London's Economy Today



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GLAECONOMICS

London named world's favourite city

by Christopher Lewis
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In the lead up to Christmas, the Chancellor of the Exchequer's Pre-Budget Report (PBR) on 5 December contained few surprises. UK economic growth forecasts were revised downwards for this year and 2006 while public borrowing forecasts were revised upwards. As anticipated, the Chancellor predicted that his Golden Rule would still be met, but only just. The Golden Rule means that over the economic cycle the Government should only borrow to invest and not to fund current spending. However, the length of the current economic cycle was once again revised by HM Treasury – this time to a dozen years. This month's feature provides a guide to these issues and other points of interest in the PBR.

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The team at GLA Economics wishes you a safe and enjoyable Christmas and New Year.

London's economy shows signs of further improvement

Overall, London's economy continues to perform reasonably well. In November, the Purchasing Managers' Index (PMI) measures of seasonally adjusted business activity, new orders and the level of employment all increased and were above the national average. All three London indices have been on an improving trend since August and show that the capital's economy is expanding. The PMI's measure of London's seasonally adjusted business activity rose to 56.7 (from 55.4 in September), which is its highest level since April. This is significantly above 50, which is the level consistent with no change on the previous month.

The London retail sector over Christmas shows no signs of booming. However, all may not be doom and gloom with four-fifths of leisure businesses and two-thirds of retailers interviewed for a recent London Chamber of Commerce and Industry report saying that they were confident of a good Christmas for their business. Prospects for luxury items seem better than for goods and services as a whole due to higher bonuses in London's financial and business services sector. In addition, London Retail Consortium figures show that retail sales in central London during November were stronger than in the UK as a whole. During November, central London retail sales were 2.1 per cent higher, on a like-for-like basis, than in November 2004 compared with a 0.8 per cent rise for the UK.

Another sign that the economic impact of the terrorism attacks in July on London seems to be easing slightly are recovering visitor attraction data. Visit London reports that all sectors of London attractions witnessed higher visitor numbers during October compared to September. The annual rate of decline in visitor numbers to London attractions has also slowed with overall visits to London attractions decreasing by 5.2 per cent in October 2005 compared with October 2004.

'London came out on top for: finding a job, doing business, obtaining a valuable education qualification and finding a community in which one could fit.'

London has been ranked the world's favourite city by the Anholt-GMI City Brands Index with the capital's business climate receiving particularly high marks. London came out on top for: finding a job, doing business, obtaining a valuable education qualification and finding a community in which one could fit.

UK industrial production remains depressed

According to Gordon Brown this year has been the toughest and most challenging year for the economy since his time as Chancellor. UK industrial production continues to put a break on the nation's economy. Industrial production fell one per cent in October to its lowest level since June 2002 and it is worth noting that it was at its current level way back in 1995. Within the industrial production sector manufacturing output fell 0.7 per cent in October. As expected the combination of below trend economic growth but above target inflation meant the Bank of England kept interest rates at 4.5 per cent for the fourth consecutive month in December. The seasonally adjusted volume of UK retail sales has continued its modest pick-up and rose by its quickest rate for five months during November. However, the UK labour market is currently subdued with unemployment rising, job vacancies falling and no signs of overall higher wage inflation. Claimant count unemployment rose for the tenth consecutive month in November.

Gold glittering as Christmas draws near

The price of gold has climbed to its highest level since 1981 (see Figure 1). The demand for precious metals has been boosted by investors looking to protect themselves against worldwide inflationary pressures. There is also speculation that Asian and European central banks may increase their gold holdings in the place of some US dollar holdings. This, alongside the US' large current account deficit, could put downward pressure on the US dollar which has actually appreciated in 2005. However, solid US growth and rising US interest rates are currently supporting the US dollar. On 13 December the Federal Reserve once again raised interest rates by 0.25 per cent (the thirteenth such increase since June 2004) to 4.25 per cent.

Despite a sluggish Eurozone economy the European Central Bank (ECB) has also raised interest rates for the first time since October 2000 (from two to 2.25 per cent) in response to inflationary pressures. Eurozone interest rates had remained steady at two per cent since June 2003 and the Organisation for Economic Co-Operation and Development had advised that they should be kept on hold. The recovery in Japan's economy is expected to continue with business confidence rising. The OECD has revised upwards its Japanase growth forecast for 2005 to 2.4 per cent from 1.5 per cent and the stockmarket has reached five year highs. Meanwhile China's export levels continue to grow and its trade surplus has risen to over £50 billion for the first eleven months of this year. The OECD expects the Chinese economy to grow at a rapid rate of above nine per cent in 2005, 2006 and 2007.

Figure 1. Gold Price (US $ per ounce)

Source: Ecowin

A mixed picture for economic prospects

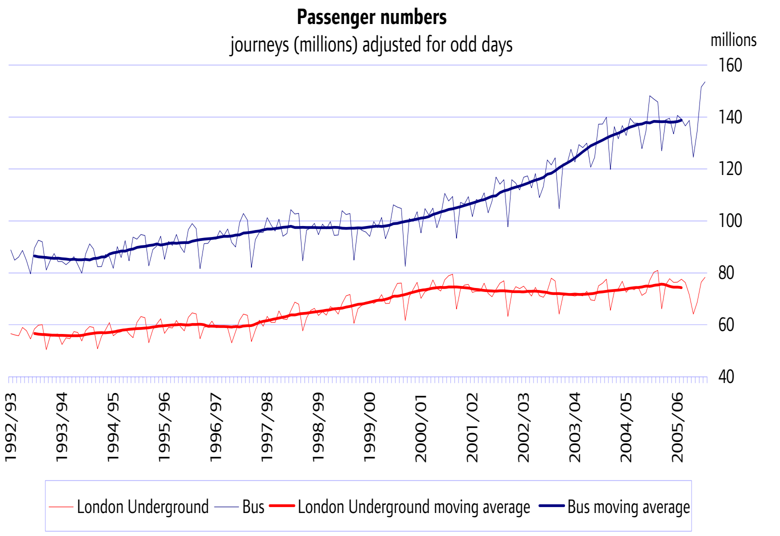
The world economy heads into 2006 with oil prices remaining high, though below their peak in the summer. Concerns about worldwide inflationary pressures have led the ECB and Federal Reserve to raise interest rates, which will dampen economic activity. The decision by the ECB has been questioned as the Eurozone economy still shows few signs of a significant pick-up in fortunes. Meanwhile below trend growth in the UK may well encourage the Bank of England into making at least one further interest rate cut in 2006. Household consumption remains relatively weak and the Turner report on pensions could also see people save more for their old age, which would impact upon current consumption. As for the UK housing market it is expected to be broadly stable next year with the Nationwide forecasting that prices will increase by zero to three per cent. In general, stockmarkets throughout the world have performed well in 2005, which has provided strength to the City of London's activities. With the financial and businesses sector still growing strongly London's economy should have a steady if unspectacular year in 2006.

Small decrease in moving average of passenger numbers

- The most recent 28-day period is from 16 October to 12 November 2005. London's public transport had 231.8 million passenger journeys; 153.5 million by bus and 78.3 million by Underground.
- The moving average decreased slightly to 213.1 million passengers every period. The average for buses was 138.8 million passenger journeys while the Underground average was 74.3 million.

Latest release: December 2005

Next release: January 2006



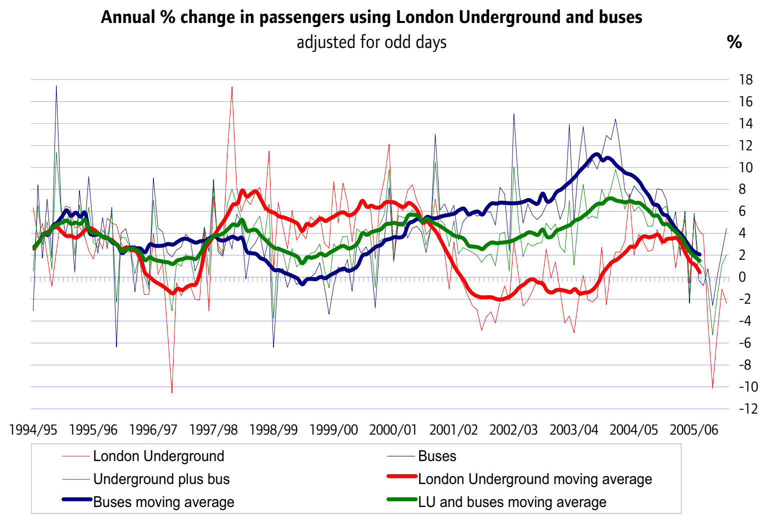
Source: Transport for London

Passenger journeys' annual growth rate continues to slow

- The moving average annual rate of growth in passenger journeys is 1.4%, below the revised annual growth in the previous period of 1.7%.
- The moving average annual rate of growth in bus journey numbers slowed further to 1.9%, down from 2.1% in the previous period.
- The moving average annual rate of growth in Underground passenger journey numbers was 0.3% down from revised growth of 1.0% in the previous period.

Latest release: December 2005

Next release: January 2006



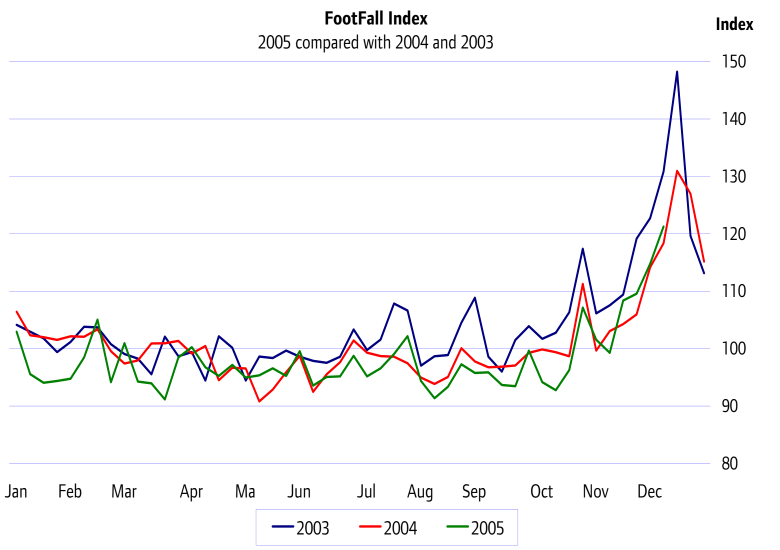
Source: Transport for London

Shopping numbers increase in run up to Christmas

- The Footfall Index of shoppers in London was 121.1 in the first week of December compared to 114.6 in the last week of November.
- Since the second week of November 2005, the number of shoppers has been above the level in 2004 during the same period.
- The FootFall Index measures the number of shoppers and does not necessarily reflect the level of spending.

Latest release: Mid-December

Next release: Every week

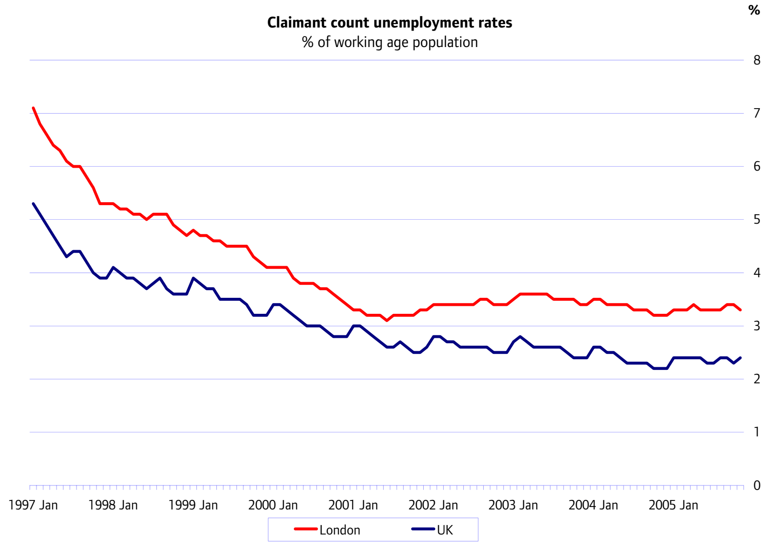


Source: FootFall Limited

Claimant count unemployment

- The rate of claimant count unemployment, people unemployed and claiming Jobseeker's Allowance, in London was 3.3% in November 2005.
- There were 165,300 unemployment claimants in London in November 2005 compared with 157,700 in November 2004.
- The claimant count unemployment rate in the UK remains below that of London's.

Latest release: December 2005
Next release: January 2006

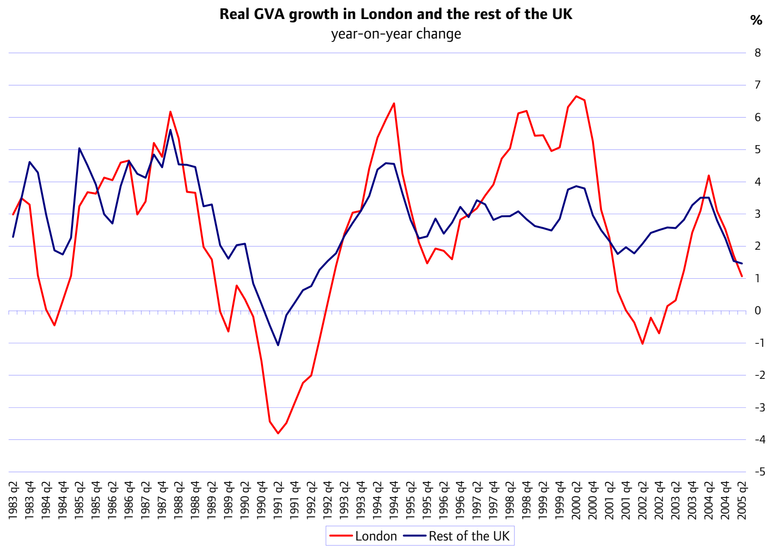


Source: Claimant Count, Nomis

London's economy growing slightly slower than the rest of the UK's

- London's annual growth in output was 1.1% in Q2 2005, down from a revised 1.7% in Q1 2005.
- The annual growth in output for the rest of the UK remained constant at 1.5% in Q2 2005.
- London's output growth was a little less than that for the rest of the UK in Q2 2005.

Latest release: November 2005
Next release: February 2006

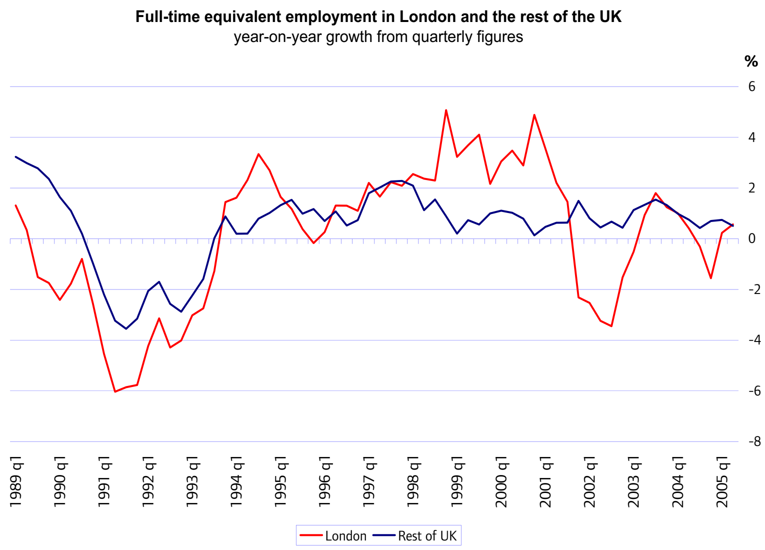


Source: Experian Business Strategies

London employment continues to grow

- London's year-on-year employment growth increased further to 0.6% in Q2 2005 compared to 0.2% in Q1 2005.
- Annual employment growth in the rest of the UK decreased slightly to 0.5% in Q2 2005 from 0.7% in Q1 2005.
- London's annual employment growth was slightly higher than that for the rest of UK in Q2 2005.

Latest release: November 2005
Next release: February 2006

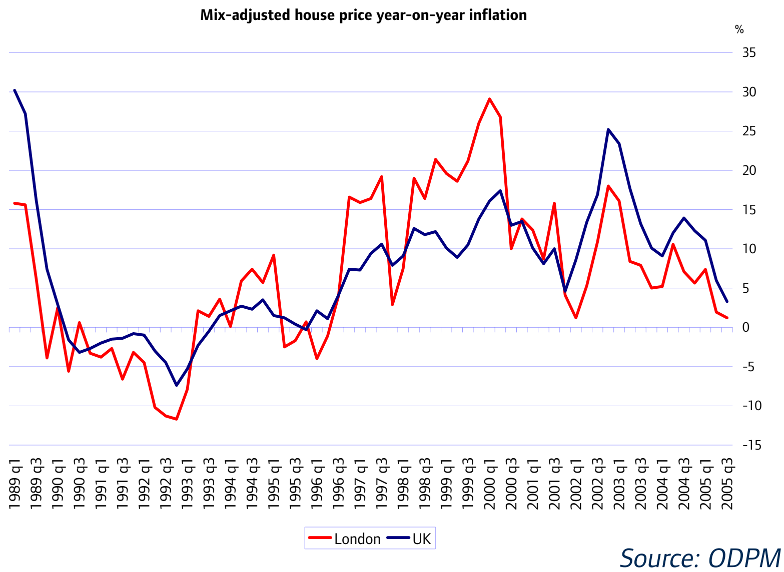


Source: Experian Business Strategies

Slowdown in house price growth in Q3

- The ODPM house price index is an official measure of house prices. It is available up to Q3 2005.
- Annual house price growth in London decreased slightly to 1.2% in Q3 2005 from 1.9% in Q2 2005.
- Annual house price growth for the UK slowed to 3.3% in Q3 2005 from 6.0% in Q2 2005.

Latest release: December 2005
Next release: March 2006

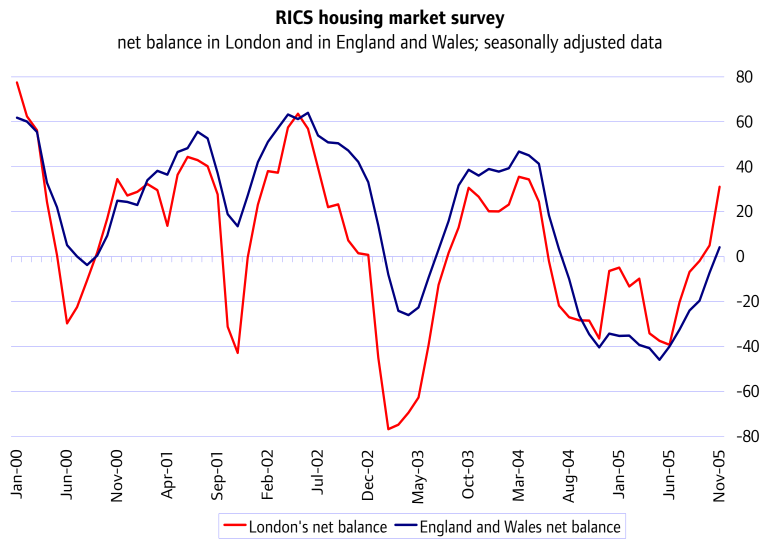


Source: ODPM

Surveyors reported a strong recovery in London house prices in November

- The RICS survey showed a positive net balance for London house prices over the past three months of 31 in November.
- This net balance marks a sharp increase from 5 in October and a clear recovery from a low of –40 in June.
- Surveyors are also reporting increased house prices in England and Wales. The net balance was 4 in November, reversing a negative balance of -8 in October.

Latest release: December 2005
Next release: January 2006

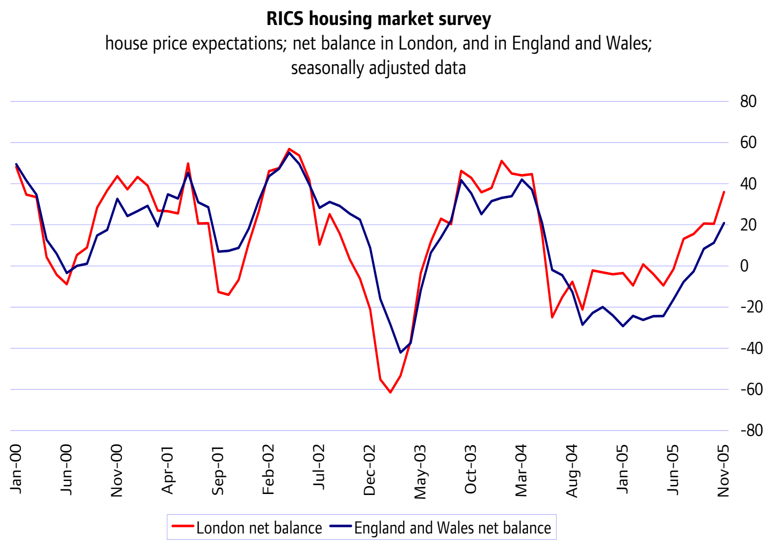


Source: Royal Institute of Chartered Surveyors

Surveyors expect house price growth

- The RICS survey shows a clear majority of surveyors expect house prices to increase over the next 3 months in London.
- The net expectations balance in London was 35 in November 2005, rising from a balance of 20 in October.
- For England and Wales, the net expectations balance was also positive. It was 20 in November 2005 up from 11 in October.

Latest release: December 2005
Next release: January 2006

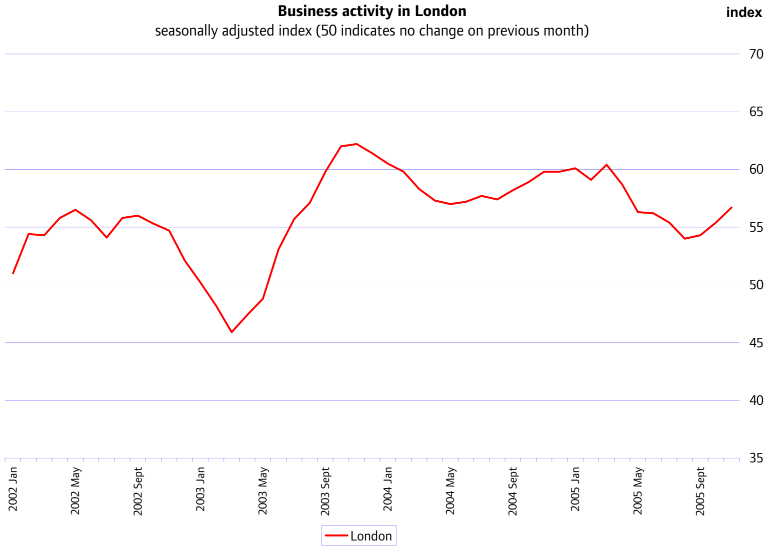


Source: Royal Institute of Chartered Surveyors

Business activity in London grows quicker

- London firms continued to expand their output of goods and services in November 2005.
- The Purchasing Managers' Index (PMI) of business activity recorded 56.7 in November compared to 55.4 in October.
- A rate above 50 on the index indicates an increase in business activity from the previous month.

Latest release: December 2005
Next release: January 2006

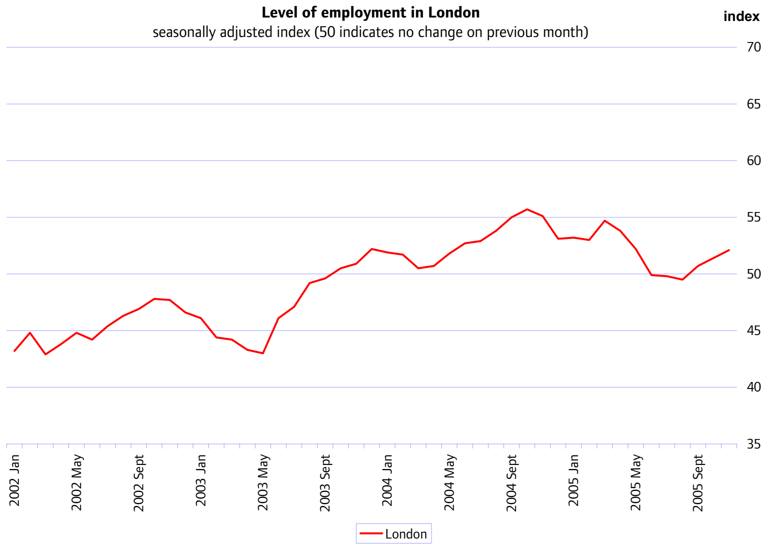


Source: PMI/The Royal Bank of Scotland

London employment expands

- London firms continue to increase their level of employment in 2005. The PMI for the level of employment was 52.1 in November 2005.
- The PMI shows that the employment level in London firms has increased for the past three months.
- A rate above 50 on the index indicates an increase in the level of employment from the previous month.

Latest release: December 2005
Next release: January 2006

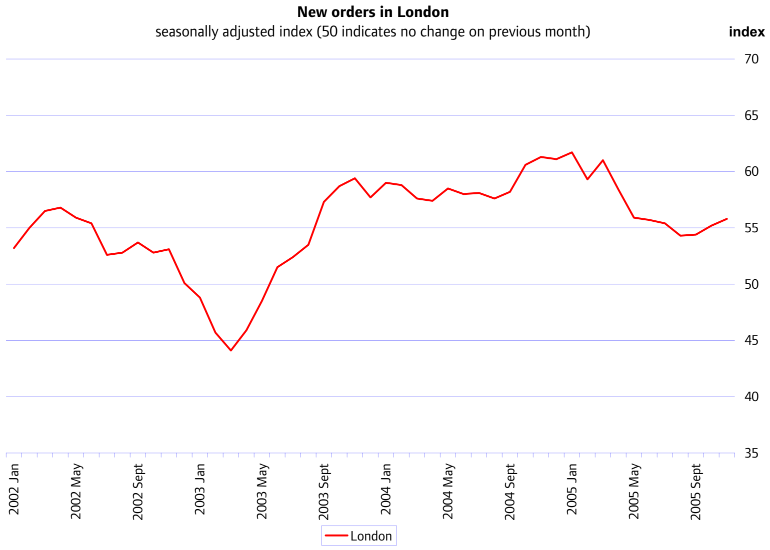


Source: PMI/The Royal Bank of Scotland

Growth in new orders picks-up further

- New orders for London firms continued to rise in November.
- The PMI for new orders recorded 55.8 in November 2005 compared to 55.2 in October 2005.
- A rate above 50 on the index indicates an increase in new orders from the previous month.

Latest release: December 2005
Next release: January 2006



Source: PMI/The Royal Bank of Scotland

Assessing the Pre-Budget Report

Duncan Melville
Deputy Chief Economist,
GLA Economics

The economy and public finances

In a year of high oil prices, and slowdowns in consumer spending and the housing market, it is not surprising that the Chancellor has almost halved his forecast for 2005 output growth in his Pre-Budget Report (PBR). He is now more inline with the consensus amongst independent forecasters (see Table 1).

Key Points

- The Chancellor has reduced his forecasts for economic growth and increased his forecasts for public borrowing.
- GLA Economics projects that the Chancellor will just fail to meet his Golden Rule (to borrow only to invest) over the course of the current economic cycle.
- The Pre-Budget Report suggests that the Comprehensive Spending Review will be very tight and there will be little additional funds for increased public spending.
- A number of initiatives to increase the supply of housing and review planning policy to 'better deliver economic growth and prosperity' were announced.
- The PBR was published earlier this month. The last Budget was published in March 2005.

While halving his forecast for growth in his PBR, the Chancellor, Gordon Brown, has increased his forecasts for public borrowing by £5 billion for this financial year and next compared to his Budget released earlier this year. However, as Table 1 shows, his forecast for public borrowing is more optimistic than the consensus amongst independent forecasters.

Table 1: Projections of economic growth and public borrowing

Source: HM Treasury

	Economic Growth (%)		Public Borrowing - PSBN £bn	
	2005	**2006**	**2005/06**	**2006/07**
Budget 2005	3-3.5	2.5-3	32.0	29.0
Census	1.7	2.1	39.4	39.4
PBR 2005	1.75	2-2.5	37.0	34.0

Notes: Consensus = November 2005 Consensus average of new forecasts from HM Treasury Survey of Independent Forecasts. PSNB = Public Sector Net Borrowing

Meeting the fiscal rules?

The Chancellor continues to expect to meet his Golden Rule and his Sustainable Investment Rule. A potential flaw in the Chancellor's expectations though are his projections of growth. While the Chancellor predicts rapid growth of 2.75 – 3.25 per cent in both 2008 and 2009, the consensus amongst independent forecasters is for growth of just 2.5 per cent and 2.6 per cent respectively.

The Chancellor's Rules

The Chancellor has two key fiscal rules:

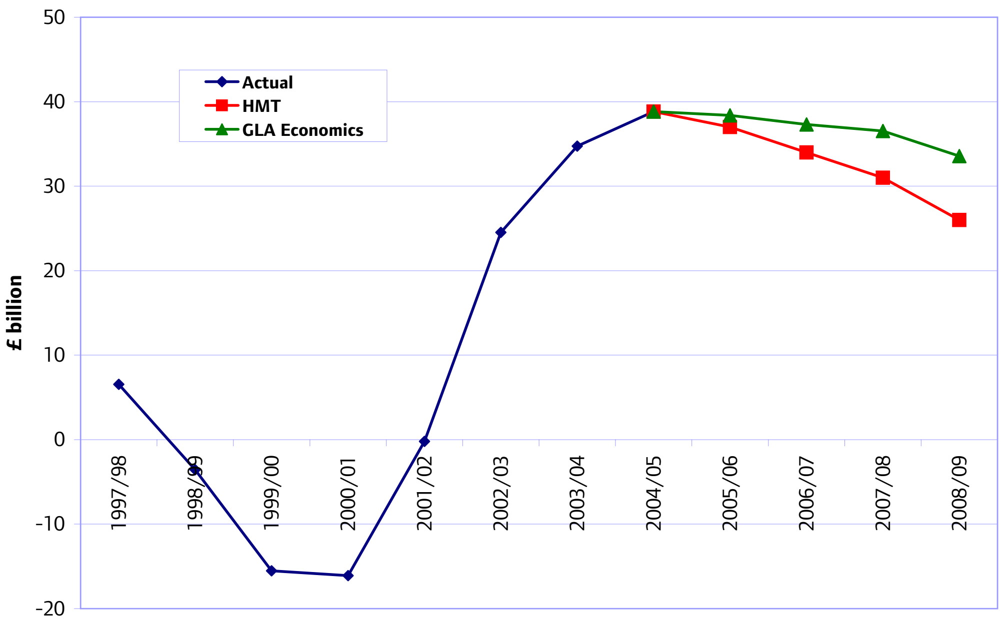
1) Golden Rule: Over the economic cycle, the Government will borrow only to invest and not to fund current spending.

2) Sustainable Investment Rule: Public sector net debt will be held over the economic cycle at a stable and prudent level which the Chancellor has defined as below 40 per cent of GDP.

GLA Economics has undertaken its own fiscal projections starting from the consensus amongst independent forecasters with regard to economic growth and public borrowing. These are shown in Figure 2 together with HM Treasury's PBR projections.

Figure 2: Public Sector Net Borrowing

Source: HM Treasury and GLA Economics' calculations



GLA Economics says...

Our projections show a gradual decline in public borrowing (as measured by public sector net borrowing (PSNB) – the most commonly used measure of public borrowing) but we project a less rapid decline than the Chancellor. Given these higher levels of public borrowing we do not believe the Chancellor will meet his Golden Rule. Our projections give an average surplus on the current budget for 1997/98 to 2008/09 of –0.04 per cent.

GLA Economics says...

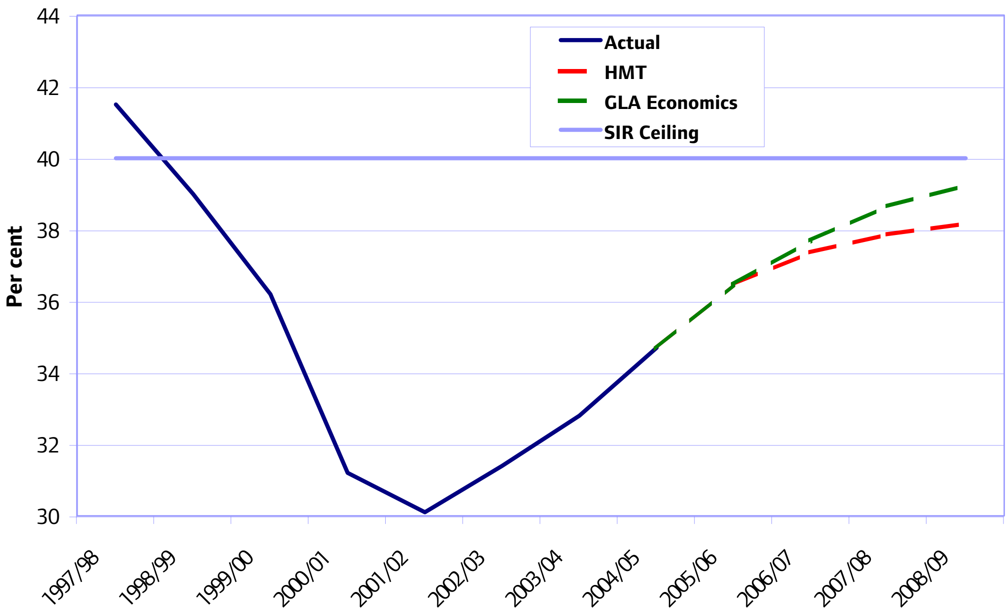
So while the Chancellor thinks he will achieve a marginal pass on the Golden Rule we believe he will marginally fail. However on our projections we do have the Chancellor meeting his Sustainable Investment Rule as we project public sector net debt to reach 39.3 per cent of Gross Domestic Product (GDP) by 2008/09, just below the rule's 40 per cent ceiling – see Figure 3.

In reality, the economic difference between the Chancellor's projections and our own is of little economic significance. Even if our projections turn out to be more accurate than the Chancellor's, a small breach of the Golden Rule does not mean that the public finances are out of control.

Public borrowing reached 3.3 per cent of GDP in 2004/05 and we project that this will decline to around 2.5 per cent by 2008/09. Between 1992/93 and 1996/97 public borrowing averaged around six per cent of GDP. In addition as noted above we expect public sector net debt to reach 39.3 per cent of GDP by 2008/09, equal to the average percentage of the last 30 years and low by current international standards – for example this percentage is currently 47 per cent in the USA, 61 per cent in Germany and 81 per cent in Japan.

Figure 3: Public sector net debt (% of GDP)

Source: HM Treasury and GLA Economics' calculations



A case for reform?

However there are issues over the continued usefulness of the Chancellor's fiscal rules. The Golden Rule has generally served us well but now appears to be losing its effectiveness. The rule depends on the economic cycle's timing. At the Budget, the Treasury's view was that the current cycle started in 1999/00 and would finish at the end of this financial year, 2005/06. In the summer the Treasury revised its view as to the start date of the current economic cycle to 1997/98. In the PBR, the Treasury pushed out the assumed end date of the current economic cycle to 2008/09 as a consequence of the reduced growth forecast for this year and next. Thus the Treasury now believes that the current economic cycle will last 12 years rather than seven.

Neither of these changes to the start and assumed end date of the current economic cycle are in themselves unreasonable. However they do mean that the timing of the current economic cycle has become very elastic and this reduces the rule's effectiveness in ensuring fiscal responsibility.

GLA Economics says…

In addition, the 40 per cent ceiling in the Sustainable Investment Rule is arbitrary. Clearly some sort of ceiling is required but with public sector net debt projected to reach levels close to this ceiling by 2008/09, rigid adherence to this 40 per cent ceiling may make investing in important pieces of infrastructure, such as Crossrail, very difficult.

It should be stressed that any reforms to the Government's fiscal rules must be ones that seek to ensure continued fiscal discipline and not ones that effectively free policymakers from any constraints on their actions. It would be much better to stick with the existing rules than walk down this road.

Implications for the 2007 Comprehensive Spending Review (CSR 2007)

GLA Economics says…

The PBR sets out figures for public spending for the period 2008/09 to 2010/11, the period for which the CSR 2007 will determine the level and allocation of public spending. While the Treasury says these figures are 'assumptions', the indications are that CSR 2007 will be very tight and tough decisions are needed.

Figure 4: Possible real spending growth in CSR 2007

Source: Carl Emmerson, Institute for Fiscal Studies

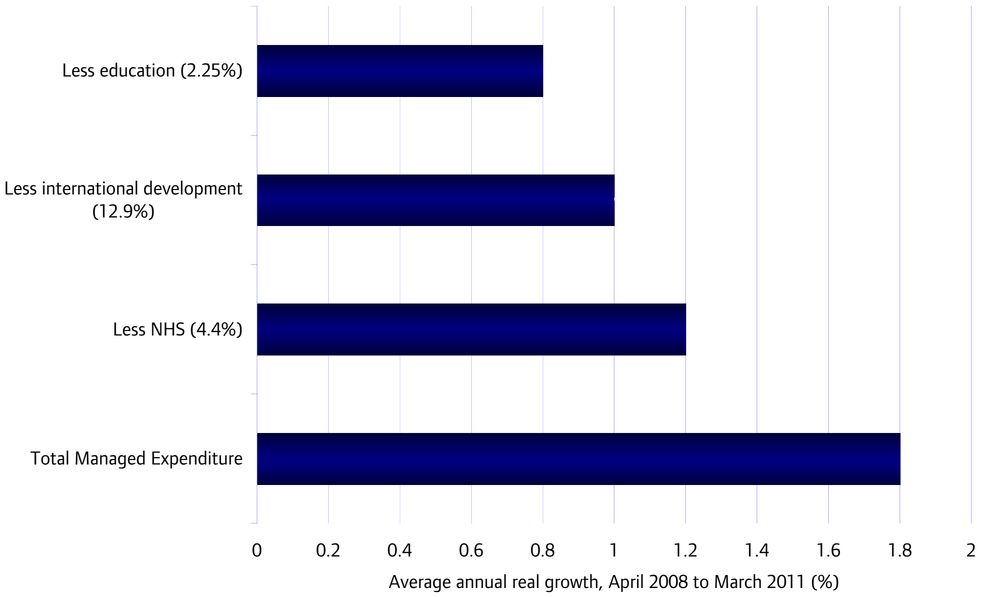


Figure 4 is taken from an analysis of the PBR produced by Carl Emmerson of the Institute for Fiscal Studies (IFS). The figures in the PBR imply that total public spending (Total Managed Expenditure) is projected to rise by just 1.8 per cent a year in real terms (i.e. after allowing for inflation) over the CSR 2007 period. This compares with plans for average real annual growth of 3.4 per cent over the current Spending Review 2004 period (2004/05 to 2006/07), which in itself was a deceleration from growth seen in the previous spending review period. However the resources available for certain areas of public spending may be squeezed further than even this figure implies.

The Government's Wanless report which investigated the funding requirements of the NHS projected that a growth in real spending of between 4.4 and 5.6 per cent would be needed between 2008 and 2012. Even if the NHS receives the lower end of this scale, a 4.4 per cent increase in spending, this would allow for real public spending outside the NHS of just 1.2 per cent between 2008/09 and 2010/11. The Government has committed to increasing international development aid spending to 0.7 per cent of GDP. Allowing for this reduces real spending growth elsewhere to just 1.0 per cent. Finally, the Government's 2005 General Election manifesto contained a pledge to 'continue to raise the share of national income devoted to education'. This probably implies a greater increase in real spending than the 2.25 per cent allowed for by the IFS but even at this level it implies real spending growth outside health, education and overseas aid of just 0.8 per cent. That is, less than one percent spending growth to cut child poverty in half by 2010, to modernise Britain's transport infrastructure and to tackle crime and international terrorism to name just a few. Clearly this demonstrates the very hard choices that will have to be made in the CSR 2007 process.

Housing

The PBR announced a number of initiatives to increase the supply of housing following on from the Barker Review:

- New housing planning guidelines to make the planning system more responsive to housing markets and ensure a better supply of land to meet long-term housing needs.
- A consultation for a planning gain supplement which would ultimately help finance local infrastructure needs.
- Real Estate Investment Trusts (REITs) would be set up to provide tax incentives for investments in new property developments.
- Partnering with three of the biggest building societies and banks in shared equity schemes for home ownership while four of the biggest builders are also now offering shared equity purchases.

All these measures are presumably designed to contribute towards the Government's commitment to increase the number of houses built from the current 150,000 to 200,000 over the next decade.

Planning

GLA Economics says...

One PBR announcement that has received relatively little publicity but which could have significant implications for the GLA and more widely London is that the Government has asked Kate Barker, who undertook the review of housing supply, to review planning policy and procedures to consider how these 'can better deliver economic growth and prosperity'. This is a welcome announcement. Whilst the planning system is important for weighing social, environmental and economic factors, it is important that planning policy and its implementation help promote the competitiveness of the economy. For example, current processes for planning policy inquiries tend to be convoluted, lengthy, have no regard to the cost-benefit of the process and lack clear criteria for their decision-making processes.

Additional information

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

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39 Creative data for London

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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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