EY ITEM Club winter forecast

Outlook for the Channel Islands

March 2022

Building a better working world

Table of contents

Introduction

The relaxation of COVID-19 restrictions over much of 2021, a release of pent-up demand and still considerable support from fiscal policy contributed to the UK economy staging a strong recovery last year. GDP rose 7.5% in 2021, retrieving much of 2020's 9.4% loss (the biggest fall in a century).

Nevertheless, hopes that the UK economy would start 2022 on a robust note were hurt by the rapid spread of the Omicron COVID-19 variant at home and abroad. The health effects of the latest variant have been mercifully much milder than previous strains. However, increased consumer hesitancy and a rise in the number of people isolating probably held back activity at the start of this year. And headwinds to the recovery from cost of living challenges are building. Surging energy prices suggest CPI inflation will reach around 8% in the spring, a thirty-year high. Consequently, the outlook for real household income growth this year is gloomier than at any point since the 2008-09 financial crisis. And pressure on households' budgets will also mount as interest rates are likely to head higher over the course of 2022.

That said, the success of the UK's vaccination drive and greater adaptability among workers and firms mean the economic damage from Omicron looks to have been modest. Low unemployment and savings amassed by households during the pandemic's lockdowns should go some way to offsetting the drag on consumer spending from high inflation. Corporate balance sheets are strong, and surveys of investment intentions have picked up. Manufacturers will also gain from an easing of supply bottlenecks. As a result, the EY ITEM Club still expects the UK economy to grow almost 5% this year.

Evidence of healing from the economic damage caused by the COVID-19 crisis was also evident in the Channel Islands during 2021. But the starting point for recovery was far from uniform, with Jersey's economy suffering a much bigger loss of output in 2020 than Guernsey's. Looking ahead, the islands' economies face similar headwinds to those confronting the UK, notably a squeeze on households' spending power from higher inflation. The structure of the Channel Islands' economies, particularly the importance of tourism in sustaining employment and local spending, leave the islands, in some respects, more vulnerable to continued COVID-19 uncertainty.

But the worst of the pandemic hopefully being in the past now should boost confidence and the willingness of consumers and businesses to spend. Other forces which should support growth in the UK economy, particularly strong household finances, are also present in the Channel Islands. Moreover, the important role played by banking in the islands' economies, particularly Jersey's, means rising interest rates should prove a net economic positive, resulting in a faster recovery in banking profits and GDP.

Differing government responses to COVID-19 evident in economic outcomes

The latest GDP estimates for the Channel Islands show the COVID-19 crisis had a very unequal effect on the economies of the two biggest Crown Dependencies, with the impact on the finance sector accounting for most of the difference. Jersey's economy contracted by an estimated 9.2% in 2020, close to the 9.4% fall in UK GDP and comfortably the largest fall in GDP since the annual data series began in 1999. The decline was bigger than the 7.6% fall forecast by Jersey's Fiscal Policy Panel (FPP) in October of last year.[1]

Guernsey's economy suffered a more modest 3% real-terms contraction in 2020. This was much smaller than predictions in the early stages of the pandemic of a 6%-8% fall in GDP. It was also a drop exceeded as recently as 2012, when the economy contracted by almost 4%.[2] 2020's outturn left Guernsey's GDP per capita at £50,353, 57% greater than in the UK (2020 GVA per capita figures for Jersey are awaiting updated population figures from Jersey's 2021 census).

In percentage terms, hospitality was the hardest hit sector in both Jersey and Guernsey in 2020. Jersey's hotel, restaurant and bars sector shrunk by a massive 45%, while the hostelry sector in Guernsey contracted by a less severe, but still sizeable, third. Hospitality was particularly vulnerable to disruption to the summer tourist season and restrictions on public gatherings. Air and sea departures from Jersey in the peak month of August were 51% lower than in August 2019, while Jersey's reliance on international travel contributed to total tourism spend in the island in 2020 falling by an estimated 83%.[3] International visits to Guernsey also suffered a considerable decline – passenger movements via Guernsey airport in 2020 were almost 80% lower than a year earlier, and visitors to the island arriving by boat fell a similar amount.[4] The fact that domestic COVID-19 restrictions in Guernsey were relaxed more quickly than in Jersey over the summer of 2020, reflecting the successful suppression of the virus, helps to explain the less severe, if still substantial, hit to Guernsey's hospitality sector.

Hospitality is a relatively small part of both Jersey and Guernsey's economies (equivalent to 4% and 2% of GDP in 2019 respectively). The importance of financial services in both economies (representing around two-fifths of GDP in Jersey and Guernsey) meant falls in output in this sector delivered by far the biggest hit to GDP in absolute terms. Strikingly, a 11% decline in the output of Jersey's financial sector was much larger than the 2% contraction in Guernsey's, a difference which explains more than half of Jersey's bigger drop in total GDP. Although banking is typically the most important part of the financial sector in both Jersey and Guernsey, its economic weight is greater in the former. As a result, Jersey's financial sector was more exposed to a loss of net interest income from 2020's record low level of UK Bank Rate. Net interest income earned by Jersey's banking sector fell 24% in 2020, reversing the trend of rising net interest income between 2016 and 2019. [5]

However, other financial activities such as insurance and fiduciary held up well during the crisis, to the particular benefit of Guernsey, as did the funds and private wealth sectors. The value of regulated funds business serviced in Jersey grew by 9% in 2020 to a new record high.[6] And the net asset value (NAV) of funds domiciled in Guernsey rose 20% over the year to Q2 2021, also to an all-time high.[7]

Meanwhile, both Jersey and Guernsey saw hefty contractions in the transport, storage and communication sector, an area heavily impacted by lockdown restrictions. Output fell just over a fifth in Jersey, although Guernsey suffered a smaller 9% contraction. Helped by a shift in spending online, the damage to retail was more modest in both Jersey (a contraction of 6%) and Guernsey (where output fell 2%). Guernsey's relative retail outperformance was probably helped by a lighter-touch approach to domestic COVID-19 restrictions. The Bailiwick's longer-lasting travel restrictions may have also played a role, resulting in more spending being retained on the island.

In both Jersey and Guernsey, public administration was one of the few sectors to record growth in 2020, expanding by 9% in Jersey, but a more modest 1% in Guernsey. Growth in this area largely reflected increased activity in response to the pandemic, including test and tracing and vaccinations.

---

1 Statistics Jersey, 'Measuring Jersey's economy: GVA and GDP 2020'. 1 October 2021. https://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/R%20GVA%20and%20GDP%202020%2020211001%20SJ.pdf

2 States of Guernsey, 'Guernsey Annual GVA and GDP Bulletin'. 19 November 2021. https://www.gov.gg/CHttpHandler.ashx?id=147608&p=0

3 Jersey's Fiscal Policy Panel 'Annual Report – November 2021', page 18. https://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/FPP%202021%20Annual%20Report.pdf and Oxford Economics, 'Jersey's tourism recovery, opportunities, risks and constraints', December 2021, page 19.

4 The Islands of Guernsey, 'Statistics and Surveys', https://guernseytrademedia.com/facts-figures/statistics-surveys/

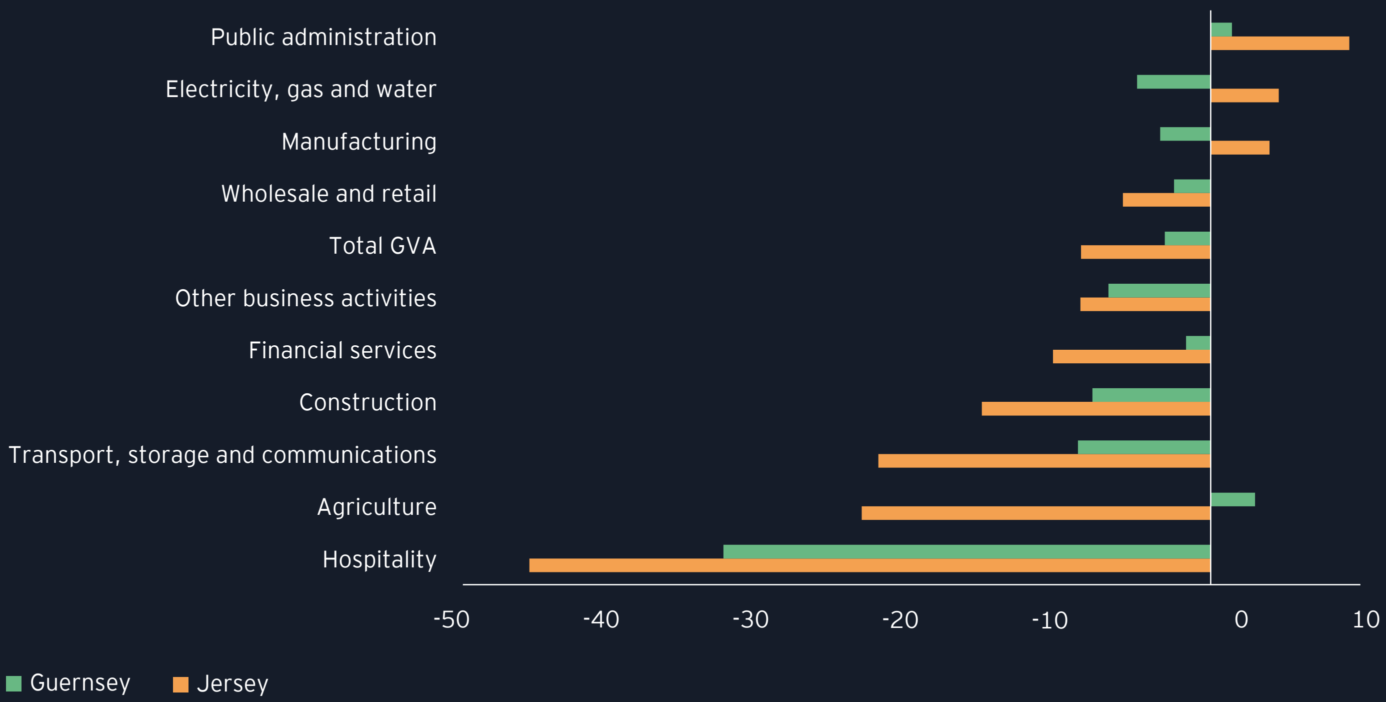
5 Jersey's Fiscal Policy Panel 'Annual Report – November 2021', page 12.

6 Jersey Financial Services Commission, 'Fund Statistics', https://www.jerseyfsc.org/industry/sectors/funds/funds-statistics/

7 Guernsey Financial Services Commission, 'Investment Statistics Summary, Q2 2021'. 25 January 2022. https://www.gfsc.gg/sites/default/files/2022-01/June%202021.pdf

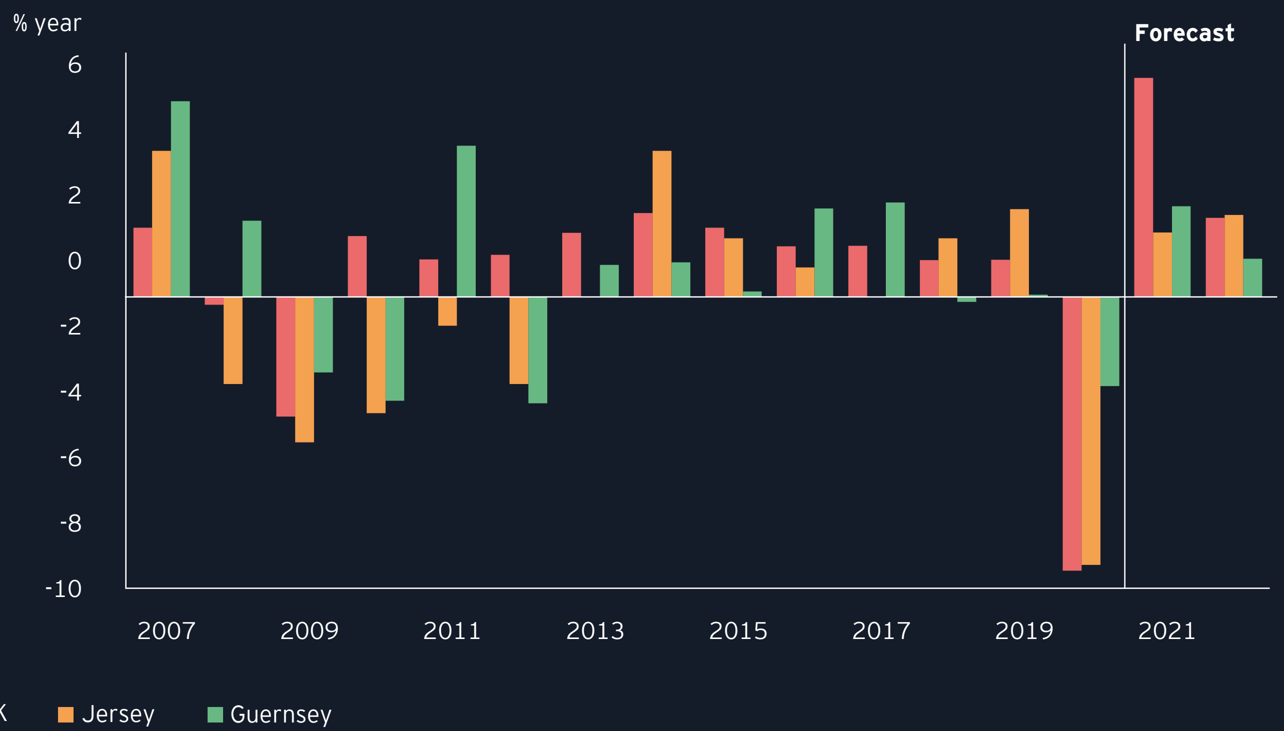
GVA by sector

% change between 2019 and 2020



Source: EY ITEM Club/Statistics Jersey & States of Guernsey

GDP growth



Source : EY ITEM Club/States of Jersey/Guernsey Economics Unit/S&P

A range of economic indicators point to recovery in 2021

GDP data for the Channel Islands in 2021 is not yet available. But other, timelier, indicators point to a recovery in activity over the last year, helped by the resumption of temporarily paused activities and successful vaccine rollouts. Notably, unemployment data has shown a significant improvement in both Jersey and Guernsey. The number of people actively seeking work in Jersey fell from a peak of 2,380 in May 2020 to 810 in December 2021.[8] This was below the level during the same period in 2019 and the lowest since 2018. The number of unemployed people in Guernsey stood at 313 at the end of December 2021, the 10th month in a row to see a fall and down by 23 from December 2019, before the COVID-19 pandemic began.[9] The unemployment rate in the same period stood at only 1.1%, down from a recent peak of 2.3% in August 2020.

However, high frequency data on mobility has struck a more subdued tone. Footfall data for St Helier showed footfall on the high street in the week to the start of 2022 almost a quarter lower than in the same period two years earlier.[10] Granted, the spread of the Omicron COVID-19 variant will have depressed numbers during this period. On an annual basis, the picture was better – footfall during 2021 was 10.4% higher than in 2020. But travel restrictions and a continuation of home working for many people meant 2021's recovery went only some way to reversing the previous year's 39.8% drop.

In common with many developed economies, house prices in 2021 saw significant rises in Jersey and Guernsey, bolstering household wealth. In the year to Q3 2021, the average purchase price for property in Jersey reached £634,000, 18% higher than a year earlier, while prices rose even faster in Guernsey (19%) over the same period. House price inflation in both islands was substantially above the 10% rate recorded in the UK. At £554,290 in 2021, the average property in Guernsey was somewhat more affordable than in Jersey, although still well above the UK average of £271,000.[11] Price rises were aided by record low mortgage rates, while the substantial unplanned savings built by some households during the pandemic will have helped finance deposits on properties. The strength of housing markets appears to have boosted the construction sector in both Jersey and Guernsey.

---

8 Statistics Jersey, 'Registered Actively Seeking Work: Fourth Quarter – 2021', 12 January 2022. https://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/R%20December%202021%20Registered%20ASW%2020220112%20SJ.pdf

9 States of Guernsey, 'Unemployment falls below pre-pandemic levels'. 22 January 2022. https://gov.gg/article/187358/Unemployment-falls-below-pre-pandemic-levels

10 Springboard (2022), 'Footfall report for St Helier, King Street', Week 52, 2021. 27 Dec 2021-02 Jan 2022. https://jerseychamber.com/storage/app/media/pdf/WeeklyFootfall_StHelierKingStreet_Wk52Yr2021_L4L.pdf

11 Statistics Jersey, 'House price report for the third quarter 2021', 18 November 2021. https://www.gov.je/News/2021/Pages/HousePriceIndexQ32021.aspx and States of Guernsey, 'Guernsey Quarterly Residential Property Prices Bulletin Quarter 3 2021', 12th November 2021. https://www.gov.gg/CHttpHandler.ashx?id=147348&p=0

2022 should see another year of growth, COVID-19 permitting

Vaccinations, widespread immunity in the population and the milder nature of the Omicron variant suggest that the worst of the pandemic has now hopefully passed. In that case, 2022 should deliver a year of above-trend economic growth in both Jersey and Guernsey. Last August, Jersey's FPP forecast that after a 2.2% rise in GDP in 2021, Jersey's economy would expand 2.8% this year and a further 3.3% in 2023. Increased consumer hesitancy in response to the spread of Omicron and staff shortages as a result of more workers on sick-leave or isolating likely made for a weaker than expected starting point for growth this year. This will hold back calendar-year growth in 2022.

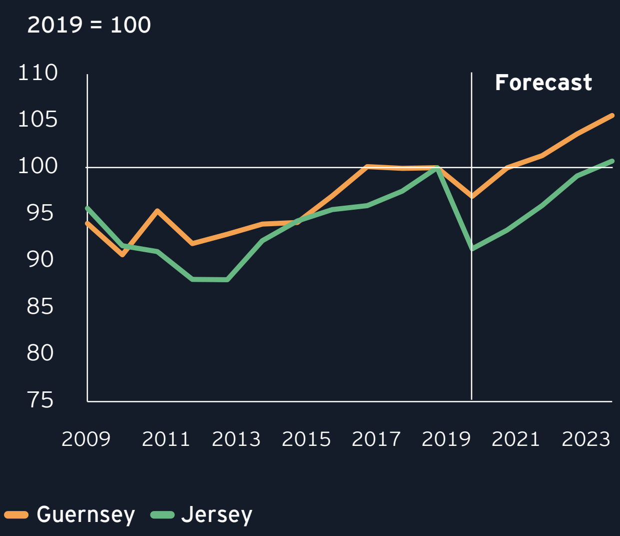
But the economic damage should be modest. Jersey's government took a relatively light-touch approach to new restrictions (early January saw face masks made mandatory in shops and indoor spaces and people encouraged to work from home, but no lockdown) and the co-funded payroll scheme was extended over the winter. Thanks to falling infection numbers and a high level of vaccinations, the mask mandate was dropped from 1 February and all COVID-19 restrictions will end on 31 March. So some of the economic activity lost at the start of 2022 should be made up later this year. However, if the FPP's forecasts prove accurate, Jersey's economy in 2023 would still be slightly smaller than in 2019.

The States of Guernsey estimates that the economy returned to its pre-pandemic size last year, implying growth of around 3% in 2021.[12] Guernsey's government also choosing not to place the island under a lockdown in response to Omicron will have reduced the potential economic damage from the latest variant. And 17 February saw the end of both the legal requirement to self-isolate for COVID-19 cases and border restrictions. But Guernsey's economy has suffered from some of the consequences of a rise in COVID-19 infections. Notably, the hospitality sector experienced cancellations and a shortage of staff.[13] As with Jersey, this points to the economy getting off to a less strong start in 2022 than hoped.

S&P is forecasting GDP growth of 1.3% this year.[14] This would be slower than in 2021, but indicative of an economy which has less opportunity to exploit catch-up growth, given its impressive resilience during the pandemic.

Sector-wise, the output of most parts of the Channel Islands' economies should enjoy further recoveries this year. In particular, banking will gain from the likelihood of further rises in interest rates (see below), while the record amounts of 'dry powder' held by private equity firms bodes well for the funds sector and M&A activity managed from Jersey and Guernsey. The outlook for those sectors most dependent on external travel, such as transport and hospitality, is most uncertain. But Guernsey's decision to relax border restrictions and isolation requirements from 19 January, the planned return of cruise ship visits to the island in April and the suspension in Jersey on 7 February of all requirements under the safer travel policy have removed some of the major obstacles to a revival in tourism.

Level of GVA



Source: EY ITEM Club/Jersey FPP/States of Guernsey & S&P

---

[12] States of Guernsey, 'Guernsey Economic and Financial Stability Overview', January 2022, page 3. https://gov.gg/CHttpHandler.ashx?id=148977&p=0

[13] ITV News, 'Restaurants and pubs in Guernsey forced to close due to Covid', 31 December 2021. https://www.itv.com/news/channel/2021-12-30/hotels-restaurants-and-pubs-in-guernsey-forced-to-close-due-to-covid

[14] S&P, 'States of Guernsey Outlook Revised to Negative On Risk Of Eroding Liquid Asset Buffer; 'AA-/A-1+' Ratings Affirmed', 14 January 2022. https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/type/HTML/id/2780822

Key issues facing the economies of the Channel Islands

The chief economic uncertainty facing the Channel Islands, in common with the rest of the world, is the future path of COVID-19. In an optimistic scenario, the Omicron strain quickly passes, and the virus moves from a pandemic phase to a more manageable 'endemic' phase. In this world, confidence would be boosted, and households and firms would spend more of the savings accumulated during the crisis. The Bank of England's plans to raise the interest rate would be accelerated. But as Omicron has demonstrated, the risk of a new variant emerging means the virus picture could quickly change in an undesirable direction. In that event, new restrictions would depress consumer spending and monetary policy tightening would be pushed back. Meanwhile, greater uncertainty around the future would curtail some investment plans.

Other macroeconomic issues which will bear on the economic outlook include:

1 A (temporary) squeeze on spending power from high inflation

Rising inflation, driven by the consequences of economies reopening and surging energy prices, has affected the Channel Islands. December saw the RPI measure of inflation reach 3.8% in Jersey and 4.4% in Guernsey.[15] These were the highest rates since Q3 2018 and Q3 2008 respectively and compared with growth in retail prices last March of 2.1% and 0.8%. However, inflation in both Jersey and Guernsey was not as heated as in the UK, where RPI inflation reached 7.5% in December, before climbing further to 7.8% in January.

Last August, Jersey's FPP expected retail prices to rise 3.6% this year, while conceding that data published subsequent to its forecast pointed to faster price rises.[16] The latest forecast from the States of Guernsey predicts that inflation in the Bailiwick (on an RPIX basis) could exceed 4% in 2022.[17] Given recent jumps in commodity prices, this will almost certainly prove an underestimate. However, differences in the path of energy prices mean RPI inflation is unlikely to reach the 8%–9% peak we expect to see in the UK later this spring. Granted, last October saw gas bills in Jersey and Guernsey rise 13% and 17% respectively and energy costs have seen some further hikes already this year (the price of electricity in Jersey rose 4% in January). However, as both Jersey and Guernsey are connected to the French nuclear power network rather than the UK power grid means they should avoid the 54% rise in UK household energy bills due in April following a rise in the energy regular Ofgem's price cap.

Meanwhile, labour shortages in some sectors could push up pay in those areas. But, overall, average pay growth is likely to fall short of inflation, with 2022 being a year of falling real wages (price rises outstripping pay rises was already in evidence in the UK in late 2021).

However, we think inflation will fall back towards the end of this year and into 2023. Assuming energy prices do not continue to jump, their effect on the year-on-year inflation rate should gradually ease. Global goods prices should weaken as post-lockdown consumer spending patterns rotate from goods back to services and supply frictions are resolved. Also, the recent strength of the UK pound, which began 2022 at the highest level against a basket of currencies since the Brexit referendum in 2016, will offer some offset to the rising prices of imported energy and other products. As a result, we see CPI inflation in the UK falling back to the Bank of England's 2% target in the first half of 2023. With inflation likely to peak at a lower level in the Channel Islands, a slowdown in inflation in Jersey and Guernsey should be more modest.

2 A mixed outlook for supply pressures

Globally, the supply bottlenecks which manufacturers faced last year should ease during 2022 as COVID-19 restrictions are relaxed, investment comes on stream and the shift in consumer spending from services to goods during the pandemic unwinds, taking some pressure off demand for goods. This should help to ease inflationary pressures facing households and firms in the Channel Islands.

---

[15] Statistics Jersey, 'Jersey Retail Prices Index December 2021', https://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/R%20Latest%20RPI%2020180518%20SJ.pdf and States of Guernsey, 'Guernsey Quarterly Inflation Bulletin December 2021', https://www.gov.gg/CHttpHandler.ashx?id=149387&p=0

[16] Jersey's Fiscal Policy Panel, 'Annual Report – November 2021', page 30.

[17] States of Guernsey, 'Guernsey Economic and Financial Stability Overview', page 6.

The picture is more mixed as far as domestic issues are concerned. A key supply-side constraint facing the economies of the Channel Islands relates to the supply of workers. The pandemic appears to have had some adverse consequences here, if not huge. Figures cited by the FPP suggest that Jersey's labour force shrank over the course of 2020 but had rebounded to pre-COVID-19 levels last summer. However, over the period 2009 to 2019, Jersey experienced strong net inward migration averaging 900 per year. But as of last summer, the number of 'registered' workers (i.e. those who have been in Jersey less than five years) had fallen by approximately 1,000 since June 2019.[18]

Guernsey's rate of population growth fell sharply in Q2 2020, as COVID-19's disruption reached a peak. But the full-year figure for 2020 saw some improvement – as of December 2020 (the latest available data), Guernsey's population had increased by 0.6% over the year (404 people), only slightly below a rise of 0.8% (509 people) in 2019.[19] And that the island has continued to attract expats, despite the travel complications created by the pandemic, has been evident from the property market. 2021 saw 127 Open Market transactions in Guernsey. This was 30 more than in 2020, and well above the previous record high of 101 in 2006.[20]

But some reassuring headline numbers disguise some sector-specific problems. Anecdotal evidence from hospitality firms in Jersey and Guernsey point to staff shortages and recruitment difficulties and a struggle to recruit back the levels of staffing that were lost during the crisis. As well as the pandemic, attracting short-term seasonal workers from overseas has also been adversely impacted by changes to visa requirements for EU nationals working within the UK Common Travel Area following Brexit. And non-EU migration has faced obstacles from the rules on isolating and testing for those arriving in the Channel Islands from countries on the UK's 'red list'. These developments have exacerbated the challenges to workforce growth already presented by ageing populations. Both islands are seeking to overcome these headwinds. One of the objectives of Jersey's 'Common Population Policy' is to reduce reliance on net inward migration via policies to boost automation and productivity.[21] In Guernsey, a new marketing campaign launched in January ahead of the 2022 tourist season to attract labour, mainly targeted at UK-based workers.[22]

Whether these initiatives will succeed is debatable. The ability of governments to boost long-run productivity appears to be heavily constrained, particularly in small economies.[23] And whether the hospitality sector will regain its previous size and

RPI inflation

Source: EY ITEM Club/Statistics Jersey and States of Guernsey

[18] Jersey's Fiscal Policy Panel 'Annual Report – November 2021', page 21.

[19] States of Guernsey, 'Guernsey Economic and Financial Stability Overview', page 7.

[20] Carey Olson, 'Record year for Open Market activity in Guernsey', 11 January 2022. https://www.careyolsen.com/news-and-deals/record-year-open-market-activity-guernsey?utm_source=Mondaq&utm_medium=syndication&utm_campaign=LinkedIn-integration

[21] States of Jersey, 'Common Population Policy', 10 December 2021. https://statesassembly.gov.je/assemblypropositions/2021/p.116-2021.pdf

[22] States of Guernsey, 'Economic Development and Home Affairs working with hospitality on marketing campaign to help recruit staff', 19 August 2021. https://www.gov.gg/Hospitalitymarketing

[23] See Peter Robertson and John S Landon-Lane, 2003. 'Can government policies increase national long-run growth rates?', Royal Economic Society Annual Conference 2003 175, Royal Economic Society. http://www.sas.rutgers.edu/virtual/snde/wp/2002-13.pdf 19 August 2021. https://www.gov.gg/Hospitalitymarketing

capacity to employ workers is unclear. Evidence received by Jersey's Fiscal Policy Panel suggests that the accommodation sector will lose up to 10% of bed-stock due to the closure or planned closure of several hotels.[24]

The surge in property prices in the Channel Islands in 2021 and previous years could also make attracting people harder. The governments of both Jersey and Guernsey have become more activist in recent years in pursuing affordable housing polices, but to mixed success. Jersey's Housing Gateway was introduced in 2012 to administer access to affordable housing and there has been an expansion of social rental and affordable homeownership products from providers such as Andium Homes. Andium has a target of building 3,000 more homes in the Island by 2030. However, an official 2020 report on Jersey's housing market judged it "not fit for purpose" and that improvement would require "bold action and significant change from the status quo".[25] In Guernsey, since 2016, developers building more than 20 dwellings have been required to provide part of the developable area of the site for affordable housing. However, to date, no new affordable houses have been built as a result of the rules. And some argue that the rules have discouraged new house building.[26]

Beyond COVID-19, the jobs markets in the Channel Islands face longer-term pressures. According to the Jersey Employer Group, automation and the 'Fourth Industrial Revolution' mean that more than a quarter of current jobs in Jersey could "radically change or be rendered obsolete" within 15 years. Responding to this will require a well-targeted migration policy to bring in skills from other jurisdictions and appropriate education policies to develop and nurture skills and talents.[27]

3 Interest rates are heading higher

The Bank of England's Monetary Policy Committee (MPC) surprised by voting 8-1 to raise Bank Rate from 0.1% to 0.25% in its meeting last November. Though the strength of UK labour market data had fulfilled the earlier criteria set by the MPC for hiking interest rates, the uncertainty caused by the emergence of the Omicron variant had seemed to warrant a "wait-and-see" approach.

With CPI inflation coming in at 5.4% in December, well ahead of both the MPC's expectation and the Bank of England's 2% target, evidence that economic damage from Omicron has been modest and the UK government's decision to remove social distancing restrictions in late January, the committee's decision to raise Bank Rate to 0.5% in its January meeting was less of a shock. But that inflation concerns resulted in four of the MPC's nine members voting for a bigger increase in rates, to 0.75%, did surprise.

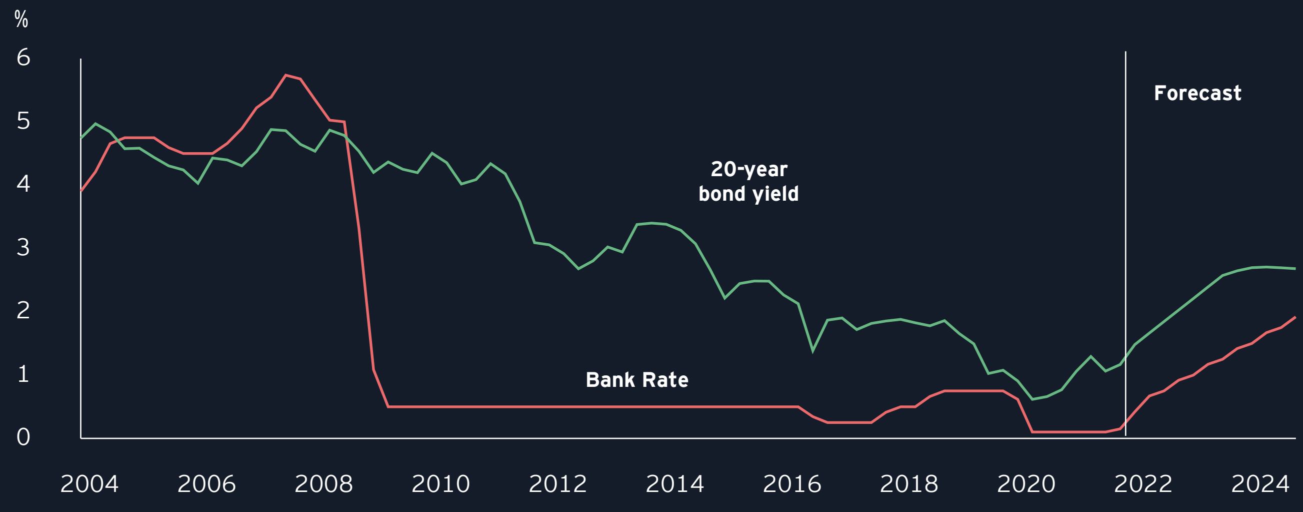
[24] Jersey's Fiscal Policy Panel 'Annual Report – November 2021', page 19.

[25] Housing Policy Development Board's Final Report, 16 April 2021. https://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/R%20Housing%20Policy%20Development%20Board%20Final%20Report%20April%202021.pdf

[26] BBC News, 'Bid to scrap Guernsey affordable housing policy', 3 February 2022. https://www.bbc.co.uk/news/world-europe-guernsey-60229268

[27] Jersey Employer Group, 'Developing a Strategic Workforce Plan for Jersey' June 2021. https://www.gov.je/SiteCollectionDocuments/Working%20in%20Jersey/JEGStrategicWorkforcePlanFinal.pdf

UK: Bank rate and 20-year bond yield



Source: EY ITEM Club

Heightened geopolitical uncertainty has triggered an increase in economic uncertainty and a tightening of financial conditions. And higher energy prices will weigh on discretionary spending. This is likely to encourage the MPC to proceed more cautiously in raising interest rates, certainly compared to the aggressive path of rate hikes recently expected by financial markets. That said, with inflation set to stay well above the 2% target this year and the economy continuing to make progress in returning to its pre-pandemic trajectory, we anticipate a further rise in the policy rate to 0.75% in May and then to 1% in November. Our forecast then assumes two 25 basis points hikes in both 2023 and 2024, with Bank Rate forecast to stabilise at 2% by the middle of the decade.

Higher interest rates will boost the profitability of the Channel Islands' banking sector. Even small increases in interest rates will improve net interest income due to the large value of deposits held by local banks, particularly in Jersey. However, the positives of higher borrowing costs to the Channel Islands' economies will be offset, to a degree, by increased financial pressure on households and firms holding debt.

4 A more important role for fiscal policy

Action by governments across the world to support households and firms through the pandemic has seen a reappraisal of the role of fiscal policy in economic policy. And the austerity policies that were pursued in many countries following the 2008-09 financial crisis appear to have fallen out of favour. The Channel Islands, historically bastions of balanced budgets, have not been immune from these developments.

Jersey's FPP expects the Jersey government to continue to run a budget deficit until 2024. This is a consequence of both the pandemic, with the economy expected to take several years to surpass its pre-COVID-19 size, and planned spending of £805m building a new hospital in St Helier. S&P expect the new hospital to be funded via bond issuance.[28] In addition, Andium Homes, the government's social-housing provider, will borrow up to up to £225m to fund its plans for affordable housing.

[28] S&P, 'States of Jersey 'AA-/A-1+' Ratings Affirmed; Outlook Stable', 14 January 2022. https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/type/HTML/id/2780877

Given uncertainty over the future course of COVID-19 and the potential need for fiscal support, continued deficits seem appropriate and will help to offset the drag on some parts of the economy from higher interest rates.

However, the prospect of several years of budget deficits should be set against a fiscal starting point much stronger than was anticipated early in the pandemic. Projected borrowing required to fund COVID-19 pressures has been revised down significantly by the FPP to £259m from £457m proposed in 2020. Granted, the stock of public debt is expected to peak at over £1.7bn in 2022 (equivalent to 34% of GVA), a significant increase from 5% of GVA in 2019. But the net asset position of Jersey's public sector is forecast to see a more modest deterioration, falling from 152% of GVA in 2019 to 145% in 2025. This continues to compare very favourably with most advanced economies. For example, UK public sector net debt is forecast to be around 90% of GDP in 2022, while UK government net worth was negative in each year from 2008 to 2020.[29] Jersey's strong fiscal buffers were reflected in S&P affirming the island's 'AA-/A-1+' credit rating for long and short-term debt in January.[30]

Guernsey's fiscal position has also proved more robust than was feared in the initial stages of the COVID-19 crisis, consistent with a smaller-than-expected hit to GDP. The 2021 Budget, prepared in late 2020, anticipated a full year deficit of £22million in 2021. This was revised up to £33million following the second lockdown in early 2021. But the 2022 Budget estimates that borrowing last year came in at only £5m.[31] Modest borrowing reflects support to tax receipts from a domestic economy which was able to function freely for much of 2021. A high level of transactions in the property market also helped, as did a shorter and less restrictive second lockdown compared to the first, resulting in lower spending on emergency measures.

Guernsey's headline fiscal position is expected to return to surplus this year. However, according to S&P, the government's works plan for 2021–2025, which entails capital expenditure of up to £580m in areas such as housing, education, digitalisation, and transport, means the government balance will remain in a structural deficit on average over 2022–2025 and to a greater extent than historic norms.[32] That said, with government liquid assets still forecast to exceed 100% of GDP at the end of this year, Guernsey enjoys a far stronger fiscal position than almost all of its developed economy peers. As with Jersey, S&P affirmed its 'AA-/A-1+' long- and short-term credit ratings for Guernsey at the start of this year.[33]

[29] Office for National Statistics, 'National balance sheet estimates for the UK: 2021', 2 December 2021. https://www.ons.gov.uk/economy/nationalaccounts/uksectoraccounts/bulletins/nationalbalancesheet/2021

[30] S&P, 'States of Jersey 'AA-/A-1+' Ratings Affirmed; Outlook Stable', 14 January 2022.

[31] States of Guernsey, 'Annual Budget for 2022', 5 October 2021. https://www.gov.gg/CHttpHandler.ashx?id=145085&p=0

[32] S&P, 'States of Guernsey Outlook Revised To Negative On Risk Of Eroding Liquid Asset Buffer; 'AA-/A-1+' Ratings Affirmed', 14 January 2022.

[33] S&P, 'States of Guernsey Outlook Revised To Negative On Risk Of Eroding Liquid Asset Buffer; 'AA-/A-1+' Ratings Affirmed', 14 January 2022. https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/type/HTML/id/2780822

EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EYSCORE 001812-22-UK
ED None

UKC-022130.indd (UK) 03/22.
Artwork by Creative UK.

In line with EY's commitment to minimize its impact on the environment, this document has been printed on paper with a high recycled content.

ey.com/ci