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International outlook can present Jersey with opportunities

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Twelve months ago we started the year with Europe once again in crisis mode, thanks to the election of an anti-austerity government in Greece. Yet Europe stood resilient – a referendum and another election in Greece weren't enough to derail what remains a modest but resilient euro area growth recovery. On the other side of the Atlantic, the Federal Reserve contemplated raising interest rates for much of last year.

While this was put on the backburner at its September meeting thanks to the global financial market repercussions of China's currency devaluation, the delay proved only temporary – the financial disruption did not stop the Fed three months later finally starting the process of monetary normalisation. Oil prices fell further in the second half of 2015, bad news for producing countries such as Russia (which remains mired in recession) but good news for net consumers of oil like the G7. In the UK, headline inflation has been close to zero for much of the past year as a result of falling energy prices, the Bank of England once again leaving interest rates on hold for the entire year.

What about the outlook for the year ahead? Given the uncertainties of recent years it is important we approach economic forecasting with a considerable degree of humility. First, let's consider the euro zone. We cannot yet describe the response to Europe's crisis as "mission complete", though the authorities have come a long way over the past few years to improving Europe's lot.

A combination of collapsing energy prices, action by the European Central Bank (ECB) to lower interest rates and continue with its quantitative easing programme, and a much improved banking sector/credit provision should help underscore the recovery in mainland Europe. We expect growth of around 1.5% this year – this may not sound like much, but it is a good outcome

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for the euro area relative to past form. Inflation remains well below target, but as long as we do not slip into deflation this may not be a bad thing, allowing the ECB to retain its remarkably stimulatory policies to keep the recovery alive. Still, if our generally upbeat forecasts are right then there may yet be talk of asset purchase tapering before the year is out.

In the US, the Fed tells us that it is intent on raising rates a further 1 percentage point this year, twice that expected by the financial markets. The recovery in US growth has been stronger than that of many of its competitors, but relative to the aftermath of previous recessions what we've seen so far is not so impressive. Thus it seems reasonable that the Fed should undertake the process of normalising policy in a careful, considered, and gradual manner. Even with rates 1% higher by the end of 2016, policy would remain very loose by historical standards – particularly with quantitative easing still in the system. For US households who are used to borrowing money at long tenures the rise in interest rates this year may not pose such a big problem. But it may cause more sizable fallout elsewhere around the globe.

Even before the Fed raised rates in December, emerging markets were growing at their slowest pace in over a decade (outside of the financial crisis) and the recovery we expect in 2016 is primarily the result of fading recessions in Russia and Brazil rather than a broad-based recovery across EM. Higher interest rates in the US and an appreciating dollar might even help by putting downward pressure on EM currencies, but that in turn would also imply a flow of capital away from emerging markets. In short, the days of cheap EM funding might be coming to an end.

Emerging market troubles are also home-grown. China's structural reforms – to make the economy more consumer/market focused – must be lauded, but any resultant benefits are more likely to be seen over a longer horizon. As a result, we now think that Chinese economic growth will remain sub-7% in the near-term, with the risks skewed to the downside. Weaker growth in China is more impactful now than ever before, with output worth between a fifth and a sixth of global production (in purchasing power parity terms). And China's recent decision to change the way it manages its exchange rate, in generating bouts of global fear and volatile financial markets, may end up risking the global recovery outlined in this article.

So where does all of this leave the UK? Growth has slowed of late but is expected to run at a decent clip this year of around 2.5%. Inflation too is expected to turn upwards thanks to base effects (the prices of energy and food are falling at a slower rate than a year ago) but more fundamentally a narrowing output gap. That combination may yet be sufficient for the Bank of England to begin raising rates this year – though recent comments from the Bank's Governor once again suggest a delay in the first hike. With UK households highly geared to short-term

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interest rates; high levels of house prices and household debt must be taken into account when considering the speed and timing of policy normalisation.

Household debt is not the only sizable risk on the horizon for the UK. Much of the growth we have seen in recent years has been consumer driven. While that is not necessarily unusual (after all, consumer spending represents the lion's share of spending within GDP) it is not healthy for economies to be overly dependent on one particular source of growth. Government spending is unlikely to come to the rescue with such significant austerity planned, while the combination of a fragile global economy and strong exchange rate (sterling up nearly 15% during the past three years against a basket of other currencies despite recent declines) could limit exports/boost imports.

One of the biggest tests the UK faces over the coming year relates to the referendum on EU membership. Not only are the polls tight, but whatever the outcome of the vote it seems likely that overseas investors in the UK may delay – or worse *divert* elsewhere – their capital spending in the meantime. Of course the vote may not happen until next year; much will depend on what Mr Cameron is able to broker with the European Union in the way of concessions in the coming months.

Andreas Tautscher, CEO, Deutsche Bank Channel Islands

As an international finance centre, Jersey will inevitably be impacted by global macro trends and developments in overseas markets, particularly as firms continue to diversify and extend their geographical reach.

Within that international landscape, regulatory shifts will continue to have a significant say on how firms and wealthy investors operate and this could provide opportunities as well as challenges for Jersey.

With the OECD's Common Reporting Standard and US FATCA now operational, firms are finding that there is a real interplay between economic success and regulatory compliance. In addition, the implementation of MIFID II and Basel III looks set to place further pressure on firms with a European connection on both market access as well as liquidity requirements. The reporting requirements under these various regimes are likely to put real pressures on firms both in understanding how to deal with them as well as implementing the process and systems required.

However, these regulatory developments could present firms in Jersey with something of an opportunity in positioning themselves as compliance, reporting and governance specialists. The

jurisdiction has been on the front foot in addressing international regulatory shifts, including maintaining its programme of international cooperation, rolling out a test platform for FATCA reporting in advance of its launch, and providing firms with comprehensive guidance surrounding CRS reporting, and this can all place Jersey in a commanding position.

In addition, firms in Jersey have made numerous commitments to innovate their service offering and invest heavily in addressing the regulatory and compliance requirements, to manage the increasingly complex regulatory changes and handle more bespoke structures in the investment and wealth management sectors.

UK

Meanwhile, the fate of the UK economy is also set to be a major factor for Jersey's success this year. Jersey continues to be seen as a valuable partner in managing transactions by London lawyers and advisors, as research undertaken by Capital Economics ('Jersey's Value to the UK', 2013) was able to highlight. It found that Jersey is a conduit into London for £1/2 trillion of foreign investment, representing around 5% of the entire stock of UK foreign owned assets.

In particular, Jersey has in recent years seen a spike in real estate investment business, supporting overseas financial institutions and corporate clients with their commercial and residential property investment structuring into the UK. Figures collated by the Jersey Financial Services Commission show that the value of real estate funds being serviced through Jersey maintain an upward trajectory, rising year-on-year by 16% (September 2015).

A buoyant UK property market in 2016 will be good news for Jersey. This should be tempered, however, by adopting a realistic approach as to whether this buoyancy is sustainable. Pressures on affordability and political measures relating to 'non-doms' may dampen the London market and herald a slowdown in property investment structuring. However it remains to be seen whether either of these factors will impact the investors who are not looking to reside in London.

At the same time, the UK's fortunes in 2016 look set to be defined by a key referendum on EU membership. Uncertainty as to the outcome may cause overseas investors to delay their decisions or divert their attentions elsewhere and this will have an impact, albeit temporary, on business flows for Jersey firms too.

Middle East

Finally, developments in the Middle East, a region that has become increasingly important not just as a source of private wealth business but increasingly for cross-border alternative investment fund structuring too, will be important for Jersey in 2016.

Ongoing instability in countries right across the Middle East may heighten the need amongst high net worth individuals and families and institutions in the region for a robust, professional jurisdiction to manage their affairs.

This instability is prompting Middle East investors to diversify their wealth and investment strategies too. As investors look to other markets and sectors, in particular the alternative investment space, this will play to Jersey's strengths and give firms operating in cross-border structuring some significant opportunities.

Overall, given Jersey's proactive approach to overseas markets, it is in a good position to take advantage of the economic and regulatory opportunities global developments are presenting this year.

Ends.

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