

Guernsey Quarterly Inflation Outlook Bulletin

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POLICY COUNCIL
THE STATES OF GUERNSEY

1.1 Introduction

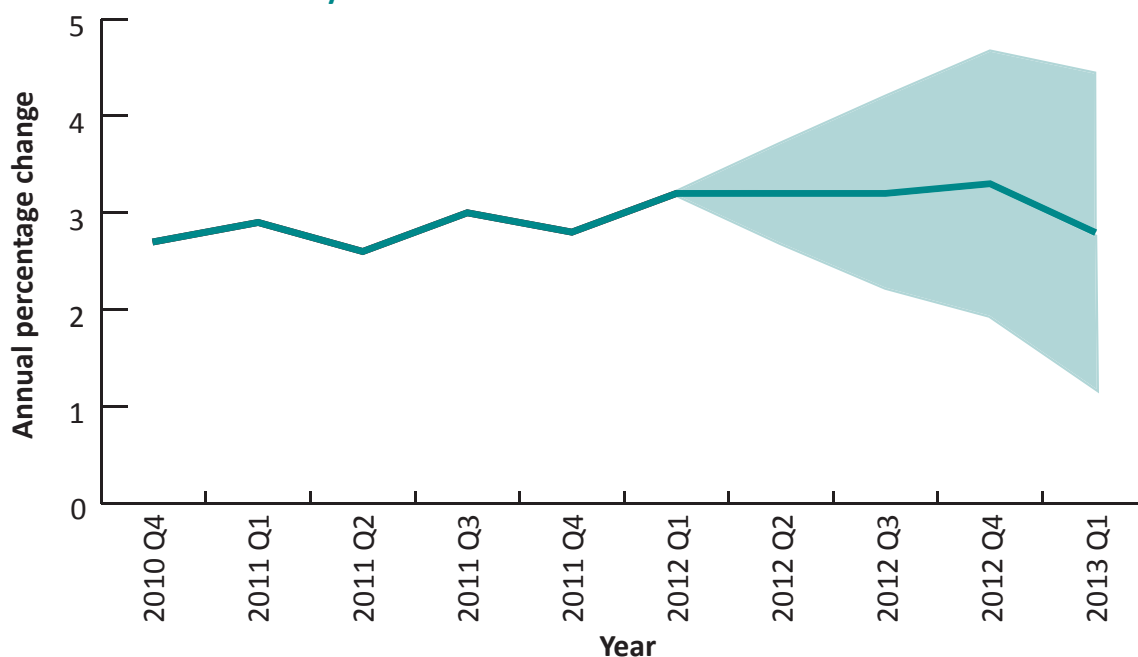
This is the second quarter edition of 'Inflation Outlook': a Policy Council report providing forecasts for inflation. The forecasts are based on econometric models and provide composite forecasts of RPIX and RPI. These forecasts are revised and published on a quarterly basis in the month following the Policy Council's publication of official Guernsey inflation rates.

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

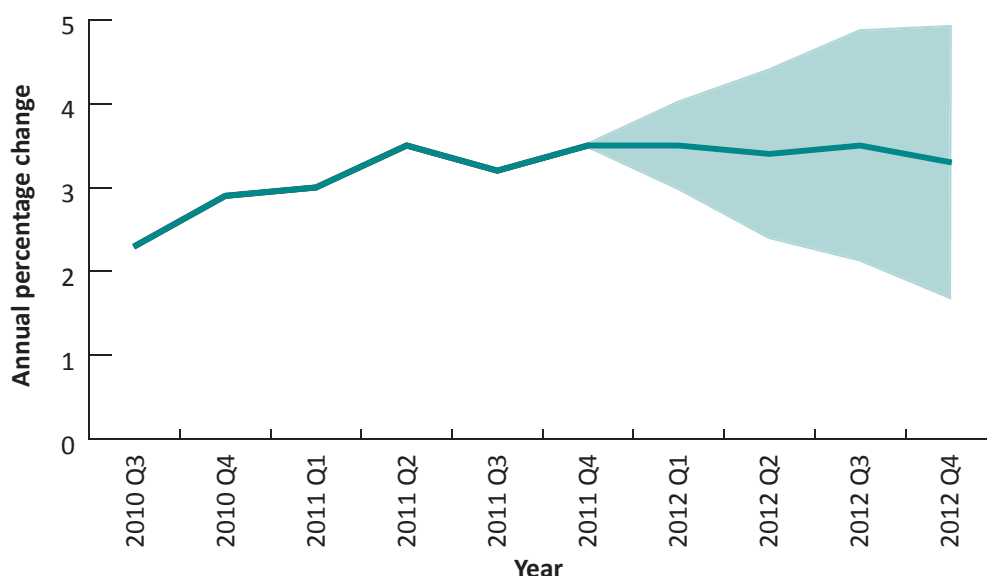
- The present central forecast is for the RPIX inflation rate (the States of Guernsey "headline" measure) to remain at 3.2% percent in the next quarter and for RPI inflation rate to remain at 3.5%.
- Central tendency of the four quarter forecast is that inflation (both measures) is expected to remain broadly similar to current levels for the next few quarters and falling slightly at the four quarter horizon (i.e. 12 months time).
- Most general indicators of domestic demand point to current economic conditions being fairly flat.
- General outlook is that the economy is likely to remain weak over the course of the rest of the year and this, together with falling pressures from projected exchange rate effects and energy price futures, are the key factors likely to reduce inflationary pressures over the coming quarters.

Figure 1.2.1: Forecast Guernsey RPIX



2.1 Inflation Outlook

Figure 2.1.1: Forecast Guernsey RPI



Over the past two years, Guernsey's domestic inflation has resolutely followed a different course from that of the UK due to the absence of the rises in VAT that have been present on the mainland. Over the course of the last few months, inflation in the UK has fallen from the elevated levels seen in 2010 and 2011 which were caused by the increases in VAT.

In Guernsey inflation has been broadly flat for the last two years, however there is some evidence of a marginal rise in core inflation over the two year period ending March 2012. It is expected that this marginal rise will disappear over the course of the next twelve months, as a result of deflationary pressures from weak demand conditions in the local economy.

The gloomy backdrop of the global economy is clearly a negative factor on current local sentiment. Whilst Guernsey's relative international economic performance over the last few years has been robust, there is little doubt that relative to its own historic performance, growth and demand are presently weak. Despite improved confidence at the turn of the year following central bank interventions in Europe and the UK, global sentiment has clearly worsened since the start of the year as the ever present euro crisis continues to impact upon confidence.

The global economic headwinds constraining growth that originated from the credit crunch of 2008 - weak bank balance sheets and governments fiscal contractions - are still strong irrespective of the further impact on confidence from the continuing uncertainty from the euro crisis. The UK has fallen back into recession and few economic forecasters are assuming a resumption of strong growth in the near future.

These are the strongest factors affecting prospects for Guernsey's domestic inflation over the next few quarters and for these reasons it is not anticipated that inflation will move significantly from its current levels in the near future. The expectation is that inflation is likely to be marginally lower than its current level in 12 months time. Whilst the States of Guernsey does not measure economic output on a quarterly basis, other general indicators support this picture. There presently is no evidence of real aggregate earnings growth; unemployment has risen over the past few quarters; new car registrations, having risen year on year in the first few months of 2012 have fallen back slightly and property price inflation has fallen to the level of retail price inflation rates.

2.1 Inflation Outlook (continued)

However, there are still specific factors that should ensure that inflation remains positive and others which contribute to the difference between inflation rates between Guernsey and the UK.

Whilst subdued demand is a strong factor bearing down on inflation this year, upside risks are not totally absent. Over half of firms surveyed in the Chamber of Commerce annual business survey indicated an intent to increase prices this year. If they are too aggressive in their re-pricing efforts and are able to do so with relative ease this will be a cause of unwelcome domestically generated inflation. The importance to Guernsey's long term competitiveness of keeping inflation at current rates, that is around the target level of 3%, and no more should not be underestimated.

Property prices are also a factor. **Figure 2.1.2** illustrates the divergence in property price levels between Guernsey and the UK over the last four years. Although not directly incorporated into the official measure (RPIX), positive property price rises do contribute to inflation, even if they do not impact on our retail experience of prices.

Housing contributed over a percentage point of inflation to the RPI measure (which incorporates house price inflation as part of the measure of mortgage interest payments) in the first quarter of 2012. This contribution is likely to fall if property price inflation remains weak but is still likely to remain greater than the UK.

The Bank of England anticipates a continued fall in inflation in the UK. Should this prove to be the case we could see inflation rates in the UK falling below those experienced in Guernsey over the course of the rest of 2012.

Figure 2.1.2: House price indices

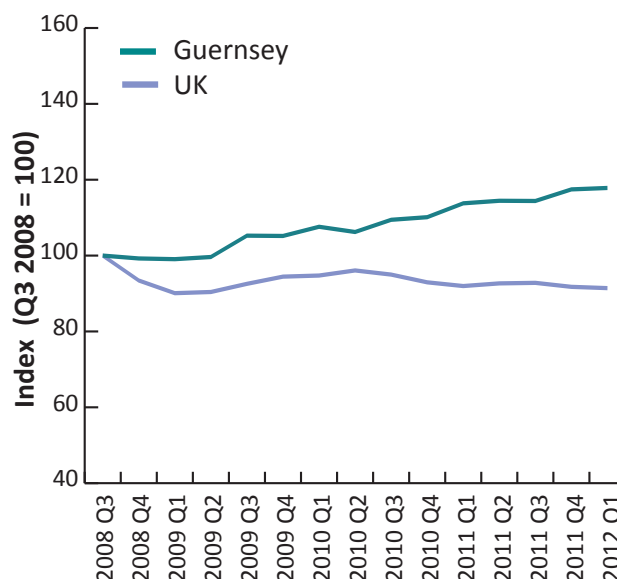


Figure 2.1.3: Guernsey RPI and RPIX

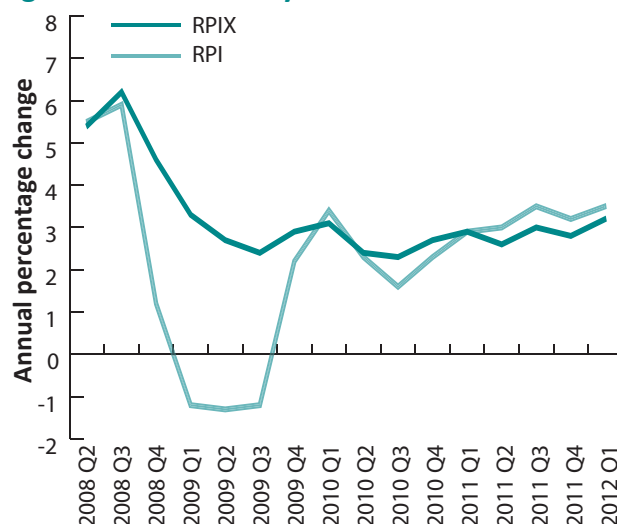
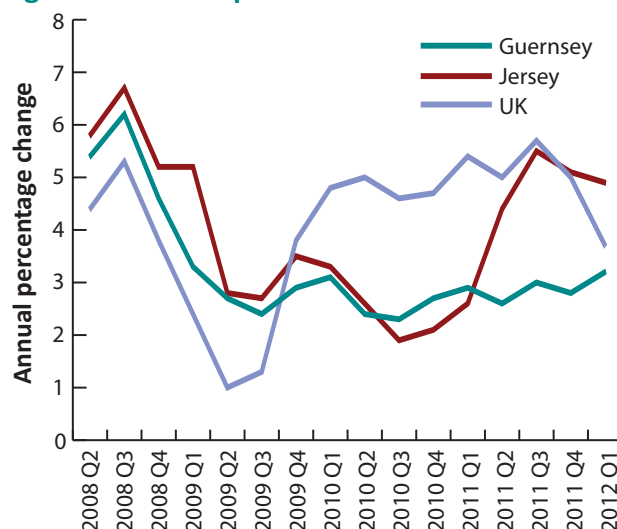


Figure 2.1.4: Comparison of RPIX



3.1 Contact details and further information

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The next inflation outlook (for Q3 2012) will be published in August 2012.