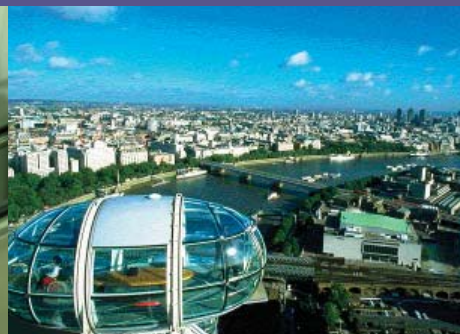


London's Economy Today



Issue 45 | May 2006

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Interest rates across the world set to rise further

By Christopher Lewis
Senior Economist, GLA Economics

Last spring, 'A Fairer London: The Living Wage in London' was published which considered the issue of a living wage in the capital. Earlier this month, the annual update of this report was published. This issue's supplement 'The London living wage in 2006', by Leticia Vereute-McKay and Alan Freeman, examines how the living wage has been calculated and explains what has changed since 2005 to produce the calculated rise in the living wage.

London's economy continues to expand and is currently outperforming the rest of the UK. In April, the Purchasing Managers' Index (PMI) measures of seasonally adjusted business activity, new orders and the level of employment for London were above that of all other regions. All three indices for London improved in April and were well above 50, which is the level consistent with no change on the previous month. At 61.5 and 61.3 the seasonally adjusted business activity and new orders indices are at their highest levels since November 2003 and January 2005 respectively.

GLAECONOMICS

Latest news...

GLA Economics is holding its seminar about 'Worklessness' on Wednesday 28 June 2006. If you would like further information on this event, please email glaeconomics@london.gov.uk.

Get your copies of GLA Economics' latest publications:

- London's Economic Outlook - Spring 2006
- A Fairer London: The Living Wage in London - May 2006

For your copies of the above publications, visit www.london.gov.uk/mayor/economic_unit/ or call +44 (0)20 7983 4922.

The latest CBI/KPMG London Business Survey has revealed that a shortage of skilled staff is now the biggest barrier to business in the capital, overtaking concerns with the transport network for the first time. The survey shows that firms in the property, professional services and transport sectors have been worst affected by skills shortages. However, London is still seen as a good place to do business with 84 per cent of employers 'optimistic' or 'very optimistic' about the prospects for the next six months. Corporate finance and mergers and acquisition activity is strong at the moment, which is good news for the financial sector within the capital where demand for staff has been healthy. Overall the London economy is doing well with business activity and house prices currently growing faster in the capital than in the rest of the UK. Annual house price growth has been especially strong in the East End, where a positive effect from London winning the Olympic Games and the anticipated improvements in facilities and transport links may well have taken place.

UK manufacturing activity finally shows some initial signs of a recovery

In March, UK manufacturing saw its biggest monthly rise in output since April 2005. Manufacturing output increased by 0.7 per cent compared with February. In Q1 2006 manufacturing activity rose by 0.7 per cent compared to Q4 2005, but still remained 0.6 per cent lower than in Q1 2005. Evidence of a recent upturn in UK manufacturing activity has been supported by a recent Chartered Institute of Purchasing Managers' (CIPS) survey. The CIPS manufacturing output index in April rose to its highest level since November 2004. New orders also grew due to a pick up in domestic demand and a lift in export orders. Meanwhile the UK service sector continues to expand at a relatively strong pace. The overall outlook for the UK economy during the rest of 2006 is for steady growth with inflation remaining close to, but potentially just above, its 2 per cent target. The Bank of England's May inflation report indicates that the next change in interest rates is now likely to be a small upward movement over the next year or so. However, any interest rate change is not expected within the next few months.

Buoyed by London, the UK housing market continues to be stronger than most commentators expected at the beginning of the year. In April 2006, seasonally adjusted UK house prices, as measured by the Halifax, rose by 2.0 per cent with the annual rate of house price inflation at its highest since March 2005. The Halifax index shows house prices in the three months to April 8.0 per cent higher than a year earlier compared with a 6.2 per cent rate in the three months to March. In comparison, the Nationwide measure recorded annual house price inflation of 4.8 per cent in April. In the second half of the year higher council tax and utility bills alongside the high house price to earnings ratio is expected to moderate annual UK house price inflation.

The UK stock market has suffered losses over the last month. Having gone above 6100 for the first time since early 2001 the FTSE 100 fell back by around 10 per cent over concerns that interest rates across the world will rise further and that the recent increases in stock values have been too rapid. Despite the fall the FTSE 100 is still around levels seen at the start of the year (5600) and considerably above May 2005 levels of just below 5000. Throughout the world stock markets are nervous at the moment with volatile trading. However, they are likely to stabilise once the full correction to recently overheated stock prices

takes place and when the recent increase in future expected global interest rates is fully factored into stock market levels.

US interest rates at a five-year high

The US Federal Reserve has raised interest rates to a five-year high of 5 per cent. US growth was extremely strong at the beginning of 2006 but the monetary tightening that started in June 2004 is expected to slow growth to a more sustainable rate in the second half of the year. The depreciation of the dollar over the last month will increase inflationary pressures in the US and make further interest rate rises more likely. Despite rising interest rates US economic data still shows signs of strength. Factory orders had their biggest gain for ten months in March and service activity as well as industrial output remained robust in April. Consumer spending and investment currently drive the economy with the huge current account deficit acting as a drag on growth. The risks to US growth are further rises in interest rates beyond what financial markets are expecting, a potential slump in the housing market and higher oil prices.

Despite falling slightly from recent peaks, oil prices remain around \$70 per barrel as the dispute over Iran's nuclear programme, violence in Iraq and instability in Nigeria continue (see Figure 1). With limited world spare oil production capacity the oil market is especially vulnerable to actual and potential supply disruptions. Demand for oil is also predicted to remain strong so most analysts expect oil prices to stay high over the next couple of years.

Figure 1. Brent crude oil price (\$ per barrel)

Source: FT.com



Despite high oil prices, eurozone growth has continued to pick up slightly, which is likely to prompt the European Central Bank (ECB) to raise interest rates further over the summer. However, consumer spending remains muted and with interest rates on the rise it is not expected to improve dramatically. The European Commission has revised up its estimate for eurozone growth to 2.1 per cent (from 1.9 per cent) in 2006. The eurozone only grew by 1.3 per cent last year.

Japan is also showing further signs of economic recovery. Inflation has remained positive after seven years of general deflation and the unemployment rate is now at its lowest level in eight years. Forecasts for the Chinese economy continue to be upgraded after rapid growth at the beginning of this year. The World Bank now expects Chinese growth to be 9.5 per cent rather than 9.2 per cent in 2006. Pressure on China to let their currency (the Yuan) appreciate further, especially from the US, continues with Chinese foreign exchange reserves reaching a record \$875 billion at the end of March.

Oil still an inflationary cloud on the world economy's horizon

Global growth remains healthy for now with Japan still recovering, the eurozone making small improvements, the US still growing strongly and China powering along. However, oil prices still pose a threat to world growth especially if they rise again. While more expensive energy prices have had a limited effect so far it is possible that further increases could dampen growth and that the effects of past rises have yet to fully pass through to higher inflation. Interest rates continue to rise in the US and with US consumer prices rising faster than expected in April, the speculation is that they will need to rise further to keep inflationary pressures under control. Interest rates are expected to increase in the eurozone over the summer and the next move in UK interest rates also now looks likely to be an upwards one though a period of further stability is probable first. In the last couple of weeks the prospect of higher interest rates across the world has been a trigger to a weakening in global stock markets after their sharp increase since the beginning of the year. Overall, this global monetary tightening and any further negative impact it may have on stock prices, is expected to dampen down the world economy over the next couple of years from its recent buoyant state. Meanwhile, London's economy is currently outperforming the rest of the UK. The capital has solid foundations for future success, even if world economic conditions become more turbulent, but it still needs to overcome potential structural constraints, notably in transport infrastructure and housing.

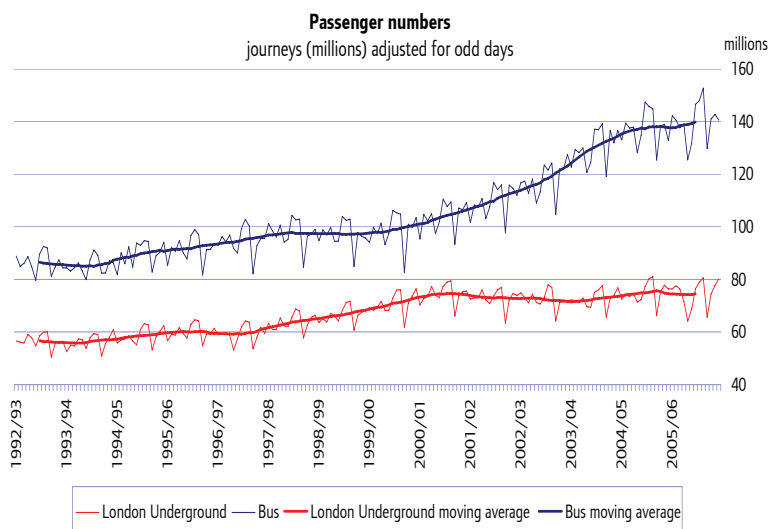
Economic indicators

Increase in the moving average of passenger numbers

- The most recent period had 27 days (from 5 March to 31 March). For this period London's public transport had 215.5 million passenger journeys; 138.2 million by bus and 77.3 million by Underground.
- The moving average increased to 214.4 million from 213.5 million passengers every period.
- The moving average for buses was 139.9 million passenger journeys. The moving average for the Underground was 74.5 million.

Latest release: May 2006

Next release: June 2006



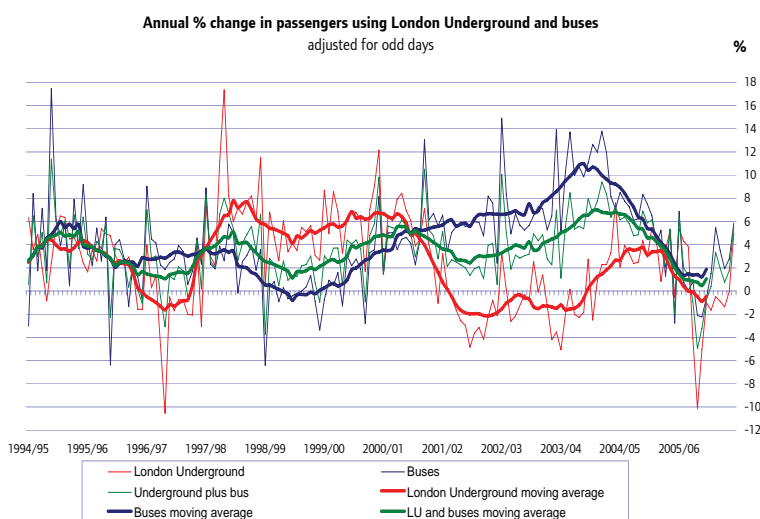
Source: Transport for London

Small increase in the annual growth rate of passenger journeys

- The moving average annual rate of growth in passenger journeys increased to 1.1% from 0.5% in the previous period.
- The moving average annual rate of growth in bus journey numbers increased to 1.9% from 1.2% in the previous period.
- The moving average annual rate of growth in Underground passenger journey numbers increased to -0.4% from -0.9% in the previous period.

Latest release: May 2006

Next release: June 2006



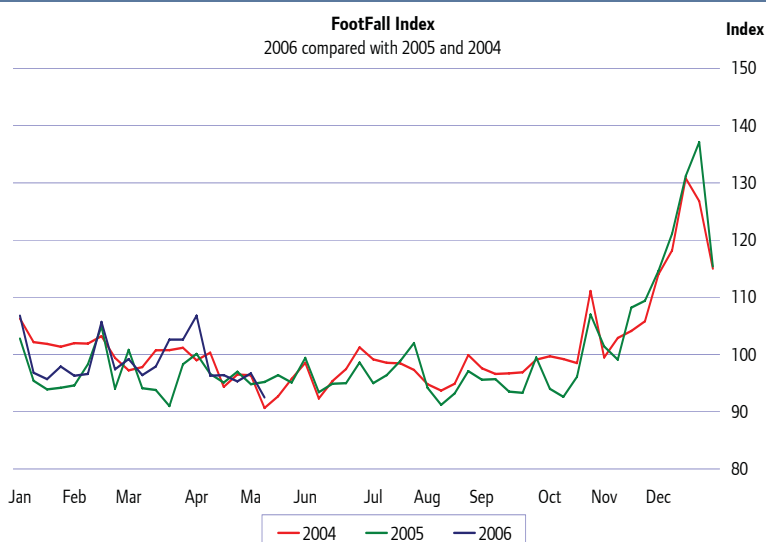
Source: Transport for London

Shopper numbers currently following similar trends as in 2004 and 2005

- The Footfall Index of shoppers in London was 92.5 in the second week of May compared to 96.7 in the first week.
- Since the second week of April 2006, the index has shown similar trends to the number of shoppers for 2004 and 2005 over the same period.
- The FootFall Index measures the number of shoppers and does not necessarily reflect the level of spending.

Latest release: mid-May

Next release: every week



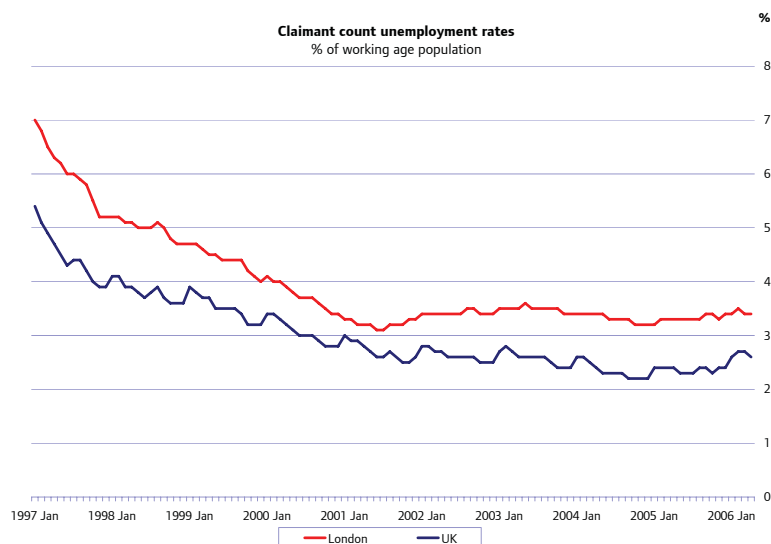
Source: FootFall Limited

Claimant count unemployment

- The rate of claimant count unemployment, people unemployed and claiming Jobseeker's Allowance, in London was 3.4% in April 2006.
- In April 2006 there were 170,400 unemployment claimants in London compared with 164,800 in April 2005.
- The claimant count unemployment rate in the UK remains below that of London's.

Latest release: May 2006

Next release: June 2006



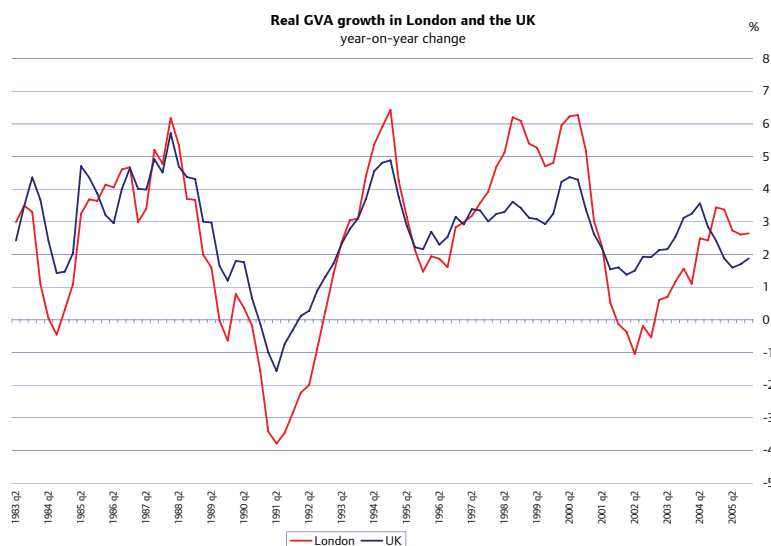
Source: Claimant Count, Nomis

London's economy continues to grow faster than the UK's

- London's annual growth in output was 2.6% in Q4 2005, stable from a revised 2.6% in Q3 2005.
- The UK's annual growth in output was 1.9% in Q4 2005, up from 1.7% in Q3 2005.
- There have been revisions to previous growth rates to reflect the availability of new data. The most significant difference is that London has been growing stronger than initially anticipated over the last year.

Latest release: May 2006

Next release: August 2006



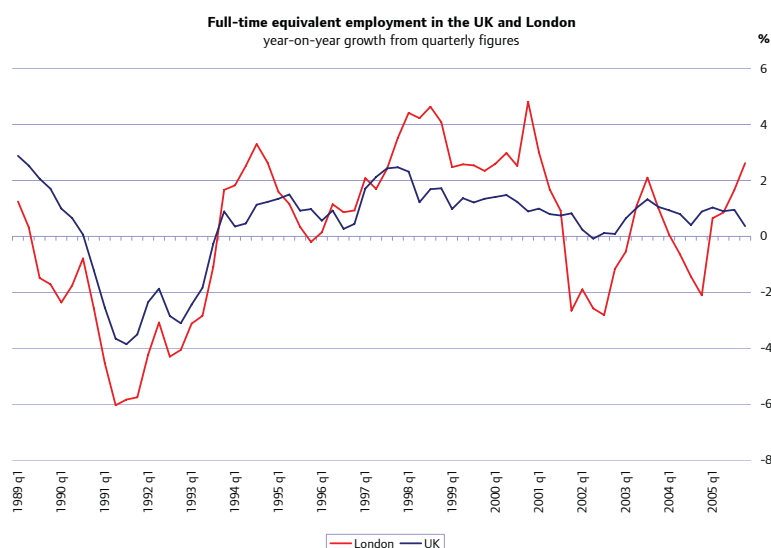
Source: Experian Business Strategies

London's employment growth remains stronger than in the UK

- London's year-on-year employment growth has increased to 2.6% in Q4 2005 compared to revised employment growth of 1.7% in Q3 2005.
- Annual employment growth in the UK decreased to 0.4% in Q4 2005 compared to revised employment growth of 1.0% in Q3 2005.
- There have been revisions to previous growth rates to reflect the availability of new data.

Latest release: May 2006

Next release: August 2006



Source: Experian Business Strategies

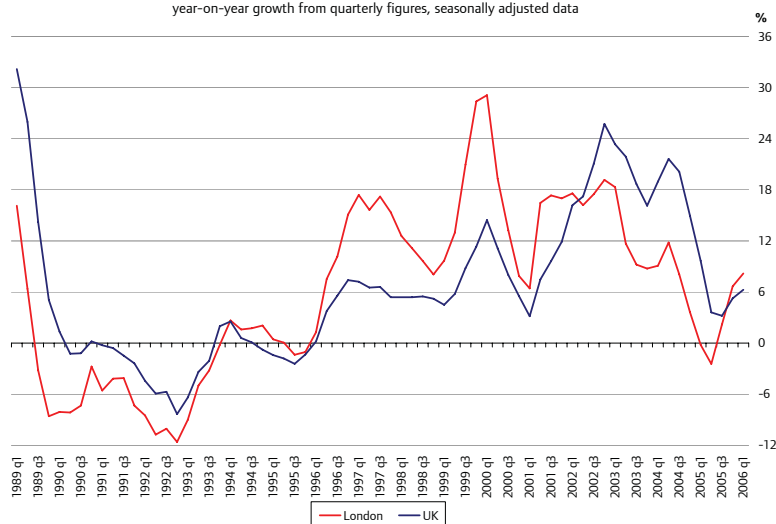
House price growth continued to gather pace at the beginning of 2006

- Annual house price growth, as measured by the Halifax Bank of Scotland, increased in Q1 2006 in both London and the UK.
- Annual house price growth in London increased to 8.2% in Q1 2006 from 6.7% in Q4 2005. Annual house price growth in the UK increased to 6.3% in Q1 2006 from 5.3% in Q4 2005.
- Annual house price growth was higher for London than in the UK for the second consecutive quarter.

Latest release: April 2006

Next release: July 2006

House prices, UK and London
year-on-year growth from quarterly figures, seasonally adjusted data



Source: HBoS

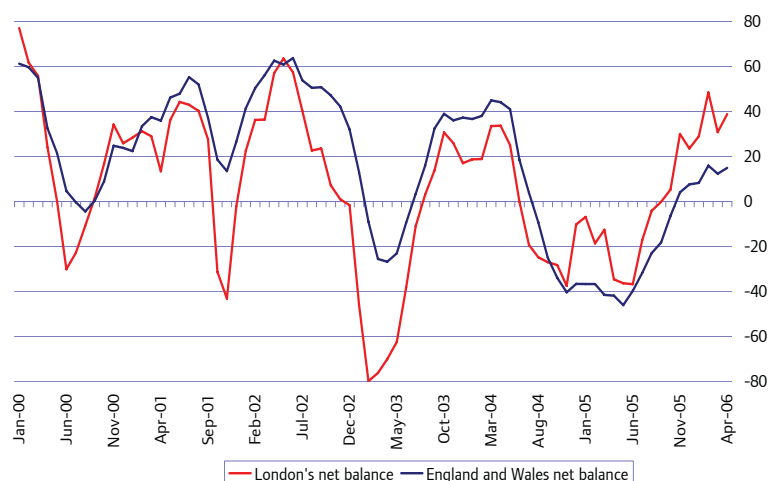
Surveyors continuing to report higher house prices in London

- The RICS survey shows a positive net balance of 39 for London house prices over the past three months up to April 2006.
- Surveyors are also reporting increased house prices in England and Wales with a net balance of 15.
- The net balance for house prices for England and Wales has been positive since November 2005. The net balance for house prices for London has been positive since October 2005.

Latest release: May 2006

Next release: June 2006

RICS housing market survey
net balance in London and in England and Wales; seasonally adjusted data



Source: Royal Institute of Chartered Surveyors

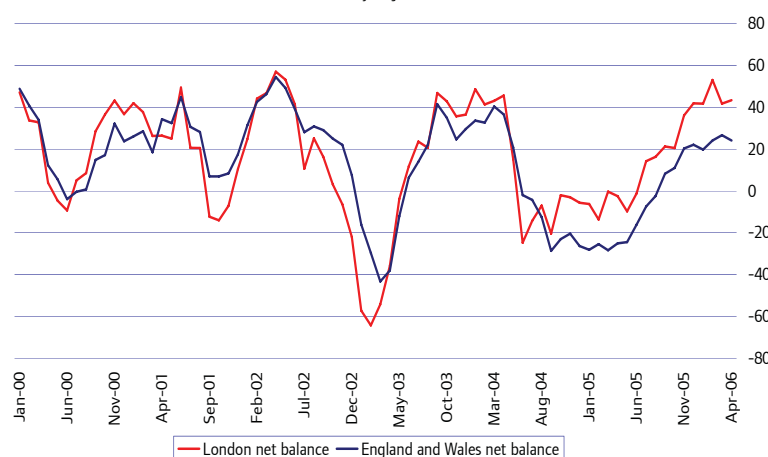
Surveyors expect house price growth over the next three months

- The RICS survey shows that surveyors expect house prices to increase over the next 3 months in London.
- The net expectations balance in London was 43 in April, up slightly from a balance of 42 in March.
- For England and Wales, the net expectations balance was also positive. It was 24 in April down from 27 in March.

Latest release: May 2006

Next release: June 2006

RICS housing market survey
house price expectations; net balance in London, and in England and Wales; seasonally adjusted data



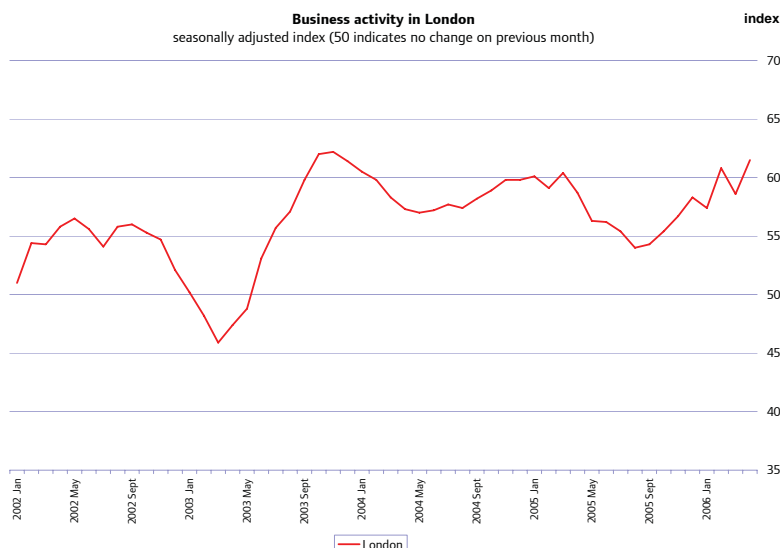
Source: Royal Institute of Chartered Surveyors

Continued expansion in London's business activity

- London firms continued to expand their output of goods and services in April 2006.
- The Purchasing Managers' Index (PMI) of business activity was 61.5 in April 2006 compared to 58.6 in March. The index is at its highest level since November 2003.
- A rate above 50 on the index indicates an increase in business activity from the previous month.

Latest release: May 2006

Next release: June 2006



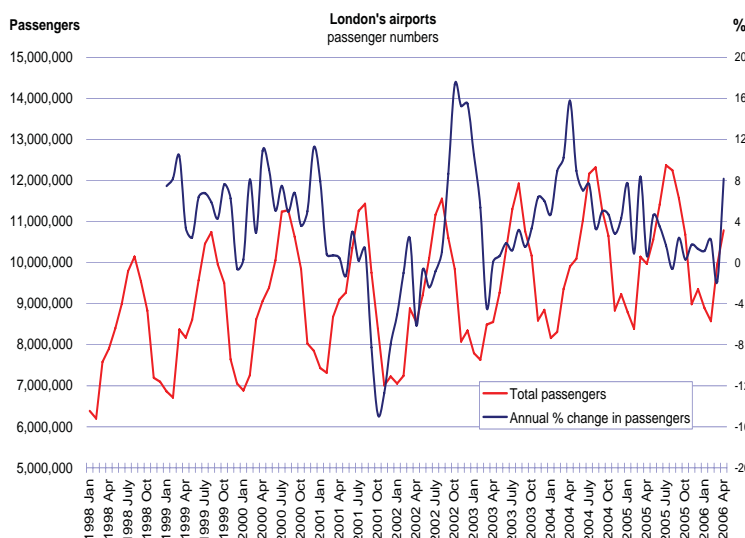
Source: PMI/The Royal Bank of Scotland

Annual growth in airport passenger numbers

- 10.8 million passengers travelled through London's airports in April 2006.
- The number of passengers using London's airports increased by 8.2% from April 2005 to April 2006.
- Year-on-year passenger number growth has been mainly positive since summer 2002.

Latest release: May 2006

Next release: June 2006



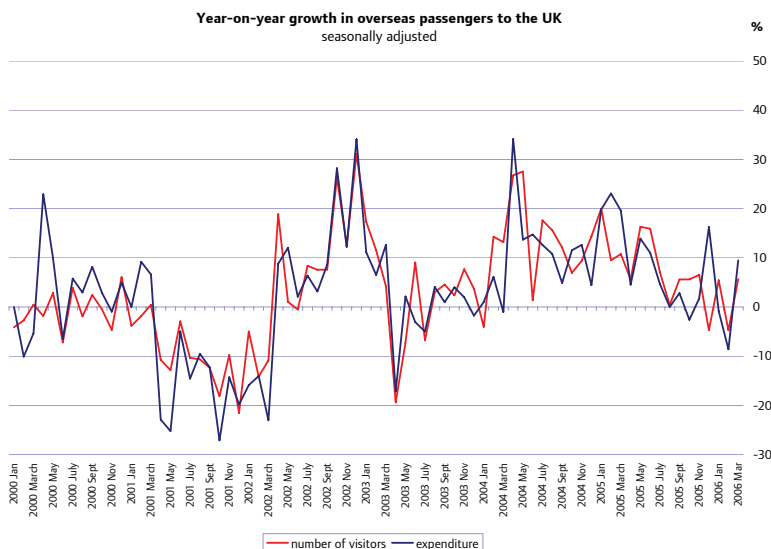
Source: Civilian Aviation Authority

Strong annual growth in tourism activity in March

- March 2006 saw an increase in the annual growth of overseas visitor numbers to the UK and their expenditure
- The annual growth rate of overseas visitors to the UK was 5.7% in March, up from -4.7% in February.
- Year-on-year growth in expenditure by overseas visitors in the UK was 9.5% in March, a sharp increase from -8.6% in February.

Latest release: May 2006

Next release: June 2006



Source: Office of National Statistics

The London living wage in 2006

**Leticia Veruete-McKay
and Alan Freeman**
Economists, GLA Economics

Introduction

London is a diverse world city, with high levels of prosperity sitting beside the most deprived neighbourhoods in the country. Three out of the UK's five most deprived boroughs are in London. In addition, around one in seven employees in London receive less than poverty level wages and almost one in four receive less than the living wage¹. Furthermore, around a third of Inner London residents are at the bottom fifth of the income distribution and 39 per cent of children in London are in poverty².

The Mayor in his manifesto at the last mayoral election pledged to set a living wage for London and to establish a Living Wage Unit in the GLA. The Unit, based in GLA Economics, published its first annual report last March³. This report set out the methodology used to calculate a living wage for London, which was set at £6.70 per hour.

The 2006 report, produced in May, updates these estimates. The Living Wage Unit calculates that the living wage has increased by almost five per cent since last year's report, to £7.05 per hour. This supplement examines how the living wage has been calculated, the improvements in methodology since 2005 and explains what has changed between 2005 and 2006 to produce the calculated rise in the living wage.

Calculation of the living wage in London

As in 2005, two approaches were used. One approach, developed by the Family Budget Unit, estimates the costs of a 'Low Cost but Acceptable' (LCA) budget for a selection of typical or model families. This approach calculates the wage required to meet those costs, and is also termed the Basic Living Costs approach. The second approach is based on the 'Income Distribution' approach. In this approach 60 per cent of median income is taken as the poverty line. This is consistent with the Government's usual definition of relative poverty. This approach estimates the wage required to achieve 60 per cent of median income for the same typical or model families.

An average of these two methods is used to calculate a 'poverty threshold' wage. However, a 'living wage' must yield a secure margin ensuring that the person involved does not fall to the level of poverty wages. Therefore, a margin of 15 per cent is applied to the poverty threshold wage, to obtain the living wage in London. This is added to protect individuals against the possibility of falling into poverty as a result of unforeseen expenses.

¹Calculations based on the Annual Population Survey (APS) 2004.

²Department for Work and Pensions (DWP).

³First Annual Report, A Fairer London: The Living Wage in London, March 2005.

Living wage in London

The results are presented in Table 1 which shows the wage required, for each model family, to reach the poverty threshold. The minimum wage of £5.05 has been used as a lower limit for the wage when calculating the overall weighted average wage. This is because it is illegal to pay at rates below the minimum wage. The bottom row of this table gives the number of adults living in each type of family in London. These numbers are used to calculate the weighted average in the final column of £6.00 for the basic living costs approach and £6.30 for the income distribution approach.

Taking the average of these two figures gives the estimate of the 'poverty threshold wage' of £6.15 per hour. Adding the 15 per cent margin to the calculated poverty threshold wage, yields a figure, when rounded to the nearest 5 pence, of £7.05 per hour as the living wage for London.

Both calculations in Table 1 take into account in work benefits and tax credits that can be claimed by low-income workers. This is because part of the aim of the tax and benefit system is to redistribute income to the least well off sections of society, while not providing disincentives to securing employment.

Table 1. Wage required to meet basic living costs and to achieve 60 per cent of median income for different households, including in work benefits and tax credits

Source: GLA Economics' own calculations

Notes: ft=full-time and pt=part-time. The number of people in different household groups was derived from Census 2001. All figures rounded to 1 decimal place (or 10 pence).

	Couple with two children			Lone parent		Couple with no children			Single no children	Weighted Average
Earners	2ft	1 ft 1pt	1ft	ft	pt	2ft	1ft 1pt	1ft	ft	
(1) Basic Living Costs	5.05	5.05	5.05	5.05	7.0	5.05	6.9	10.3	6.3	6.0
(2) Income distribution	5.05	5.2	8.4	5.05	8.4	5.4	7.5	12.2	5.8	6.30
Number of people ('000s)	455	364	173	75	42	425	340	162	802	

What has changed since 2005?

Since last year's report, the calculated living wage in London has increased by around 5 per cent, to £7.05 per hour. This was due to general inflation over this period and in particular rising costs of fuel, NHS charges, household services and council tax. In addition, methodological changes have meant that we are now allowing for higher transport and childcare costs. In the first annual report, it was assumed that individuals would pay for an annual travel card up front. This assumption, unrealistic for low-income families, has been replaced with the assumption that low-income households purchase monthly travel cards. Partially offsetting these increases, the Mayor's new policy to provide free bus and tram travel to children under 16 years has reduced transport costs for families with children.

The second annual living wage report has also used a more robust childcare cost estimate, based on the average costs of various types of childcare in Inner London and Outer London. Although this estimate is 9 per cent higher than the one used in last year's report, it is important to note that over this period nursery childminding costs in Inner and Outer London have increased by an amount respectively below and in line with the national average.

In addition, median household income rose by almost 4 per cent since the previous report. Consequently, the 60 per cent of median income thresholds for the different families types we considered also increased by 4 per cent. However, given that in general in work benefits and tax credits were only increased in line with inflation (2.7 per cent) this required the weighted average wage required to achieve 60 per cent of median household income to rise by 7 per cent to £6.30 per hour.

Future work

The Living Wage Unit will continue to undertake research in particular to increase our understanding of the patterns of low pay in London, and trying to improve our estimates of the incidence of low pay in London.

Data sources

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

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

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

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About GLA Economics

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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