.9	4.8
Company profits	1.8	2.6	4.6	4.6	4.9	5.2	5.0
Financial services profits	1.0	2.0	6.0	6.0	6.0	5.0	5.0
Compensation of employees	1.6	2.5	3.5	4.7	5.0	4.7	4.7
Employment	-0.5	0.0	0.5	1.0	1.0	0.5	0.5
Average Earnings	2.2	2.5	3.0	3.7	4.0	4.2	4.2
Interest rates (%)	0.5	0.5	0.9	1.7	2.5	3.0	3.3
House prices	-1.3	0.0	2.0	3.0	4.0	5.0	5.0

DIFFERENCE

	2013	2014	2015	2016	2017	2018	2019
Real GVA	-0.2	1.3	0.7	-0.8	-0.6	-1.9	-1.8
RPI	0.0	-0.6	-1.5	-0.8	-0.3	-0.2	-0.2
RPIY	0.0	-0.6	-1.2	-0.2	0.0	0.0	0.0
Nominal GVA	-0.4	0.7	-0.5	-1.0	-0.6	-1.9	-1.8
Company profits	tbc	-0.1	-1.2	-0.7	-0.4	-2.2	-2.0
Financial services profits	tbc	-0.2	-2.7	-1.7	-0.9	-2.0	-2.0
Compensation of employees	tbc	1.2	0.0	-0.7	-0.7	-1.7	-1.7
Employment	0.2	1.0	0.5	-0.5	-0.5	-0.5	-0.5
Average Earnings	0.0	0.1	-0.5	-0.7	0.0	-1.2	-1.2
Interest rates (%)	0.0	0.0	-0.3	-0.5	-1.0	-1.0	-0.8
House prices	0.0	3.3	1.0	1.0	1.0	-2.0	-2.0

Key:

OUTTURNS

Appendix 2 – The economic assumptions for the optimistic and pessimistic scenarios

FPP central scenario

					Return to trend	
	2014	2015	2016	2017	2018	2019
Real GVA	1.6	2.0	1.2	1.7	0.0	0.0
RPI	1.6	1.5	2.5	3.0	3.3	3.3
RPIY	1.6	1.5	2.5	2.7	3.0	3.0
Nominal GVA	3.2	3.5	3.7	4.4	3.0	3.0
Company profits(a)	2.5	3.4	3.9	4.5	3.0	3.0
Financial services profits	1.8	3.3	4.3	5.1	3.0	3.0
Compensation of employees(b)	3.7	3.5	4.0	4.3	3.0	3.0
Employment	1.0	1.0	0.5	0.5	0.0	0.0
Average earnings	2.6	2.5	3.0	4.0	3.0	3.0
Interest rates (%)	0.5	0.6	1.2	1.5	2.0	2.5
House prices	3.3	3.0	4.0	5.0	3.0	3.0

FPP central scenario - upper range

					Return to trend	
	2014	2015	2016	2017	2018	2019
Real GVA	2.6	3.5	2.7	3.2	1.5	1.5
RPI	1.6	3.0	4.0	4.5	4.8	4.8
RPIY	1.6	2.5	3.5	3.7	4.0	4.0
Nominal GVA	4.2	6.0	6.2	6.9	5.5	5.5
Company profits(a)	3.0	4.5	5.0	5.5	4.0	4.0
Financial services profits	4.8	6.3	7.3	8.1	4.0	4.0
Compensation of employees(b)	5.2	7.1	7.1	8.1	6.6	6.6
Employment	2.5	2.5	2.0	2.0	1.5	1.5
Average Earnings	2.6	4.5	5.0	6.0	5.0	5.0
Interest rates (%)	0.5	1.3	1.9	2.2	2.7	3.2
House prices	3.3	6.0	7.0	8.0	6.0	6.0

FPP central scenario - lower range

					Return to trend	
	2014	2015	2016	2017	2018	2019
Real GVA	0.6	0.5	-0.3	0.2	-1.5	-1.5
RPI	1.6	0.0	1.0	1.5	1.8	1.8
RPIY	1.6	0.5	1.5	1.7	2.0	2.0
Nominal GVA	2.2	1.0	1.2	1.9	0.5	0.5
Company profits(a)	2.2	2.3	2.7	3.0	1.5	1.5
Financial services profits	-1.2	0.3	1.3	2.1	1.5	1.5
Compensation of employees(b)	2.1	0.0	0.0	1.0	-0.5	-0.5
Employment	-0.5	-0.5	-1.0	-1.0	-1.5	-1.5
Average Earnings	2.6	0.5	1.0	2.0	1.0	1.0
Interest rates (%)	0.5	0.5	0.5	0.8	1.3	1.8
House prices	3.3	0.0	1.0	2.0	0.0	0.0

(a) Gross profits for all companies, including traders.
(b) The number of employees multiplied by the costs of employment (wages, bonuses, pensions).

Appendix 3 – Discussion of additional forecasting information provided to Treasury

This section outlines the information that we provided to Treasury in May and November 2014 and how these compare to the current provisional forecast.

May 2014

In May 2014, the Treasurer asked for the central income tax forecast to be extended until 2019 using the income tax forecasting model to help with the early stages of developing the Long Term Revenue Planning Review. Figure 32 shows the extended forecast for 2018 and 2019 in italics.

Figure 32: Budget 2015 central forecast – extended to 2019

	Forecast					
Budget year	**2014 £m**	**2015 £m**	**2016 £m**	**2017 £m**	***2018 £m***	***2019 £m***
Personal	364	373	386	404	*425*	*452*
Companies	84	85	91	97	*103*	*109*
Bad debts	-3	-3	-2	-2	*-3*	*-3*
	444	**455**	**475**	**499**	***525***	***558***
Annual growth	-8	11	20	24	*26*	*33*
Annual growth, %	-2%	2%	4%	5%	*5%*	*6%*

Figure 33: Budget 2015 central forecast compared to current provisional central forecast

	Forecast					
Budget year	**2014 £m**	**2015 £m**	**2016 £m**	**2017 £m**	**2018 £m**	**2019 £m**
Personal tax						
Budget 2015 forecast	**364**	**373**	**386**	**404**	**425**	**452**
2014 outturn	-8	-8	-8	-8	-8	-8
2015 Budget measures			2	2	2	2
2015 in-year estimate of employment income		-4	-4	-4	-4	-4
Updated economic assumptions		0	0	3	4	-5
Current provisional forecast	**356**	**360**	**376**	**397**	**419**	**437**
Company tax						
Budget 2015 forecast	**84**	**85**	**91**	**97**	**103**	**109**
2014 outturn	-1	-1	-1	-1	-1	-1
2015 in-year estimate of top 100 taxpayers		2	2	2	2	2
Updated economic assumptions		0	-3	-5	-7	-10
Current provisional forecast	**83**	**86**	**89**	**93**	**97**	**100**

Actual ; Forecast

For personal tax, the main difference is due to the £8m lower than expected outturn in 2014 that has been built in to the provisional forecast. Assuming a lower trend rate of average earnings and employment growth from 2018 onwards (corresponding to 0% growth in real terms rather than about 1.5%) also reduces the expected growth in personal income tax revenue relative to the 2015 Budget forecast.

Company income tax is expected to grow more slowly now than it was in May (and November) 2014. Following a series of interviews with executives from financial services companies, more gradual increases in financial services profits are now expected between 2015 and 2017, impacting on income tax revenue 2016-2018.

Furthermore, following the FPP's Pre-MTFP report which analysed Jersey's trend rate of growth, a slightly lower rate of financial services profit growth is now expected from 2018 onwards, affecting 2019 revenue (corresponding to 0% growth in real terms rather than about 0.5%).

November 2014

In November 2014, the Treasurer asked for a provisional update of the income tax forecast using the income tax forecasting model to inform the Council of Ministers development of initial proposals for the new Strategic Plan and next Medium Term Financial Plan.

Figure 34: November 2014 update: central forecast extended to 2019

	Estimate	Forecast				
Budget year	**2014**	**2015**	**2016**	**2017**	***2018***	***2019***
	£m	**£m**	**£m**	**£m**	***£m***	***£m***
Personal	356	364	382	402	*424*	*448*
Companies	83	84	90	96	*102*	*106*
Bad debts	-2	-3	-2	-2	*-3*	*-3*
	437	**446**	**470**	**495**	***523***	***551***
Annual growth	-15	9	24	26	*28*	*28*
Annual growth, %	-3%	2%	5%	5%	*6%*	*5%*
Difference vs 2015 Budget	**-7**	**-9**	**-5**	**-4**	***-2***	***-7***

The November update was lower than the 2015 Budget forecast because Treasury expected the income tax outturn for 2014 to be about £8m lower and expected this to be a permanent reduction in the tax base.

Offsetting this in later years is the impact of slightly more positive economic assumptions in 2014 and 2015, lower inflation and the 2015 Budget measures (£2m from 2016) (Figure 35).

Figure 35: Differences between the November 2014 update and 2015 Budget forecast

Budget year	2014 £m	2015 £m	Forecast 2016 £m	2017 £m	*2018 £m*	*2019 £m*
Personal tax						
2015 Budget forecast	**364**	**373**	**386**	**404**	***425***	***452***
Estimated outturn	-8	-8	-8	-8	*-8*	*-8*
2015 Budget measures			2	2	*2*	*2*
Updated economic assumptions	0	1	2	3	*3*	*2*
Other	0	-2	0	1	*2*	*0*
November update	**356**	**364**	**382**	**402**	***424***	***448***
Company tax						
2015 Budget forecast	**84**	**85**	**91**	**97**	***103***	***109***
Estimated outturn	-1	-1	-1	-1	*-1*	*-1*
Updated economic assumptions	0	0	0	0	*0*	*-2*
November update	**83**	**84**	**90**	**96**	***102***	***106***

Economic assumptions: Current and November 2014 update

CURRENT February 2015

						Return to trend	
	2013	2014	2015	2016	2017	2018	2019
Real GVA	0.0	1.6	2.0	1.2	1.7	0.0	0.0
RPI	1.5	1.6	1.5	2.5	3.0	3.3	3.3
RPIY	1.5	1.6	1.5	2.5	2.7	3.0	3.0
Nominal GVA	1.3	3.2	3.5	3.7	4.4	3.0	3.0
Company profits	tbc	2.5	3.4	3.9	4.5	3.0	3.0
Financial services profits	tbc	1.8	3.3	4.3	5.1	3.0	3.0
Compensation of employees	tbc	3.7	3.5	4.0	4.3	3.0	3.0
Employment	tbc	1.0	1.0	0.5	0.5	0.0	0.0
Average Earnings	2.2	2.6	2.5	3.0	4.0	3.0	3.0
Interest rates (%)	0.5	0.5	0.6	1.2	1.5	2.0	2.5
House prices	-1.3	3.3	3.0	4.0	5.0	3.0	3.0

PREVIOUS November update 2014

						2018+ averages	
	2013	2014	2015	2016	2017	2018	2019
Real GVA	-0.2	1.4	1.7	1.7	1.8	1.1	1.1
RPI	1.5	1.8	2.7	3.2	3.3	3.3	3.3
RPIY	1.5	1.8	2.5	2.6	2.7	3.0	3.0
Nominal GVA	1.3	3.2	4.2	4.4	4.5	4.1	4.1
Company profits	tbc	2.6	4.6	4.7	4.7	3.7	3.7
Financial services profits	tbc	2.0	6.0	6.0	6.0	3.8	3.8
Compensation of employees	tbc	3.7	3.8	4.0	4.3	4.5	4.5
Employment	tbc	1.0	1.0	0.5	0.5	0.5	0.5
Average Earnings	2.2	2.6	3.0	3.8	4.0	4.0	4.0
Interest rates (%)	0.5	0.5	1.0	1.8	2.3	3.5	3.5
House prices	-1.3	1.0	3.0	4.0	5.0	5.0	5.0

DIFFERENCE

	2013	2014	2015	2016	2017	2018	2019
Real GVA	0.2	0.2	0.3	-0.5	-0.1	-1.1	-1.1
RPI	0.0	-0.2	-1.2	-0.7	-0.3	0.0	0.0
RPIY	0.0	-0.2	-1.0	-0.1	0.0	0.0	0.0
Nominal GVA	0.0	0.0	-0.7	-0.7	-0.1	-1.1	-1.1
Company profits	tbc	-0.1	-1.2	-0.8	-0.2	-0.7	-0.7
Financial services profits	tbc	-0.2	-2.7	-1.7	-0.9	-0.8	-0.8
Compensation of employees	tbc	0.0	-0.3	0.0	0.0	-1.5	-1.5
Employment	tbc	0.0	0.0	0.0	0.0	-0.5	-0.5
Average Earnings	0.0	0.0	-0.5	-0.8	0.0	-1.0	-1.0
Interest rates (%)	0.0	0.0	-0.4	-0.6	-0.8	-1.5	-1.0
House prices	0.0	0.0	0.0	0.0	0.0	-2.0	-2.0

Key:

OUTTURNS

States of Jersey
Economics Unit
May 2015

ANNEX 2

DETAILED ANALYSIS SUPPORTING THE ECONOMIC ASSUMPTIONS FOR THE NEW INCOME TAX FORECAST

AS PRESENTED TO THE COUNCIL OF MINISTERS 19TH MARCH 2015

ANNEX 2

States of Jersey
Economics Unit
March 2015

Income Forecasting Group - Detailed analysis supporting the economic assumptions for the new income tax forecast, March 2015

Introduction

This note supports the IFG's income tax forecast paper by describing the underlying economic assumptions that have been used and their longer term trends.

The Fiscal Policy Panel (FPP) published their Pre-MTFP report on 30 January 2015. The report included their latest assessment of the economic position, an economic growth forecast and, for the first time, an assessment of Jersey's longer term economic growth rate. This is supported by an analysis of the past trends in economic growth and what these are likely to be in the future. All this analysis supports the FPP's economic growth forecast and central economic assumptions.

The income tax forecast is based on the FPP's central economic assumptions. This note summarises the key points in the analysis from the FPP's Pre-MTFP report and also covers any new economic data and developments that will need to be considered when these economic assumptions are finalised in April.

The paper is set out as follows:

Section 1 describes the FPP's economic growth forecast and how it has changed since last year. Section 2 outlines the new data since the FPP's economic growth forecast. Section 3 discusses the long term trends in the economic variables and what they mean for the future. There is also an appendix, for information, which contains the UK's Office for Budget Responsibility (OBR) economic assumptions which determine their fiscal forecasts for the UK.

1. FPP economic growth forecast

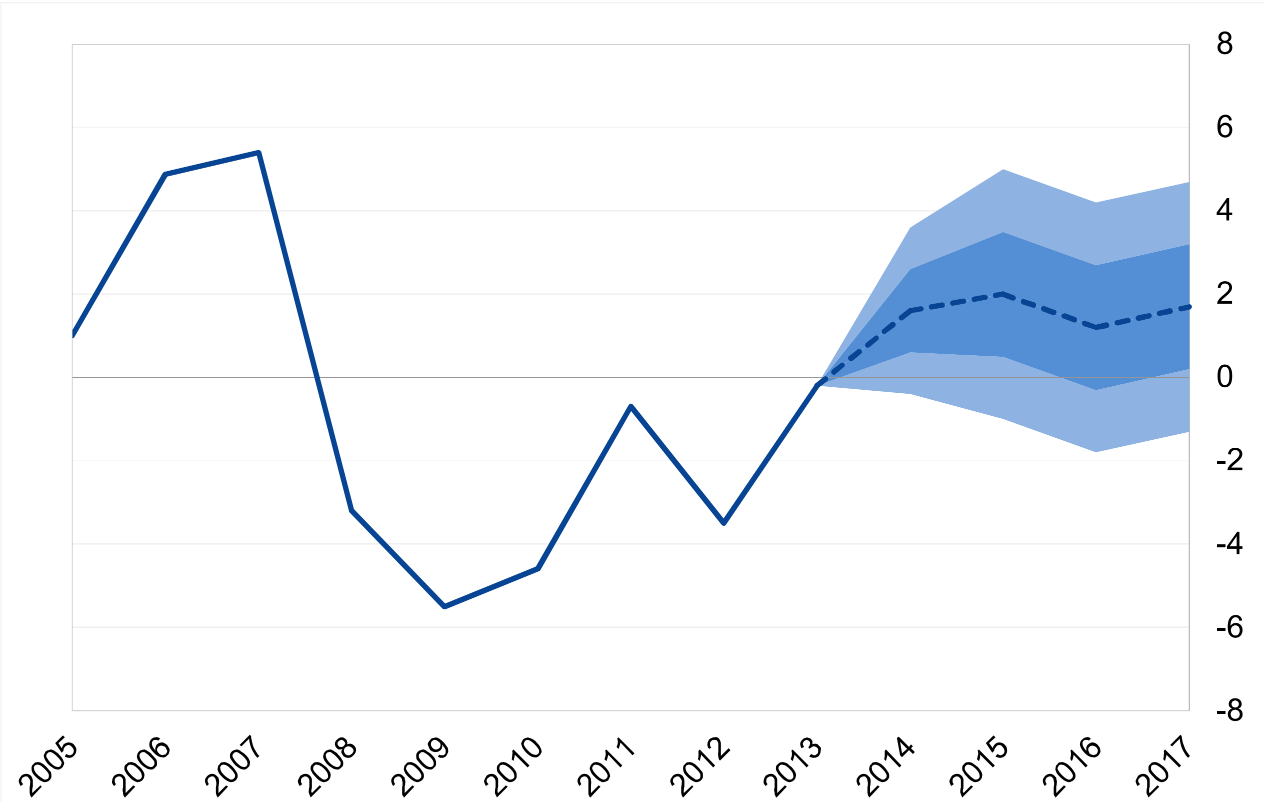
Central assessment of economic position

The FPP's central assessment of the current economic position is that Jersey's output is about 5% below its potential level and that spare capacity will be used up by about 2018 as Jersey's economy recovers. This assessment is subject to great uncertainty relating mainly to: the speed and durability of the global economy, the competitiveness of Jersey financial services and the ability of businesses to employ people locally and internationally.

Economic growth forecast: 2014-2017

The FPP's economic growth forecast up to 2017 is based on recent developments, including data on Jersey's economy, survey findings, market interest rate expectations and information from interviews with financial services businesses (Figure 1). It is also based on the States' expected fiscal stance not changing significantly.

Figure 1: Economic growth forecast
% change in real GVA on year before



Source: Jersey Statistics Unit and FPP judgement.

The central forecast is for between 1% and 2% real growth each year between 2014 and 2017, with a central range of 1% either side in 2014 and 1.5% either side from 2015-2017. The dark blue area around the central growth forecast represents a more likely range around future growth rates. The light blue area represents a less likely, but still possible, range of growth rates that could occur.

Economic growth forecast: From 2018 onwards

The FPP suggests that there is not enough evidence to assume a trend rate of growth that is positive in Jersey and that future fiscal trends should be tested against a trend rate of 0% a year. Future productivity performance will have a profound impact on the long term rate of growth. However, these estimates are uncertain because of the nature of the economy and the period for which data are available (Figure 2).

Figure 2: Calculation of trend GVA growth
Summary of projections for trend in each component of GVA

	Low Scenario	Central Scenario	High Scenario
GVA/FTE	-2.0	0	+0.7
Hours worked	-0.5	0	+0.1
Employment rate	-0.2	+0.2	+0.3
Working age	-0.4	0	+0.2
Total	**-3.1**	**+0.2**	**+1.3**

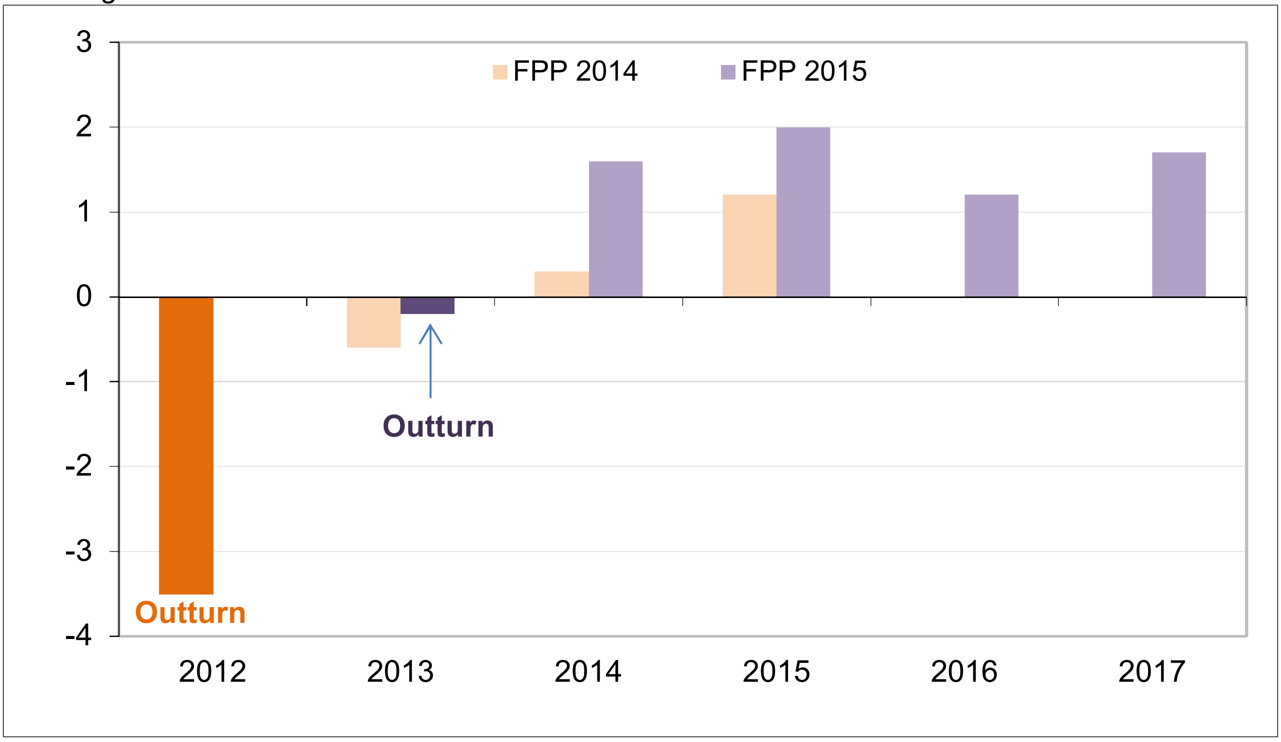
Source: FPP Pre-MTFP report January 2015

Comparison with previous economic growth forecasts

The FPP latest forecast is more positive than their previous forecast (July 2014 annual report), because more recent local developments have been slightly better than expected (Figure 3). For example:

- Total employment in June 2014 had increased by 620 and stood at its highest level on record.
- Average earnings in nominal terms increased by 2.6% in the year to June 2014, slightly higher than the 2.2% increase in 2013. It was also the second successive year in which average earnings increased faster than inflation.
- Unemployment, as measured by the internationally comparable ILO rate, fell to 4.6% in June 2014 – a significant fall from 5.7% in June 2013. The numbers actively seeking work have also been on a downward trend.
- Survey data suggest an improvement in sentiment in both the finance and non-finance sectors in 2014.

Figure 3: FPP forecast 2015 v FPP forecast 2014
% change in real GVA



Sources: FPP Annual Report 2014, FPP Pre-MTFP report 2015

2. Additional data on the local economy

So far in 2015 there has been new data on business sentiments and expectations (Business Tendency Survey Q4 2014 – published before the FPP reported), the housing market (House Price Index Q4 – 2014) and retail sales (Retail Sales Index – Q4 2014).

Overall, the new developments shown in this data are positive and support the other improvements in economic indicators that have been seen during 2014.

Recent trends in interest rate expectations (particularly important for future trends in the banking sector) are covered in more detail on page 19.

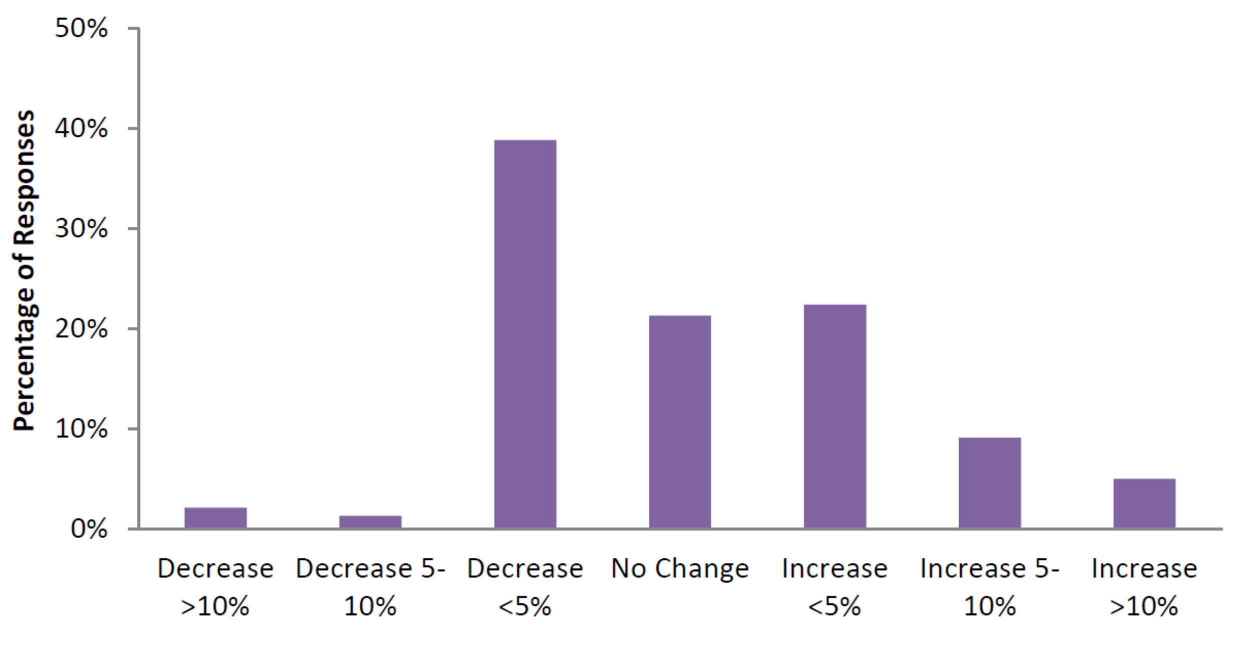
Business sentiments and expectations

The latest Business Tendency Survey showed:

- The headline all-sector Business Activity Indicator declined slightly (down from 12pp to 5pp) in the latest quarter, returning to the broadly neutral levels seen in late 2013 and early 2014.
- For the finance sector, the indicators were generally slightly positive (business activity +10pp, new business +27pp, profitability +5pp, employment +4pp, future business activity +17pp and future employment +8pp). Four of the indicators declined compared with the previous quarter, five were broadly unchanged and one improved.
- For the non-finance sectors, the indicators were generally neutral or negative (business activity +3pp, new business +2pp, profitability -23pp, employment -1pp, future business activity +13pp and future employment +4pp). All ten indicators were broadly unchanged compared with the previous quarter.

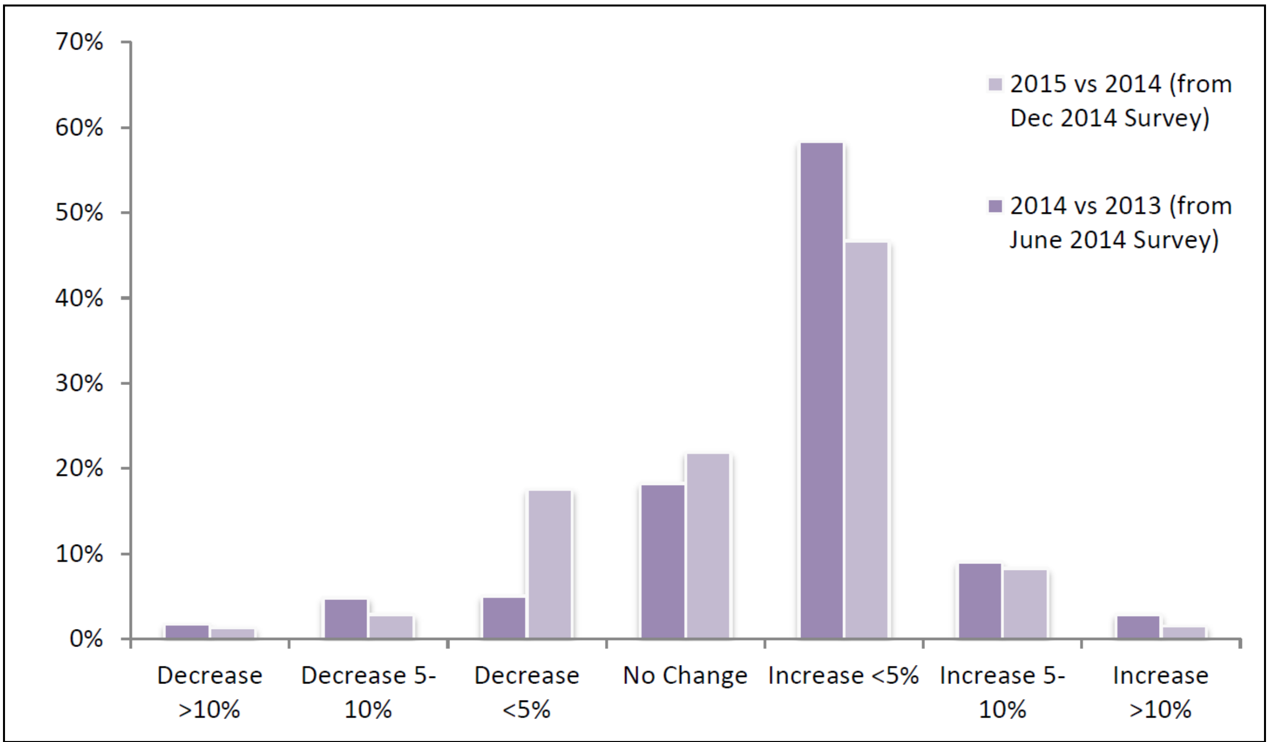
Figures 4 and 5 show the finance sector's employment and profit expectations for 2015.

Figure 4: Finance sector's employment expectations, 2015
% of responses



Source: Jersey Statistics Unit, BTS December 2014, Figure A2a, page 12.

Figure 5: Finance sector's profit expectations for 2015 (compared with 2014, expressed in December 2014) and for 2014 (compared with 2013, expressed in June 2014)
% of responses



Source: Jersey Statistics Unit, BTS December 2014, Figure A4a, page 14.

36% of finance sector businesses expected to increase employment in 2015, 21% of companies anticipated no change, whilst the remaining 42% of businesses expected employment to decrease during 2015 – most of which thought the decrease would be by less than 5%. Weighting the replies by expected size of change implies that employment is still expected to increase on average by about 1%.

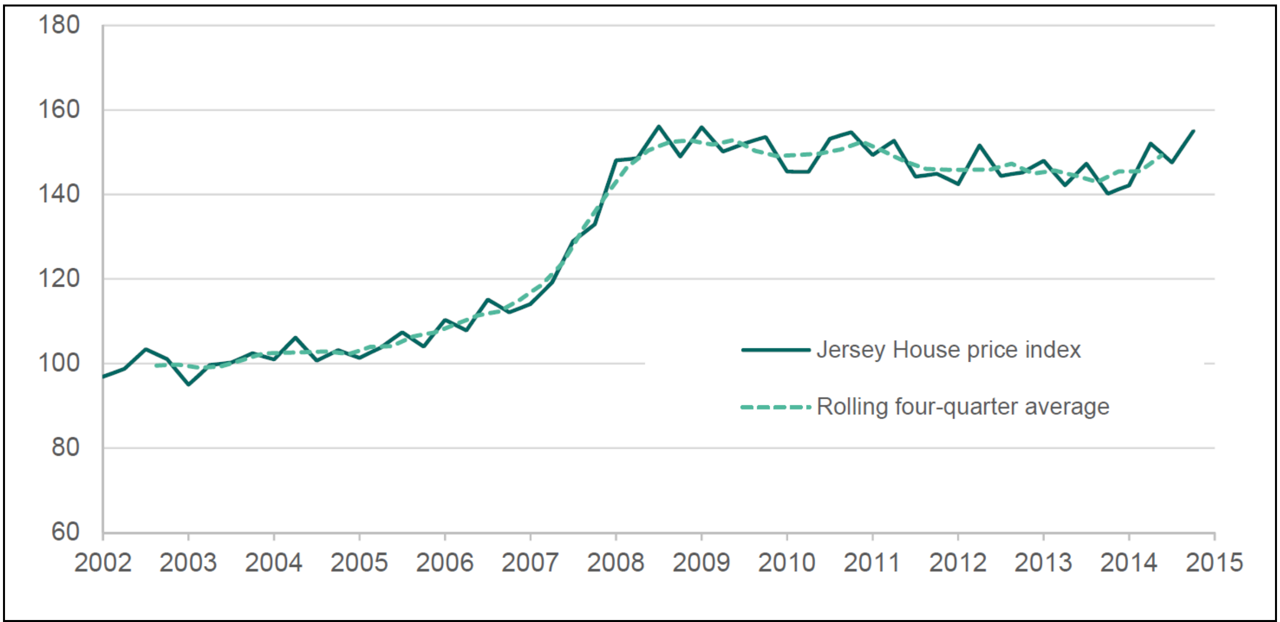
Profit expectations for 2015 (expressed in December 2014) were less positive than those for 2014 (expressed in June 2014); the weighted net balances were positive in each case, +35 pp for 2015 and +59 pp for 2014.

Care is required in interpreting the survey results. The survey is qualitative and has only been in existence since 2009 which makes it harder to understand what changes in its indicators mean about conditions in the local economy.

House prices

There are two developments of interest from the latest Jersey House Price Index. Firstly, average house prices were 3% higher in 2014 compared to 2013, representing the first annual increase in property prices since 2009 (Figure 6). Secondly, the number of properties sold in 2014 was 15% higher than in the previous year.

Figure 6: Jersey House Price Index
(2002 = 100; including share transfer properties; non-seasonally adjusted)



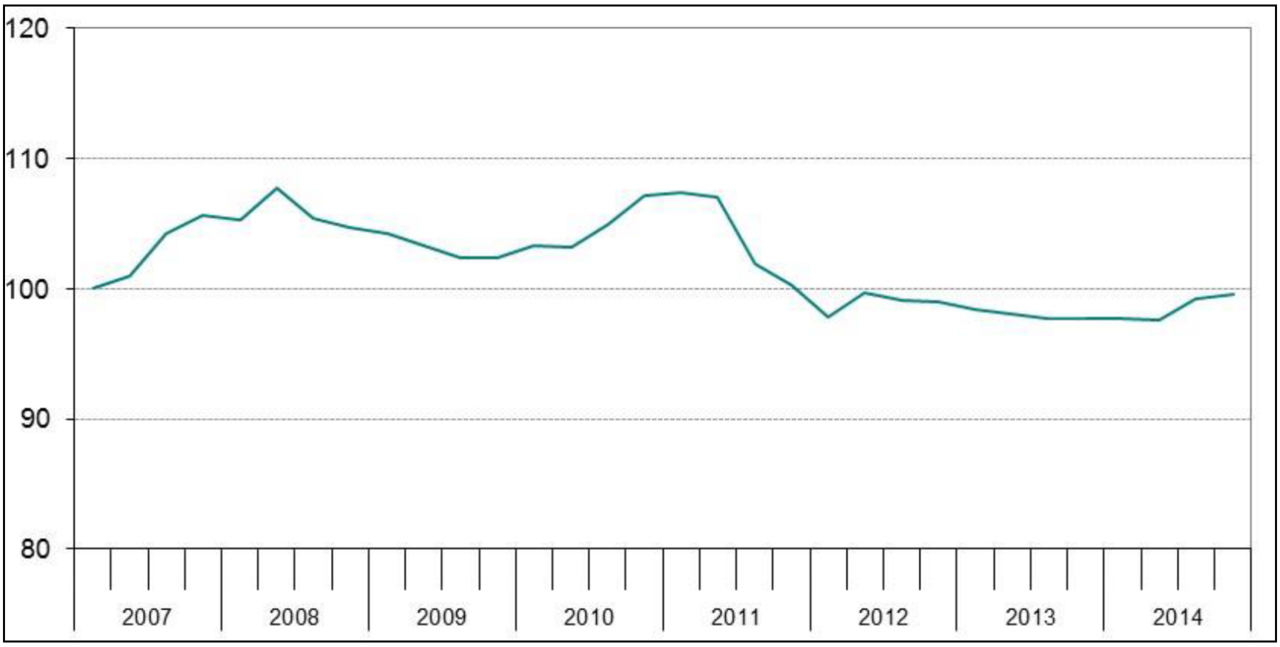
Source: Jersey Statistics Unit, Jersey House Price Index Q4 2014

These developments may be indicative of more confidence and perhaps a stronger economy in 2014. This would be consistent with the positive developments seen in a number of the other economic indicators.

Retail sales

The total volume of retail sales increased by 2% on an annual basis in Q4 2014, reversing the -1% a year decline between 2012 and 2014. The increase in 2014 is mostly due to the volume of retail sales in the (predominantly) food sector being 3% higher than the year before (Figure 7).

Figure 7: Retail sales – total volume
(Q1 2007=100) Seasonally adjusted



Source: Jersey Statistics Unit, Jersey Retail Sales Q4 2014

3. Long-term trends

Section 2 of the FPP's Pre-MTFP report describes and analyses the long-term trends in all the key economic variables and explains the assumptions that should be used when the economy is expected to return to its trend growth rate from 2018 onwards.

This section summarises they key points and provides some further analysis of the trends where possible.

GVA

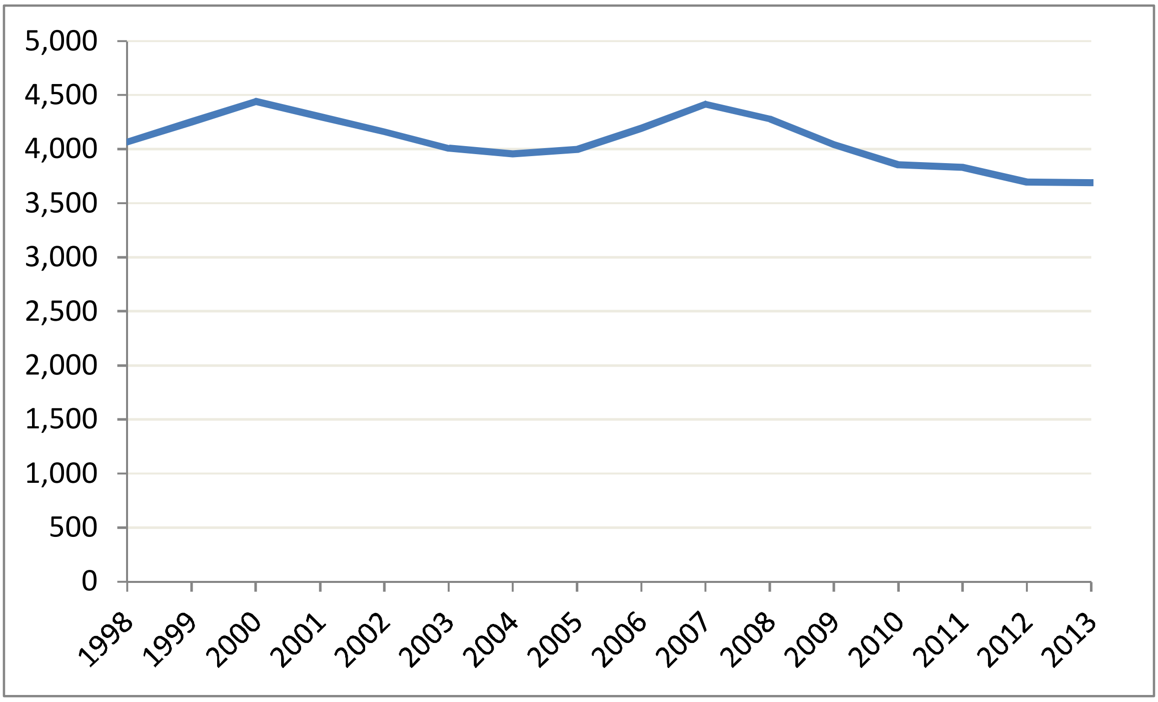
Over the period 1998 to 2013, measured GVA fell by 9% in real terms – equivalent to an average annual fall of 0.6%. However, this period covers more than one economic cycle, and looking over a single cycle may give a more accurate estimate of trend growth for that cycle.

The most recent full cycle is from the peak in 2000 to the peak in 2007, a period over which measured GVA declined by 1%, equivalent to an average annual fall of 0.1%.

If the FPP forecasts prove to be correct (i.e. the economy grows in 2014) then 2004-2013 would also represent a complete economic cycle. Over this period measured GVA declined by 7%, equivalent to an average annual fall of 0.8%.

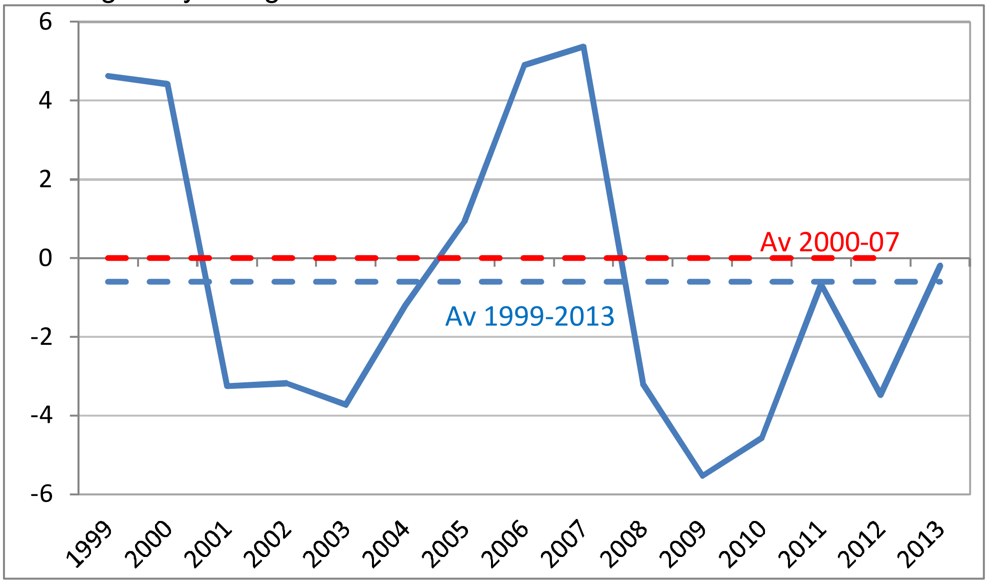
The significant fall in GVA over the 2004-2013 period is due to trends in the financial services sector (and in particular the banking sector) as the GVA of the non-finance sectors (excluding the rental income of private households) grew by 3% over the same period.

Figure 8: Economic performance (as measured by GVA)
2013 prices, £m



Source: States of Jersey Statistics Unit

Figure 9: Economic performance (as measured by GVA)
% change on year ago

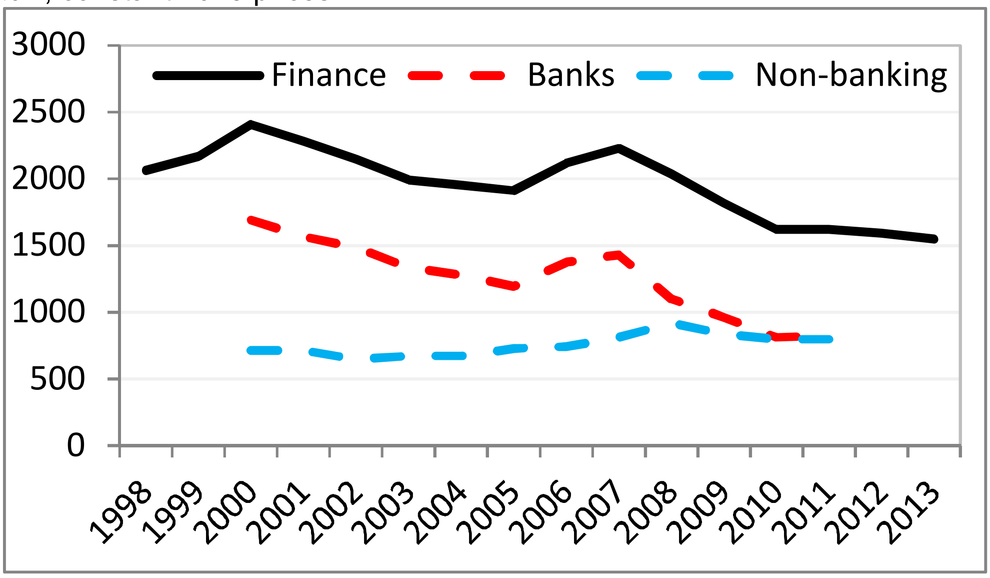


Source: States of Jersey Statistics Unit

Figure 10 shows that the trend in banking sector GVA has driven the overall trend in finance sector GVA in recent years. The fall in banking sector profits, and in particular revenues, explain the recent falls in banking sector GVA. An important component of the banking sector's revenue is the net interest income they receive which fell sharply as UK interest rates were cut.

The 2008 to 2012 period, however, is influenced by the global "great recession". This appears to represent a one-off "step down" in GVA, rather than a standard cycle. Caution is therefore required in drawing any conclusions about trends over this period. GVA over this period will also have been negatively influenced by the low interest rate environment, given the importance of financial services profits to total GVA.

Figure 10: Finance and banking GVA
£m, constant 2013 prices



Source: States of Jersey Statistics Unit

Trend GVA/FTE

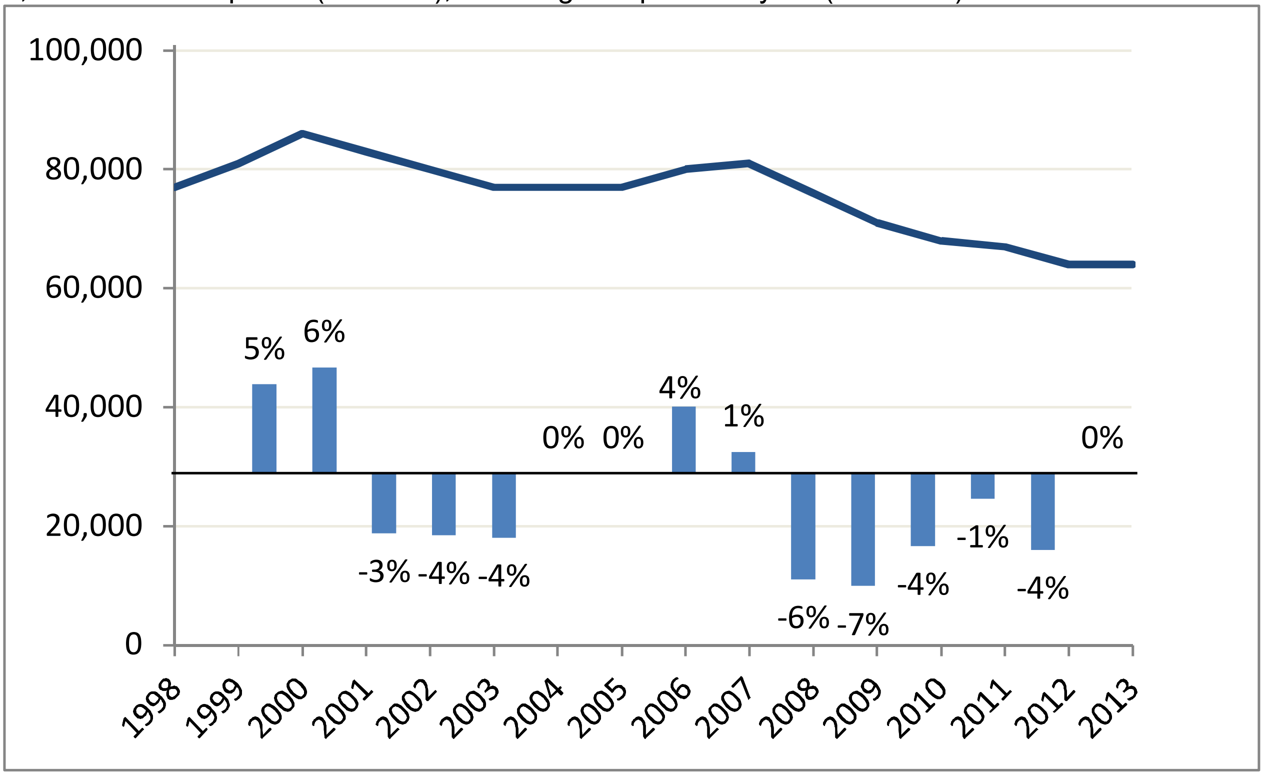
GVA per full-time equivalent employee (FTE) is a measure of labour productivity. Figure 11 shows GVA per FTE for Jersey since 1998. GVA per FTE tends to follow the economic cycle, recording high growth rates when GVA growth is high and vice versa. This is because employment tends to be less volatile than GVA.

Over the economic cycle 2000-2007, GVA per FTE fell by an average of almost 1% per year, driven by a fall in finance sector GVA/FTE. While non-finance productivity grew by an average of 0.7% per year over the period, finance sector productivity fell by an average of 2.4%.

Over the possible economic cycle 2004-2013, GVA/FTE fell by an average of 2% per year – again driven by a fall in finance sector productivity (averaging 3.6% per year) with non-finance productivity relatively flat over the period.

Looking forward, any increase in productivity would represent a considerable improvement on previous performance.

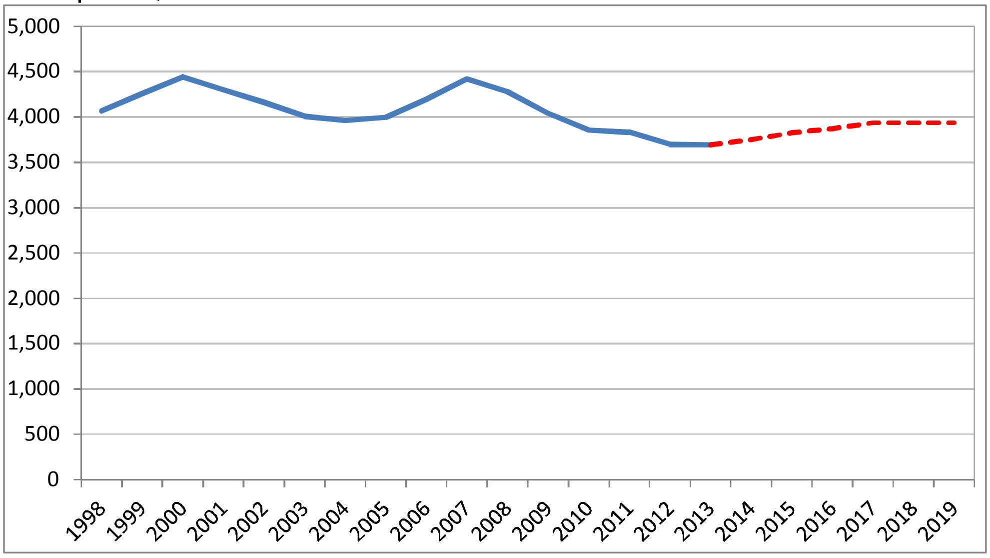
Figure 11: GVA per FTE
£, constant 2013 prices (blue line), % change on previous year (blue bars)



Source: States of Jersey Statistics Unit

The chart below shows what is expected to happen to the level of real GVA as the Jersey economy returns to trend growth from 2018 onwards.

Figure 12: GVA levels including FPP forecast and forward looking assumptions
2013 prices, £m

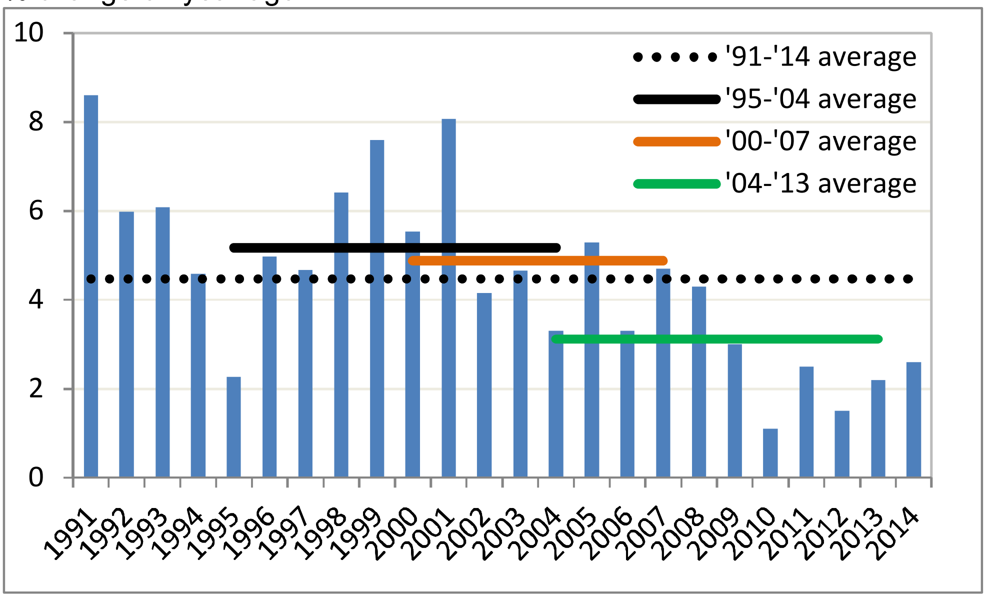


Source: States of Jersey Statistics Unit/Economics Unit calculations

Average earnings

The long-term trend in average earnings growth has been lower in the last ten years (2004-2013: 3.1%) than in the previous ten years (1994-2003: 5.3%). Therefore, the long-term trend appears to be downward (Figure 13). However, the trends in recent years have clearly been affected by the economic downturn. It is difficult at this stage to judge whether recent trends are purely cyclical, structural or a combination of the two.

Figure 13: Average earnings growth
% change on year ago



Source: States of Jersey Statistics Unit

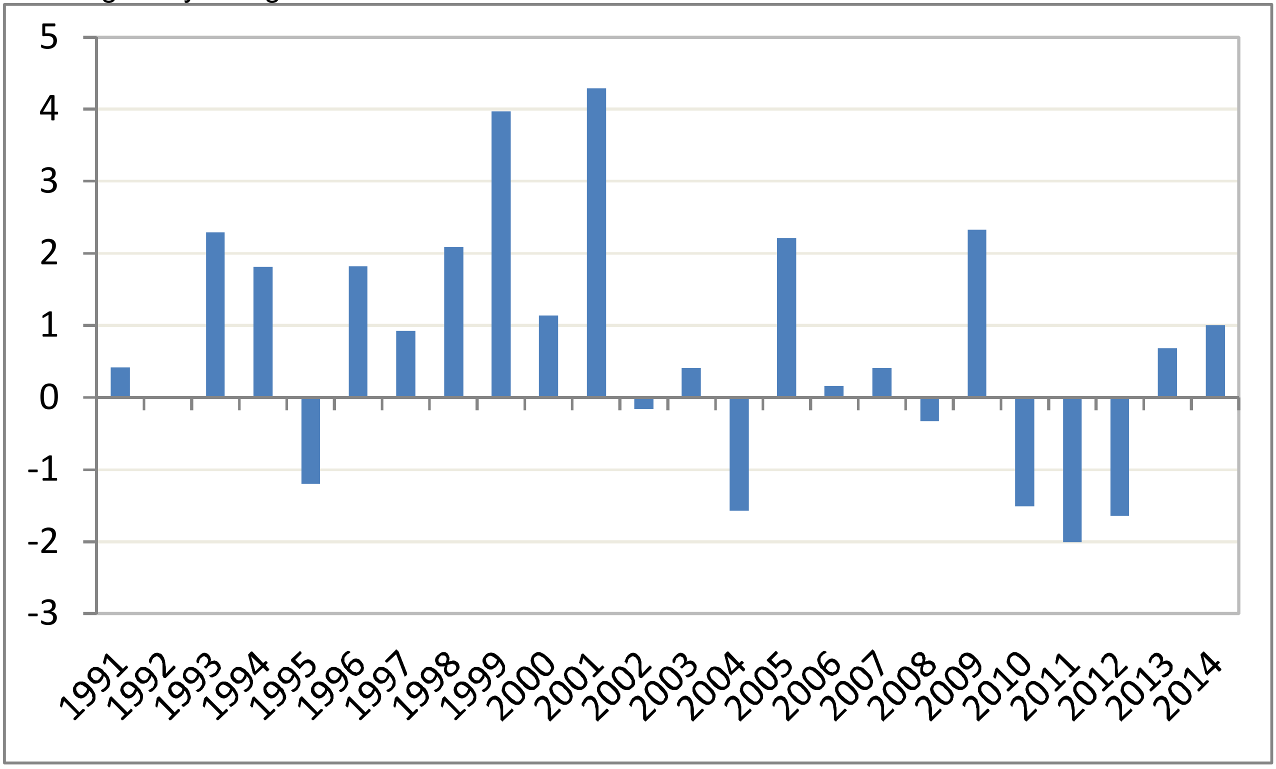
In understanding trends in average earnings it is also important to consider trends in inflation as often the wage bargaining process uses them as a reference point. Figure 14 shows the long-term trend in average earnings relative to RPI. In the long-term (1991-2014), average earnings growth has averaged 0.7% above RPI and this is similar to the 0.9% above RPI achieved over the recent economic cycle (2000 to 2007). However, over the last 10 years, real average earnings growth has been much lower at 0.1% above RPI.

In the income tax forecast it has been assumed that real earnings continue to grow by between 0.5% and 1% in 2016 and 2017. From 2018, when the Jersey economy is expected to return to its long term trend rate of growth, it has been assumed that average earnings grows at a similar rate to RPI – i.e. no real earnings growth.

The assumptions for 2015, 2016 and 2017 are consistent with the past trends in real average earnings growth and the assumptions for 2018 and 2019 are consistent with the central expectation of no real growth in the economy.

Figure 14: Differential between average earnings and RPI

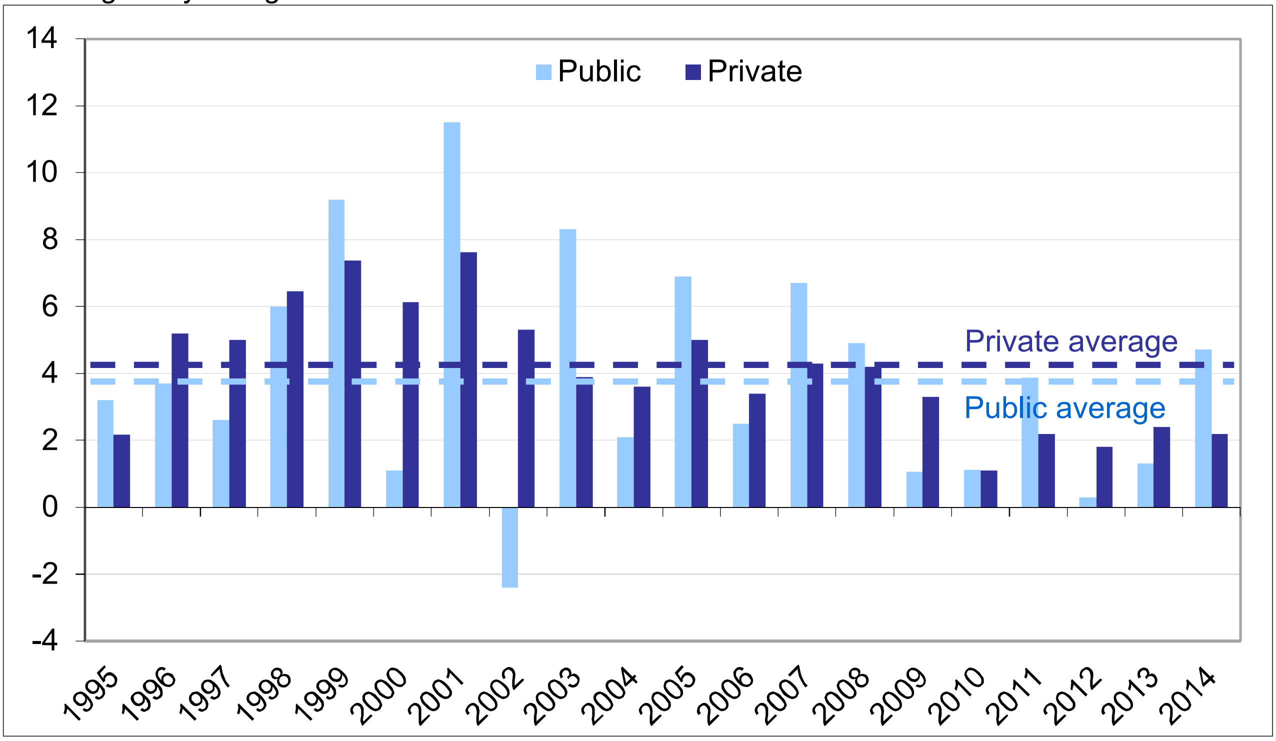
% change on year ago



Source: States of Jersey Statistics Unit

The chart below shows that public sector and private sector earnings growth have on average been quite similar since the mid 1990's. (Care is required in looking at public sectors earnings data as it can be distorted by the fact that in some years there is no pay award due to continued negotiations and it carries forward into the next year meaning that in others there may be two awards.)

Figure 15: Public and private sector earnings growth
% change on year ago



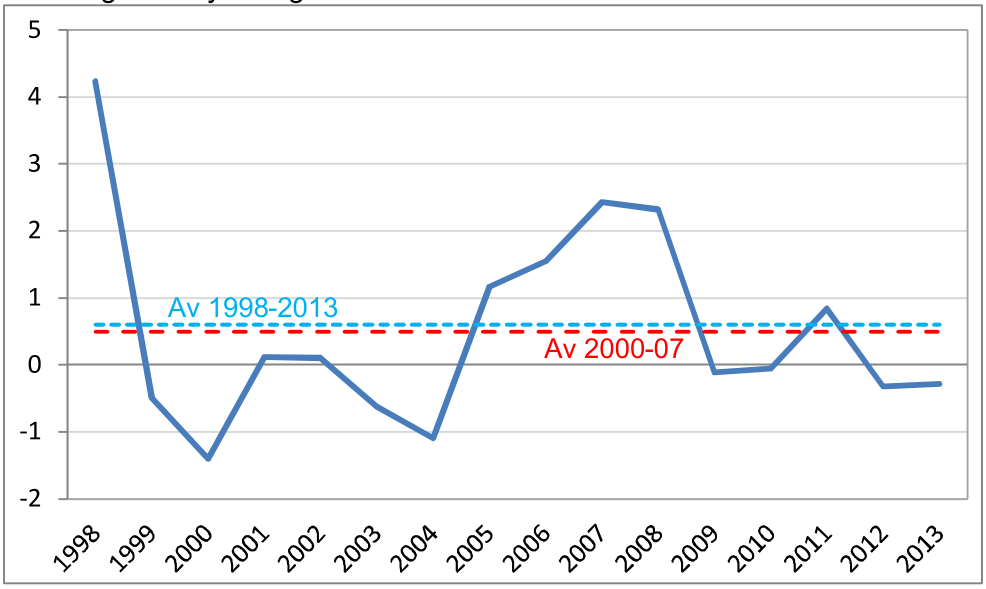
Source: States of Jersey Statistics Unit

Employment

Employment growth has averaged around 0.5% a year over the long-term and over the recent economic cycle 2000-2007 (Figure 16). This has been influenced by external economic conditions, and productivity, demographic and migration trends. Looking forward, it is difficult to see how any of these are going to be more supportive of employment growth given the weak global economy, concern about levels of inward migration and the ageing population (i.e. a risk that the working age population becomes smaller).

As the economy uses up spare capacity over the next few years, employment is initially expected to grow by 1% in 2015 before returning to the long-term average growth rate of 0.5% in 2016/17. From 2018 onwards, employment is expected to remain stable, given the trends outlined above (Figure 17) and the FPP's advice to use flat trend real GVA growth.

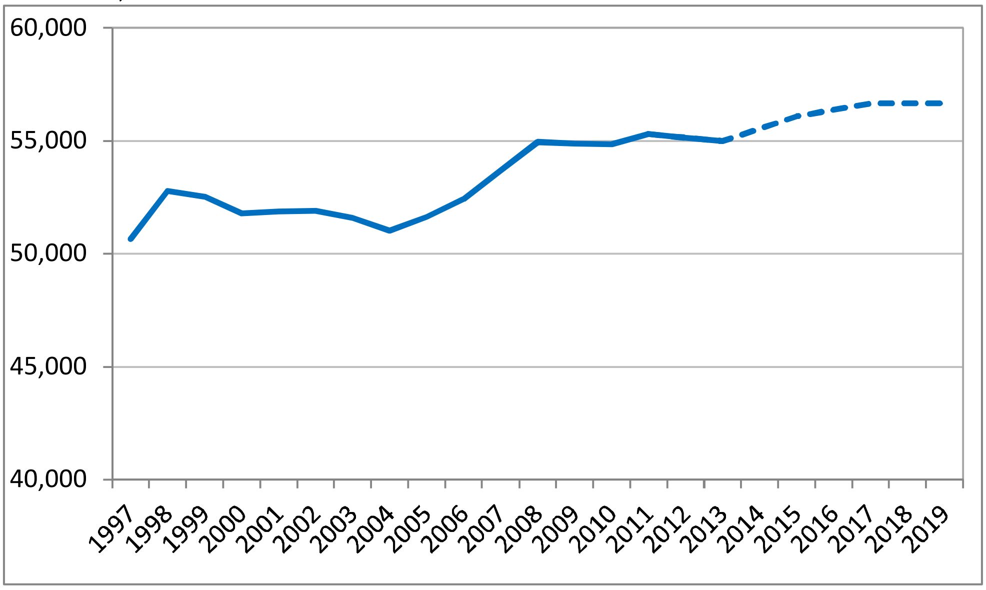
Figure 16: Trends in employment
% change on a year ago



Source: States of Jersey Statistics Unit

Figure 17 shows that under these assumptions, employment continues to grow until 2017, before stabilising from 2018 onwards.

Figure 17: Trends in level of employment
numbers, headcount basis



Sources: Jersey Statistics Unit / FPP assumptions

Company profits

Figure 18 shows that company profits have fallen slightly, by about 0.3% a year between 2001 and 2013 in nominal terms, although over the recent economic cycle (2000-2007) there has been 2.9% growth a year on average.

This is quite a short run of data and over a period when the data has been impacted by trends in financial services profitability which has suffered as a result of the global financial crisis and the low interest rate environment. At the same time there have been ongoing changes in global financial services regulation which will also have impacted on the profitability of the financial services sector, although it is difficult to separate out the scale of this impact which is likely to be ongoing, from the other factors mentioned above. In addition, pressure remains on offshore centres across the world.

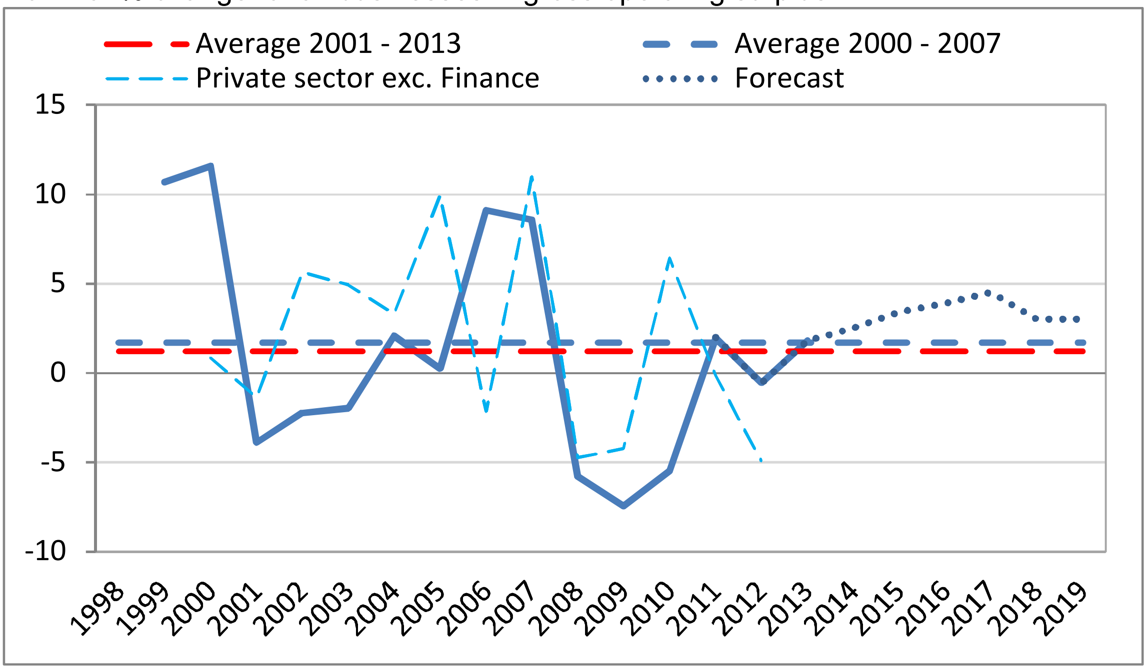
Figure 18 also shows that trends in company profits excluding finance and rental income have been higher with nominal growth at about 2% on average or 4% over the 2000-2007 period.

Given all these uncertainties, 2.5% to 4.5% a year nominal growth (i.e.weak real growth) in company profits has been assumed until 2017, with a trend growth rate of company profits after this of about 3% a year (flat in real terms).

This assumption factors in a gradual improvement in financial services profitability (Figure 19) based on interviews with finance sector representatives carried out towards the end of 2014, the most recent Survey of Financial Institutions and the Business Tendency Survey Q4 finance sector expectations for 2015.

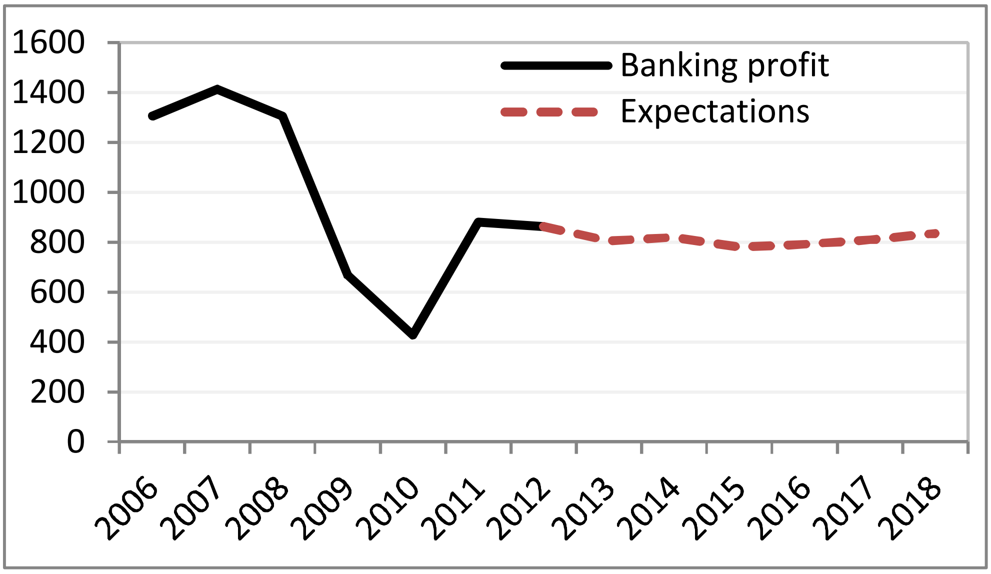
There is a lot of uncertainty surrounding the assumptions for company and particularly financial services profit growth. Parts of the banking sector are undergoing changes to meet new regulatory requirements, and it is unclear how quickly and by how much interest rates will increase in the future. Future increases in interest rates should improve the profitability of the banking sector.

Figure 18: Company profits
Nominal % change for all businesses in gross operating surplus



Source: States of Jersey Statistics Unit / FPP assumptions

Figure 19: Banking sector taxable profit and future expectations
Net profit, £m (constant 2013 prices)



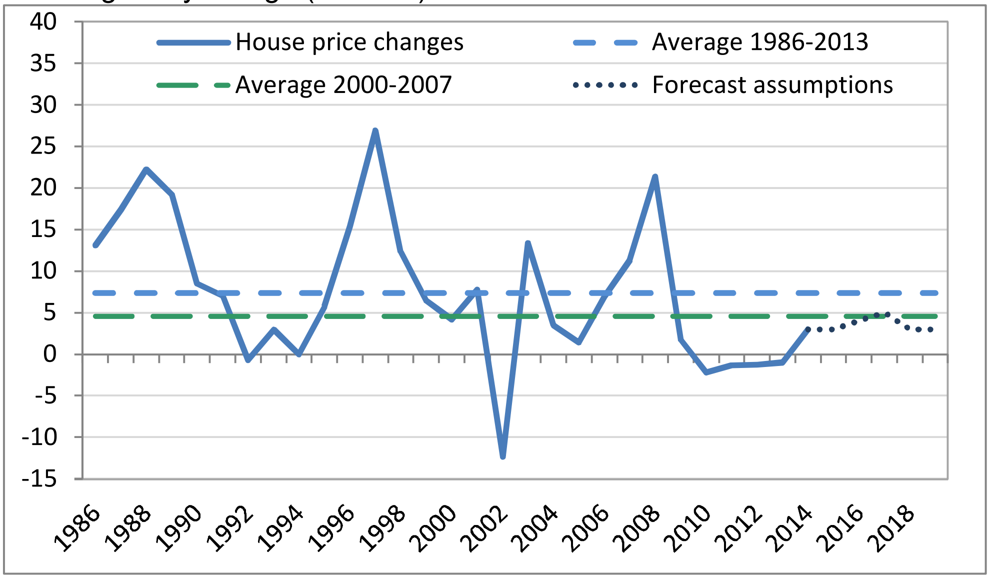
Sources: Jersey Statistics Unit / FPP assumptions. (FPP pre-MTFP report Figure 2.13)

House prices

The long-term average increase in house prices is 7.3% a year (1985-2014) although over the last economic cycle (2000-2007) they have averaged 4.6% growth each year (Figure 20). Over the last few years, changes in house price have been lower than expected with prices falling 1% in 2012 and 2013. However, in 2014, house prices increased slightly more than expected (3% growth compared to 1% growth).

Taking this into account, house prices are now assumed to increase gradually until 2017 and then grow at a longer term trend rate of 3% a year afterwards - similar to the longer term assumption for average earnings growth. This is equivalent to 0% real growth each year, after taking into account the assumptions for future inflation.

Figure 20: Trends in house prices
% change on year ago (nominal)



Source: Jersey Statistics Unit / Economics Unit calculations

Interest rates

Interest rates have been at historically low levels since 2009 (Figure 21) and in recent years there has been increased commitment from central banks across the world to keep interest rates low for an extended period.

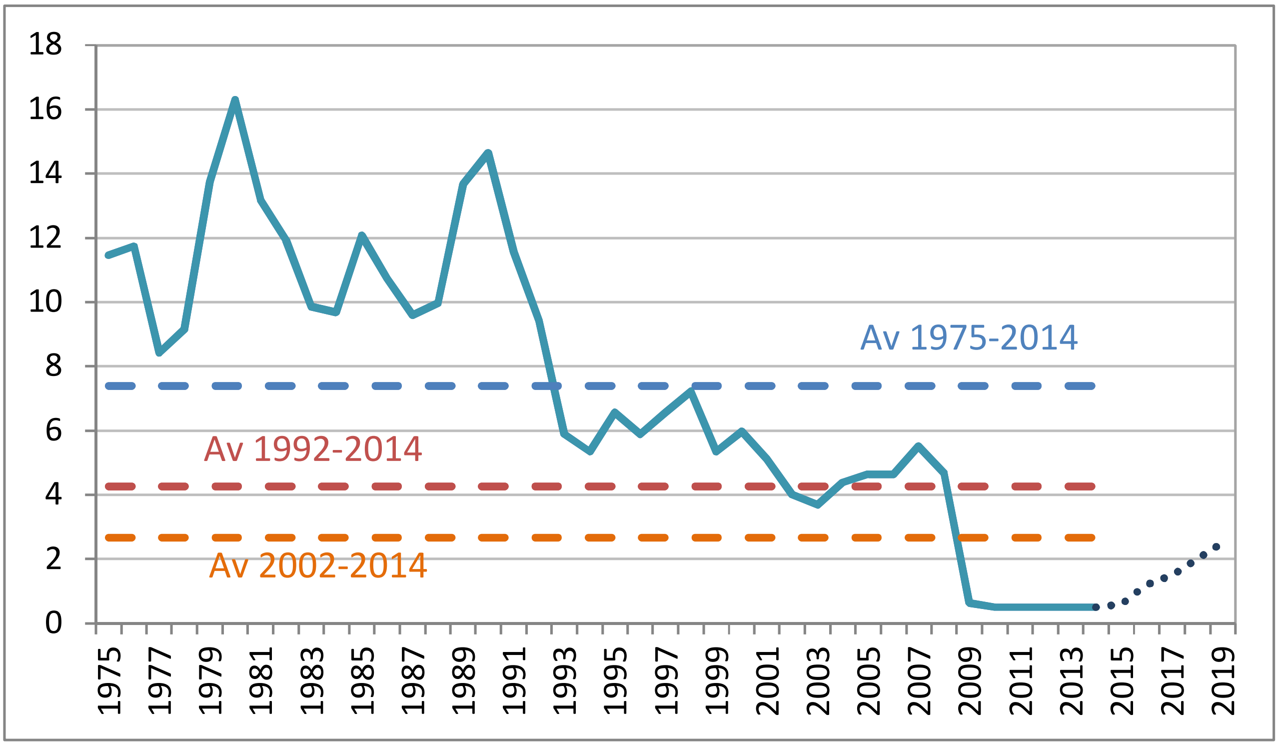
The Bank of England has indicated that when interest rates increase, they will do so slowly and perhaps to 2% or 3%, which is still very low by past standards.

There are uncertainties between market commentators about when the UK's interest rates will start to go up. It will depend on how quickly the UK economy recovers and the UK inflation outlook. Figure 22 shows market interest rate expectations published alongside the last three Bank of England Inflation reports. Market expectations have fallen sharply over the last nine months as there appears to be more scope for the UK economy (and productivity) to recover over the next few years without increasing inflationary pressure to an unacceptable level. Part of this is due to the lower than expected inflation caused by the falls in oil prices over the last year.

The FPP's assumptions for interest rates are based on the market expectations published in November 2014 and the income tax forecast assumptions are based on these.

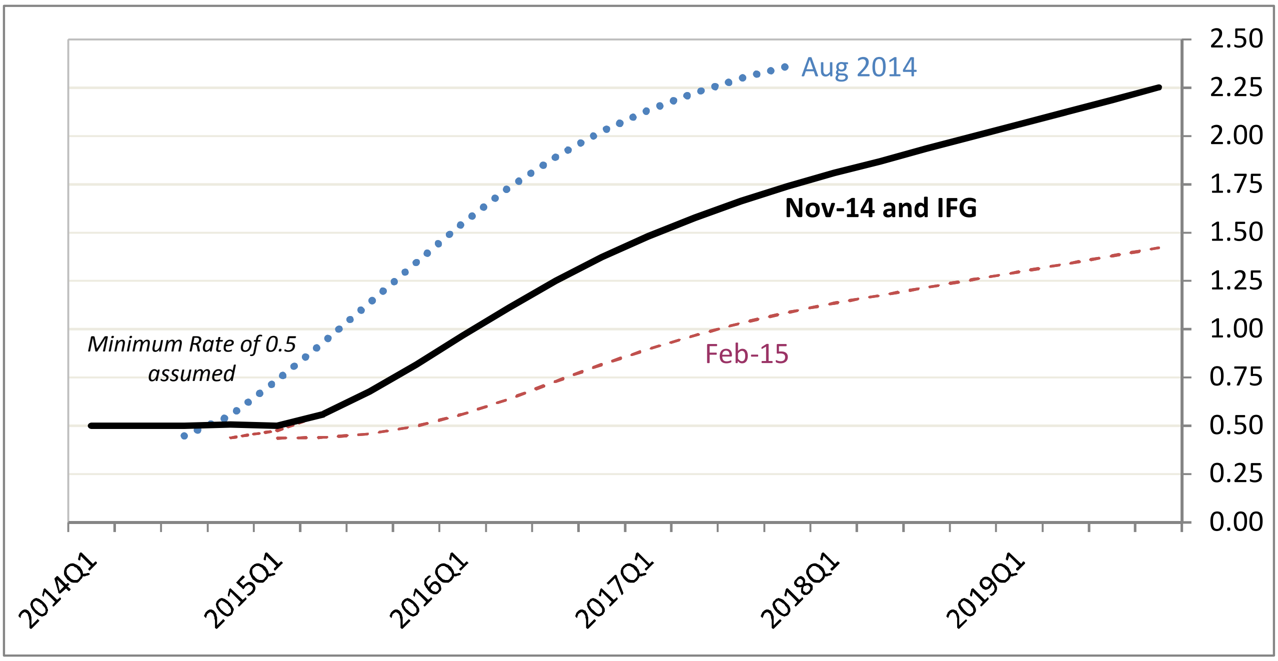
However, since then, market expectations have slipped back again, for an initial rate rise in 2017 and increasing slowly to about 1.5% by the end of 2019 (Figure 22). This suggests there is a risk that financial services profits may not grow as strongly as expected at the time of the finance sector interviews.

Figure 21: Interest rates
% bank base rates



Source: Bank of England (and forecast assumptions 2015+)

Figure 22: Market interest rate expectations
% bank base rates



Source: Bank of England Inflation reports

Appendix: UK OBR's fiscal forecast – key assumptions

The Office for Budget Responsibility (OBR) was established in 2010 to provide independent and authoritative analysis of the UK's public finances. In their December 2014 Economic and Fiscal outlook, they set out their fiscal forecasts to 2019-20.

These assumptions are specific to the UK's economy as are the FPP's assumptions specific to Jersey's economy. Therefore, differences between the two sets of assumptions should be expected.

The economic assumptions that underpin their forecasts are included below for information.

OBR's economic assumptions for their fiscal forecast, December 2014

	Percentage change on a year earlier					
	2014	2015	2016	2017	2018	2019
Real GDP	3.0	2.4	2.2	2.4	2.3	2.3
Nominal GDP	5.0	4.0	3.6	4.1	4.2	4.3
Employment	2.3	1.6	0.6	0.3	0.3	0.3
Average earnings	1.8	2.0	3.1	3.9	3.9	3.8
CPI	1.5	1.2	1.7	2.0	2.0	2.0
RPI	2.4	2.2	2.9	3.4	3.6	3.6
House prices	10.2	7.4	5.9	5.8	5.1	3.8