

# London's Economy Today



Issue 23 | July 2004

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## Growth – Onwards and upwards?

by Christopher Lewis

**Gordon Brown, the Chancellor of the Exchequer, announced the Government's Spending Review 2004 on Monday 12 July. Spending Review 2004 sets out the allocation of public spending over the three-year period of 2005/06 to 2007/08.**

As expected the growth in public spending over these three years is set to be slower than we have seen in recent years. This month's supplement (page 8) provides an overview of Spending Review 2004 and draws out the areas that are most likely to be of relevance to London. In addition, it touches on some of the more detailed proposals made by departments after the Review, including the Department for Transport's statement on Crossrail which set out plans to begin the legislative steps for Crossrail to be built.

### London's recovery continues

London's economy is continuing to recover. There is strong growth in the number of passengers using London airports, which suggests that tourism activity will increase this summer. London's new orders and business activity figures continue to be encouraging. The Purchasing Managers' Index (PMI) measure of new orders for London firms continues to expand strongly at 58.0 in June (this is significantly above 50, which is the level consistent with no change on the previous month). The PMI measure of business activity in London rose to 57.2 in June (from 57.0 in May). The gradual recovery in tube passenger numbers has also continued and the average rate of growth in bus passenger numbers remains strong.

GLAECONOMICS

## Latest news...

### New publication online

GLA Economics has just published an *Appraisal of the Department for Transport's Guidance on Preparing an Economic Impact Report*. For a copy of this or any GLA Economics publication, please contact 020 7983 4922 or visit [www.london.gov.uk/mayor/economic\\_unit](http://www.london.gov.uk/mayor/economic_unit).

### Capital Impact Seminar Invite

Mark your diaries for Wednesday 28 July, 2:00 - 5:30 pm, City Hall – GLA Economics are hosting a free half-day seminar, *Capital Impact – London and the international economy*. The seminar will examine London's interaction with the UK, ways to estimate London's trade, developments in some of the world's large emerging economies and methods for comparing London to other world cities. RSVP by this Friday 23 July 2004 by phoning 020 7983 4922 or emailing [glaeconomics@london.gov.uk](mailto:glaeconomics@london.gov.uk).

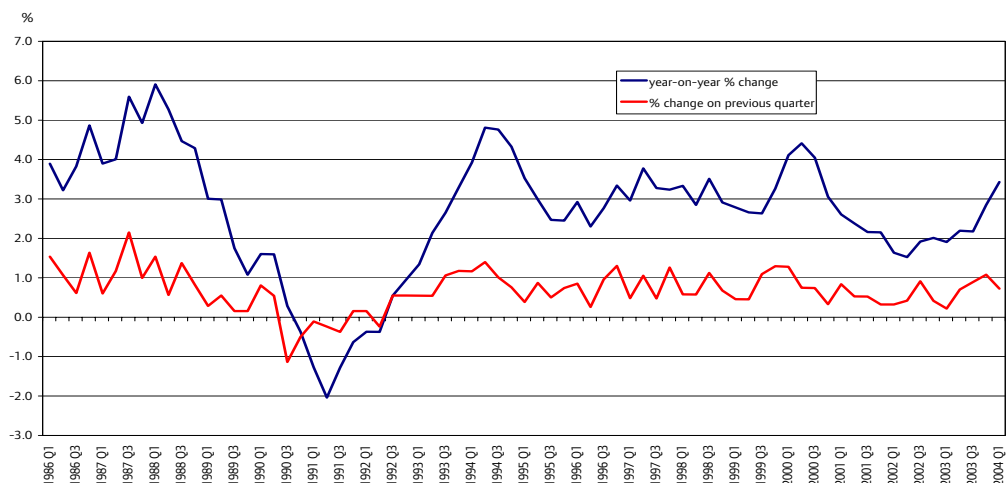
The financial sector plays a key role in London's economy and recent UK survey data suggests that this sector is experiencing an ongoing recovery. The latest Chartered Institute of Purchasing and Supply report on services found that financial services companies were experiencing strong growth. The quarterly financial services survey published by the Confederation of British Industry and PricewaterhouseCoopers showed that building societies, banks and insurers are hiring staff at the fastest rate in 15 years in their branches and their UK call centres. This has been driven by the strongest growth in business volumes since December 1999. However, the survey indicated that optimism about the future is now declining among building societies, general insurers, fund managers and securities traders, so it is possible that the growth in activity in the financial services sector is peaking.

### UK economic growth revised upwards

The UK economy grew faster in the first quarter of 2004 than was previously estimated. As Chart 1 shows, Gross Domestic Product (GDP) rose by 0.7 per cent in Q1 with year-on-year growth revised upwards to 3.4 per cent (the fastest rate since Q3 2000). Manufacturing output rose strongly for the second consecutive month during May taking the annual rate of output growth to two per cent, the highest since October 2003, suggesting that GDP in Q2 will rise even faster than in Q1. Government figures also show that in the last financial year Britain was the top investment location in Europe for overseas firms, particularly for research, software, electronics, pharmaceuticals, financial services and call centres.

Chart 1. UK GDP Growth

Source: ONS



Despite the UK economy's current robustness, risks to consumers remain with the Bank of England's *Financial Stability Review* warning that 'the UK household sector debt-to-income ratio has continued to rise rapidly, increasing households' vulnerability to any unexpected rises in interest rates or falls in income' and that 'prospects for house prices are highly uncertain and, after the strength of house price inflation in recent years, the chances of a fall have risen'.

### The global economic recovery stabilises

The US Federal Reserve has raised US interest rates by a quarter of a percentage point to 1.25 per cent in a sign that it is more confident about the US economy. The reason given for the rise was that the US economy was now growing at a solid pace with an improving jobs market allowing for a measured tightening of the current high level of monetary policy stimulus. US consumer confidence has reached a two-year high alongside higher profitability and productivity. Retail

sales, however, did fall in June but the annual growth figure was still above six per cent. Meanwhile, Japanese firms now see the brightest prospects for their country's economy since the slump in the early 1990s with the important *Tankan Survey* rising to its highest level in June 2004 since August 1991.

The European Commission has announced that economic growth in the eurozone is set to improve on its 1.7 per cent forecast for 2004. In a quarterly report it stated that solid world trade, a weakening euro and better consumer demand were all improving the outlook. However, despite breaking out of its long stagnation, consumer demand remains fragile and the European Commission's economic affairs chief, Joaquin Almunia, warned that a resurgence in oil prices risked inflicting serious damage.

Oil prices have risen over the last month but have not reached the levels seen at the beginning of June. The recent upturn in oil prices has been caused by further concerns about supply disruptions, especially in the Middle East, and strong global demand led by the US. Looking forward, the monthly oil outlook report of the Energy Information Administration, the forecasting arm of the US Energy Department, stated that 'the chances of even a gradual, sustained decline in crude oil prices through 2005, as previously projected, seem to have diminished'.

#### **Future prospects**

Healthy growth has continued in the London, UK and world economies with future prospects for the rest of 2004 looking strong. The economic recovery in the eurozone now seems to be strengthening, however it is still extremely reliant on increasing world demand. A productivity study by the European Central Bank has calculated that between 1996 and 2003 real gross domestic capita increased by 1.6 per cent a year in the euro area compared with 2.2 per cent in the US. This led the European Central Bank to comment that rapid and forceful implementation of the European Union's liberalisation plans were now even more urgent. Without domestic structural reforms the eurozone is likely to be more vulnerable than the UK to any future world slowdown. Closer to home, the London economy continues to recover with business activity and new orders indicators remaining robust.

# Economic indicators

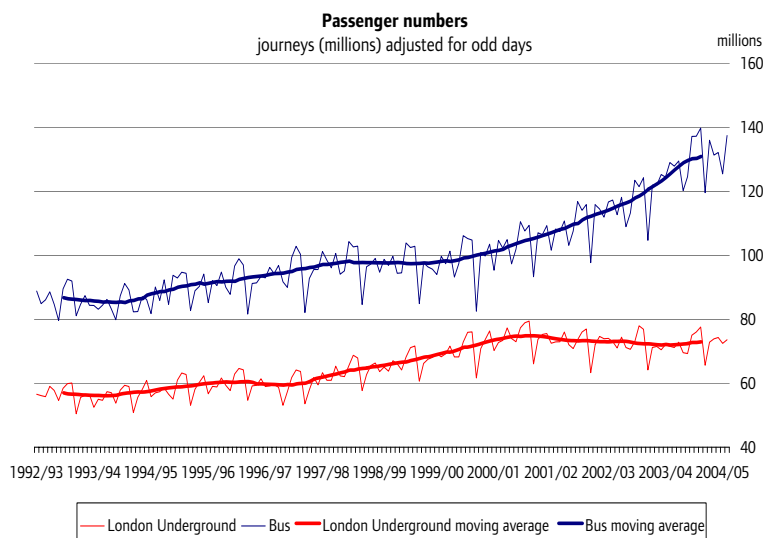
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## Passenger numbers grow

- The sustained growth in the number of passenger journeys is continuing.
- In the most recent 28-day period there were 211 million passenger journeys on London's public transport – 137 million by bus and 74 million by Underground.
- The moving average is now 203 million passenger journeys each period – the average for buses rose to 131 million and the average for the Underground increased to 72 million.

Latest release: 06/07/04

Next release: August 2004



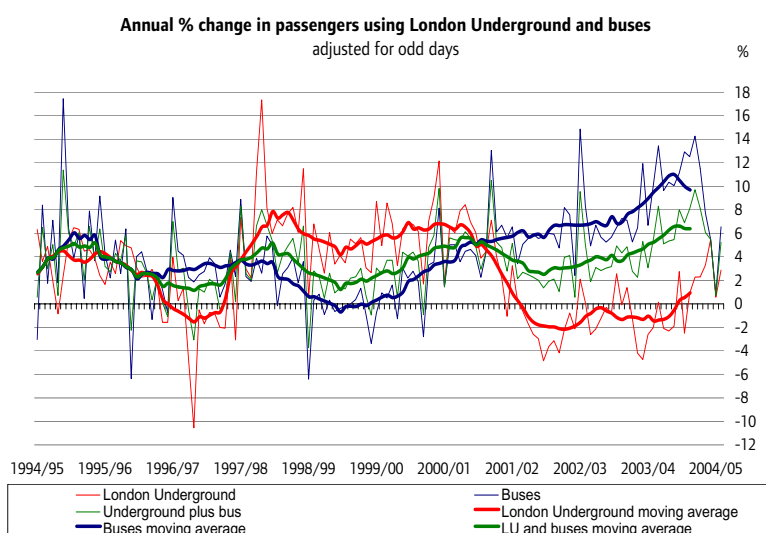
Source: Transport for London

## Tube use recovering

- The average annual rate of growth in passenger journeys has decreased slightly to 6.3%.
- The average annual rate of growth in the number of bus journeys has slowed but is still at high levels, just below 10%.
- There is a gradual recovery in Underground passenger numbers. The average annual rate of growth is now 0.9%, its third period of positive growth.

Latest release: 06/07/04

Next release: August 2004



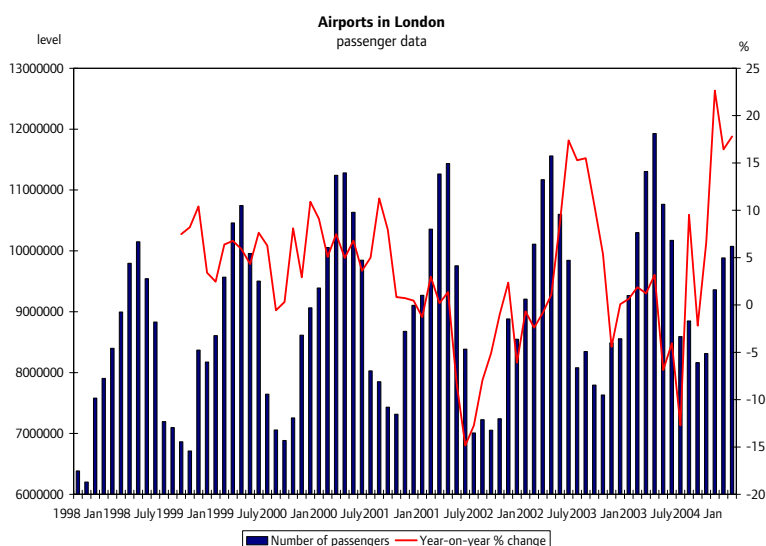
Source: Transport for London

## Record May for London airport passenger numbers

- The number of passengers using London's airports was 18% higher in May 2004 than in May 2003.
- More than ten million passengers travelled through London's airports in May 2004 – the highest May total on record.

Latest release: 06/07/04

Next release: August 2004



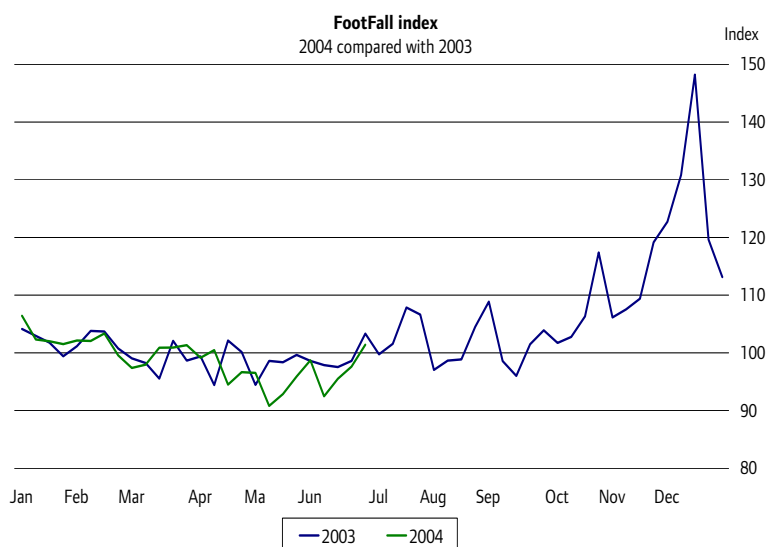
Source: Civil Aviation Authority

## Rise in the number of shoppers

- The FootFall index made a strong recovery in mid-June after a dip at the beginning of the month.
- The current level of the index is comparable with the same time last year.
- The FootFall index measures the number of shoppers but does not necessarily reflect the level of spending.

Latest release: 28/06/04

Next release: Every week



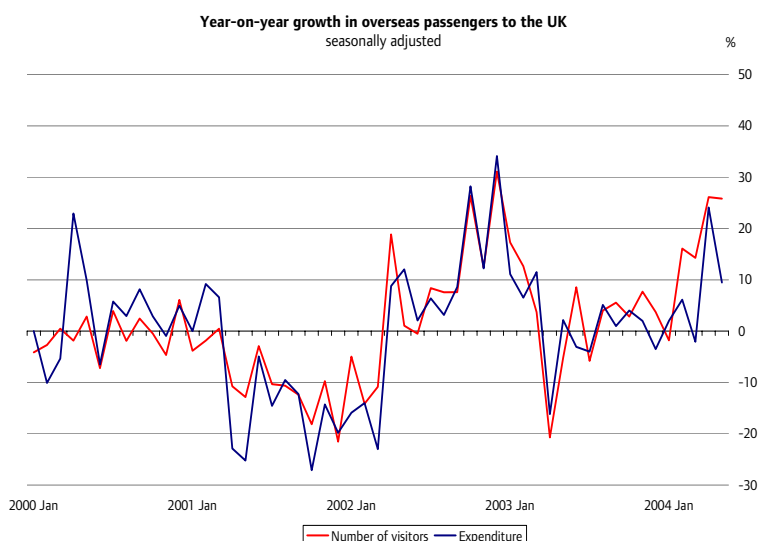
Source: FootFall Ltd.

## Tourism activity remains strong

- The annual growth of overseas visitors to the UK remained high at 26% in May 2004 continuing the 26% achieved in April.
- The year-on-year growth in expenditure by overseas visitors retreated but remained relatively high, growing by 9.5% between May 2003 and May 2004.

Latest release: 07/07/04

Next release: 06/08/04



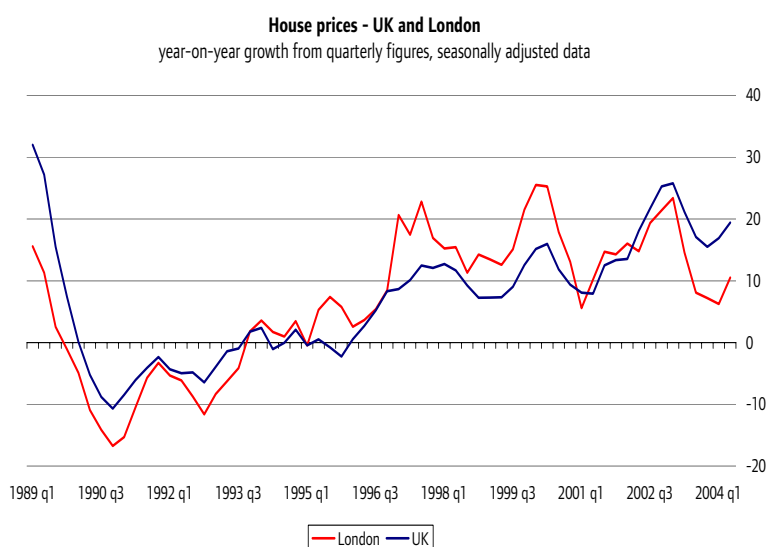
Source: ONS

## London's housing market remains robust

- House prices, as calculated by the Nationwide, showed an increasing rate of growth in Q2 2004 in London and across the UK.
- Annual house price growth in London increased to 10.5% in Q2 2004 from 6.3% in Q1. This was the highest rate since Q2 2003.
- Annual house price growth for the UK increased to 19.4% in Q2 2004 from 16.9% in Q1.

Latest release: July 2004

Next release: October 2004



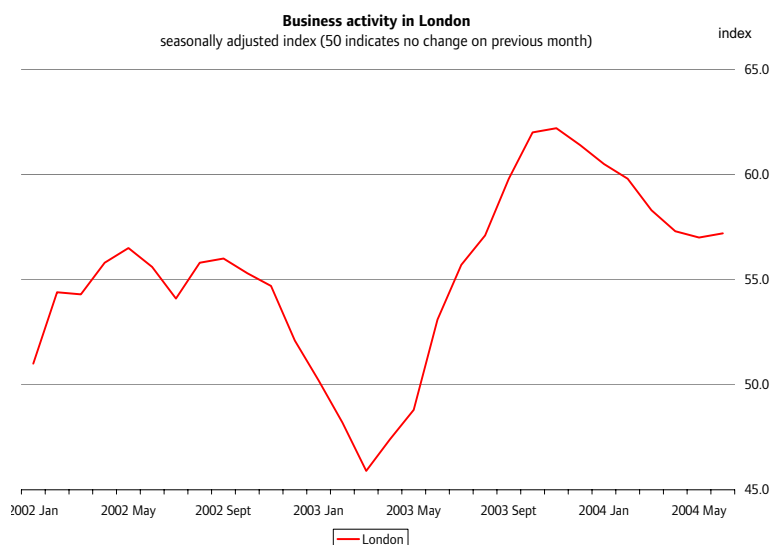
Source: Nationwide

## London's business activity strengthens

- London firms expanded their output of goods and services in June. The Purchasing Managers' Index (PMI) of business activity recorded 57.2 in June 2004. This compares with 53.1 in June 2003 and 55.6 in June 2002.
- A rate above 50 on the index indicates an increase in business activity from the previous month.

Latest release: 12/07/04

Next release: August 2004

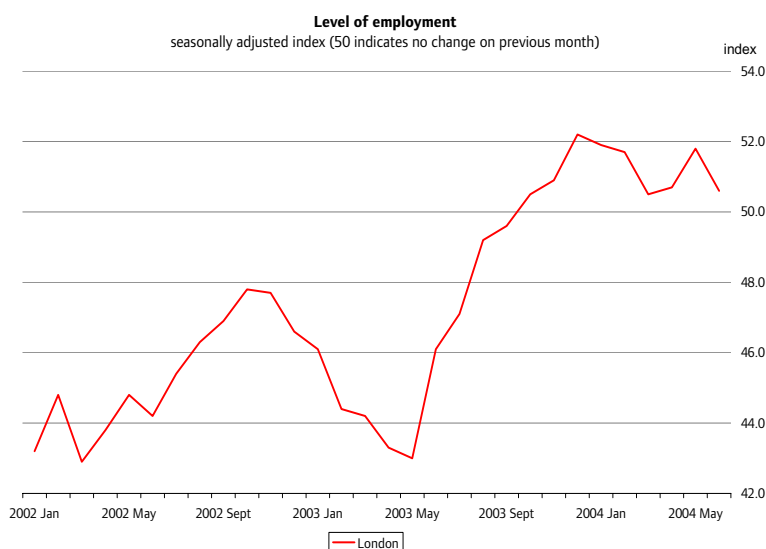


## Employment still expanding

- London firms have increased their level of employment. The PMI for the level of employment was 50.6 in June 2004, compared to 46.1 in June 2003 and 44.2 in June 2002.
- A rate above 50 on the index indicates an increase in the level of employment from the previous month.

Latest release: 12/07/04

Next release: August 2004

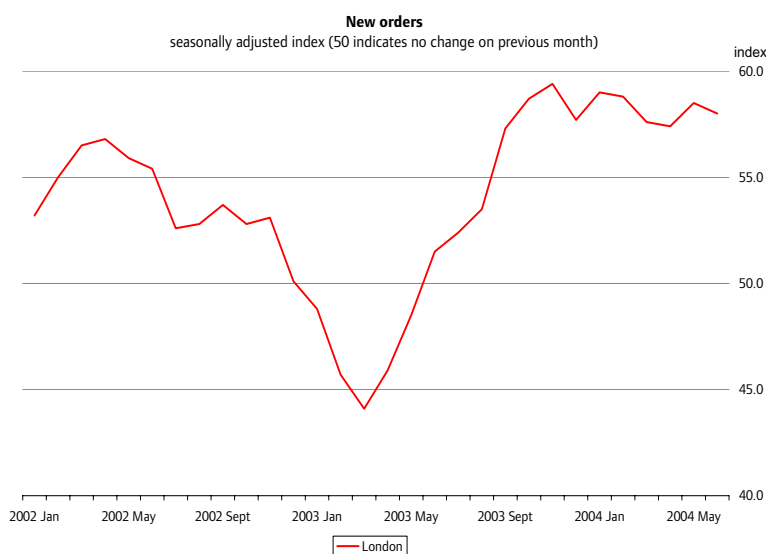


## New orders remain strong

- New orders for London firms continued to expand in June. The PMI for new orders was 58.0 in June 2004, compared to 51.5 in June 2003 and 55.4 in June 2002.
- A rate above 50 on the index indicates an increase in new orders from the previous month.

Latest release: 12/07/04

Next release: August 2004



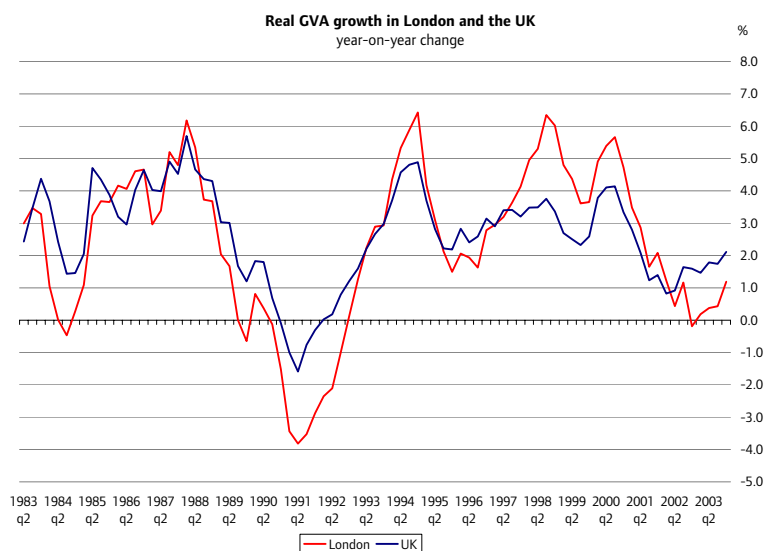


## London GVA growth slower than UK's

- Despite improving, London's GVA growth is slower than the UK's.
- Latest revised GDP figures show a firm recovery in the UK economy. The revised figures show that the UK's GDP rose by 0.7% in Q1 2004 with year-on-year growth at 3.4% (not shown in the chart).

Latest release: May 2004

Next release: July - August 2004



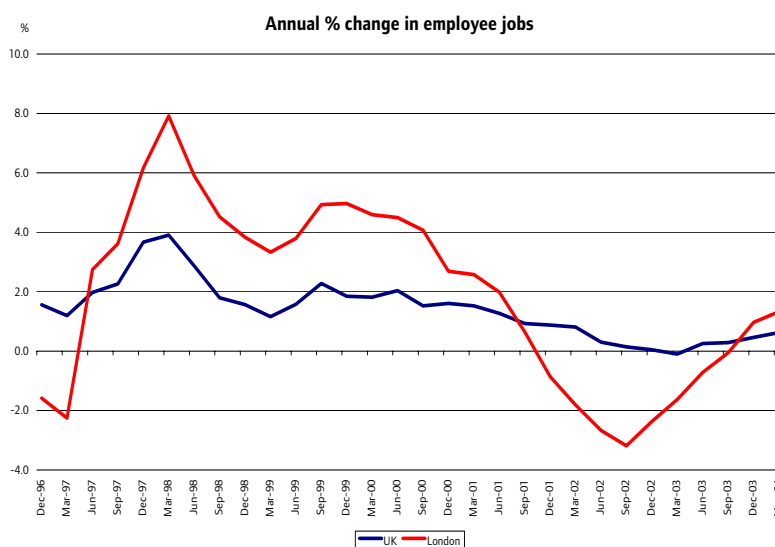
Source: ONS and Experian Business Strategies

## London's employment growth stronger than UK's

- The Short Term Employer Survey shows that London's year-on-year employment growth continues to recover.
- London's employment growth is currently faster than the UK's.
- Historically, London's employment growth rate fluctuates more than the UK's rate.

Latest release: July 2004

Next release: October 2004



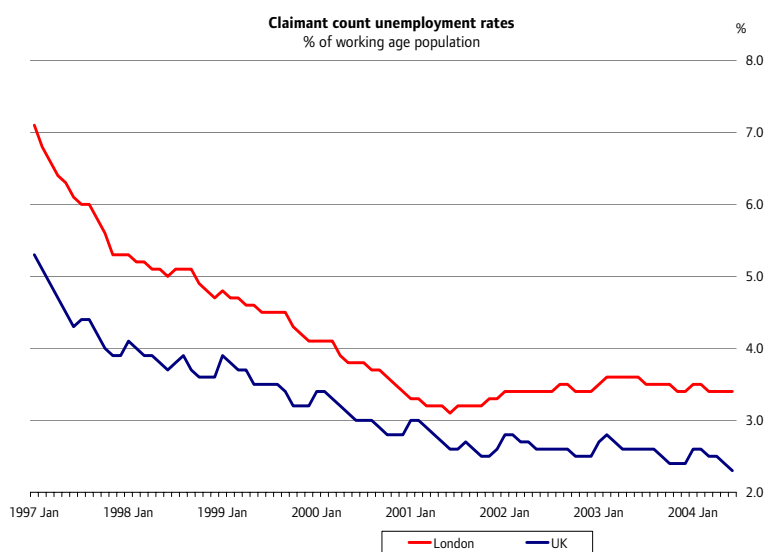
Short Term Employer Survey, Nomis

## Unemployment rate remains low

- The rate of claimant count unemployment (as a % of working age residents) in June remained at 3.4% for the third consecutive month in London.
- There were 164,000 unemployed claimants in London in June 2004, compared with 174,000 in June 2003.
- Claimant count unemployment in the UK fell slightly to 2.3% in June 2004 from 2.4% in May.

Latest release: July 2004

Next release: August 2004



Source: Claimant Count, Nomis

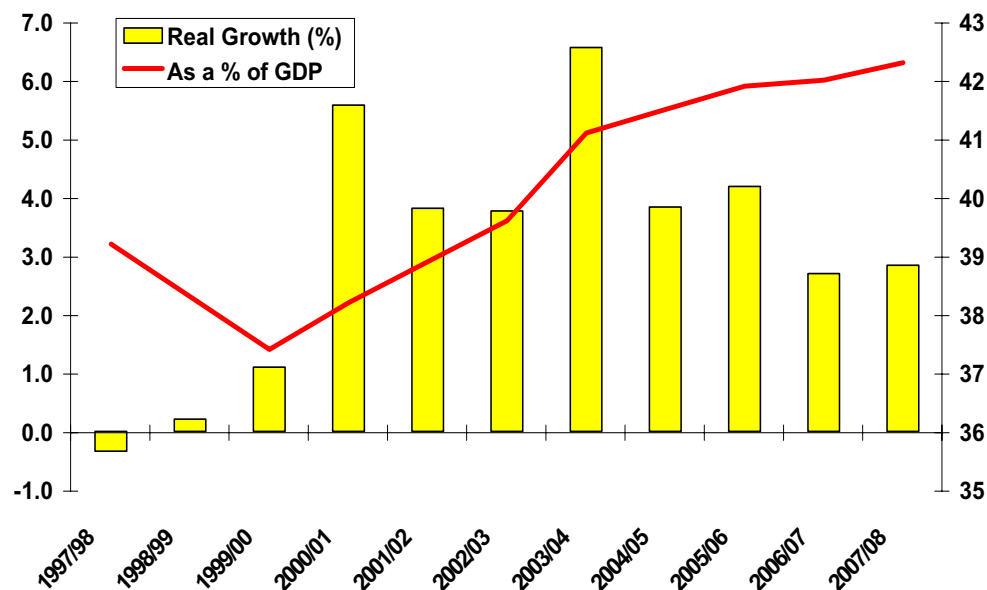
# The Spending Review reviewed

by Duncan Melville and  
Matthew Waite,  
Senior Economists

Last week's Spending Review 2004 (SR2004) announced by the Chancellor of the Exchequer, Gordon Brown, allocated public spending over the three-year period of 2005/06 to 2007/08. As Chart 2 shows, public spending in these three years should grow less than in recent years and that public spending as a proportion of GDP will only rise by a modest amount in contrast with the rapid growth between 1999/00 and 2003/04.

**Chart 2. Public spending:  
Growth and as a  
% of GDP**

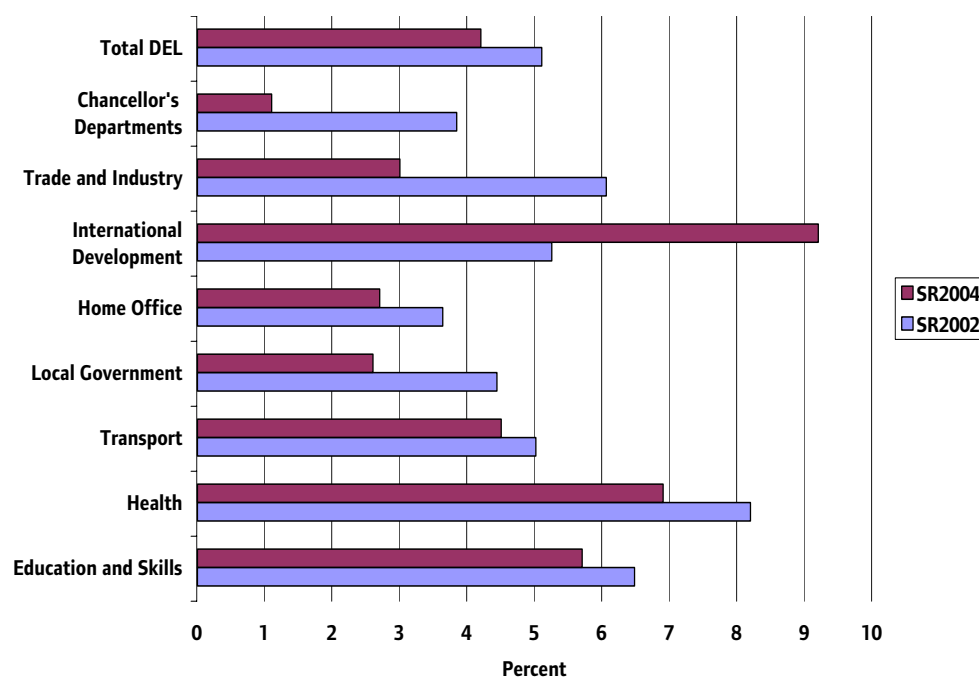
Source: HM Treasury and  
GLA Economics



The picture of a tight SR2004 in comparison with SR2000 and SR2002, can be seen by comparing the spending allocations made to government departments. Chart 3<sup>1</sup> compares SR2002 and SR2004 for selected departments.

**Chart 3. Growth in public  
expenditure (DEL)<sup>1</sup> in  
SR2002 and SR2004**

Source: HM Treasury and  
GLA Economics



(Footnote)

<sup>1</sup>This chart shows a comparison for Department Expenditure Limits (DEL) only. Total public spending is made up of DEL and Annually Managed Expenditure (AME). DEL is set for three years in the Government's spending reviews while AME is, as its name suggests, set annually and includes essentially demand driven expenditure such as spending on welfare benefits.



The big winner from SR2004 is the Department of International Development as the Government increases its focus on reducing global poverty. However, the Chancellor is following his own prescriptions at home with a large reduction in spending growth in the Chancellor's Departments.

With lower public spending growth planned to 2007/08, the Chancellor has sought to ensure that 'frontline services' have more money by cutting back on administration costs and making other efficiency savings. After allowing for the redeployment of staff to frontline jobs, the Chancellor announced that there would be a reduction of 90,000 jobs throughout central government, the devolved administrations and local government. Furthermore, 20,000 posts are to move from London to the South East by 2010. However, there must be doubt over whether these job reduction plans will be achieved. The Institute for Fiscal Studies (IFS) has shown that civil service employment has exceeded HM Treasury plans in every annual public spending projection since May 1999.

These job cuts are part of a wider pledge to cut administration costs across central government departments by six per cent in real terms between 2005/06 and 2006/07. Chart 4 shows the IFS's estimates of actual administrative expenditure and Treasury projections made since 1995<sup>2</sup>. The large fall in the Treasury's projection for administrative costs between April and July 2004 can be explained by their reclassification of £5 billion of Home Office administration costs into other legal departments as 'frontline' expenditure.

**Chart 4. Administrative spendings actual and projections**

Source: IFS

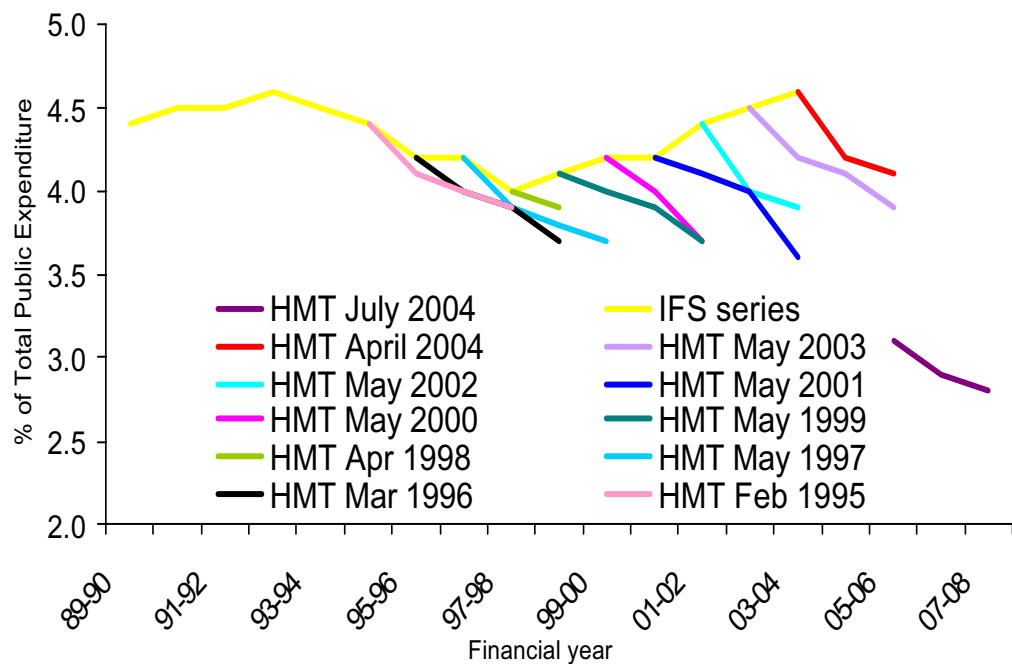


Chart 4 shows that projected reductions in administrative expenditure by the Treasury have consistently failed to materialise. Although these administrative savings appear difficult to deliver, they are only one part of the Chancellor's ambition for improved cost effectiveness in the public sector. Based on the review by Sir Peter Gershon, the Chancellor announced that he expects total annual efficiency savings of more than 2.5 per cent a year to produce annual efficiencies of £21.5 billion by 2007/08.

(Footnote)

<sup>2</sup>The Treasury does not publish estimates of administrative expenditure on a comparable basis over time. Hence the IFS have constructed their own estimates. The details of their methods are available at: [http://www.ifs.org.uk/gbfiles/sr2004/sr2004\\_notes.pdf](http://www.ifs.org.uk/gbfiles/sr2004/sr2004_notes.pdf)

However not all of these efficiencies will, if achieved, directly release money for frontline services. According to Sir Peter, 'over 60 per cent' will come from such savings while the remainder will apparently come from the public service doing more with existing resources. These are perhaps the efficiencies that are least likely to materialise as their basis is rather unclear. For example, the Department for Education and Skills (DfES) expects to achieve efficiency savings of around £1.25 billion from 'frontline professionals in schools, colleges and higher education institutions' using 'their time more productively' and so 'enabling institutions to achieve more with their resources'.

In short, it seems unlikely that efficiency savings will meet the Chancellor's expectation of £21.5 billion so the reduction in the growth of public spending in SR2004 is still likely to mean lower growth in expenditure on 'frontline' public services.

## London and SR2004

As part of SR2004 the GLA published *The Case for London*<sup>3</sup> to provide an analysis of why London requires greater public investment and spending. The GLA, in co-operation with the Government Office for London and London Development Agency (LDA), also produced the shorter *Regional Emphasis Document* that each region was invited to submit to the Treasury as part of SR2004. On Wednesday 21 July, the Treasury provided a response to the general issues raised in the *Regional Emphasis Documents*. In this article, we have drawn out the areas of SR2004 that are most likely to be of relevance to London. As yet we have few details of the geographical split of the spending as few departments have made statements on how they propose to distribute their spending allocations.

### Transport

In SR2004 the Transport budget was increased from £10.4 billion in 2004/05 to £12.8 billion in 2007/08, equating to an average annual growth rate of 4.5 per cent in real terms. Of this £2.4 billion increase, £200 million has been set aside for the Thames Gateway Bridge. In addition, further to SR2004, the Secretary of State for Transport, Alistair Darling, confirmed that the case for a Crossrail link across London is clear and will get stronger as London continues to grow. The Secretary of State for Transport set out plans to introduce a hybrid bill at the earliest opportunity to take the powers necessary for Crossrail to be built. However, the Secretary of State for Transport highlighted that funding Crossrail remained a challenge and that the Government will need to work with the Mayor of London and the London business community to find a funding solution where everyone pays their fair share of the cost. Furthermore, the Secretary of State for Transport provided a boost to London's Olympic bid by announcing an additional £340 million of Government funding while also announcing Government support for Transport for London's (TfL) prudential borrowing plans of a further £2.9 billion for the period up to 2009/10. While welcome, prudential borrowing is available for capital spend only, not revenue spend requirements, and the costs of servicing prudential borrowing will add to future liabilities.

(Footnote)

<sup>3</sup> To see a copy, please visit [http://www.london.gov.uk/mayor/case\\_for\\_london/index.jsp](http://www.london.gov.uk/mayor/case_for_london/index.jsp)

The Department for Transport (DfT) has also set out plans to restructure the railway industry. These plans involve increasing the Mayor of London's influence on rail services within the GLA boundary. In the short term, the DfT will work with the Mayor of London on proposals to rationalise fare structures and ticketing technology across different types of public transport in London, in particular making TfL's Oyster smartcard fully available across the whole London public transport network. The DfT also propose to explore options for giving an increased role to the Mayor of London on services that are entirely, or almost entirely, within the GLA boundary.

The plans propose that the Mayor of London should be able to buy additional services or propose savings with TfL paying any additional costs (or recouping any savings). Consideration will also be given as to whether there should be scope for TfL, among other things, to have a greater role in relation to new or self-contained infrastructure. In this instance, in order to ensure that the overall costs of the railway are controlled, the Mayor of London would have a budget to cover the cost of rail services. This would also allow TfL to prioritise spending on rail, and between rail and other public transport modes, to ensure the best overall value for money.

Greater influence over rail services in London should help provide a more co-ordinated, complementary system of public transport for London, given TfL's existing responsibility for the Underground and buses.

### Children

SR2004 provides an increase of £769 million from 2004/05 to 2007/08 to help the Sure Start Unit further support childcare and services for disadvantaged children. This represents an additional £100 million on the £669 million increase announced in the 2004 Budget. This will deliver 2,500 Children's Centres by 2008, which exceeds the Government's previous commitment of 1,700. The previous target was to have a Children's Centre in the 20 per cent of wards in England that are the most disadvantaged. The increase is consistent with expanding the programme to the 30 per cent of wards that are most disadvantaged, although this aim is not explicitly stated in SR2004 and the measures used to determine the most disadvantaged wards have been revised since the Sure Start programme was established. SR2004 also projects that there will be at least 120,000 new childcare places by 2008. This is especially important for London which has the highest rate of child poverty in Britain and where the employment rate for women with dependent children is more than ten percentage points below the national average (whereas the employment rates for women without dependent children in London and the UK are similar).

### Housing

As a result of SR2004, spending on housing – including regional and local programmes – will be £1.3 billion higher in 2007/08 than in 2004/05, equivalent to an annual average growth rate of 4.1 per cent in real terms. This provides for a 50 per cent increase in new social housing building (equivalent to an extra 10,000 homes a year). SR2004 also provides for increased housing supply and improved affordability by funding the Sustainable Communities Plan to deliver 200,000 additional homes in the Thames Gateway and other growth

areas<sup>4</sup>. As recommended by the Barker Review, this growth will be supported by a new Community Infrastructure Fund of £150 million by 2007/08.

Such measures should particularly benefit London which, because of its growing economy and population, has seen an increased demand for housing that has not been matched by an adequate increase in supply.

### **Safety and security**

SR2004 has allocated additional resources of over £1 billion by 2007/08 to enable departments to strengthen the UK's counter terrorism and resilience capabilities. This spending includes additional funding for, amongst others, the expansion of counter-terrorism activities and the Security and Intelligence Agencies. Given London's status as a likely terrorist target in the UK, a significant proportion of this extra spending may well be focused on London. Further to SR2004, the Home Secretary announced more detailed plans this week that include pursuing a neighbourhood approach to policing, involving the recruitment of 20,000 more community support officers. It is not yet clear how these plans will affect London where the Step Change programme, launched last year, involved an increase in neighbourhood policing.

### **London Development Agency**

SR2004 maintained funding for Regional Development Agencies (RDAs) in real terms and devolved new responsibilities to the RDAs from departments with a transfer of around £200 million a year from 2005/06. Amongst others, the new responsibilities include the delivery of Business Link services from April 2005, the delivery of research and development grants and an enhanced role in supporting business-university collaboration.

### **Conclusion**

As widely anticipated, the growth in public spending in SR2004 is less than was seen in SR2002. The Chancellor is seeking to make up for this via widespread efficiencies and therefore achieve more 'bang for your buck'. However his efficiency programme is ambitious and there is a significant risk that these efficiencies will not be achieved in practice. The details of the geographical distribution of public spending have yet to be announced fully so it is difficult to know the extent to which London's public services will benefit. However there have been welcome announcements that seem likely to benefit London, notably regional devolution of transport policy in London and the expansion of Children's Centres to help combat child poverty.

(Footnote)

<sup>4</sup> Milton Keynes/South Midlands, Ashford and London-Stansted-Cambridge.

## Data sources

<b>Tube and bus ridership</b>	Transport for London on 020 7941 4500
<b>GDP/GVA growth</b>	Experian Business Strategies on 020 7630 5959
<b>Tourism – overseas visitors</b>	<a href="http://www.statistics.gov.uk">www.statistics.gov.uk</a>
<b>Tourism – domestic visitors</b>	<a href="http://www.visitlondon.com">www.visitlondon.com</a>
<b>London airports</b>	<a href="http://www.caa.co.uk">www.caa.co.uk</a>
<b>Business activity</b>	<a href="http://www.rbs.co.uk/pmireports">www.rbs.co.uk/pmireports</a>
<b>Employment</b>	<a href="http://www.rbs.co.uk/pmireports">www.rbs.co.uk/pmireports</a>
<b>London FootFall</b>	<a href="http://www.footfall.com">www.footfall.com</a>
<b>Office space demand</b>	<a href="http://www.cbhillierparker.com">www.cbhillierparker.com</a>
<b>House prices</b>	<a href="http://www.nationwide.co.uk/hpi/">www.nationwide.co.uk/hpi/</a>
<b>Unemployment rates</b>	<a href="http://www.statistics.gov.uk">www.statistics.gov.uk</a>

## Glossary

### Civilian workforce jobs

Measures jobs at the workplace rather than where workers live. This indicator captures total employment in the London economy, including commuters.

### Claimant count rate

Unemployment rate based on the number of people claiming unemployment benefits.

### Employee jobs

Civilian jobs, including employees paid by employers running a PAYE scheme. Government employees and people on training schemes are included if they have a contract of employment. Armed forces are excluded.

### FootFall Index

Measures the average number of people passing through London shopping centres on a weekly basis. This index is positively correlated with UK retail spending so it can provide an indication of consumer spending in London.

### Gross domestic product (GDP)

A measure of the total economic activity in the economy.

### Gross value added (GVA)

Used in the estimation of GDP. The link between GVA and GDP is that GVA plus taxes on products minus subsidies on products is equal to GDP.

### ILO unemployment rate

The International Labour Organisation's calculation of the number of people out of work.

### Tube ridership

Transport for London's measure of the number of passengers using London Underground in a given period. There are 13 periods in a year – twelve 28-day periods and one 29-day period. Period 1 starts at the beginning of the financial year rather than the calendar year.

## Acronyms

<b>ABI</b>	Annual Business Inquiry	<b>IMF</b>	International Monetary Fund
<b>BAA</b>	British Airports Authority	<b>LCCI</b>	London Chamber of Commerce and Industry
<b>BCC</b>	British Chamber of Commerce	<b>LET</b>	London's Economy Today
<b>BITOA</b>	British Incoming Tour Operators Association	<b>MPC</b>	Monetary Policy Committee
<b>CAA</b>	Civil Aviation Authority	<b>ODPM</b>	Office of the Deputy Prime Minister
<b>CBI</b>	Confederation of British Industry	<b>ONS</b>	Office of National Statistics
<b>EBS</b>	Experian Business Strategies	<b>PMI</b>	Purchasing Managers' Index
<b>GDP</b>	Gross domestic product	<b>PWC</b>	PricewaterhouseCoopers
<b>GVA</b>	Gross value added	<b>RICS</b>	Royal Institute of Chartered Surveyors
<b>ILO</b>	International Labour Organisation		

## Past features

### Issue

- 1 A future Gulf war – the potential economic impact on London
- 2 Forecasts for the London economy: a comparison of independent forecasts and a GLA Economics view
- 3 Public sector finance and recession
- 4 The risk of recession in London
- 5 Emerging trends in employment in London, 2000/01
- 6 Recent developments in UK and London's business investment
- 7 Response to claims that congestion charging is holding back London's economic recovery  
Transport trends for London
- 8 Contribution of open green spaces to London's economy  
Why are Londoners spending more than the average Briton?
- 9 Tourism and the London economy
- 10 The UK and Economic and Monetary Union
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GLA Economics provides expert advice and analysis on London's economy and the economic issues facing the capital. Data and analysis from GLA Economics provide a sound basis for the policy and investment decisions facing the Mayor of London and the GLA group. The unit was set up in May 2002.

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