

Guernsey Quarterly Inflation Outlook Bulletin

Quarter 3 2012 - Issue date 21st August 2012



POLICY COUNCIL
THE STATES OF GUERNSEY

1.1 Introduction

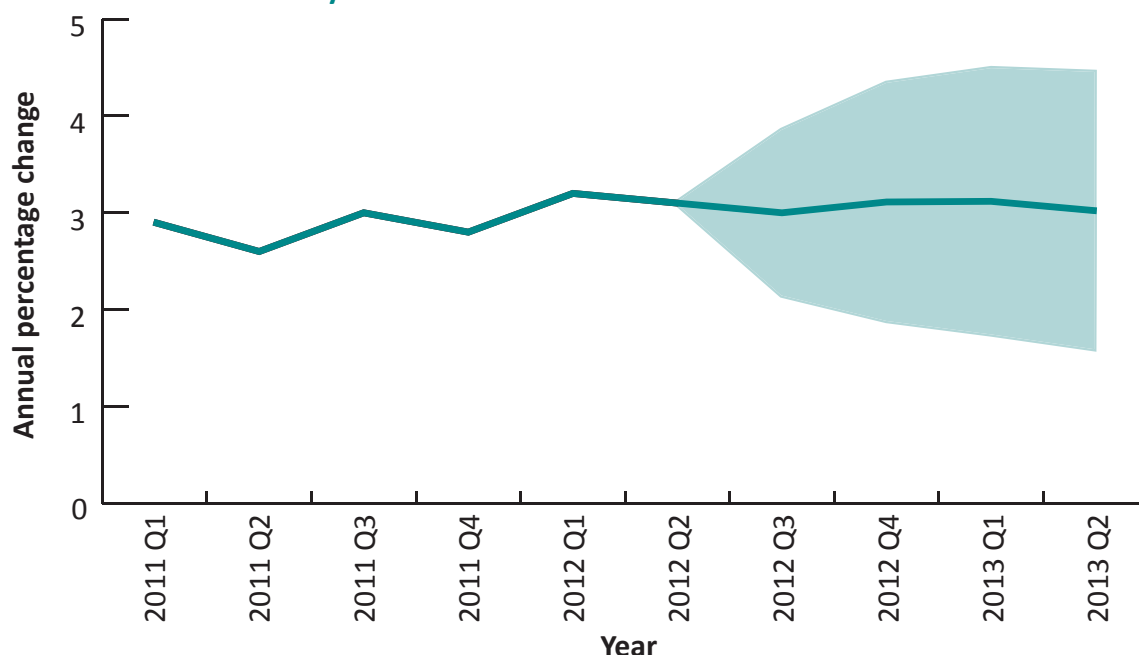
This is the third quarter edition of 'Inflation Outlook': a Policy Council report providing forecasts for inflation. The forecasts are based on econometric models and provide composite forecasts of RPIX and RPI. These forecasts are revised and published on a quarterly basis in the month following the 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 outlook for inflation continues to be benign, with RPIX forecast to remain at around 3% for the next four quarters.
- However, positive pressures and risks still exist and there is a possibility of additional food and fuel inflation as a result of global commodity price pressures.
- The recent spike in UK inflation (in July) is thought by market commentators to be a result of one-off effects. Subdued UK demand conditions are expected to result in a continuation of the downward trend in UK inflation.
- Inflationary conditions are likely to continue to vary across the basket. Subdued property price inflation is likely to have a dampening effect in the next few quarters: similarly alcohol and tobacco are unlikely to exert much positive pressure.

Figure 1.2.1: Forecast Guernsey RPIX



2.1 Inflation Outlook

Figure 2.1.1: Forecast Guernsey RPI

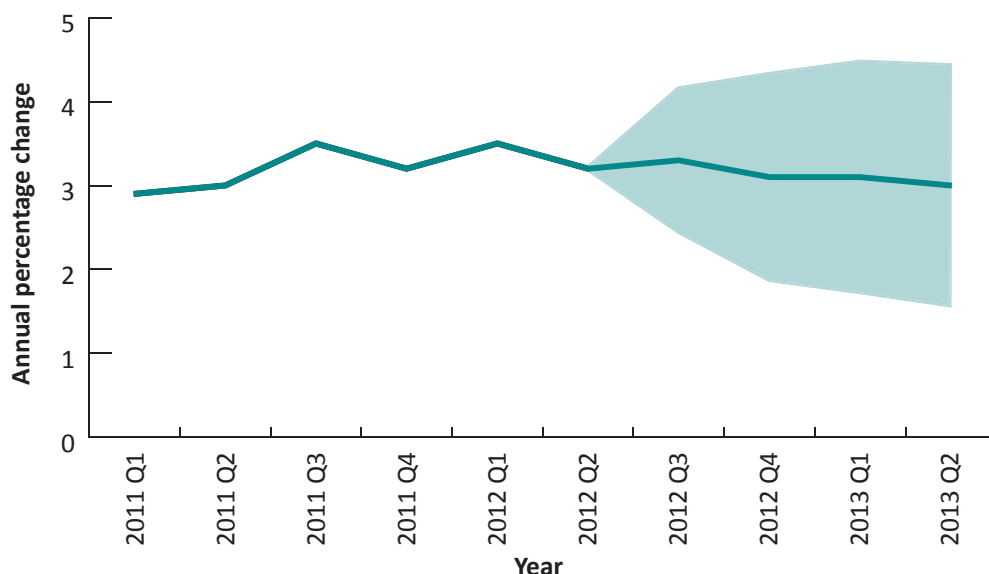
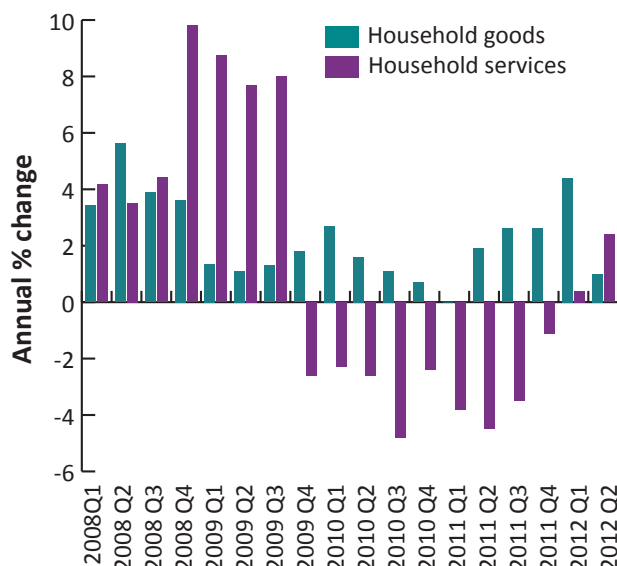


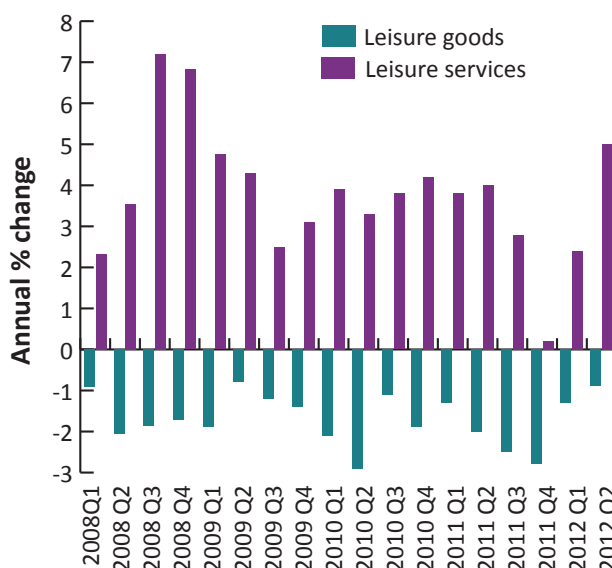
Figure 2.1.2: Household goods and services



Locally, inflation remains steady at around its target rate. It is not expected to veer significantly from this stable course over the next four quarters.

Both domestic and UK inflation have behaved as anticipated this year. Local inflation rates have been stable over the course of the year to date and UK inflation rates have fallen quite markedly as forecast by both the Bank of England and market commentators. However, last month did see a mild spike in UK inflation caused by early clothes discounting, oil price rises and a jump in airfares. Most commentators attribute these to one-off effects and forecast subdued demand to result in a continuation of the downward trend in inflation over the rest of the year, moving UK inflation back towards its target.

Figure 2.1.3: Leisure goods and services



Higher airfares will feed into our domestic measure through the travel component of the inflation basket. Although this is not a major component of the index, local travellers will feel the impact. The rise in global oil prices, 10% in recent weeks, is a salient reminder that these inflationary pressures still exist.

Commodity prices for grain have been adversely impacted by the US drought resulting in price rises on a similar scale to the summer of 2008, when increases caused food price riots in certain areas of the globe. Locally this could lead to additional food price inflation if these pressures do not abate, an outcome which would not be particularly welcome.

2.1 Inflation Outlook (continued)

Whilst the last couple of years have been a benign period for inflation, conditions do vary across the basket. Figures 2.1.2 and 2.1.3 demonstrate the different movements in the price of household goods and services; and leisure goods and services.

Both household and leisure services experienced quite a marked rise in the last quarter, household services having been negative for a prolonged period previously. This suggests that, after a period of competitive pricing, suppliers seem to be raising prices (the Chamber survey earlier this year reported that most local firms would be seeking to do so), although it remains to be seen whether consumers will resist this move. However, perhaps a little counter intuitively, if these continue this may point to stronger domestic demand conditions than indicated by other economic indicators, including labour market statistics, which point to conditions being slightly weaker this summer than last.

The different performance of household and leisure goods is noteworthy and reflects most probably the differing retail market conditions and the different type of goods in each. Whilst both baskets are mainly comprised of imported items, household goods incorporates bulkier items such as furniture which are most likely sold through local retail outlets. Leisure goods includes smaller items, such as music, film and video game products, which are more easily bought direct from the UK via the internet. Whether they are or not, the degree of extra competition from lower prices and heavy UK discounting is likely to have helped push prices down. This is not necessarily all a good thing, margins will be tighter and in the UK the High Street has been a significant casualty in the recession.

Elsewhere, subdued local market property inflation should also have a dampening effect in the next few quarters and tobacco and alcohol are unlikely to provide much in the way of positive pressure. This may be offset by pressures from heating costs going into the later half of the year. However, whilst inflation continues (and is likely to remain) mixed across different types of goods and services, in general inflation looks set to remain broadly stable. However, positive risks and pressures remain and there are some signs that economic conditions could be healthier than analysis of other economic indicators may suggest.

Figure 2.1.4: Guernsey RPI and RPIX

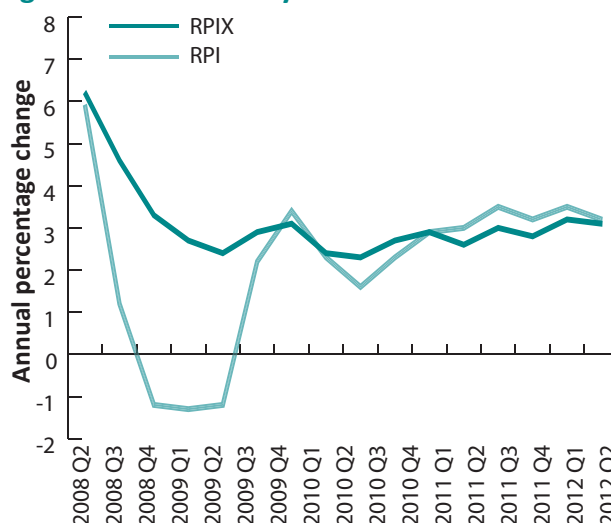
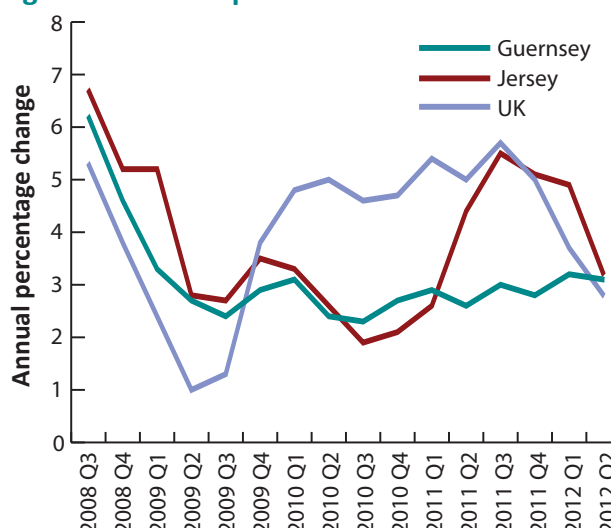


Figure 2.1.5: Comparison of RPIX



3.1 Contact details and further information

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The next inflation outlook (for Q4 2012) will be published in November 2012.