

Guernsey Quarterly Inflation Outlook Bulletin

Quarter 1 2012 - Issue date 20th February 2012



POLICY COUNCIL
THE STATES OF GUERNSEY

1.1 Introduction

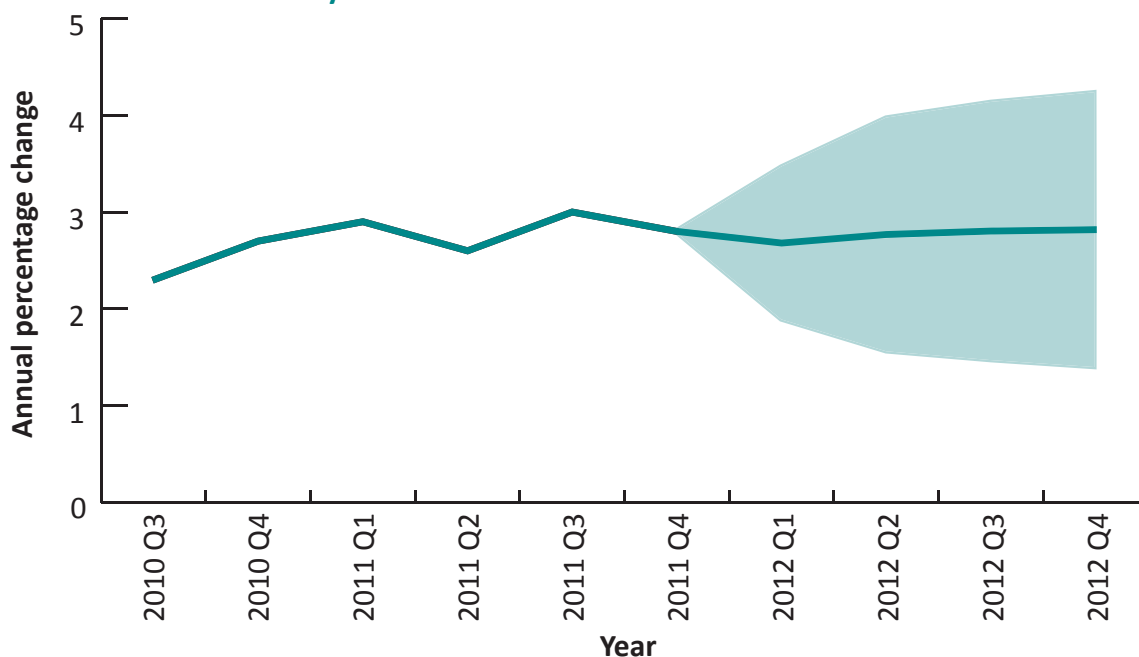
This is the fourth quarter edition of 'Inflation Outlook': a Policy Council report providing forecasts for inflation. The forecasts are based on econometric models and provide a composite forecast of RPIX and RPI. These forecasts are revised and published on a quarterly basis in the month following the Policy Council's publication of official Guernsey quarterly inflation rate and timed to follow the Bank of England's quarterly inflation outlook.

NB - Forecasts are presented with statistical confidence (or error) bands (the shaded area). These represent the range of possible outcomes with (in this case) a 95% statistical certainty.

1.2 Headlines

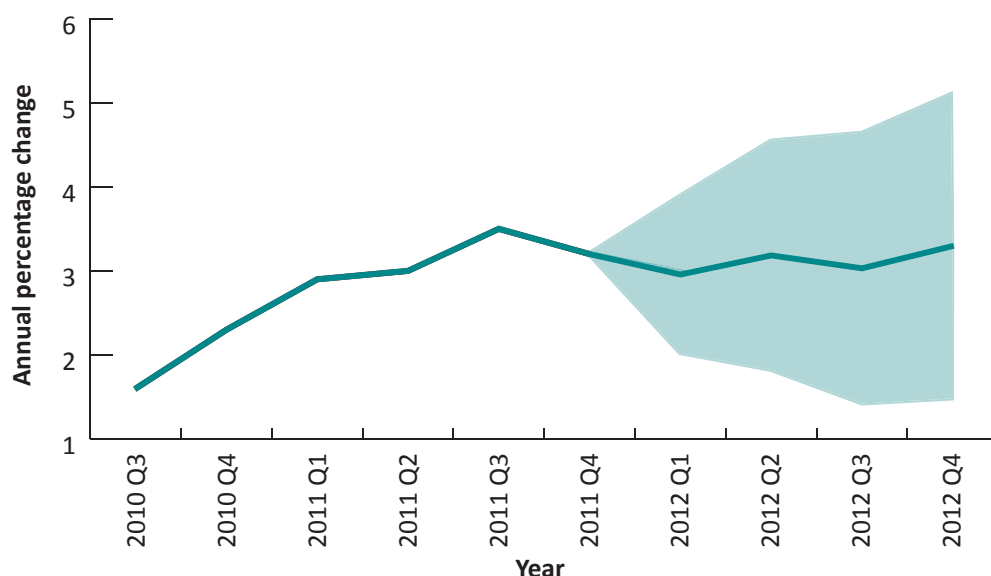
- Inflation fell in the last quarter of 2011, our forecasts are that it will fall slightly again the first quarter 2012.
- The outlook for the rest of the year is for continued stable inflation around and about the target level of 3%.
- Subdued domestic demand is likely to keep domestic inflation restrained but higher utility prices could put mild upwards pressure on inflation in the second and third quarters.
- The Bank of England expects UK CPI inflation to fall during the course of 2012 as the effects of the VAT increase drop out of UK calculations. As goods and services in Guernsey are not subject to VAT or other sales tax, this effect is not expected to occur locally.

Figure 1.2.1: Forecast Guernsey RPIX



2.1 Inflation Outlook

Figure 2.1.1: Forecast Guernsey RPI

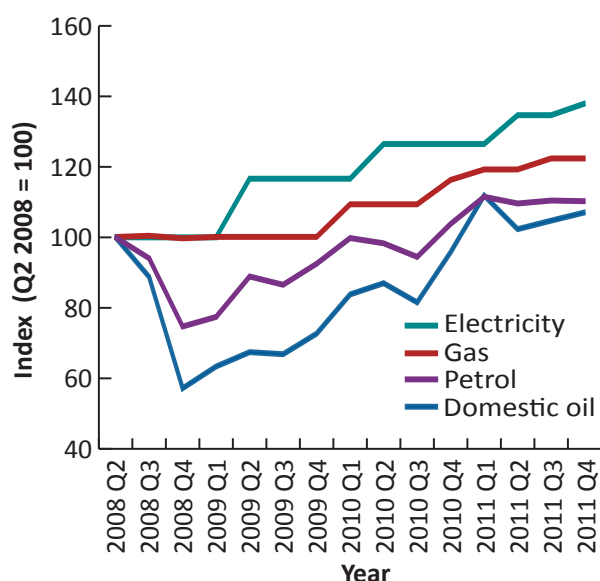


Inflation in Guernsey has now been around its target level of 3% for over three years. Whilst it might be tempting fate, this is a pleasing development. Clearly numerous factors have been involved but it is also quite probable that the policy approach of trying to reduce and anchor expectations of domestic inflation to a target level has been beneficial.

The Bank of England is expecting quite a rapid tail off in UK CPI inflation as the effects of VAT rises fall out of the annual calculations. Clearly in Guernsey we are unlikely to see a similar effect as we were spared the experience of rising inflation caused by the VAT rises in the first place. Similarly, inflation across the water in Jersey is still likely to continue to track a percentage point or two higher for the next couple of quarters until the GST effects falls out of the calculations.

Guernsey inflation fell in the final quarter of 2011 and it is quite probable that there will be a further mild drop in the first quarter of 2012. Further out the prospects for inflation continue to look relatively benign for the rest of year. Barring unforeseen shocks or developments, the current expectation is that inflation will be around target for the next twelve months.

Figure 2.1.2: Fuel and energy price indices



It is quite possible that the second quarter might see a mild temporary uptick in inflation as utility rises feed through into the general index. [Figure 2.1.2](#) illustrates the change in the price level of various energy components; petrol, domestic fuel, gas and electricity. As is demonstrated, whilst domestic heating oil and petrol experienced price falls in late 2008, utility prices have only moved one way. With prices rises due in April, we are likely to experience quite strong upwards pressure the fuel and heating inflation basket. For the rest of the year, market commentators have forecast little significant movement in global oil and commodity prices, this could readily change if there were to be more political upheaval in the middle East, particular of the type involving tensions between Israel and Iran.

Since the last bulletin the third quarter employment

2.1 Inflation Outlook (continued)

numbers have been released which showed that employment continued to grow into the third quarter. However, that positive news on the employment front was superseded by the recent publication of December and January unemployment figures which show an unwelcome spike at the turn of the year and unemployment levels are similar to those of 18 months ago. Detailed analysis of the numbers does not point to any particular area of the economy experiencing greater employment loss than any others at this time; the evidence is of marginally higher levels quite evenly across the economic sectors.

In some ways this was a disappointing end to the year and several other indirect indicators of domestic demand point to a slowdown in consumer spending in the last quarter: new car registrations fell year on year and the volume growth of notes and coins in circulation also slowed. However, whilst earnings growth slowed in the last quarter, it remained positive on annualised basis and aggregate earned income grew year on year. In a similar vein, the local residential property market continued to demonstrate resilience, in the final quarter prices were mildly up year on year and just as significantly, volumes were at similar levels in 2011 against the previous year.

As a whole these signals from the local economy suggest that any slowdown in the last half of the year could readily prove to be temporary if we see a return to global growth conditions, particularly in the finance sector, which is the main driver of the economy in Guernsey.

Domestic consumers in Guernsey have been spared the squeeze in real incomes from rising prices driven by VAT and GST in other jurisdictions. Incomes are also unlikely to be squeezed from the effects of rising interest given the monetary stance of the Bank of England is likely to continue for at least the next few quarters. Whilst earnings growth is likely to be subdued, real income levels are unlikely to contract in the manner experienced in the UK, which itself should underpin domestic consumer spending once global confidence returns.

This economic scenario supports the central projection of a continued steady outlook for inflation in 2012.

Figure 2.1.3: Guernsey RPI and RPIX

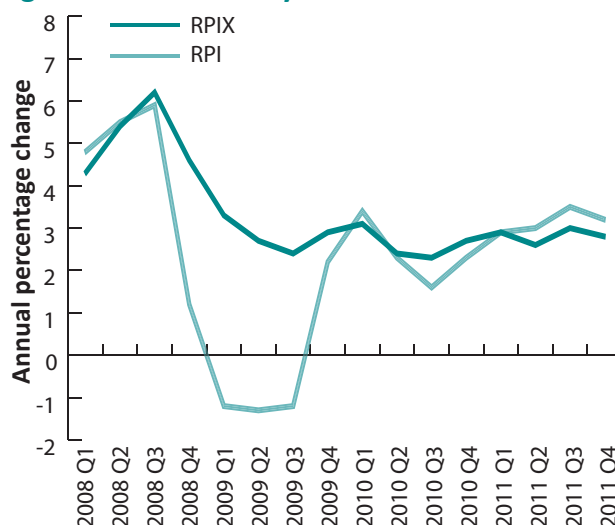
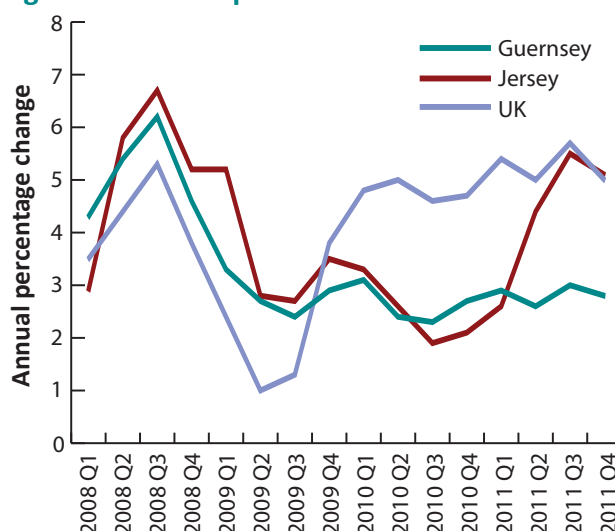


Figure 2.1.4: Comparison of RPIX



3.1 Contact details and further information

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The next inflation outlook (for Q2 2012) will be published at 9:30am on Friday 18th May 2012.