# Guernsey Quarterly Inflation Outlook Bulletin

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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 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 quarterly inflation rates and are 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

- The latest reported rate of inflation remains at the target 3%, with RPIX, the official headline rate, at 3.0% for the third quarter of 2012.
- However, rates are expected to rise slightly above the target in the fourth quarter of 2012 due to temporary fluctuations in global supply forces affecting food and energy prices. This could possibly continue into the first quarter of the new year, as illustrated in ***Figure 1.2.1.***
- Current flat economic conditions including a softer local property market should ensure this effect proves temporary.
- Risks of positive pressure still exist and there is a possibility of additional food and fuel inflation if global conditions continue to affect production into 2013.

**Figure 1.2.1: Forecast Guernsey RPIX**

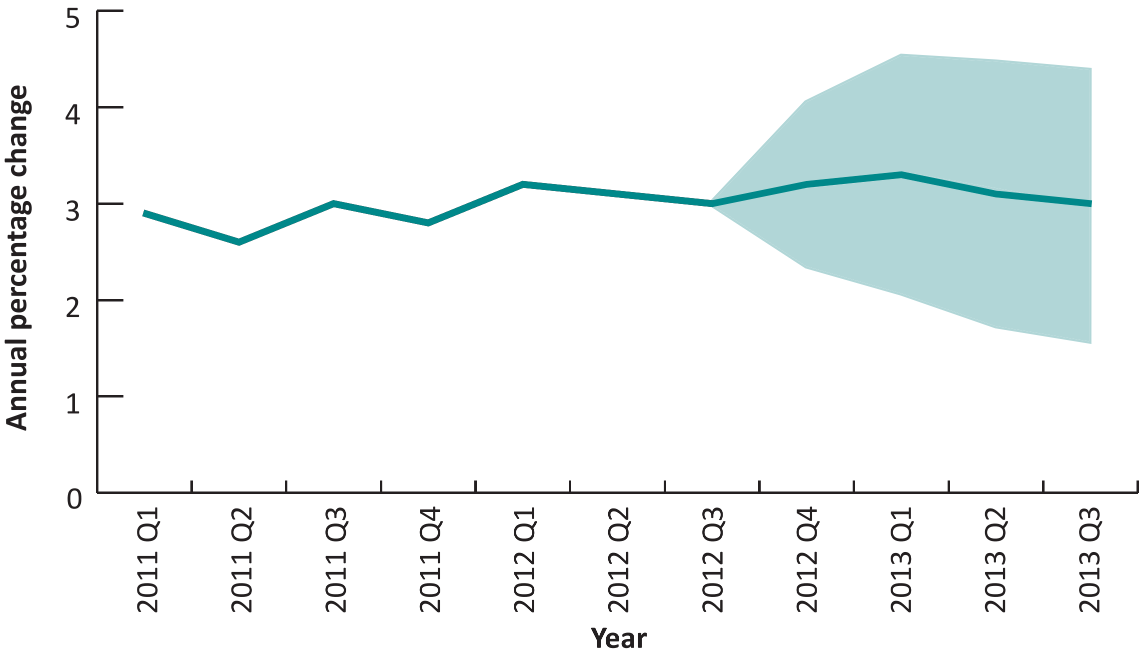
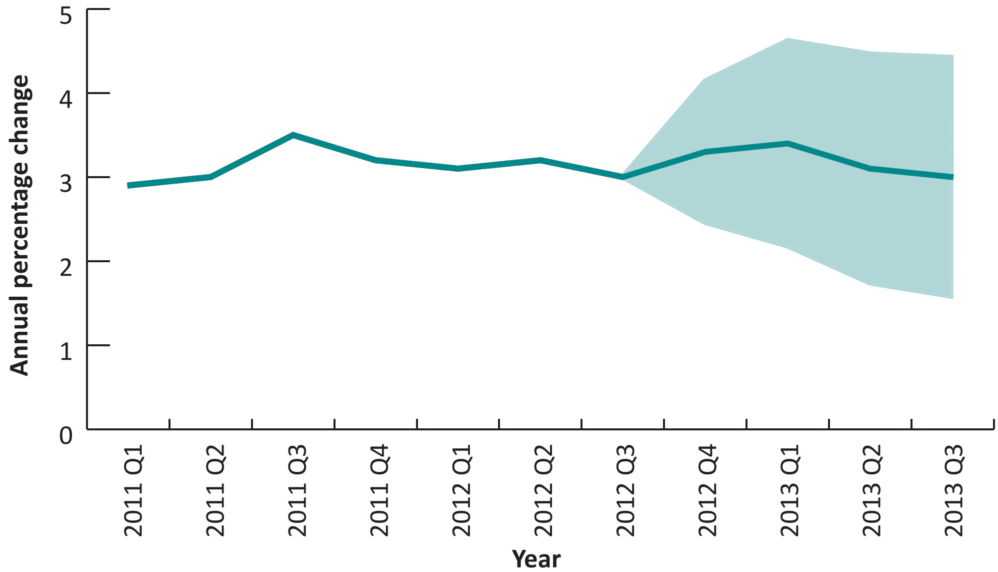


**Figure 1.2.2: Forecast Guernsey RPI**

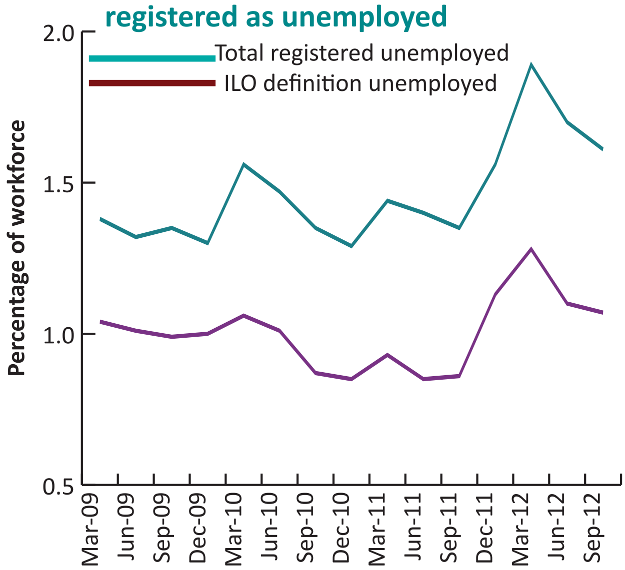



Most of the inflation targeting of the 90's and 00's was predicated on a belief that too much inflation is a bad thing; and that targeting an inflation rate should lead to macroeconomic stability within which other policy goals could be pursued. The experience of the last decade has taught us that monetary policy conducted with such a singular target overlooks other sources of potential stability particularly in the financial system. That said, it still holds that it is preferable to have a 'goldilocks' level of inflation – that is not too much not too little. Managing expectations of inflation is possible without monetary control - as has been successfully demonstrated in Guernsey with inflation being around target for the last three years since its introduction. That said there are times when expectations take second place to real economic forces. A lengthy preamble to state that the central forecasts suggest that for at least the next quarter or two this is likely to be one of those times: we expect inflation to rise temporarily in the coming quarters.

On the one hand domestic demand conditions, as outlined in the Economic Overview published in the summer, are flat (and thus non-inflationary) which would ordinarily drive inflation down, perhaps even to below the 3% rate. In the short term this is likely to be outweighed by stronger supply forces of food and energy price rises. CPI in the UK jumped to 2.7% last month driven primarily by those factors: the impact of a wet summer on this side of the Atlantic and a drought on the other, forcing food inflation to spike temporarily. The UK also experienced energy price rises. These forces are similarly projected to cause a temporary lift in Guernsey's inflation rate in the final quarter (possibly extending into the first quarter of 2013) by a few percentage points (around 0.3 or 0.4 points) higher than the target rate.

The prevailing general economic conditions suggest that absent these factors, demand is such as to be generating little inflationary pressure over the course of the end of 2012. It is thus anticipated that the effect of energy and food prices are likely to be temporary. Labour and property markets both point to a sideways movement in the economy. Employment levels have held up but unemployment spiked in late 2011/early 2012 (see ***Figure 2.1.1***) and whilst this has come down in the last quarter, it has not been accompanied by an increase in employment levels. In the local property market, whilst volumes have continued to remain at levels similar to 2011, rates of price increases have fallen to nominal rates close to retail inflation.

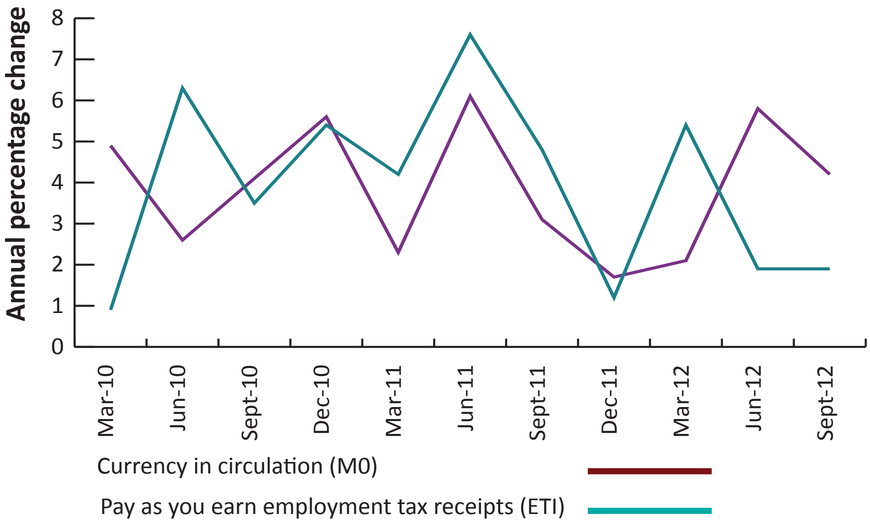
**Figure 2.1.1: Percentage of workforce registered as unemployed**



## 2.1 Inflation Outlook (continued)

The view (set out in the Economic Overview) that the economy was likely to be flat this year is supported by recent data on ETI (employment tax income) and M0 (notes and coins in circulation) for the third quarter (see ***Figure 2.1.2***). Nominal growth rates of just over 2% for ETI corresponds to flat conditions (after accounting for allowance increases) and nominal rates of around 4% in the third quarter for M0 equates to neither an expansion or contraction in domestic spending. That said, and whilst the States collects no formal data on consumption, new vehicle registrations fell markedly in the third quarter. On the other hand, first reports of this year's Tennerfest[1] suggest a record number of covers. Personal experience suggests that this year there was a higher degree of genuine £10 menus for quite some years and this was accompanied by full bookings – anecdotal evidence perhaps to suggest that consumers still have cash to spend if value is perceived.

**Figure 2.1.2: Annual percentage change in pay as you earn employment tax receipts (ETI) and currency in circulation (M0) (nominal)**




The central economic projection - that activity will pick up in 2013, led by the export oriented finance sector - was based on a central assumption that financial market conditions and activity will improve going into 2013. This should positively affect domestic demand, albeit with a degree of lag. Net net it is anticipated that current subdued demand should ensure that the projected mild pickup in inflation over the next quarter or so should subside before positive pressures from any increased economic conditions begin to be felt.

**Figure 2.1.3: Guernsey RPI and RPIX**

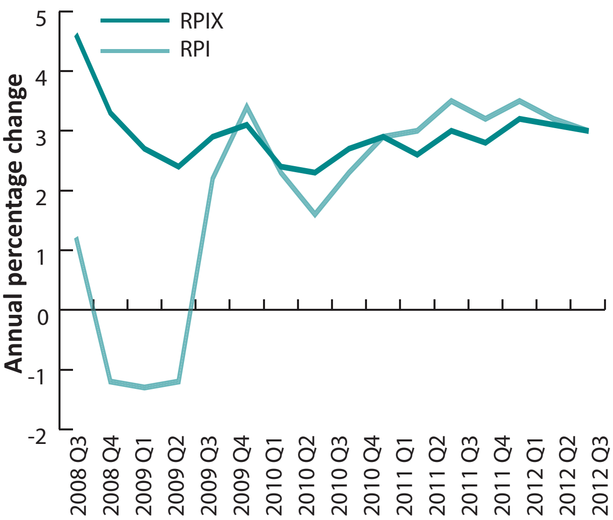
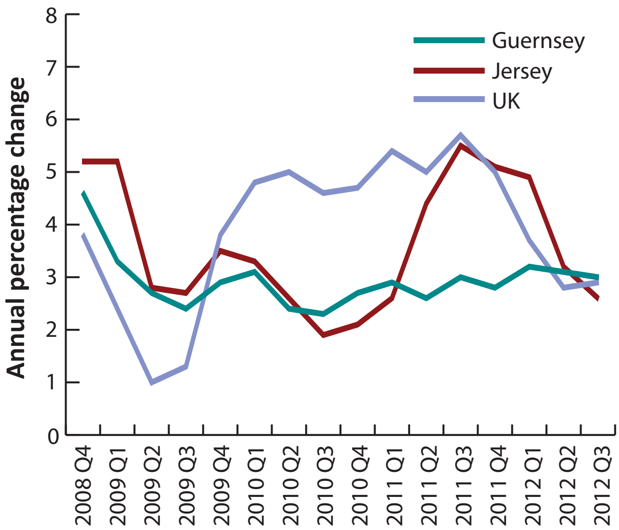



**Figure 2.1.4: Comparison of RPIX**




[1] An annual event held in Guernsey and Jersey in which local restaurants offer set price menus starting at £10 during October and November.

## 3.1 Contact details and further information

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The next inflation outlook (for Q1 2013) will be published in February 2013.