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Ratings

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Research Update:

States of Jersey 'AA-/A-1+' Ratings Affirmed; Outlook Revised To Stable

January 17, 2020

Overview

- Following the outcome of the U.K.'s December 2019 general election, Brexit negotiations will now move to the next phase--that is, the terms of the future relationship between the U.K. and the EU.
- In our opinion, while Jersey remains vulnerable to the fortunes of the U.K.'s financial services sector, immediate risks have dissipated.
- We are therefore revising the outlook on our sovereign credit ratings on Jersey to stable from negative, and affirming our long- and short-term sovereign credit ratings at 'AA-/A-1+'.

PRIMARY CREDIT ANALYST

Aarti Sakhuja
London
(44) 20-7176-3715
aarti.sakhuja
@spglobal.com

SECONDARY CONTACTS

Samuel Tilleray
London
+ 442071768255
samuel.tilleray
@spglobal.com

Abril A Canizares
London
(44) 20-7176-0161
abril.canizares
@spglobal.com

ADDITIONAL CONTACT

Himani Joshi
Mumbai
himani.joshi
@spglobal.com

Rating Action

On Jan. 17, 2020, S&P Global Ratings revised the outlook on its sovereign credit ratings on Jersey to stable from negative. At the same time, we affirmed our 'AA-/A-1+' long- and short-term foreign and local currency sovereign credit ratings.

Outlook

The stable outlook reflects balanced risks to Jersey's creditworthiness.

Downward pressure could build on the ratings if risks to Jersey's external environment were to return, testing the ability of Jersey's authorities to set appropriate policies to mitigate the fallout. For instance, these could pertain to the terms of the U.K.'s future relationship with the EU; in particular, the U.K. financial services sector's future access to the single market. We could also lower the ratings if general government liquid assets--a key rating strength and important buffer against economic shocks--fall below 100% of GDP.

We could raise the ratings if Jersey's financial sector and the broader economy prove more resilient than we expect, or if greater availability of statistical data were to prompt us to revise our assessment of external risks.

Rationale

In the U.K.'s December 2019 general election, the Conservative and Unionist Party won a sizable parliamentary majority which we believe in turn would afford the government more room to engage with the EU over the details of their future relationship.

With the U.K. moving to the next phase of negotiations with the EU, we anticipate immediate risks to Jersey as having dissipated. Even then, the level and terms of the U.K. financial services sector's future access to the EU are still likely to affect Jersey's corresponding sector, as will changes in U.K. taxation and regulation of the sector.

Our ratings on Jersey are based on our view of the island's strong and flexible institutions, wealthy economy, and considerable fiscal buffers. These strengths are offset by the external risks to Jersey's economy and policymaking framework, and its lack of meaningful monetary flexibility.

Institutional and Economic Profile: The terms of the U.K. financial sector's future access to the EU remain pertinent for Jersey, as do any changes in U.K. taxation and regulation for the sector

- After the U.K.'s departure from the EU and at the end of the transition period, Jersey will enter into a customs arrangement with the U.K., binding it to the U.K.'s external tariffs.
- Managing reputational risks, against a backdrop of rising global regulation of low-tax jurisdictions, is critical to Jersey's authorities.
- We factor in average real GDP growth of about 1% a year over 2020-2023.

Jersey is a small, wealthy economy with a workforce of about 61,000 people and GDP per capita estimated about $57,000 in 2019. The financial services sector dominates the economy, directly contributing nearly 40% of Jersey's gross value added (GVA), and nearly 22% of employment.

Jersey, as one of three British Crown Dependencies (the others being Guernsey and the Isle of Man), has a right to self-determination. In the context of most EU regulations, the island has its own representation and is treated as a third country (non-EU counterparty). It has access to the single market in goods (but not services) through Protocol 3 of the U.K.'s accession agreement. Moreover, as a third country, Jersey chooses to demonstrate comparability of regulation to EU members to access the EU service markets, and will continue to do so after Brexit.

In an orderly Brexit scenario, we anticipate that Jersey will remain vulnerable to the level of access that the U.K.'s financial services sector has to the EU, and also to any potential changes in taxation and regulation for the sector in the U.K. that could render it more competitive vis-à-vis the Crown Dependencies. Any changes in the U.K.'s immigration policies would also have an impact on Jersey, where EU nationals currently represent nearly a quarter of the workforce.

Although the Channel Islands--Guernsey and Jersey--have their own joint representation in Brussels, the U.K.'s presence in European policymaking has been important to them, and they are likely to feel the loss of the U.K.'s influence in Europe after Brexit.

After the U.K.'s departure from the EU and at the end of the transition period, the Channel Islands will enter into a customs arrangement with the U.K., binding them to its external tariffs. An adverse impact on the U.K.'s terms of trade in goods would therefore hinder Jersey.

In the event of a scenario where the U.K. and the EU cannot agree on the terms of their future relationship and the U.K. falls back to trading with the EU on World Trade Organization norms, Jersey is likely to be exposed to supply-side disruptions, given that most of its imports are routed through the U.K. We understand, however, that the authorities have contingency plans in place to cope with such an event. In our opinion, the effectiveness of such plans could eventually depend on considerations outside the authorities' control, such as the length of any potential disruptions and the U.K.'s preparedness.

We factor in average real GDP growth of about 1% a year over 2020-2023. Even though Jersey is already a third country to the EU, we anticipate that the U.K. financial sector's less-favorable access to the EU following Brexit could weaken prospects for the corresponding sector in Jersey. Although Jersey's financial sector has a geographically diverse funding base, much of its client base originates from U.K. referrals. In an effort to counter this, Jersey's authorities have stepped up efforts to widen the sources of business inflows and improve bilateral government relations; for example, with administrations in the Middle East, Africa, and Asia.

External demand for greater transparency from jurisdictions such as Jersey has been increasing. In December 2017, in the wake of the Paradise Papers scandal, EU finance ministers (Ecofin) assessed Jersey, along with other jurisdictions including the other Crown Dependencies, as cooperative but subject to the implementation of certain commitments. These commitments related to the concern that profits from relevant activities were registered in Jersey without adequate economic activity taking place on the island. Subsequently, Jersey's authorities introduced new economic substance legislation requiring companies tax-resident on the island to meet certain tests related to their local activities. In March 2019, Ecofin confirmed that Jersey had delivered on its commitment.

In July 2019, the OECD Forum on Harmful Tax Practices concluded that the domestic legal frameworks in the Crown Dependencies were in line with its prescribed standards and "not harmful".

Another recent instance was in 2019 when some members in the U.K. House of Commons unsuccessfully attempted to pass legislation related to beneficial ownership on behalf of the Crown Dependencies without their consent. As per their constitutional arrangements, the Crown Dependencies do not have representation in Westminster, and the U.K. parliament cannot legislate for them on domestic matters without their consent.

In an effort to meet developing global norms, the Crown Dependencies have committed to opening up their beneficial ownership registers to the public. This will occur in a staggered manner that is aligned to the EU's fifth anti-money-laundering directive and will follow the EU's post-implementation review in 2022.

Flexibility and Performance Profile: Jersey's sizable fiscal buffers are an important rating strength

- Jersey has significant fiscal assets, estimated at over 120% of GDP at the end of 2019, and low general government debt of about 5% of GDP.
- The lack of external statistics makes Jersey's exposure to external risks less visible.
- Jersey does not have a monetary policy toolkit of its own because it lacks a central bank and the Jersey pound is at parity with the pound sterling.

We regard Jersey's liquid fiscal assets, estimated at over 120% of GDP at the end of 2019, as a key rating strength. The assets include the fiscal reserves directly on the government's balance sheet; social security reserves; and the assets of public sector, defined-benefit pension schemes. We understand that these portfolios are invested in various asset classes around the globe and do not have a U.K. bias.

Jersey's government finances have historically been characterized by low deficits and debt, given the general consensus among successive policymakers regarding prudent public finances. We estimate the general government position by consolidating Jersey's annual audited accounts with the data on social security funds and on public sector pension schemes. In our view, this provides sufficient comparability with other rated sovereigns.

In 2018, Jersey ran a general government deficit of 0.6% of GDP, compared with a surplus of 1.3% of GDP in 2017, due to higher social security expenditure. In 2019, we estimated the deficit to have widened further to 1.4% of GDP in line with higher planned capital expenditure. The final fiscal outcome for the year will depend on the dynamics of the social security account. From 2020 onward, we anticipate the deficit will gradually narrow to below 1% in 2023. We expect that Jersey will finance these deficits via asset drawdowns.

Jersey does occasionally issue debt to finance large-scale capital projects. The previous government intended to part-finance a new general hospital by issuing £275 million of fresh debt. However, the plans are being reconsidered and we no longer include any government borrowing in our projections. We estimate that gross general government debt at year-end 2019 represented only 5% of GDP.

Jersey's lack of monetary policy flexibility constrains its ratings. The Jersey pound is at parity with the pound sterling; it circulates only in cash form; it is not a unit of account; and is not convertible. Furthermore, Jersey does not have a central bank that can act as a lender of last resort to its financial sector if needed. However, we expect the banking system would have indirect access to the Bank of England or European Central Bank through parent banks or U.K. and Luxembourg branches of Jersey-based banks in the event of stress.

In our opinion, this monetary arrangement is appropriate in light of Jersey's fiscal assets and economic links with the U.K. Nevertheless, it limits the authorities' toolkit because monetary policy is effectively set by the Bank of England.

Like other British Crown Dependencies, Jersey does not collect external data, and its economic data is limited in coverage and published with lags. This hampers our analysis and reduces visibility on external risks. Although Jersey's assembly passed a new statistics law in December 2017 that allows Jersey to collect external data, significant improvements in statistical availability will likely appear with a considerable lag.

Key Statistics

Table 1

States Of Jersey Selected Indicators

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Economic indicators (%)										
Nominal GDP (bil. LC)	4	4	4	4	5	5	5	5	5	6
Nominal GDP (bil. $)	7	6	6	6	6	6	7	7	8	8
GDP per capita (000s $)	66.7	62.5	55.8	54.6	58.8	57.7	60.7	63.3	67.2	68.7
Real GDP growth	4.6	2.0	0.8	0.8	1.4	0.9	1.0	1.3	0.8	0.6

Table 1

States Of Jersey Selected Indicators (cont.)

Real GDP per capita growth	3.5	0.3	(0.7)	(0.5)	0.3	(0.3)	(0.2)	0.1	(0.4)	(0.6)
Unemployment rate	4.6	4.0	3.7	3.6	3.5	3.5	3.5	3.5	3.5	3.5
Fiscal indicators (general government; %)										
Balance/GDP	(0.3)	0.6	1.2	1.3	(0.6)	(1.4)	(1.6)	(1.4)	(1.2)	(0.7)
Change in net debt/GDP	(8.6)	(6.6)	(13.0)	(11.8)	4.1	(3.8)	(4.7)	(4.8)	(5.1)	(5.6)
Primary balance/GDP	(0.2)	0.9	1.4	1.5	(0.4)	(1.2)	(1.4)	(1.3)	(1.0)	(0.6)
Revenue/GDP	25.6	27.1	27.5	27.3	25.6	25.8	25.8	25.6	25.4	25.3
Expenditures/GDP	25.9	26.4	26.3	26.0	26.1	27.2	27.4	27.0	26.6	26.1
Interest/revenues	0.4	0.8	0.8	0.8	0.8	0.7	0.7	0.7	0.7	0.7
Debt/GDP	6.1	6.0	5.8	5.6	5.3	5.1	4.9	4.8	4.6	4.4
Debt/revenues	23.9	22.0	21.2	20.4	20.8	19.8	19.2	18.6	18.0	17.5
Net debt/GDP	(105.8)	(109.8)	(120.1)	(127.3)	(117.0)	(116.5)	(117.2)	(117.5)	(118.4)	(120.1)
Liquid assets/GDP	111.9	115.7	125.9	132.9	122.3	121.6	122.1	122.2	123.0	124.5
Monetary indicators (%)										
CPI growth	1.6	0.6	1.6	3.2	3.6	2.8	2.6	2.7	2.9	2.8
GDP deflator growth	1.6	0.6	1.7	3.2	3.6	2.9	2.5	2.7	2.9	2.8
Exchange rate, year-end (LC/$)	0.64	0.67	0.81	0.74	0.79	0.76	0.76	0.74	0.72	0.72

Sources: Official website for the States of Jersey (Economic, Fiscal and Debt indicators), Jersey Financial Services Commission (Monetary indicators).
Definitions: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. e--Estimate. f--Forecast. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

States Of Jersey Ratings Score Snapshot

Key rating factors	Score	Explanation
Institutional assessment	2	Predictable, stable, and consensus-based policy-making. Effective checks and balances, efficient court system, strong contract enforcement, favorable business environment, and political commitment to fiscal prudence. Public finance data is audited; data on external finances is not produced. Statistical information on other macroeconomic variables comes with a lag.
Economic assessment	2	Based on GDP per capita as per Selected Indicators in Table 1. Negative trend growth in real GDP per capita as the financial services sector adjusted in the aftermath of the global financial crisis.
External assessment	4	Jersey does not produce data on external stocks and flows. The initial external score is the same as the initial external score for the sovereign issuing the currency used or "host country," in this case, the U.K. Material data inconsistency.
Fiscal assessment: flexibility and performance	1	Based on the change in net general government debt (% of GDP) as per Selected Indicators in Table 1. General government liquid assets of over 25% of GDP.
Fiscal assessment: debt burden	2	Based on net general government debt (% of GDP) and general government interest expenditures (% of general government revenues) as per Selected Indicators in Table 1. Moderate banking sector contingent liabilities
Monetary assessment	5	The Jersey pound is not a unit of account and does not exist in electronic form. Jersey adopts Bank of England monetary policy via use of sterling and parity of Jersey pound with sterling. De facto lender of last resort access for banks via parent banks.
Indicative rating	a+	As per Table 1 of "Sovereign Rating Methodology."
Notches of supplemental adjustments and flexibility	1	Government liquid assets exceeding 100% of GDP.
Final rating		
Foreign currency	AA-	
Notches of uplift	0	Default risks do not apply differently to foreign- and local-currency debt.
Local currency	AA-	

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Sovereign Ratings Score Snapshot, Jan. 2, 2020
- United Kingdom Outlook Revised To Stable; 'AA/A-1+' Ratings Affirmed, Dec. 17, 2019
- Sovereign Risk Indicators, Dec. 12, 2019. Interactive version available at http://www.spratings.com/sri
- Sovereign Ratings History, Dec. 4, 2019
- Sovereign Ratings List, Dec. 4, 2019
- Global Sovereign Rating Trends: Third-Quarter 2019, Oct. 15, 2019
- Default, Transition, and Recovery: 2018 Annual Sovereign Default And Rating Transition Study, March 15, 2019

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Jersey (States of)		
Sovereign Credit Rating	AA-/Stable/A-1+	AA-/Negative/A-1+
Ratings Affirmed		
Jersey (States of)		
Transfer & Convertibility Assessment	AAA	
Senior Unsecured	AA-	