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Ratings

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Research Update:

States of Jersey Affirmed At 'AA-/A-1+'; Outlook Negative

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Overview

- Despite Jersey's institutional strengths, uncertainties arising from the U.K.'s departure from the EU will likely test its policy responses and weigh on its economic growth prospects.
- We anticipate that the government will raise debt to part-finance capital expenditure in the near term, but will nevertheless maintain its sizable net asset position of about 130% of GDP through 2022.
- We are therefore affirming our long- and short-term sovereign credit ratings on Jersey at 'AA-/A-1+'.
- The negative outlook continues to be underpinned by the uncertainty related to the U.K.'s withdrawal from the EU, which is likely to have implications for Jersey's financial sector and therefore its overall economy.

Rating Action

On Jan. 25, 2019, S&P Global Ratings affirmed its long- and short-term sovereign credit ratings on the States of Jersey at 'AA-/A-1+'. The outlook is negative.

Outlook

The negative outlook reflects our view that the risks for the ratings on Jersey remain tilted to the downside. External policy uncertainties--including those associated with the slower-than-anticipated progress of the Brexit negotiations and a potential policy shift in the U.K.--could make it difficult for Jersey to set appropriate policies in response.

We could lower the ratings over the next 18 months if we consider that Jersey's institutions are less able to respond to risks arising from shifts in the external policy environment, such that it could damage economic performance. We could also lower the ratings if general government liquid assets fall below 100% of GDP.

The ratings could stabilize over the next 18 months if uncertainties related to Jersey's external policy environment subside, and its financial sector and the broader economy remain resilient. Enhanced transparency through greater availability of statistical data could also support the ratings.

Rationale

Our ratings on Jersey continue to reflect our view of the island's strong and flexible institutions, wealthy economy, and considerable fiscal buffers. These strengths are offset by our expectation of medium-term economic stagnation, the external risks to both Jersey's economy and its policymaking framework, and its lack of meaningful monetary flexibility.

Institutional and Economic Profile: Brexit uncertainties will test policy responsiveness and weigh on growth prospects

- We believe a disorderly Brexit could weigh on the effectiveness of Jersey's institutions and on its economic growth prospects.
- As a small jurisdiction, Jersey remains vulnerable to events that could hurt its reputation as a finance center.
- We expect economic stagnation over 2020-2022 as Jersey's financial sector adjusts to new arrangements after Brexit.

Jersey is a small, wealthy economy with a workforce of slightly over 60,000 people and GDP per capita estimated about $57,700 in 2018. The financial services sector dominates the economy, directly contributing 41% of Jersey's gross value added (GVA), and nearly 22% of employment. Although diversification has mildly increased since 2008, the economy remains concentrated in the financial sector--a key growth driver and the main source of export revenues. The downturn in Jersey's financial industry was the main contributor to its shrinking economy in 2009-2012, while the expansion of the fund and trust industries in 2014-2015 was the key component of the island's economic recovery.

Jersey, as one of three British Crown Dependencies, has a right to self-determination. The island has its own representation and is treated as a third country (non-EU counterparty) in the context of most EU regulations. It has access to the single market in goods (but not services) through Protocol 3 of the U.K.'s accession agreement.

As a third country, Jersey chooses to demonstrate comparability of regulation to another EU member in order to access the EU service markets. The European Securities and Markets Authority has advised that no significant obstacles exist for EU passporting rights to be extended to Jersey-based investment funds, although the introduction of such passports is likely to be delayed for all third countries as the EU considers changes to the regime.

We understand that Jersey is undertaking extensive measures to secure a favorable relationship with the EU, while strengthening its relationship with the U.K. For instance, in November 2018, together with the other Crown dependencies, Jersey and the U.K. signed a new arrangement to establish a customs union between the two after the U.K.'s departure from the EU. However, it is our view that Jersey will remain exposed to changes in the external policy environment as the U.K.'s influence on European policymaking diminishes after Brexit. We also believe that Jersey will likely be exposed to supply-side disruptions in the event of a disorderly Brexit, due to the U.K.'s less favorable access to the EU.

Even in an orderly Brexit scenario, we believe Jersey will remain vulnerable to changes in the U.K.'s immigration policies. Jersey's goods exports to the EU are limited; nevertheless, we note that it would be bound by the U.K.'s external tariffs and by its immigration restrictions on EU nationals, which currently represent nearly a quarter of its workforce. Furthermore, political uncertainty in the U.K. and risks associated with Brexit could test the policy responsiveness in Jersey. In our view, Jersey's stable and predictable institutions are key to the attractiveness of its economic model.

As a small economy with a heavy focus on the financial sector, we think Jersey is vulnerable to single-event reputational risk. For instance, the Paradise Papers leak in 2017 thrust the island into the spotlight when it was discovered that an Apple subsidiary had become a tax resident in Jersey, despite its business activities remaining in Ireland. Notwithstanding the leaks, no illegal activities were found and Jersey was not placed on the list of 17 countries blacklisted by the Economic and Financial Affairs Council.

Jersey aims to be an early implementer of international tax standards. Its financial transparency and anti-money-laundering provisions are consistent with global regulatory requirements. The Organization for Economic Co-operation and Development assessed Jersey's tax transparency and considers it to be fully compliant with all 10 elements reviewed.

Jersey continues to rely on its financial sector, which is vital to its economy. The composition of Jersey's financial sector has changed considerably over the past decade; job losses in banking have been offset by growth in trust administration services, which has significantly lower productivity. As a result, GVA per full-time employee has stabilized at about £130,000-£140,000 over 2012-2017, a third below its peak of about £191,000 in 2007. Nonetheless, the banking sector remains significant and still accounts for more than half of the sector's GVA.

U.K. bank ring-fencing rules came into force from January 2019 and will primarily affect the four largest U.K. banking groups. Jersey and other Crown dependencies will be outside the ring-fence (unlike deposits within the European Economic Area). Even though ring-fencing will reduce the fungibility of resources within affected banking groups, banks may still find upstreaming attractive as a source of funding for their non-ring-fenced operations. We note that bank deposits were broadly stable in 2017-2018 after declining in 2016. The rules could also bring opportunities for Jersey, as some banks select the island as a center in which to consolidate their non-ring-fenced activities. The recent implementation of the Bank (Recovery and Resolution) (Jersey) Law 2017 will allow the island's authorities to restrict upstreaming activities in times of stress.

We factor in 1.5% real GDP growth in 2019, strengthening from 0.4% in 2017 when a contraction in the financial sector weighed on overall growth. Through 2020-2022, we expect the economy will stagnate. Even though Jersey is already a third county to the EU, we anticipate that the U.K financial sector's less favorable access to the EU following Brexit, will likely 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, which may decline if global banks diversify their European operations away from London.

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

- Significant fiscal assets, estimated about 130% of GDP as of the end of 2018, and low debt remain key rating strengths.
- Lack of external statistics reduces our visibility on Jersey's exposure to external risks.
- Lack of monetary flexibility remains a rating weakness.

We regard Jersey's liquid fiscal assets, estimated at about 130% of GDP at the end of 2018, 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. The portfolios are invested in various asset classes around the globe and do not have a U.K. bias.

We see Jersey as having a healthy overall fiscal position. 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, which, in our view, provide sufficient comparability with other rated sovereigns. We anticipate Jersey's government finances will remain close to balance through 2022.

Jersey does not issue debt to fund deficits. Instead, it draws on financial assets if deficits occur. That said, Jersey does occasionally issue debt to finance large-scale capital projects. For instance, a new general hospital is planned at a cost of £450 million (about 10% of estimated 2018 GVA), will likely be partly funded via £275 million of fresh debt. We estimate gross general government debt at year-end 2018 represented only 5.4% of GDP. Even with the issuance of fresh debt for the proposed hospital, we estimate gross general government debt levels will remain low at about 10% of GDP.

In our view, Jersey's lack of monetary policy flexibility constrains the ratings. We treat the Jersey pound as equivalent to the British pound. The Jersey pound circulates 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 Jersey's monetary policy flexibility because its 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, which 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 lag.

Key Statistics

Table 1

States of Jersey Key Statistics

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Economic indicators (%)										
Nominal GDP (bil. LC)	4	4	4	4	4	5	5	5	5	5
Nominal GDP (bil. $)	6	7	6	6	6	6	6	7	8	8
GDP per capita (000s $)	58.6	65.1	61.2	54.8	53.4	57.8	59.0	64.7	68.2	69.5
Real GDP growth	(0.2)	4.9	2.2	1.2	0.4	1.6	1.5	0.0	0.0	0.0
Real GDP per capita growth	(1.2)	3.9	0.5	(0.3)	(0.8)	0.4	0.3	(1.2)	(1.2)	(1.2)
Real investment growth	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Investment/GDP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Savings/GDP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Exports/GDP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Real exports growth	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Unemployment rate	5.7	4.6	4.0	3.7	3.6	3.5	3.5	3.5	3.5	3.5
External indicators (%)										
Current account balance/GDP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Current account balance/CARs	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
CARs/GDP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Trade balance/GDP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Net FDI/GDP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Net portfolio equity inflow/GDP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Gross external financing needs/CARs plus usable reserves	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Narrow net external debt/CARs	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Table 1

States of Jersey Key Statistics (cont.)										
	2013	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Narrow net external debt/CAPs	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Net external liabilities/CARs	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Net external liabilities/CAPs	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Short-term external debt by remaining maturity/CARs	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Usable reserves/CAPs (months)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Usable reserves (mil. $)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Fiscal indicators (general government; %)										
Balance/GDP	(0.8)	(1.9)	(1.0)	(0.5)	(0.5)	(0.4)	(0.3)	(0.1)	0.1	0.2
Change in net debt/GDP	(19.7)	(8.8)	(6.8)	(13.2)	(12.1)	(6.4)	(0.9)	(7.1)	(7.4)	(7.7)
Primary balance/GDP	(0.8)	(1.8)	(0.8)	(0.3)	(0.3)	(0.2)	(0.1)	0.2	0.4	0.5
Revenue/GDP	24.0	22.9	23.7	25.8	25.7	25.5	25.5	25.0	25.0	25.0
Expenditures/GDP	24.8	24.8	24.7	26.3	26.2	25.9	25.8	25.1	24.9	24.8
Interest/revenues	0.0	0.5	1.0	0.9	0.8	0.8	0.6	1.3	1.3	1.2
Debt/GDP	0.0	6.3	6.1	5.9	5.7	5.4	10.8	10.4	9.8	9.4
Debt/revenues	0.0	27.3	25.7	22.9	22.2	21.2	42.5	41.5	39.4	37.5
Net debt/GDP	(106.1)	(108.3)	(112.1)	(122.2)	(130.1)	(129.5)	(124.8)	(128.6)	(131.6)	(135.4)
Liquid assets/GDP	106.1	114.6	118.2	128.2	135.8	134.9	135.6	139.0	141.4	144.8
Monetary indicators (%)										
CPI growth	1.5	1.6	0.6	1.6	3.2	4.0	3.0	2.7	3.6	3.0
GDP deflator growth	1.5	1.6	0.6	1.6	3.2	4.0	3.0	2.7	3.6	3.0
Exchange rate, year-end (LC/$)	0.61	0.64	0.67	0.81	0.74	0.79	0.72	0.69	0.68	0.68
Banks' claims on resident non-gov't sector growth	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Banks' claims on resident non-gov't sector/GDP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Foreign currency share of claims by banks on residents	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Real effective exchange rate growth	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

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. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments.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	
Institutional assessment	2
Economic assessment	2
External assessment	4
Fiscal assessment: flexibility and performance	1
Fiscal assessment: debt burden	2
Monetary assessment	5

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

- Global Sovereign Rating Trends 2019, Jan. 14, 2019
- Sovereign Risk Indicators, Dec. 13, 2018; a free interactive version is available at http://www.spratings.com/sri
- Sovereign Ratings History, Jan. 7, 2019
- Sovereign Ratings List, Jan. 7, 2019
- Sovereign Ratings Score Snapshot, Jan. 7, 2019
- Research Update: Ratings On The United Kingdom Affirmed At 'AA/A-1+'; Outlook Remains Negative, Oct. 26, 2018
- Default, Transition, and Recovery: 2017 Annual Sovereign Default Study And Rating Transitions, May 8, 2018
- Sovereign Debt 2018: Global Borrowing To Remain Steady at US$7.4 Trillion,

Feb. 22, 2018

- Everyone Passed: Stress Test Results Reflect Strengthening U.K. Bank Balance Sheets, Nov. 29, 2017

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

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

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm

(46) 8-440-5914; or Moscow 7 (495) 783-4009.