GLAECONOMICS

London's Economic Outlook: Spring 2004

The GLA's medium-term planning projections

Transport for London

LONDON DEVELOPMENT AGENCY

MAYOR OF LONDON

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enquiries **020 7983 4000**
minicom **020 7983 4458**

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For more information about this publication, please contact:
GLA Economics
telephone 020 7983 4922
email glaeconomics@london.gov.uk

The Mayor of London established GLA Economics in May 2002 to provide a firm statistical, factual and forecasting basis for policy decision-making by the GLA group. GLA Economics is funded by Transport for London (TfL), the London Development Agency (LDA) and the Greater London Authority (GLA).

Contents

Executive summary

The GLA's fourth London forecast,[1] which includes the year 2006 for the first time, predicts that:

- London's recovery will see growth above trend at around 3 per cent through to 2006. The strong growth seen in 2003 took London's job total to 4,570,000 – the highest since the GLA's dataset began in 1971. This strong growth is expected to continue into 2004 and then moderate.
- The growth of consumer spending, which fell to 2.5 per cent in 2003 from 4.3 per cent in 2002 but remained above GDP growth, is forecast to fall slightly behind GDP growth in 2004 at 3.0 per cent. Growth rates below GDP are expected to continue as a consequence of higher interest rates and a slowing in house price inflation.
- The GLA's forecasts are slightly more conservative than the average consensus among independent forecasters.
- Output growth is expected to be positive in all sectors. Growth is anticipated to be strongest in Finance and Business, and Transport and Communications.
- Initially job growth is broadly across the sectors, but from 2005 the strongest growth is anticipated in Finance and Business Services, and in Public Services and Distribution.

Table 1: Summary of projections

Annual growth rates (%)	**2003**	**2004**	**2005**	**2006**
London GVA (constant 2000 £b)	0.6	3.3	2.9	3.0
London civilian workforce jobs	1.6	1.7	0.7	0.7
London household income (constant 2000 £b)	1.1	2.4	3.2	3.5
London household spending (constant 2000 £b)	2.3	3.2	2.4	2.6
Memo: Projected UK inflation rate (RPIX)[2]	*2.8*	*2.4*	*2.0*	*2.0*
Projected CPI inflation rate[3]	*1.3*	*0.8*	*1.9*	*2.3*

Source: Experian Business Strategies

The predictions find strong support among London's independent forecasters, whose consensus conclusions are published in Chapter 2.

Some of the main risks on the downside come from the world economy. Although latest output data suggests European growth is picking up, more recent indicators have been less optimistic. China's continued strong performance and Japan's four quarters of positive

[1] The forecast was commissioned by GLA Economics and prepared by Experian Business Strategies.
[2] Retail price inflation without mortgage interest. While not part of the GLA Economics forecast for London, for information the forecaster's view of the inflation rate is reported. Up to December 2003, the Bank of England's inflation target was to keep RPIX at 2.5 per cent.
[3] While not part of the GLA's forecast for London, for information the forecaster's view of the CPI inflation rate is reported. Since December 2003, the Bank of England's inflation target is to keep CPI at 2.0 per cent.

growth create an optimistic picture for South-East Asia, but the US dollar's decline and the twin US deficits continue to give cause for concern.

Further possible risks arise from commodity prices, which are now rising worldwide. If this is merely a correction after a period of exceptionally low prices, then it could be expected to stabilise. If, however, it reflects under-capacity in world production, then commodity price inflation could be signalling supply-side constraints which could obstruct a sustained expansion. Finally, in the wake of the Madrid bombings the increased risk of terrorist attacks introduces a further element of uncertainty.

Sustained borrowing on the strength of continued house price inflation introduces a further downside risk that interest rates will rise more steeply than previously anticipated This could lead to a sharp decline in consumer spending on the back of a correction to house prices (possibly worldwide).

On the upside, there is a possibility that international growth, especially in the EU, will pick up more strongly than anticipated. Investment might also accelerate markedly as the global economy gains momentum, as has sometimes occurred in past recoveries. More problematic is that although there is a widespread assumption that consumer spending will slow in response to rising interest rates, there is no clear sign that this is actually happening. In the short term, this would lead to a more rapid expansion than forecast. In the medium term it creates a downside risk of a boom-and-bust development, after which there could be a rapid contraction in consumer spending and growth.

Introduction

London's Economic Outlook is the GLA's fourth London forecast. The forecasts are issued every six months to assist the GLA group and other organisations that prepare medium-term planning projections for London. Each forecast provides:

1. Projections for output, employment, household expenditure, and household income in London.[4]
2. A review of independent forecasts (the consensus forecast) provides an indication of the range of views about London's economy and the possible upside and downside risk.
3. An in-depth assessment of a topic of particular importance to London's medium-term future.

In the Spring 2004 forecast, Chapter 1 reviews the recent world, UK and London economic background to the forecast. Chapter 2 presents the GLA's *Review of Independent London Forecasts* (the consensus forecast). The GLA's medium-term forecast for London's economy is in Chapter 3. The international economy is one of the biggest uncertainties, and Chapter 4 focuses on the growing importance of London's global trading relationships.

Any economic forecast represents the forecaster's view as to the most likely future path of the economy, and as such is inherently uncertain.

The GLA's review of independent forecasts provides an indication of the range of alternative opinions. These are supplied to the GLA by five organisations:

- Cambridge Econometrics
- the Centre for Economic and Business Research
- Experian Business Strategies (EBS)
- the London Economy Research Project forecast, produced by the National Institute for Economic and Social Research, run by the London Chamber of Commerce and Industry
- Oxford Economic Forecasting.

Only the most likely outcomes provided by the different forecasting organisations are recorded in this report. Each forecaster may also prepare scenarios they consider less likely which are not shown here. The low and high forecasts combine the worst or best growth forecasts taken from each year and come from different forecasters. The high and low estimates may not represent the view of any one forecaster over the whole of the forecast period.

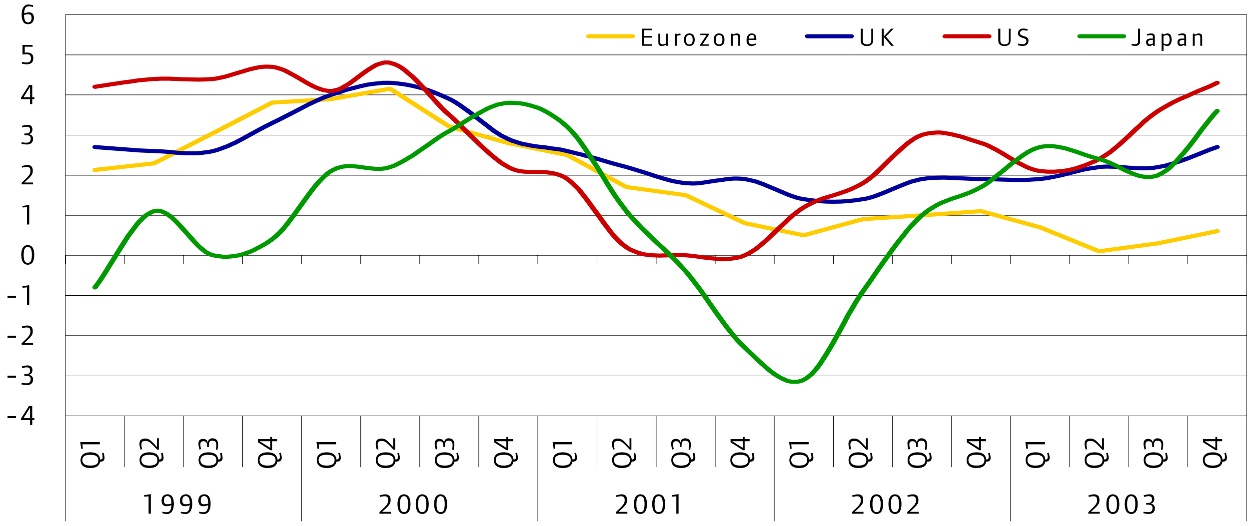
Economic forecasting is not a precise science. These projections provide an indication of what is judged to be most likely to happen in the London economy, not what will happen.

[4] See Appendix A for definitions.

1. The current economic context

The world economic context

Chart 1.1: Output growth rates



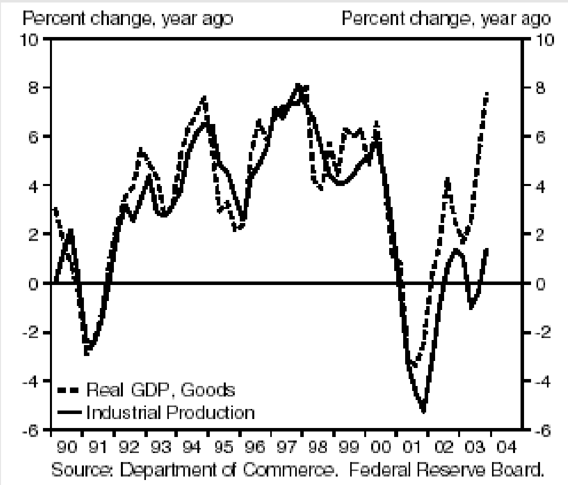
Source: Crown copyright, HM Treasury
Units: Per cent growth from same quarter last year, national currency, constant price

Fourth quarter provisional estimates of gross domestic product (GDP) confirm that growth has spread to all major regions of the world. In its April 2004 *World Economic Outlook,* the International Monetary Fund has revised upwards its forecast for global economic growth in 2004 from 4.1 per cent to 4.6 per cent. However, the recovery remains uneven. The US is leading with year-on-year growth of 4.3 per cent in the last quarter of 2003 (Chart 1.1). Japanese growth has now been positive for four quarters and is catching up with the US. The weakest part of the industrialised world remains the Eurozone, with aggregate (year-on-year) growth in real gross value added (GVA) still less than 1 per cent.

Are official estimates exaggerating US growth?

Research by leading global investment bank Goldman Sachs[5] has argued that US output growth may be substantially slower than what is shown by the official statistics.
It is noteworthy that employment growth in the current US recovery has been much lower than expected given the apparent rapid increase in output and past relationships between US output and employment growth. Does this suggest that output growth is lower than the official estimates, or that productivity growth has risen to new heights? A marked piece of evidence in support of the first of these is that industrial production has grown much slower than goods sector GDP. Historically these two have moved closely in step with one another, but they have diverged in the past two years (Chart 1.2).

Chart 1.2: Two views of the growth pace



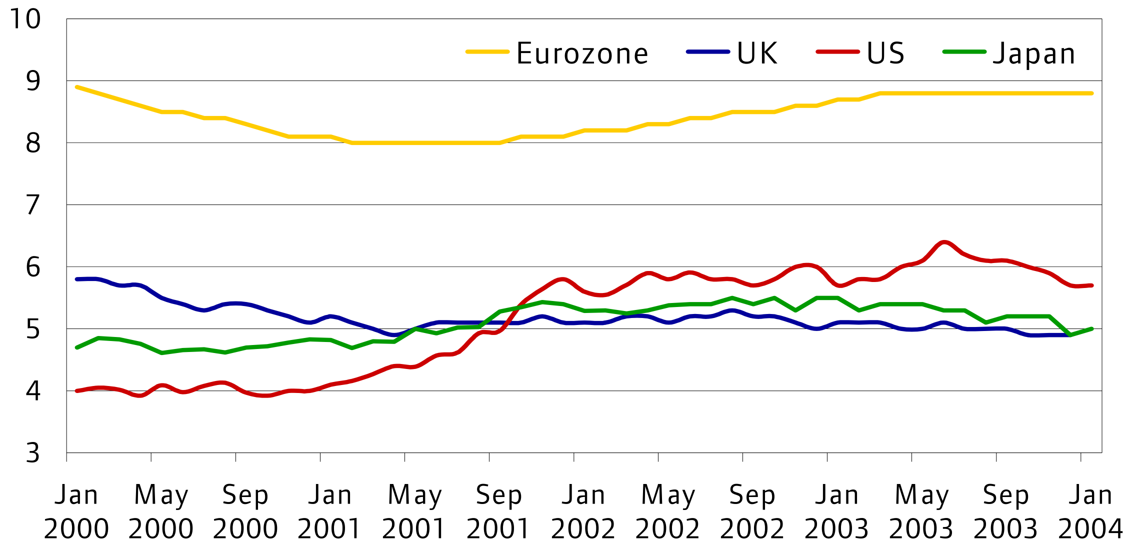
Source: Reproduced from Hatzius 2004

On the basis of the industrial production figures, growth in the year to the fourth quarter of 2003 would have been just 2.2 per cent rather than the official estimate of 4.3 per cent. However the latest US employment figures, published after the Goldman Sachs report was completed, show that payrolls expanded dramatically in March – up by 308,000 – with upward revisions for earlier in 2004. So at least part of the quandary over the apparent coincidence of strong output growth and weak employment growth may be due to a greater lag than previously seen between US output and employment growth. Hence it will be important to monitor the outturns for US output and employment over the rest of this year.

[5] Hatzius, J (2004)

Unemployment rates in the US have been falling since January of 2003 (Chart 1.3). US employment growth has until very recently been weaker than many expected, given the apparent strength of the upturn in US output (as discussed above). The monthly increase in payrolls for the first three months of this year is well above 150,000, suggesting that significant job growth has resumed. The falling unemployment trend supports this.

Chart 1.3: Standardised unemployment rates



Source: Crown copyright, HM Treasury
Units: per cent of economically active population not in work, ILO definitions.

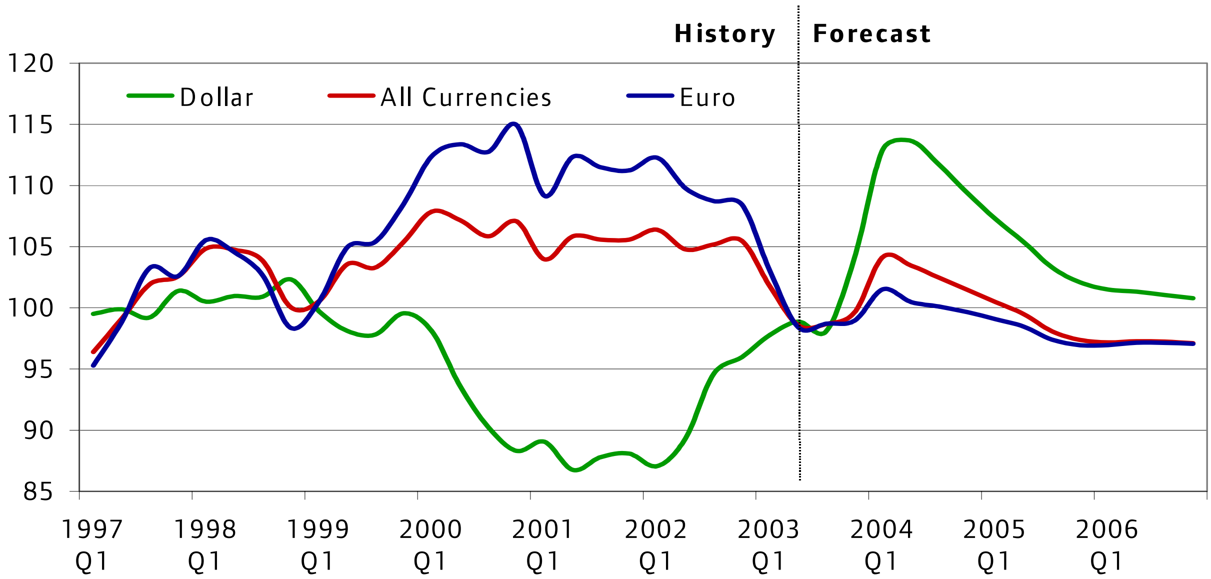
The continued strength of the Chinese economy is contributing to the upward pressure on commodity prices. The potential inflationary impact of commodity prices has been moderated by the fact that they are priced on international markets in US dollars and the dollar has been depreciating.

Downside risks centre on uncertainties provoked by the dollar's decline. Between 1999 and 2001 the pound fell against the dollar and rose against the Euro, but in 2001 this trend reversed and the pound rose against the dollar and fell against the Euro (Chart 1.4). UK goods are becoming more expensive in the US but cheaper in Europe. Conversely, UK imports from the US are becoming cheaper, but from Europe they are becoming more expensive.

Half of the UK's trade is with Europe and a fifth is with the US. Foreign exchange trends tend to increase inflationary pressures from European trade (since the goods that we buy the most of are becoming more expensive) but raise the UK's competitiveness (since the goods that we sell the most of are becoming cheaper to our customers). The US dollar's fall will have the reverse effect. Since a higher proportion of London's trade relative to the rest of the UK is with the US, the fall in the US dollar may affect London differently.

The US economy has an important link to London, and this increases the significance of downside (and upside) risks arising from the performance of the US economy, and the US dollar in particular.

Chart 1.4: Purchasing power of the pound, 1997=100



Dollar: Sterling-dollar exchange rate, period average
Bank of England Trade Weighted Index, sterling
Sterling-euro exchange rate (£ per euro), period average
Source: Experian Business Strategies

A falling US dollar will also affect dollar-denominated assets. The world has lent heavily to the US, and a continued devaluation in the dollar reduces the value of these assets. If this takes place in a benign manner, it could introduce a long-overdue correction in the US balance of payments. If, however, it provokes speculative attacks on the dollar and on currencies linked to it, this could provoke a rapid withdrawal of capital from US financial markets leading to a fall in US financial markets. This would have a direct impact on the wealth of US consumers and a negative impact on US growth. In addition, the UK and other stockmarkets could be expected to follow any declines seen on Wall Street.

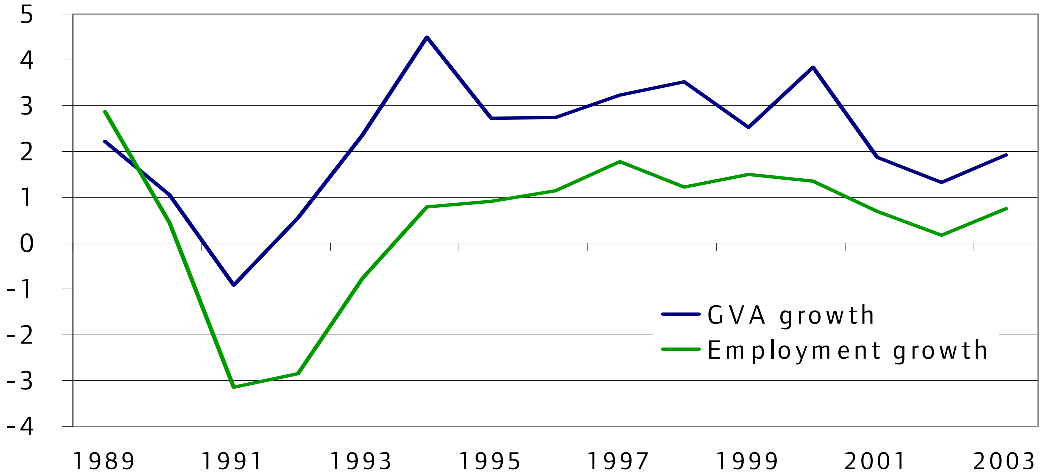
The stability of the US economy remains the principal downside risk for London's economy. The second main risk is the possibility of a sharp reversal in house prices, accompanied by a rapid fall in consumer spending. In the wake of the Madrid bombings, further terrorist attacks could also undermine global economic confidence.

The UK Economy

The UK economy performed more strongly in 2003 than most forecasters expected (Chart 1.5), and the Treasury continues to expect growth in the range of 3-3½ per cent during 2004 and 2005, slowing to 2½-3 per cent in 2006.

However, this growth has remained unbalanced because consumer and government spending have been the principal sources of growth. A sustained and balanced expansion requires a pick-up in investment growth.

Chart 1.5: Growth of real UK output and employment, year-on-year

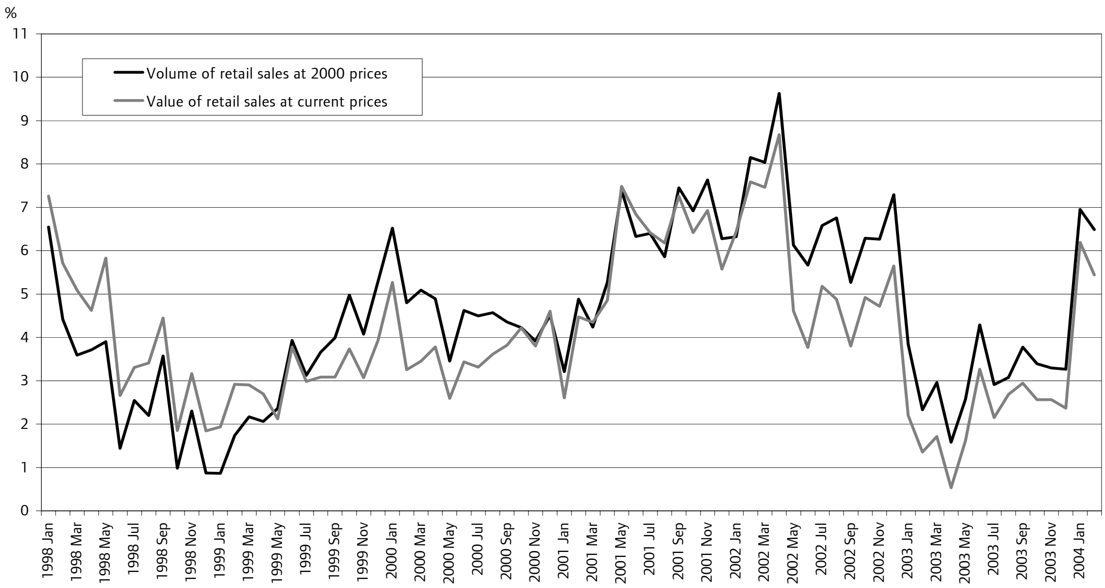


Source: Office of National Statistics and Experian Business Strategies
Note: GDP: £ billion at constant 2000 prices; Employment: number of workforce jobs.

Government spending continues to make a positive contribution to UK growth and with the plans for 2005/06 from Spending Review 2002 confirmed in the Budget, this boost is only likely to tail off from 2006.

Household expenditure growth has exceeded GDP growth in every year since the mid 1990s. While retail sales growth slowed over 2002 and the first half of 2003 the consumer has apparently found fresh vigour since then (Chart 1.6).

Chart 1.6: UK retail sales, percentage change, year-on year

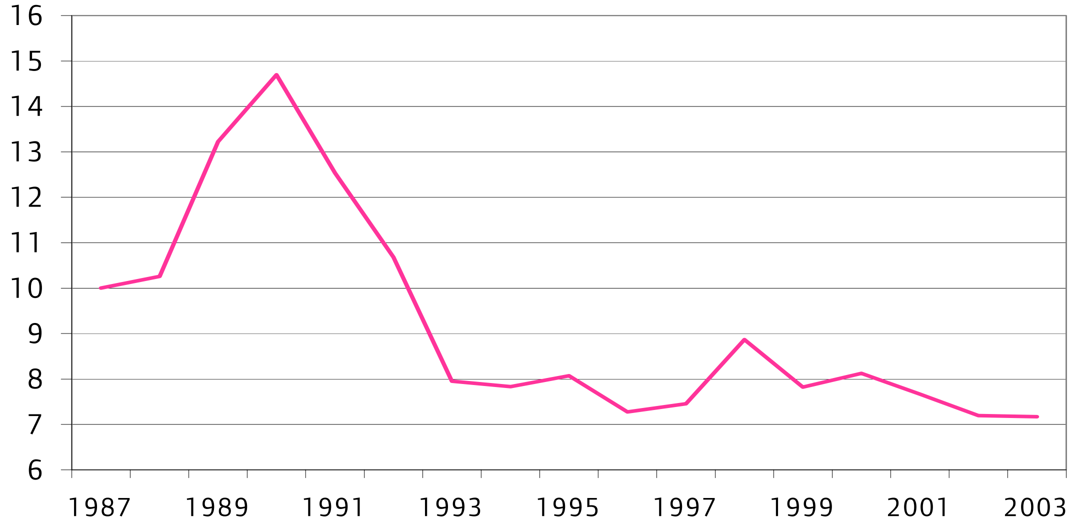


Source: Office of National Statistics

Despite this, Experian Business Strategies, in common with most forecasters, expects the growth in consumer spending to moderate (see Chapter 3). The GLA expects that house price rises, coupled with mortgage equity release, will continue to drive consumption initially. As a consequence, interest rates will rise further as the Bank of England attempts to dampen consumer spending in order to prevent CPI inflation from rising beyond its 2 per cent target.

This may be unduly pessimistic. It is possible that consumers may do no more than make a realistic appraisal of the true cost of borrowing, comparing the costs of debt service to their disposable income. Debt service ratios are at an all-time low, with an average of only 7 per cent of disposable income being spent on mortgage repayments and interest combined (Chart 1.7). There may be a considerable way to go before interest rate rises begin to affect consumers' apparently unshakeable determination to borrow and spend as if there was no tomorrow. However, such optimism comes with a sting in the tail as it implies that interest rates would have to be raised more sharply than is generally supposed (Table 1.1) in order to reduce consumption growth. This could imply a sudden drop off in growth rather than a more gradual and benign rebalancing of the UK economy.

Chart 1.7: Interest plus mortgage payments as a per cent of people's disposable income



Source: Experian Business Strategies

Table 1.1: Forecasts of the Bank of England interest rate

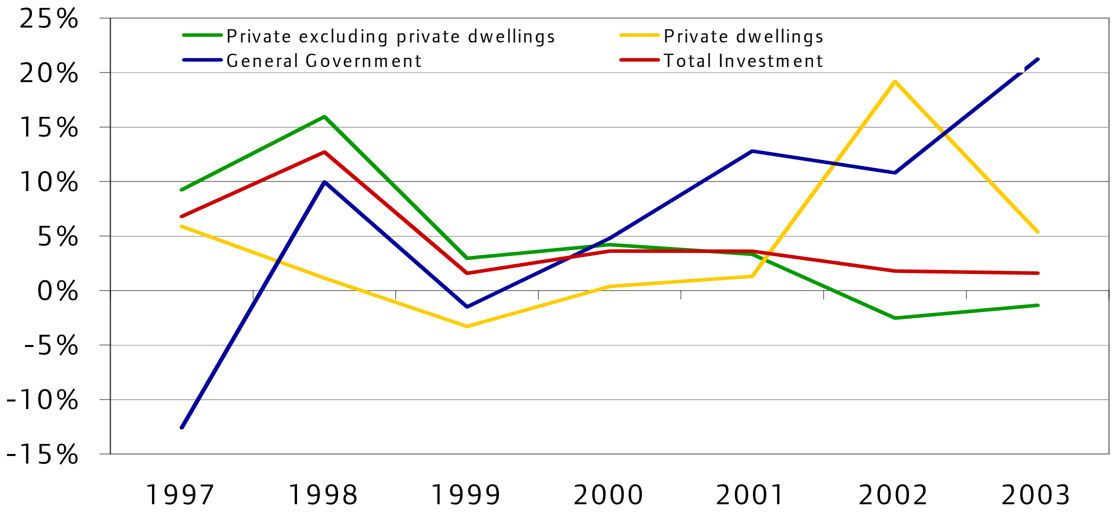
	2004	2005	2006
EBS	4.3	4.5	4.2
Bank of England average of external forecasts	4.5	4.7	4.7

Source: Experian Business Strategies and Bank of England 2004, Table 1 (p49)

A further problem is that if consumption does continue to rise at rates above GDP growth, it implies that the UK savings rate is falling. This introduces a potential further imbalance in that it reduces the sources of domestic finance for investment. In the medium to long term, if this trend continued, it would increase interest rates and investment rates would fall and, or the UK would have to attract more capital from abroad.

There has been some recovery in investment in the UK, particularly if quarter-on-quarter growth is considered. However, a closer examination shows that government investment (although a small proportion of the total) has risen much faster than private investment. Moreover, private dwellings account for a substantial amount of what is normally reported as private investment. While total annual investment has risen every year since 1992, business investment has failed to return to positive growth rates if expenditure on private dwellings is excluded.

Chart 1.8: Investment growth in the UK



Source: Experian Business Strategies
Note: Annual percentage growth in investment at 2000 prices. Government investment net of council house sales

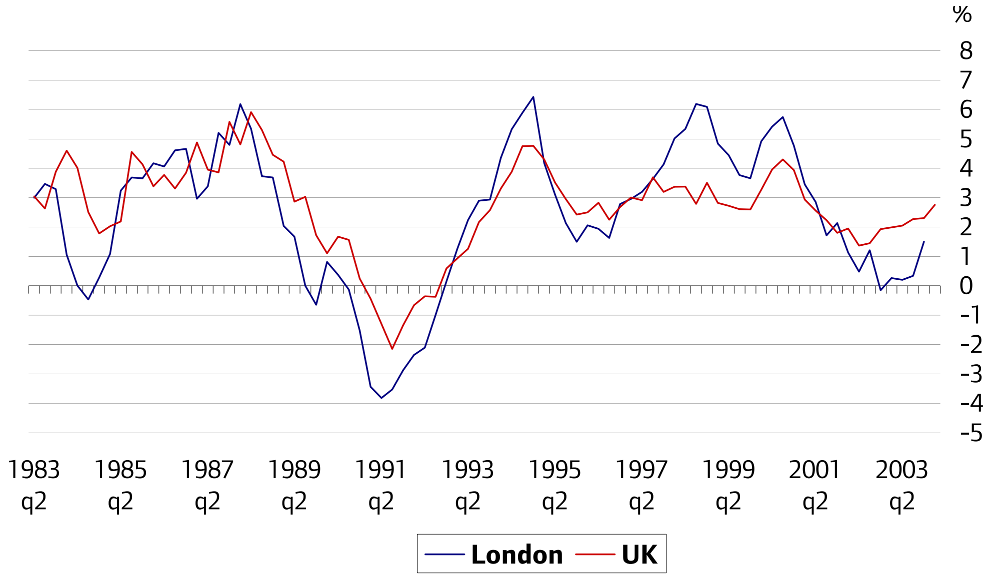
The latest results on company profitability provide some encouragement. The rate of return on capital employed by private non-financial corporations, outside of those involved in gas and oil production, was 12.1 per cent in the final quarter of 2003 the highest rate of return recorded since 1999. The question that remains is how much will increased profitability be used to fund new investment as opposed to reducing corporate debts and holes in company pensions schemes.

London

After enjoying very strong growth in the late 1990s, London was particularly affected over the last couple of years by turbulence in the financial markets and the associated weakness in the financial and business services sectors. It was also affected by the downturn in the tourism following September 11 and the Iraq war. But the recovery in the London has started. London's economy grew slightly more strongly than the UK economy in the last quarter of 2003, when London's GVA rose by 1.0 per cent in the quarter compared to UK growth of 0.8 per cent. However, London's annual GVA growth at 1.5 per cent still lags behind UK annual GVA growth of 2.7 per cent (Chart 1.9). In line with this, in February London firms recorded stronger growth than the UK as a whole for the ninth consecutive month, but the rate of expansion has slowed slightly since October 2003. London firms also expanded their workforce in February for the fifth month in a row.

London's recovery is reflected in transport use, a strong leading indicator. Tube ridership was higher than the previous year in period 13 (roughly, April) for the first time in three years. Annual growth in bus use continued its rising trend, reaching 11 per cent in period 13 compared to 10.4 per cent in period 10 (roughly December 2003). The annual growth in the number of passengers on buses and the tube combined has been above 6 per cent throughout 2004 and reached 6.7 per cent in period 13. Both these growth rates were the highest since 1994.

Chart 1.9: Real London GVA growth and UK GDP growth



Source: Experian Business Strategies

On the downside, there has been some fall-off in export optimism among London manufacturers. Future prospects of export orders have fallen to a net balance of zero, which is the first time for nine surveys that this balance has not been positive.

Fears of interest rate rises have also dented confidence among London firms, according to a new survey reported by the London Chamber of Commerce and Industry (LCCI 2004). Although optimism about the economic outlook is far higher than 12 months ago, it has dipped from the start of the year, according to the report. A net 23 per cent of companies believe the capital's economy will improve over the next year, compared with 35 per cent three months ago.

The LCCI survey also shows more pessimism surrounding inflation and interest rates now than at any time in the past six years. A net 82 per cent of companies are braced for an increase in the cost of borrowing, despite the Bank of England's decision to leave rates on hold at 4 per cent on 8 April 2004. The dip in confidence is reflected in lower expectations about companies' own performance. A net 39 per cent predict better times ahead compared with 58 per cent three months ago.

2. Review of independent forecasts

What the forecasts provide

The GLA's forecast reports on four indicators: workforce employment, real output, private consumption (household expenditure) and household income in London. The consensus reports on the first three of these, as most forecasters do not yet provide forecasts of household income. Both annual growth rates and 'standardised' absolute levels (see the box below) are reported.

Both the GLA and consensus forecasts also provide predictions of growth rates for employment and output in six broad industry sectors:

- manufacturing
- construction
- transport and communications
- distribution, hotels and catering
- finance and business services
- other (mainly public) services.

Summary of the consensus

There is a clear consensus that London's economy has turned the corner and will see three years of steady growth. However, no forecaster expects a return to the high rates of the late 1990s.

Output growth is expected to rise above trend in 2004 and remain there in 2005 and 2006. Employment growth at 1.6 per cent in 2003 was above all forecasters' expectations, and they do not expect this to be sustained. The average forecast growth for employment is 0.8 per cent, with a maximum of 1.7 per cent and a minimum of –0.1 per cent.

Is a London consensus possible?

To complete the picture of what any forecast entails for London, the rate at which each variable is growing, and its absolute level, must be known.

The difficulty with providing a consensus for future levels is that forecasters do not agree on present levels. However, the GLA has a standard estimate of workforce employment, and uses EBS estimates of output and household expenditure.

Forecasters' predictions are standardised using growth estimates from the forecasters, and the GLA/EBS estimates of the three main indicators. What each forecaster would predict for the future if it used the EBS estimates for the past is then calculated (assuming that different past data would not change the forecasters' view of the future).

This provides a common basis to compare the reports, abstracting from the statistical differences which arise because the forecasters adopt different definitions.

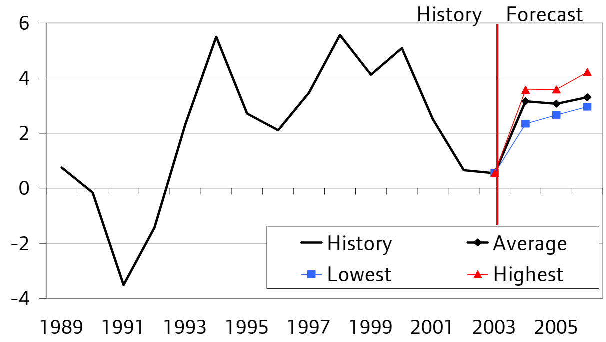
Output (constant year 2000 £b)

Forecasters all expect a significant increase in output for 2004 with growth ranging from 2.3 to 3.6 per cent.

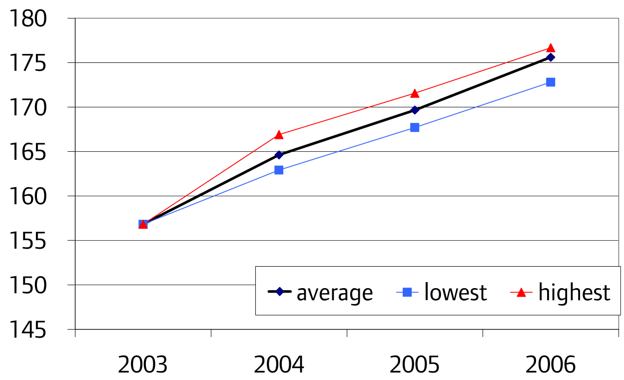
They expect this growth to be sustained into 2006. The average estimate of growth is 3.2 per cent for 2004 and 2005, with similar rates in 2005 and 2006.

This average would bring London's output up to £176 billion in 2006, at constant 2000 prices.

Annual growth (%)



Level (constant year 2000 £b)



Annual growth (%)			
	2004	2005	2006
Average	3.2	3.1	3.3
Lowest	2.3	2.7	3.0
Highest	3.6	3.6	4.2

Level (constant year 2000 £b)			
	2004	2005	2006
Average	165	170	176
Lowest	163	168	173
Highest	167	172	177

History: annual growth (%)

1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
0.8	-0.2	-3.5	-1.4	2.3	5.5	2.7	2.1	3.5	5.6	4.1	5.1	2.5	0.6	0.6

History: level (constant year 2000 £b)

1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
118	118	113	112	114	121	124	127	131	138	143	151	155	156	157

Employment (workforce jobs)

Employment growth of 1.6 per cent in 2003 was higher than most forecasters expected.

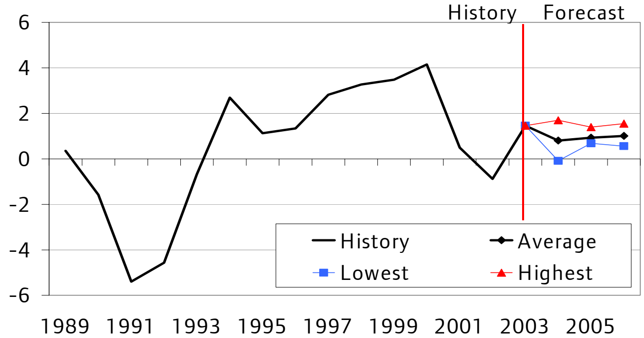
As a result, London's employment in 2003 at 4,570,000 was the highest since the GLA's dataset began in 1971.

Continued modest but steady growth is expected, at levels on or under 1.0 per cent per year.

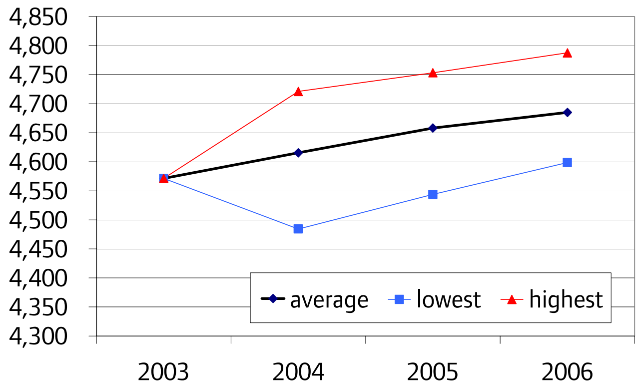
Forecasters on average do not expect the high growth of 2003 to be sustained in 2004; but the highest forecast is 1.7 per cent growth, just above the 2003 outturn.

Even on these relatively prudent average predictions, London would be home to nearly 4,700,000 jobs by 2006.

Annual growth (%)



Level (thousands)



Annual growth (%)			
	2004	2005	2006
Average	0.8	0.9	1.0
Lowest	-0.1	0.5	0.6
Highest	1.7	1.4	1.6

Level (thousands)			
	2004	2005	2006
Average	4,620	4,660	4,690
Lowest	4,480	4,540	4,600
Highest	4,720	4,750	4,790

History: annual growth (%)

1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
0.4	-1.6	-5.4	-4.6	-0.7	2.7	1.2	1.4	2.8	3.3	3.5	4.2	0.5	-0.9	1.6

History: level

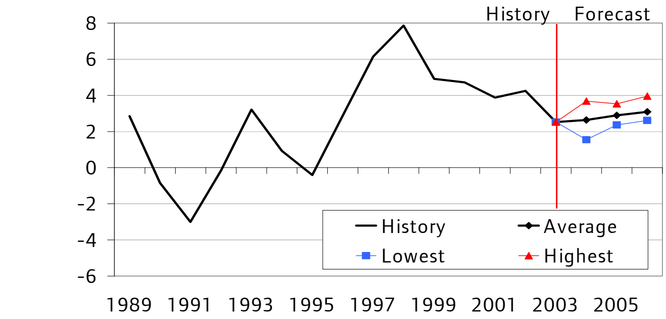
1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
4,240	4,170	3,950	3,770	3,740	3,840	3,890	3,940	4,070	4,200	4,340	4,520	4,550	4,510	4,570

Household expenditure (constant year 2000 £b)

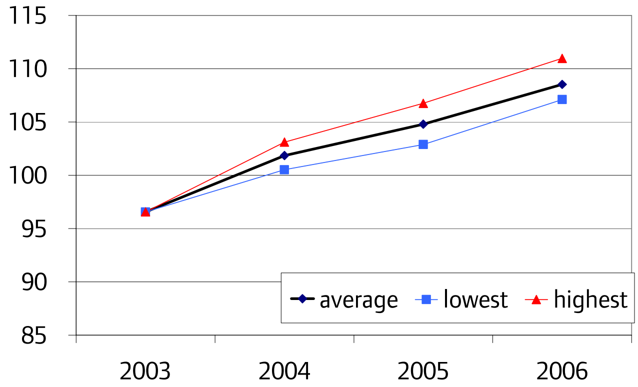
Consumer spending has grown very fast in the past six years, at rates either above or just below 4 per cent, even through the slowdown. In 2003 there was a significant reduction to 2.5 per cent and the consensus is that growth will pick up slightly reaching 3.0 per cent by 2006.

The most pessimistic estimates expect 1.5 per cent growth in 2004 rising to 2.6 in 2006.

Annual growth (%)



Level (thousands)



Annual growth (%)			
	2004	2005	2006
Average	2.6	2.9	3.0
Lowest	1.5	2.4	2.6
Highest	3.7	3.5	4.0

Level (constant year 2000 £b)			
	2004	2005	2006
Average	102	105	109
Lowest	101	103	107
Highest	103	107	111

History: annual growth (%)

1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
2.8	-0.8	-2.9	-0.2	3.1	0.9	-0.4	2.9	6.1	7.9	4.9	4.7	3.9	4.3	2.5

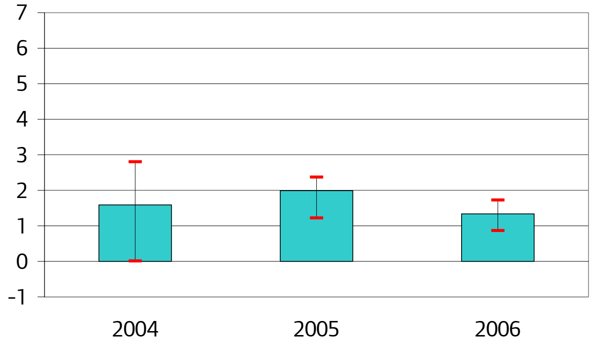
History: level (constant year 2000 £b)

1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
68	67	65	65	67	68	67	79	73	79	83	87	90	94	97

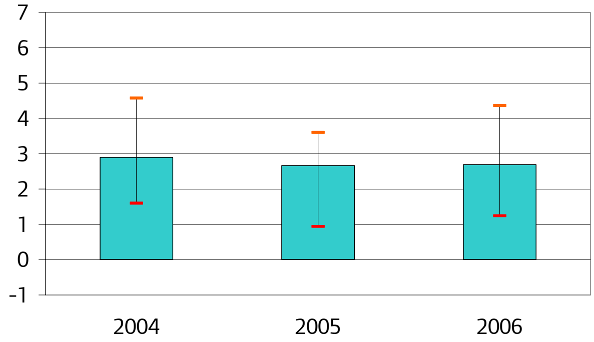
Output growth by sector

At least steady growth is expected in all sectors including manufacturing, and in some it is expected to be strong. Finance and Business is expected to grow at or above 4 per cent, and Transport and Communications is predicted to see growth rising from 3 to 4 per cent.

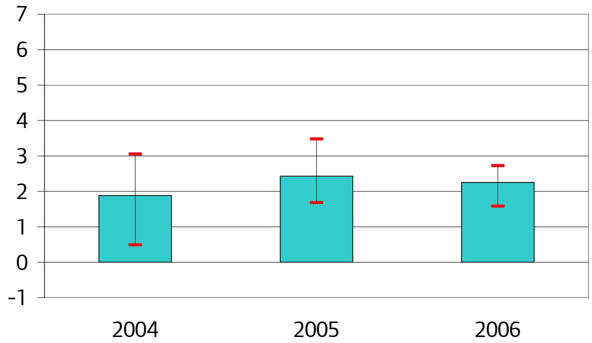
Manufacturing



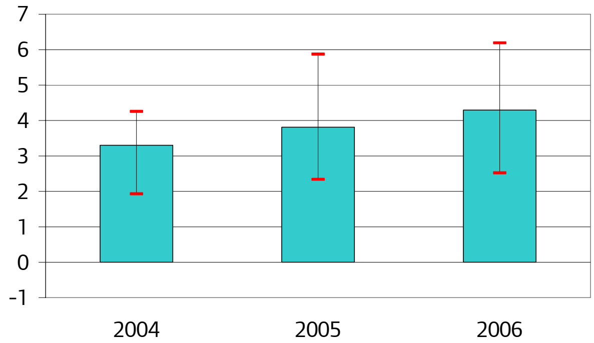
Construction



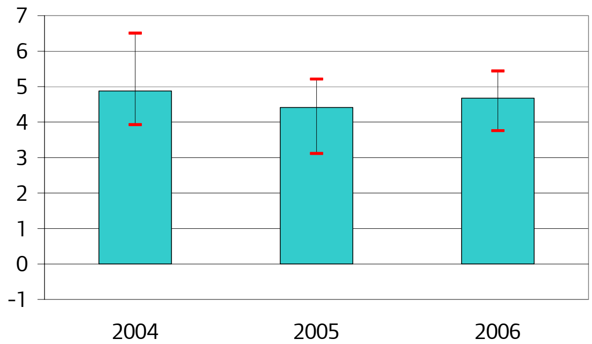
Distribution



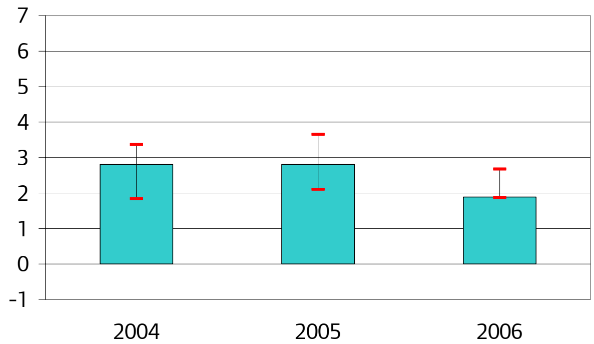
Transport and Communications



Finance and Business



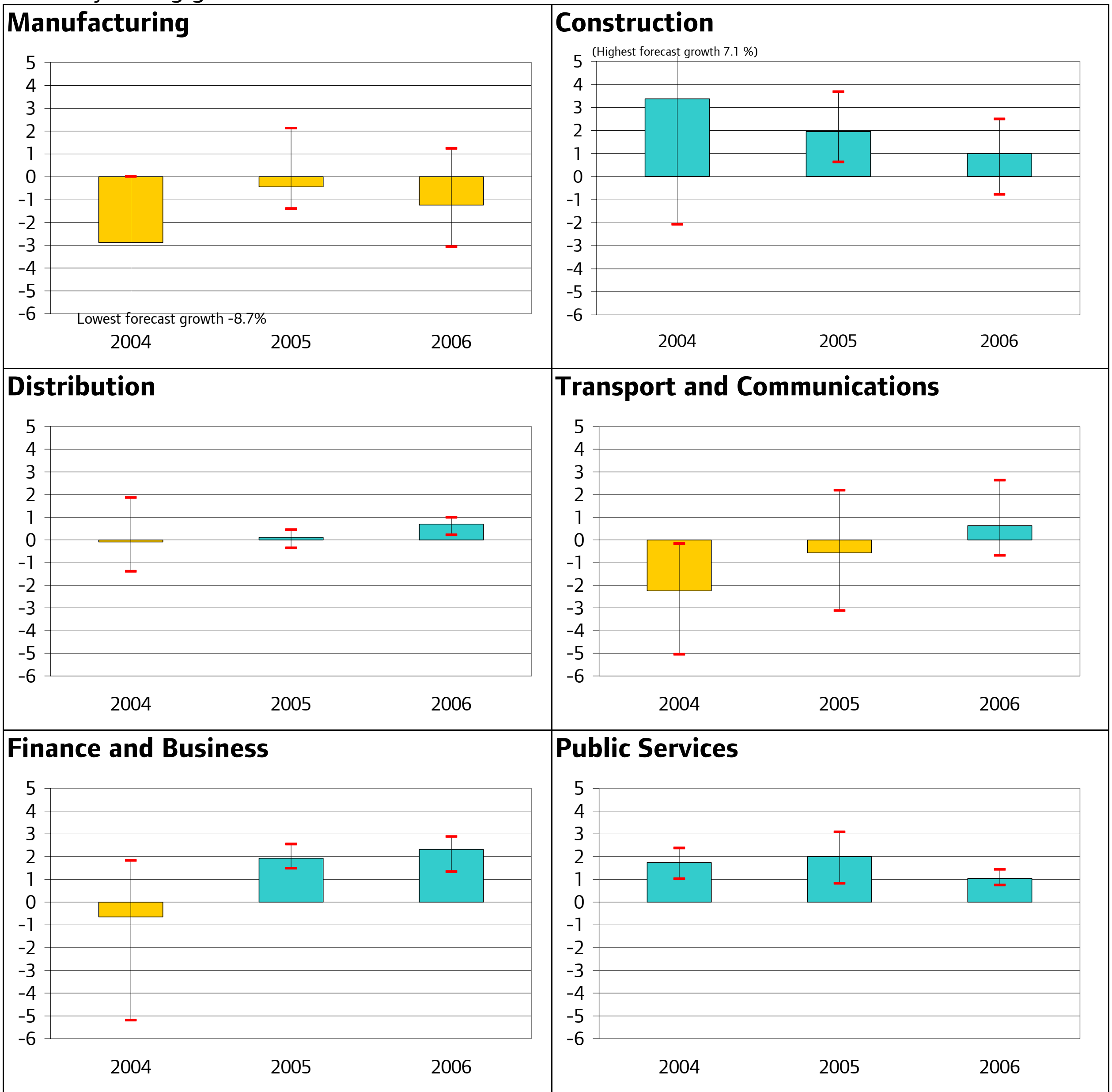
Public Services



		2004	2005	2006			2004	2005	2006
Manufacturing	Average	1.6	2.0	1.3	**Construction**	Average	2.9	2.7	2.7
	Lowest	0.0	1.2	0.9		Lowest	1.6	0.9	1.2
	Highest	2.8	2.4	1.7		Highest	4.6	3.6	4.4
Distribution	Average	1.9	2.4	2.3	**Transport and Communications**	Average	3.3	3.9	4.3
	Lowest	0.5	1.7	1.6		Lowest	1.9	2.3	2.5
	Highest	3.1	3.5	2.7		Highest	4.3	5.9	6.2
Finance and Business	Average	4.9	4.4	4.7	**Public Services**	Average	2.8	2.8	1.9
	Lowest	3.9	3.1	3.8		Lowest	1.8	2.1	1.9
	Highest	6.5	5.2	5.4		Highest	3.4	3.7	2.7

Employment growth by sector

As noted, forecasters expect modest overall employment growth, and this is reflected in a mixed picture across the sectors. Job losses in Manufacturing are expected to continue, but Construction, Public Services, and from 2005 Finance and Business, are all expected to show relatively strong growth.



		2004	2005	2006			2004	2005	2006
Manufacturing	Average	-2.9	-0.4	-1.2	**Construction**	Average	3.4	2.0	1.0
	Lowest	-8.7	-1.4	-3.1		Lowest	-2.1	0.6	-0.8
	Highest	0.0	2.1	1.2		Highest	7.3	3.7	2.5
Distribution	Average	-0.1	0.1	0.7	**Transport and Communica-tions**	Average	-2.3	-0.6	0.5
	Lowest	-1.4	-0.9	0.2		Lowest	-5.0	-3.1	-0.7
	Highest	1.9	0.5	1.0		Highest	-0.2	2.2	2.6
Finance and Business	Average	-0.7	1.9	2.3	**Public Services**	Average	1.7	2.0	1.0
	Lowest	-5.2	1.5	1.3		Lowest	1.0	0.8	0.8
	Highest	1.8	2.6	2.9		Highest	2.4	3.1	1.4

3. The GLA forecast

Assumptions and methods

This forecast[6] combines the GLA's long-term trend projections for employment and population with medium-term assumptions about the growth of the UK economy derived from the Treasury's February and March reviews of independent forecasts of the UK economy (HM Treasury 2004a, 2004b).

The GLA's long-term projections for London are those underlying the Mayor's London Plan (GLA 2004). The model is constrained for the year 2010 to London-based employment projections derived from the long-term growth rate of London's population and the workforce. The UK assumptions comprise the medium-term growth rates of UK total output.

Detailed assumptions for the UK

Table 3.1 shows the assumptions adopted by the GLA for its forecast, and for comparison the Treasury's latest Budget 2004 forecast and the latest consensus estimates.

Table 3.1: UK economic assumptions

		2004	2005	2006	2007	2008-10
GLA forecast	GDP	3.1	2.6	2.5	2.5	2.5
	Consumption	3.3	2.4	2.2	2.8	-
Budget 2004	GDP	3-3½	3-3½	2½-3	-	-
	Consumption	3-3¼	2¼-2¾	2¼-2¾	-	-
Consensus[7]	GDP	3.1	2.6	2.5	2.5	-
	Consumption	3.3	2.4	-	-	-

Note: GLA Economics has adopted consensus growth estimates throughout this forecast.

These estimates, when applied to the EBS UK model, generate UK growth rates for manufacturing and non-manufacturing. These rates have an impact on the London forecast, since it has a much higher share of non-manufacturing production than the UK average. These are shown in Table 3.2.

Table 3.2: Implicit UK growth rates

	2004	2005	2006
Manufacturing output	2.3	2.5	2.3
Non-manufacturing output	3.8	2.7	2.5

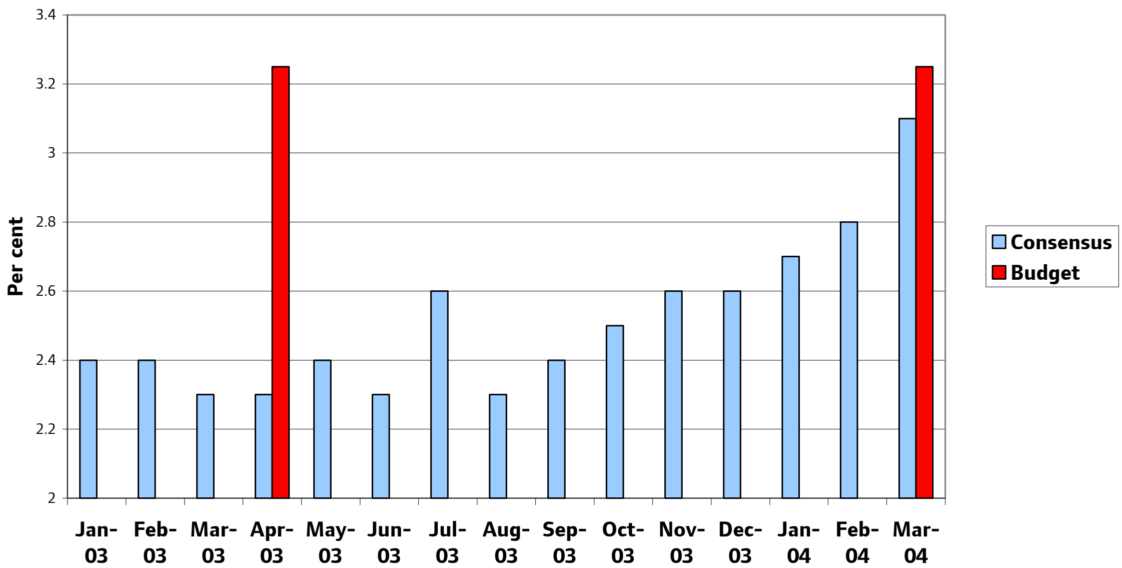
Source: EBS UK forecast using GLA Economics assumptions on UK GDP growth

[6] Prior to December 2003, London's Economic Outlook was called *The GLA's Medium-term Planning Projections*.

[7] For 2004 and 2005 the average of new forecasts from the March *Review of Independent Forecasts*; for 2006 onwards the mean taken from the February *Review*.

The fact that UK economic conditions are becoming more positive is shown by Chart 3.1 which indicates that the independent forecasters are becoming more optimistic in relation to growth this year and the consensus (3.1 per cent) is within the 3 to 3½ range forecast by the Chancellor in this year's Budget.

Chart 3.1: UK growth in 2004 (comparing Budget and Consensus forecasts)



Source: EBS and GLA Economics

Projection and forecast

It is necessary to distinguish carefully between the GLA's trend projections, which underpin the London Plan, and this forecast.

Trend projections, by definition, do not incorporate cyclical variations, and constitute estimates of jobs and output at comparable points in the cycle. The actual course of output and employment will vary around this trend.

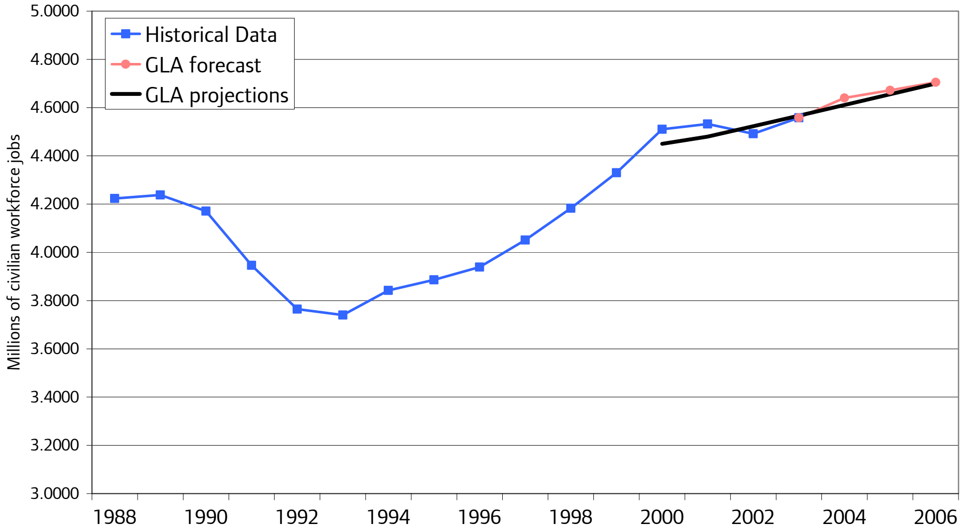
Trend projections are essential for planning to provide capacity (such as office space, housing, and transport) to accommodate the needs of the economy throughout and at the peak of the cycle, and not just at its low points. For business planning (for example, in deciding the timing of investments and the likely course of revenue) estimates of actual numbers of jobs and actual output at any point in time are required. The medium-term planning projections provide these estimates.

As time progresses and more data become available, it becomes possible to identify whether underlying trends are continuing or whether new trends are setting in. While the forecast is calibrated to the GLA's employment projections for 2010, it provides early warnings of significant deviations from these projections because it takes into account the most recent data and incorporates the latest estimates of UK growth rates.

Results and analysis

London's recovery is gathering pace, although job growth is still modest. In line with the consensus, the GLA's forecast predicts three years of steady growth without a return to the high rates of the late 1990s. The GLA's predictions for output growth remain at the lower end of the range of previous forecasts (Chart 3.2). Nevertheless, output growth is expected to rise in 2004, 2005 and 2006 and to remain above trend during this period.

Chart 3.2: Trend and forecast employment



Source: EBS and GLA Economics
Note: projections and historical data do not start from the same 2000 level because historical data has been revised.

Accompanying this change, employment growth for 2003 was higher than previously expected at 1.6 per cent, towards the high end of the consensus range.

Since employment growth in 2003 was higher than expected, it is not unreasonable that the forecast of employment growth, particularly in 2004, is now towards the high end of the range of previous forecasts. Total growth between 2003 and 2006 – at 143,000 – is substantial.

The forecast in 2004 predicts that the above-trend growth rate of 1.6 per cent in 2003 will not be sustained and will then dip to 0.7 per cent in 2005 and 2006. This is consistent with the forecasters' view of the growth in consumer spending, which is expected to decline in 2005 in response to higher interest rates.

Household spending growth fell to 2.3 per cent in 2003 but was still 1.7 per cent above GDP growth. It is expected to exceed GDP growth again in 2004 but to fall below it in 2005 and 2006.

EU enlargement and London

On 1 May 2004, 10 countries – Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia – will join the European Union (EU). The accession of these countries will increase the EU's population by around a fifth but will add only about 5 per cent to EU GDP.[8]

EU enlargement will have an impact on the economies of London and the UK principally through two channels: increased trade with the accession countries; and migration from these countries into London and the UK. The impact of both these factors on London is likely to be positive but small.

The growth of the accession countries is likely to be enhanced by joining the EU, and they are expected to grow relatively rapidly over the next decade. However, given the small addition they represent to EU GDP, they will only have a small impact on the level of UK exports. The ITEM Club, an independent economic forecaster, has estimated that it would take a doubling of UK exports to the accession countries (excluding Cyprus and Malta which already have well developed trade links with the UK) even to raise UK GDP by ½ a per cent.[9] Since most UK exports to these countries are goods and London specialises in service exports, the impact on London is likely to be even more modest.

There are substantial differences in living standards[10] between the accession countries and the current EU average. For example, per capita income in the Czech Republic and Poland is around 60 per cent and 40 per cent respectively of the current EU average. There could be substantial income gains for migrants into the current EU from the accession countries. Migrants from these countries are generally well educated and have skills demanded by UK and London employers, and are likely to be economically beneficial. The Government has recently decided to make employment a condition for accession country nationals to remain in the UK. This should reduce the number of migrants coming to London and the UK more generally and increase the probability that migrants who do come will fill skill gaps and other vacancies in the labour market.

[8] Based on 2002 figures at prevailing market exchange rates.
[9] ITEM Club (2004), Economic Update: The Impact of EU Enlargement on the UK Economy.
[10] Measured in terms of GDP per head using purchasing power parities

Chart 3.3: Comparison with previous forecasts

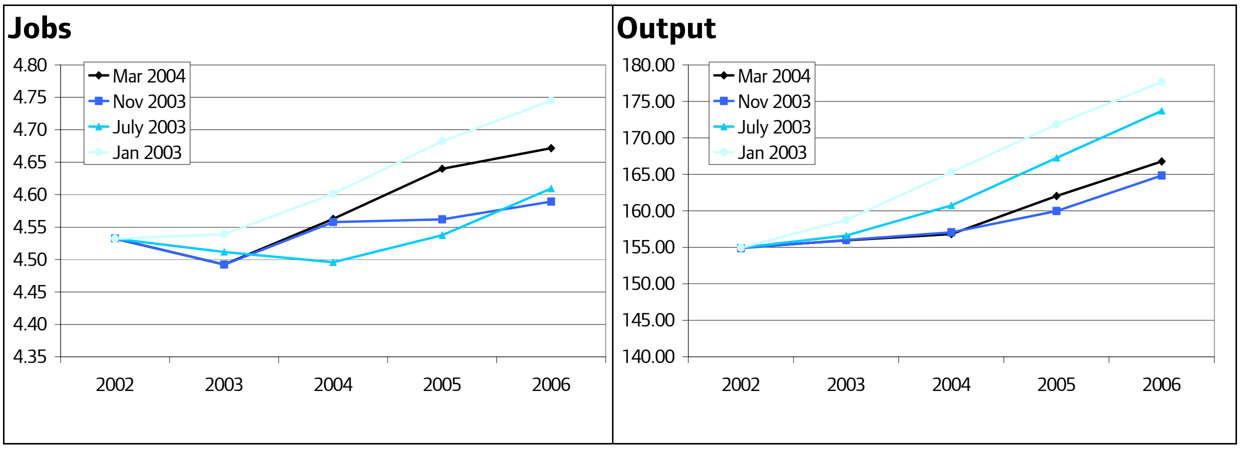


Table 3.3: Forecast growth rates (%)

	2000	2001	2002	2003	2004	2005	2006
GVA	5.2	2.5	0.6	0.6	3.3	2.9	3.0
Civilian workforce jobs	4.2	0.5	-0.9	1.6	1.7	0.7	0.7
Household income	7.3	7.1	2.0	1.4	3.0	3.5	3.6
Household spending	4.8	4.3	4.1	2.3	3.0	2.6	2.6

Table 3.4: Forecast levels (constant year 2000 £b except jobs)

	2000	2001	2002	2003	2004	2005	2006
GVA	151	155	156	157	162	167	172
Workforce jobs (millions)	4.51	4.53	4.49	4.56	4.64	4.67	4.71
Household income	97.1	104	106	108	111	115	119
Household spending	87.0	90.6	94.1	96.3	99.2	102	104

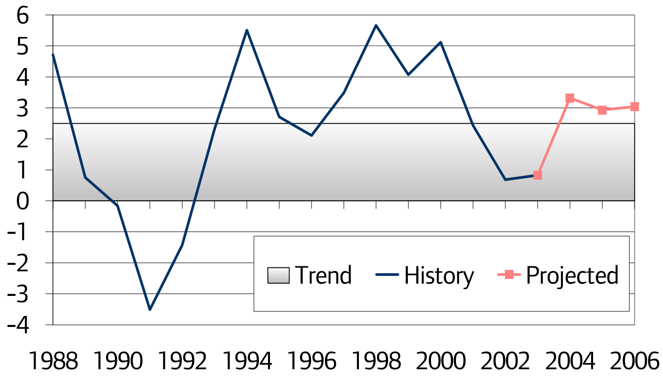
Output

Output growth fell below the trend rate of 2.5 per cent in 2001 and stayed below in 2002 and 2003.

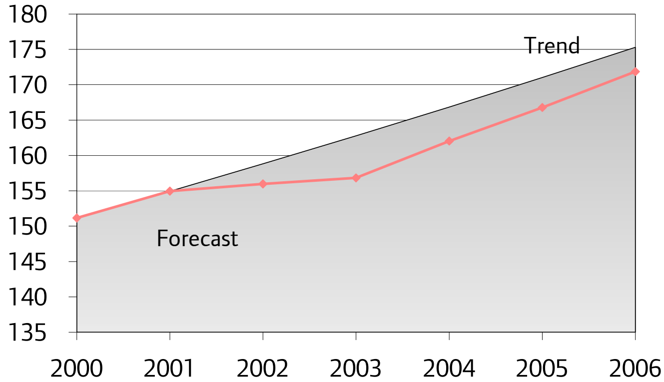
It is forecast to rise above trend again in 2004, followed by two further years of above-trend growth.

The GLA forecast output growth is slightly above the consensus in 2004 but below it in 2005 and 2006

Annual growth (%)



Level (constant year 2000 £b)



Growth (annual %)			
	2004	2005	2006
GLA	3.3	2.9	3.0
Consensus	3.2	3.0	3.0

Level (constant year 2000 £b)			
	2004	2005	2006
GLA	162	167	172
Consensus	165	170	176

Employment

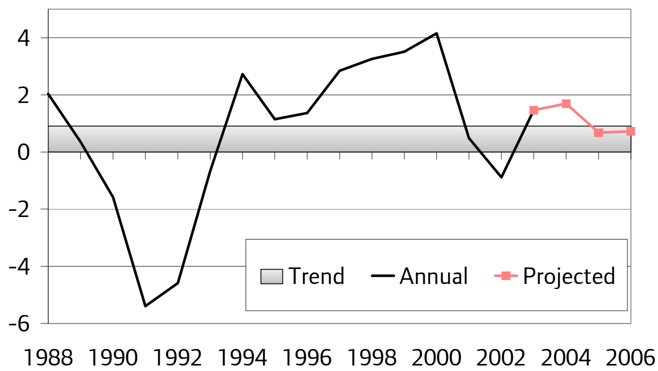
Continued strong job growth is forecast for 2004, but this is not expected to continue in 2005 and 2006 when growth is projected to be below the trend rate of 0.9 per cent a year over the next three years as a whole.

The employment growth rate forecast for 2004, at 1.7 per cent, is higher than the consensus but for 2005 and 2006 it is below this.

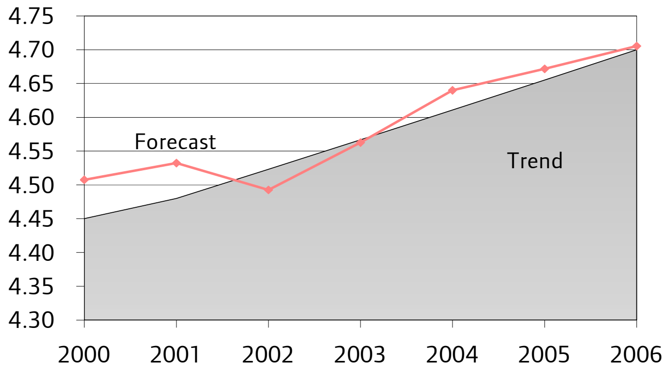
As a result, the GLA forecast of 4,710,000 jobs in 2006 is close to the consensus outcome.

The total number of new jobs between 2003 and 2006 is forecast to be 143,000.

Annual growth (%)



Level (thousands of workforce jobs)



Growth (annual %)			
	2004	2005	2006
GLA	1.7	0.7	0.7
Consensus	0.8	0.9	1.0

Level (thousands of workforce jobs)			
	2004	2005	2006
GLA	4,640	4,670	4710
Consensus	4,620	4,660	4,690

Household expenditure

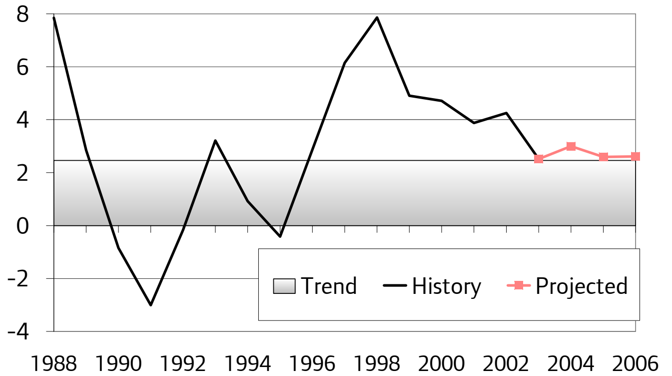
Household expenditure growth has exceeded output growth in London for three years.

In 2001 it grew at 4.1 per cent compared to 2.5 per cent GVA growth; in 2002 at 4.0 per cent (GVA 0.7 per cent) and in 2003 at 2.3 per cent (GVA 0.6 per cent).

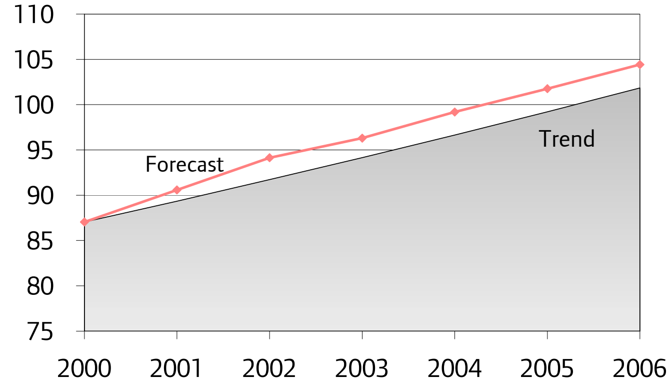
It is expected to move below output growth in 2004 at 3.0 per cent, as against forecast GVA growth of 3.3 per cent; and this is expected to continue through to 2006.

The gradual slowdown in consumption growth is predicated on the assumption that higher interest rates will slow the rate of house price inflation and equity withdrawal, factors which have been driving up consumption.

Annual growth (%)



Level (constant year 2000 £b)



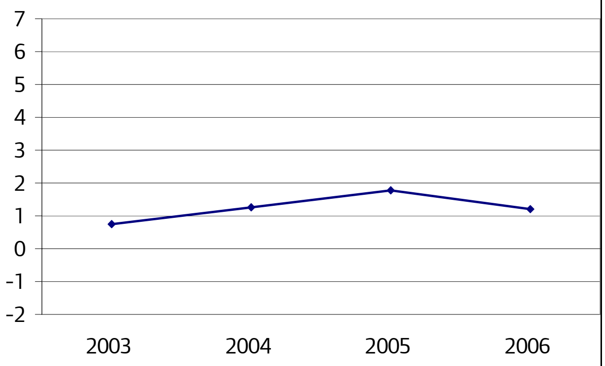
Growth (annual %)			
	2004	2005	2006
GLA	3.0	2.6	2.6
Consensus	2.6	2.9	3.0

Level (constant year 2000 £b)			
	2004	2005	2006
GLA	99.2	102	104
Consensus	102	105	109

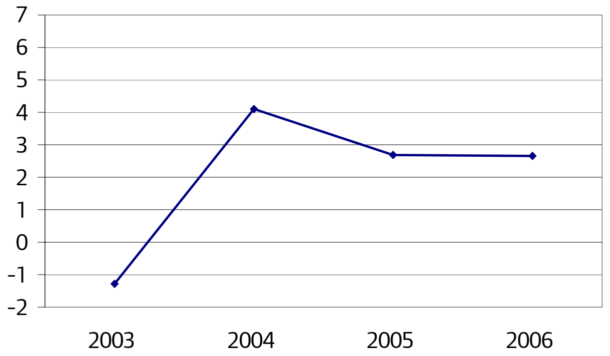
Output growth by sector

Growth is projected to be positive in all sectors through to 2006. The strongest growth is expected in Finance and Business with output growth reaching nearly 7 per cent in 2004, falling off to 4-5 per cent over the next two years. Growth in Transport and Communications expected to accelerate, reaching 5.4 per cent in 2006.

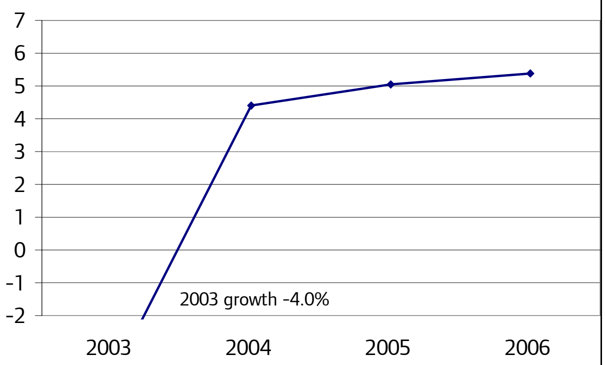
Manufacturing



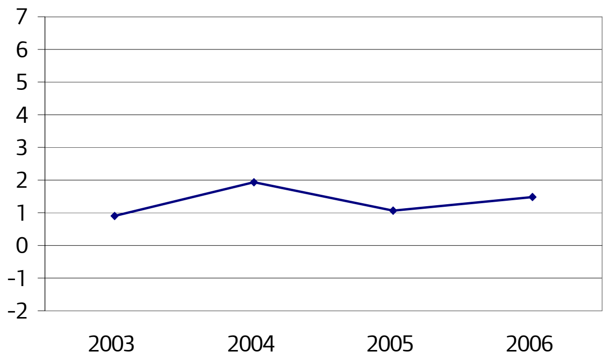
Construction



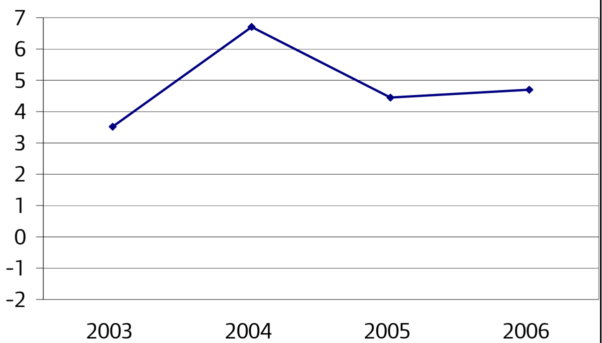
Transport and Communications



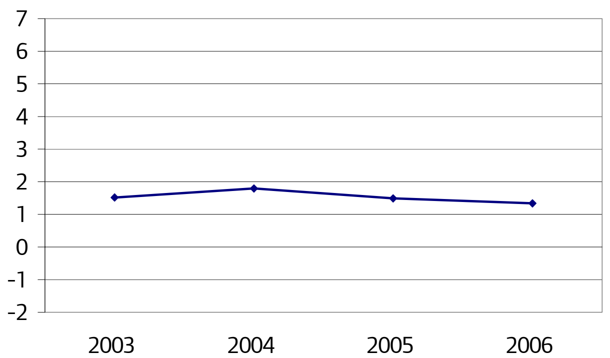
Distribution



Finance and Business



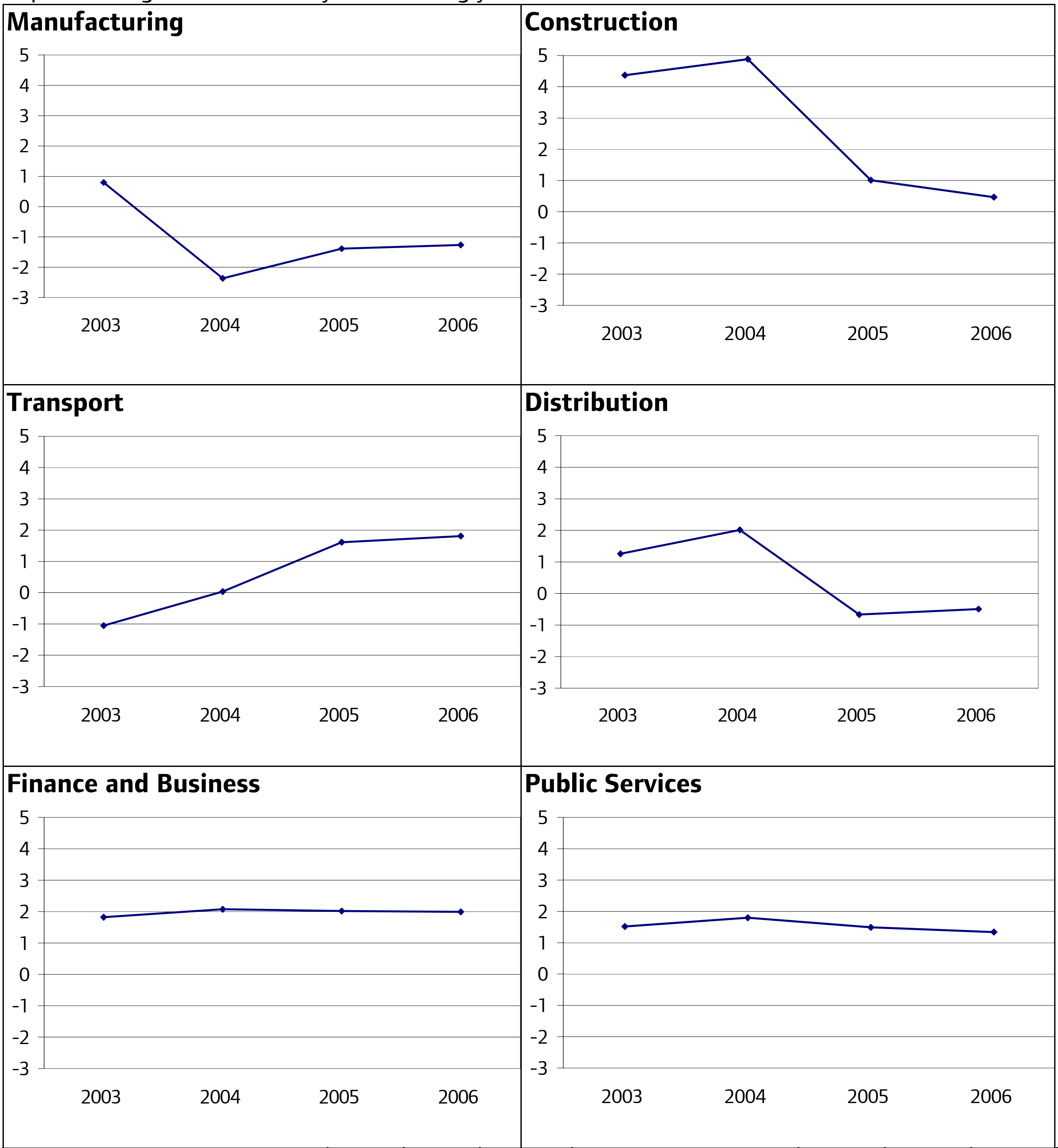
Public Services



	2004	2005	2006		2004	2005	2006
Financial and Business Services	6.7	4.4	4.7	Other (mainly Public) Services	1.8	1.5	1.3
Distribution, Hotels and Catering	1.9	1.1	1.5	Manufacturing	1.3	1.8	1.2
Transport and Communications	4.4	5.0	5.4	Construction	4.1	2.7	2.7
Memo: non-manufacturing	*4.4*	*3.2*	*3.4*				

Employment growth by sector

2004 is predicted to show strong employment growth across the board, led by Finance and Business, Distribution, Public Services and Construction. Growth in the latter three is expected to fall away in 2005 and 2006, at which point Transport and Communications is expected to grow considerably more strongly.



	2004	2005	2006		2004	2005	2006
Financial and Business Services	2.0	2.0	2.0	Other (Mainly Public) Services	2.0	0.3	0.3
Distribution, Hotels and Catering	2.0	-0.7	-0.5	Manufacturing	-2.4	-1.4	-1.3
Transport and Communications	0.0	1.6	1.8	Construction	4.9	1.6	1.8
Memo: Non-Manufacturing	*0.3*	*0.8*	*1.3*				

4. London's International Trade

This chapter was written in response to growing interest about how UK trade patterns will affect the economic growth of London. In particular, it:

- illustrates the current pattern of UK trade
- estimates London's share of UK exports and assess London's role
- explores the importance of emerging markets.

Key points

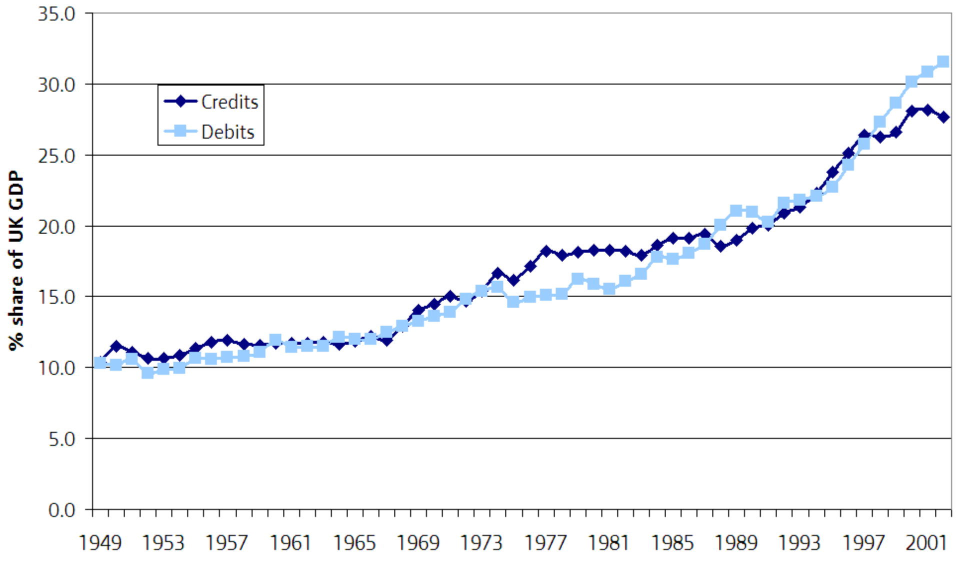
- Exports of goods and services account for up to a quarter of London's economy. This is a similar share to the UK as a whole even though London's economic structure is much more dependent on services.
- The GLA's estimates of London's share of exports are likely to be conservative given that London's productivity is higher than the UK average.
- London's exports are mostly concentrated in services and particularly sectors such as fund management, air transport and other business services. Overseas visitor spending in London is its most important export.
- The EU is the biggest market for London's exports. However, London's concentration of exports in services means it is much more interdependent than the rest of the UK on regions beyond Europe, especially the US.
- Emerging markets in South East Asia and the expansion of the EU will provide new opportunities for London's exporters.

The growing importance of trade to the UK and London
London is a world city and the UK, with London at its centre, is a trading nation. The UK's trading relationships with the rest of the world have a significant impact on London's economic prospects.

Economists have long-recognised the value of trade – in terms of the benefits of allowing countries to specialise in the activities in which they are strongest, and the dynamism of trade as a driver of competition, innovation and economic growth. Recent decades have seen a rapid expansion in world trade as countries have generally become more open.

The UK economy has expanded alongside the growth of international trade. The value of credits (total exports of goods and services, and earnings from income transfers) and debits (total imports of goods and services, repayments from income and transfers) in the current account is roughly in balance but the contribution of trade to UK GDP is rising.

Chart 4.1: Share of trade in UK GDP



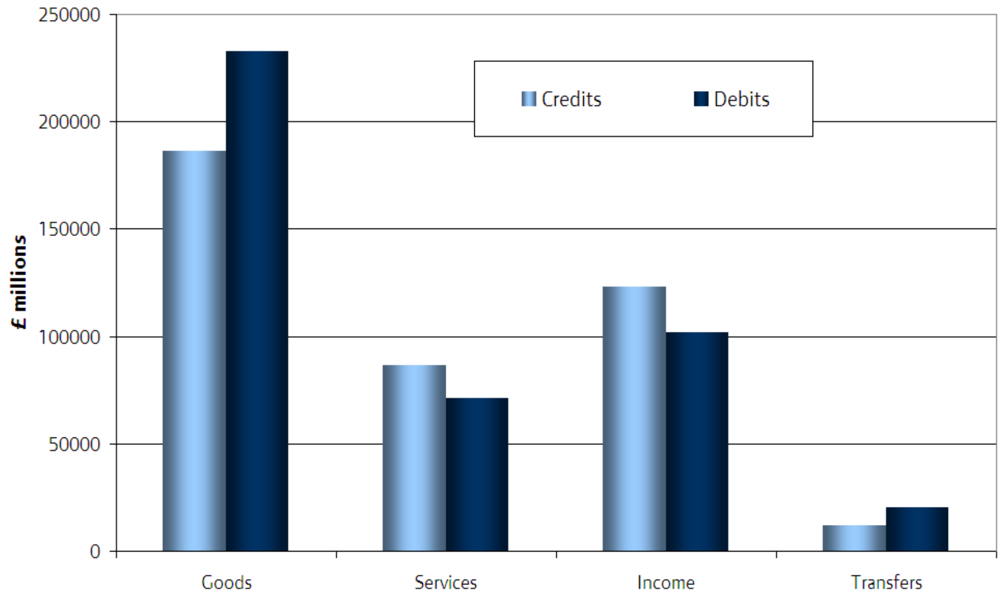
Source: ONS

The share of trade as a proportion of national GDP has been on an upward path since the 1960s, galvanised by the UK's membership of the EU and the global trends towards trade liberalisation. By 2002, credits were equivalent to nearly 30 per cent of GDP compared to 21 per cent in 1990, 16 per cent in 1980 and 13 per cent in 1970. The 1990s saw the most rapid expansion in trade as a share of GDP.

The UK current account 2002

The current account measures the annual flows of the value of goods, services and income between the UK and the rest of the world.

Chart 4.2: Summary of UK current account, 2002



Source: ONS, The Pink Book 2003

In 2002, the UK current account recorded £407 billion of credits and £426 billion of debits. This consisted of:

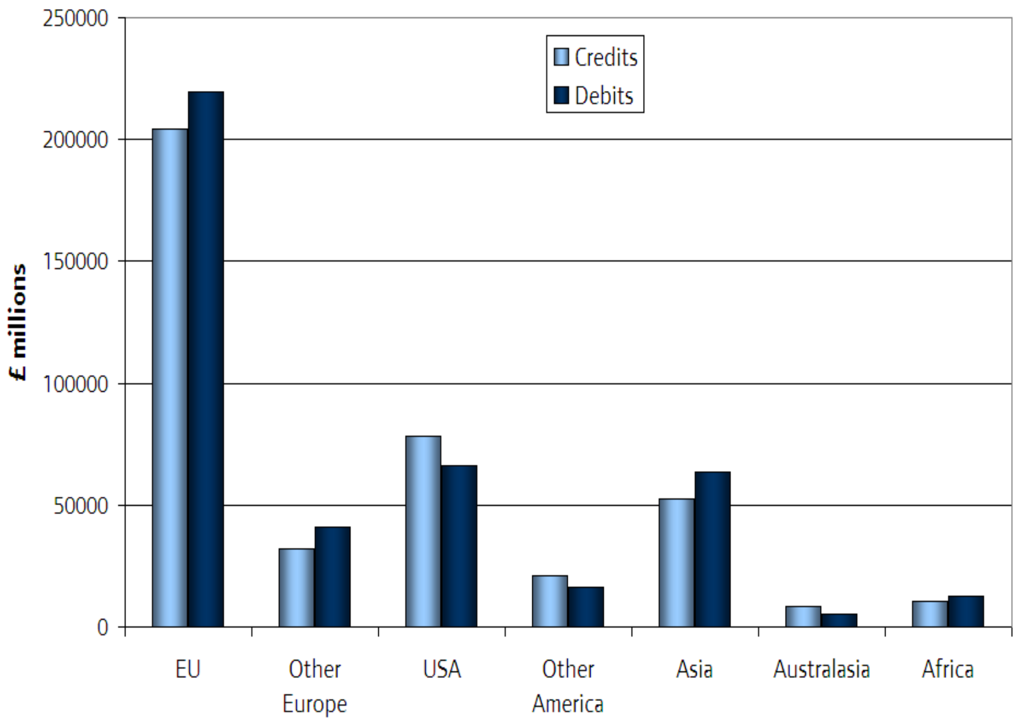
- Trade in goods: The UK exported £186 billion of goods and imported £232 billion. The UK had a deficit of £46 billion. Goods were 47 per cent of the UK's credits and 57 per cent of total debits.
- Trade in services: The UK exported £86 billion of services and imported £71 billion. The UK had a surplus of £15 billion. The export of services accounted for 22 per cent of the UK's credits and 17 per cent of debits.
- The movement of income from the UK's overseas investments and foreign investments within the UK: The UK received income of £122 billion from its overseas investments and paid income of £92 billion to foreign investors in the UK. The UK had a surplus of £30 billion. This is 31 per cent of UK credits and 22 per cent of debits.
- The remaining 1-2 per cent is from transfers such as foreign aid and payments to, and receipts from, EU institutions. The UK records a deficit in this.

The UK current account 2002 by world region

The UK trades with most countries of the world. It has a trade deficit with some countries such as Germany or China but surpluses with others such as the US, the Netherlands and Australia. This reflects that some countries produce goods and services that the UK needs to import, while others need the goods and services that the UK produces. UK trade deficits with particular countries are not a problem – they simply reflect the pattern of economic specialisation across the world, which in turn generates a diversity of trading relationships.

The UK's largest trading partner is the European Union, accounting for half of all UK trade. The UK has £204 billion of credits and £219 billion of debits with its EU partners giving a current account deficit of £15 billion. The main European markets for the UK are Germany, the Netherlands, France and Ireland. These four markets account for half of UK trade with the EU and a quarter of all UK trade.

Chart 4.3: UK current account by world region, 2002



Source: ONS, The Pink Book 2003

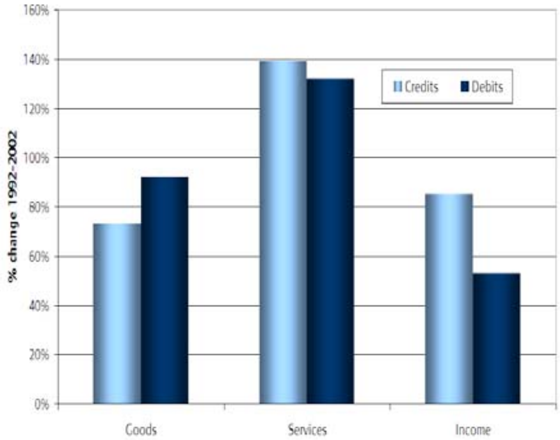
Outside the EU, the UK's main trading relationships include the US and Asia.

- The US is the largest national UK trading partner. The UK credits with USA of £78 billion, 20 per cent of the total, and debits of £66 billion (16 per cent). The UK surplus with US is mostly through services but also in goods and income.
- Trade with all Asia is worth £53 billion (13 per cent) of UK credits and £64 billion (15 per cent) of debits. A quarter of this trade is with Japan. The other key Asian trading partners are Hong Kong and Singapore, followed by China and India.

Changes in the UK current account

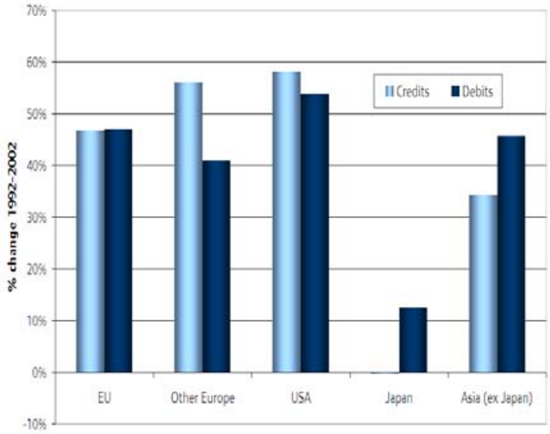
The UK current account expanded by 80 per cent in nominal terms between 1992 and 2002, reflecting the growth in world trade up to 2001 but offset a little since then. The growth in the trade of services outpaced the growth in the trade of goods. Services were 17 per cent of UK credits in 1992 but 22 per cent by 2002, with a corresponding fall in the share of goods exports. The UK grew its exports in services more rapidly than its imports in services. Conversely, the imports of goods to the UK grew faster than UK exports of goods. There was also high growth in income generated overseas for the UK.

Chart 4.4a: Change in UK trade by sector, 1992-2002



Source: ONS, The Pink Book 2003

Chart 4.4b: Change in UK trade by world region, 1992-2002



Source: ONS, The Pink Book 2003

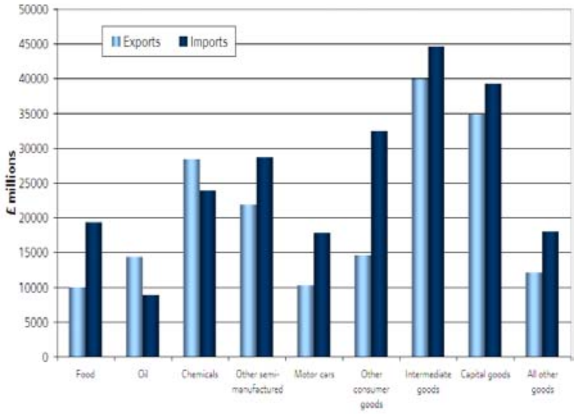
The key developments in the geography of UK trade over 1992 to 2002 were:

- Nominal trade with the EU grew by over 45 per cent with similar growth in credits and debits.
- The US was the largest source for the growth in UK trade, with UK credits growing faster than debits.
- Trade growth with Japan was poor. This may reflect the relative stagnation of the Japanese economy over the past decade. This has stunted the growth of trade with Asia a whole.
- Asia, excluding Japan, has grown as source of imports to the UK.

UK trade in goods

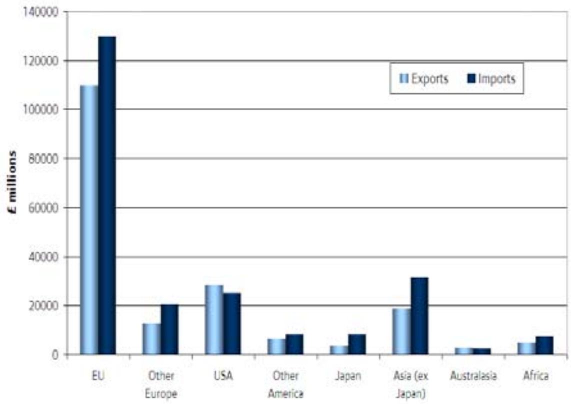
The UK has a deficit in the trade of most goods. The largest deficit is in consumer goods in which the UK imports £32 billion of goods but exports £15 billion. The UK also has sizeable deficits in the trade of motorcars, semi-manufactured and intermediate goods, and capital goods. These sectors have also recorded the fastest rates of import growth. The UK has a surplus in the trade of oil and in chemicals

Chart 4.5a: UK trade in goods by product, 2002



Source: ONS, The Pink Book 2003

Chart 4.5b: UK trade in goods by world region, 2002



Source: ONS, The Pink Book 2003

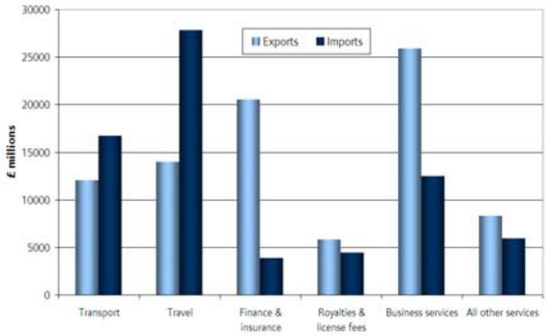
The UK records a trade surplus in goods with US, but a significant deficit with Japan, the rest of Asia, and also with other European countries. The UK has a £20 billion deficit in the trade of goods with the EU. UK goods worth £109 billion are exported to the EU, with Germany, France and Ireland accounting for half of this. The UK imports goods to the value of £130 billion from the EU, with half from Germany, France and the Netherlands.

Trade in goods has expanded between the UK and all world regions. Imports from the EU have grown more rapidly than exports to the EU, while exports to the US have grown faster than imports. The weakest growth in UK exports has been to Asia (excluding Japan), which is the most rapid growing source of UK imports.

UK trade in services

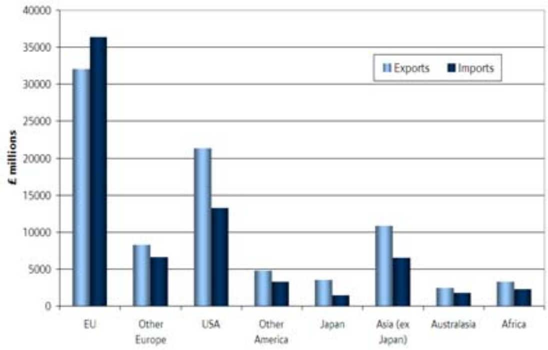
The UK's largest services export is business services, consisting of sectors such as consultancy, marketing and law. These are all sectors with particular concentrations of activity in London. This market is worth £26 billion in exports to the UK economy and records a large trade surplus. Finance and insurance is the second largest service export at over £21 billion and is also a large surplus. Travel and tourism is the UK's third largest services export at £14 billion but in which the UK records a large trade deficit. Over 1992 to 2002, finance and insurance was the fastest growing export market for UK services, followed by business services.

Chart 4.6a: UK's trade in services by product, 2002



Source: ONS, The Pink Book 2003

Chart 4.6b: UK's trade in services by world region, 2002



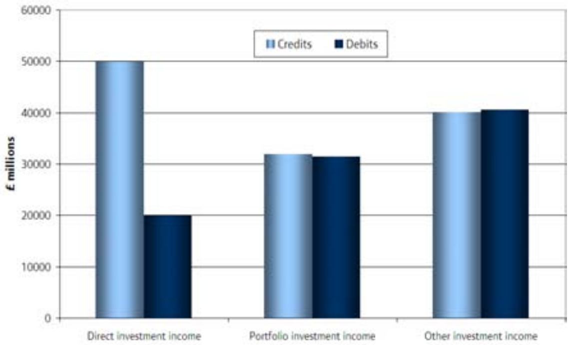
Source: ONS, The Pink Book 2003

The EU is the UK's largest trading partner in service exports, with £32 billion. The main markets are Germany, France and the Netherlands. The UK imports services to the value of £36 billion from the EU, largely from Germany, Spain and France. The UK has a £4 billion deficit in services with the EU but records a trade surplus with other world regions. The UK exported £13 billion of services to the US and recorded a surplus of £8 billion. Imports from the EU have grown more rapidly than exports to the EU, while services exports to the US, Japan, and other Europe have grown faster than imports.

UK income and repayment from international investments

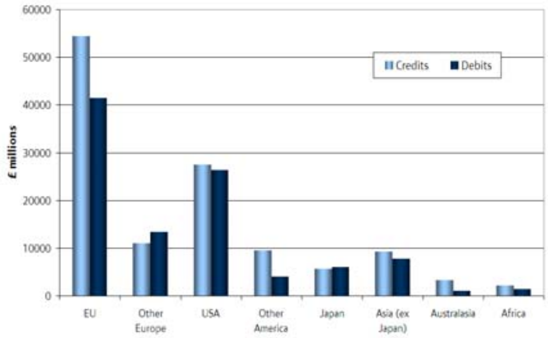
Over 40 per cent of the UK's overseas income is a return from direct investment. It reached £50 billion in 2002, £30 billion more than was returned to overseas companies investing in the UK. Returns on portfolio investment, £30 billion, and other investment, £40 billion, are in balance. Income from direct investment grew faster than portfolio investments over 1992 to 2002.

Chart 4.7a: UK's trade in income by type, 2002



Source: ONS, The Pink Book 2003

Chart 4.7b: UK's trade in income by world region, 2002



Source: ONS, The Pink Book 2003

The EU is the main source of UK income. The Netherlands, with £54 billion, is the largest source. The US brings an income of £27 billion. The UK records a large income surplus with the EU and a surplus with most other regions. The growth of income for the UK has been similar across Europe and US. Japan has fallen significantly as a source of UK income while the rest of Asia has increased.

Measuring London's role

The Office for National Statistics provides some estimates of trade statistics for regions in the UK from information collected via Customs and Excise and Intrastat surveys. However, these are in their infancy and apply only for visible goods. Moreover, close inspection raises doubts about using these statistics. For example, that London is the source of 10 per cent of UK exports for mineral fuels, 10 per cent of crude materials, and 11 per cent of live animals does not accord with the reality of London's economy. Similarly, the total visible exports these statistics attribute to London are greater than the measured total output of London's manufacturing, agriculture, mining and energy sectors. The source of this problem is that London's role as a centre of administration and distribution means survey responses are sourced to London when goods are produced and exported from elsewhere in the UK.

Disregarding such concerns over the regional trade data for goods, there is no official report on UK regional exports for services. Given that the economic base of the London economy has its concentration in business and financial services, this is a significant weakness in the understanding of regional trade.

GLA Economics endeavoured to develop a consistent approach for estimating London's exports in goods and services.[11] The method chosen was to compare London's share of exports for each sector with London's share of employment for each sector. Two specific examples were used:

1. Total UK exports of clothing goods in 2002 were £2.15 billion. The total UK employee jobs in clothing production, bringing together the Annual Business Inquiry for Great Britain and the Northern Ireland Census of Employment, is 64,000 jobs. Under 9,000 clothing jobs, 14 per cent are in London. Therefore it is estimated that London generates 14 per cent of UK exports in clothing goods to a value of £300 million.

2. Total UK exports in business and management consultancy services in 2002 were £2.58 billion. The total number of UK employee jobs in business and management consultancy is 227,000 jobs. Over 67,000 of these jobs, 30 per cent are in London. It is estimated that London generates 30 per cent of exports in these consultancy services to a value of £770 million.

No adjustment is made for the different productivity of London's employees, which is usually higher than the average for the UK. This could raise London's share of exports. Neither is there any adjustment made for a potentially higher rate of export intensity in London – that is, production in London may be more geared towards overseas markets than other UK regions. These estimates for London's exports are therefore likely to be understated.

London's exports of goods and services

London has 235,000 jobs in sectors producing export goods, which is 6.5 per cent of 3.6 million jobs in these sectors nationally. For many of these, London's share of employment is negligible with only 4 per cent of mining and quarrying jobs, 5 per cent of telecommunications jobs, 4 per cent of jobs in manufacturing motor vehicles and in machinery and equipment. London has high a higher share in some sectors such as 27 per cent in publishing and printing, 15 per cent in clothing and 7 per cent in food and drink. However, these sectors are not a large share of UK goods exports.

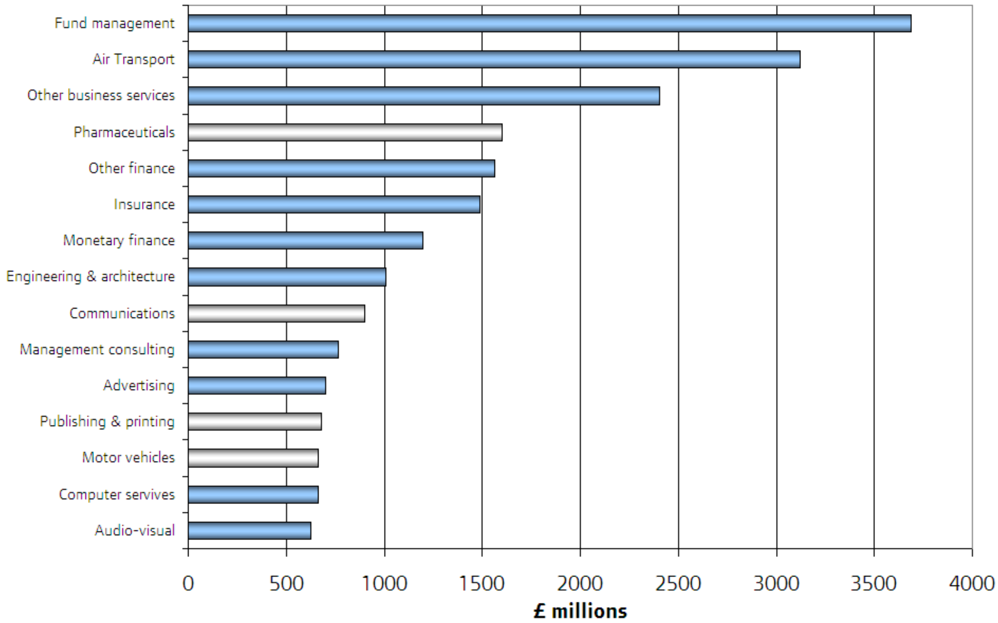
It is estimated that London's export of goods was £8.9 billion in 2002, or 5 per cent of the value of total UK goods exports. London's key sectors in exporting goods are:

- pharmaceuticals – exports of £1.6 billion
- communications – exports of £900 million
- publishing and printing – exports of £680 million
- motor vehicles – exports of £670 million.

These sectors account for 45 per cent of London's exports of goods but are equivalent to just over 2 per cent of all UK exports of goods.

[11] The calculations are shown in Appendices B and C.

Chart 4.8: Estimated trade – value of key exports from London



Source: GLA Economics calculations based on ONS, UK Trade in Goods Analysed by Industry 2003, ONS, UK Trade in Services 2003, Annual Business Inquiry, Northern Ireland Census of Employment

London's greatest exports of services, excluding travel, are in insurance, air transport, fund management, and services in engineering and architecture. London has 1.45 million jobs in exporting service sectors, 25 per cent of the national total. For many of these key exports, London's share of jobs is even higher. London has 70 per cent of jobs in fund management, 53 per cent of jobs in audio-visual services, 47 per cent of jobs in air transport, 46 per cent of jobs in other finance, 39 per cent of jobs in advertising and 33 per cent of jobs in legal activities.

It is estimated that in 2002, London's export of services was £20.8 billion. That is 32 per cent of the value of total UK services exports, exclusive of travel. London's key sectors in exporting services are:

- fund management – exports of £3.7 billion
- air transport – exports of £3.1 billion
- 'other' business services – exports of £2.4 billion
- insurance – exports of £1.5 billion

These sectors account for half of London's exports in services, equivalent to 16 per cent of all the UK's exports in services.

Travel is also included in UK services exports. The International Passenger Survey estimates that 49 per cent of expenditure in the UK from overseas visitors is spent in London. Therefore, travel to London is equivalent to a further £8.8 billion in exports in London's services – and is the largest export sector. London itself, as a destination for holiday and business tourism, is one of the UK's greatest exports.

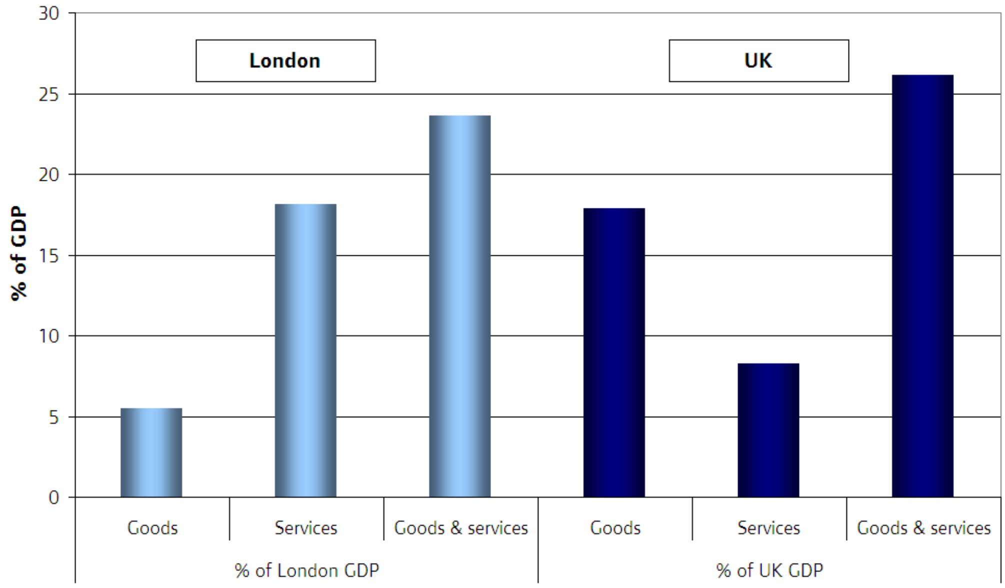
London's concentration in exports

The main findings for London using this approach are:

- The export of goods was almost £8.6 billion in 2002, 5 per cent of UK goods exports and over 5 per cent of London's GDP.
- The export of services, including tourism, was £29.5 billion in 2002, 31 per cent of UK exports in services and 18 per cent of London's GDP.
- London's exports, combining goods with services, equalled £38.1 billion in 2002, 24 per cent of London's GDP and equivalent to 15 per cent of all UK exports in goods and services.

London's economy is much more concentrated in exporting services than the rest of the UK, but also much less dependent on exporting goods.

Chart 4.9: Share of goods and services exports in London and UK output

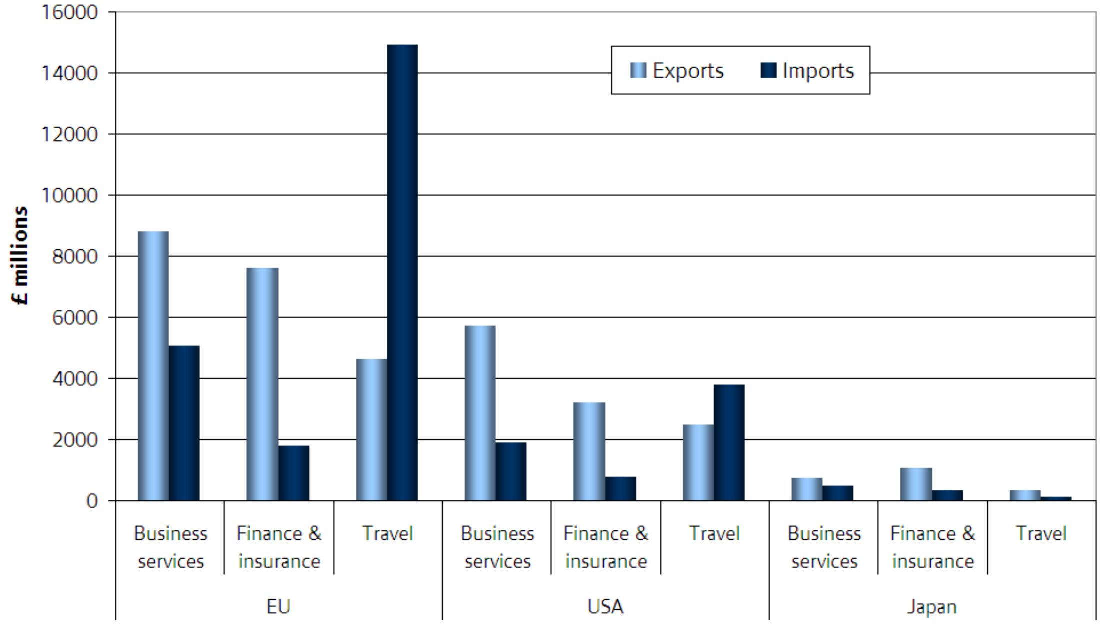


Source: GLA Economics

London: Source of UK services trade

The ONS publication, UK Trade in Services, looks at total UK trade in services by type of service and geography. The most recent data is for 2001. The UK trade surpluses in business services and in financial services with both the EU and US emphasise the competitive advantage the UK has in these sectors. The UK's only deficits in services are in travel. The services deficit with the EU can be entirely attributed to the level of UK tourists visiting Spain and France.

Chart 4.10: Trading relationships in services, 2001



Source: ONS, UK Trade in Services, 2002

London is the UK centre of services in business and finance. At least a third of UK exports in these sectors are from London. Therefore, the trade surpluses the UK records in services, and so to support the UK's balance of payment, depend upon the performance of these sectors in London.

International trade in both business services and in finance, although largely focused on the EU, is also much more exposed to international markets and the US in particular than most exporting sectors of the UK. This further emphasises London's role as a world city with global linkages in its trade of business and financial services.

The importance of emerging markets

The EU15 and US dominate the UK trade statistics. However, there is interest in what is happening beyond these long-established markets. Asia, with the vast potential of both China and India, and the expanded EU, which will include much of central and eastern Europe, are important emerging markets for UK trade.

Emerging Asia consists of:

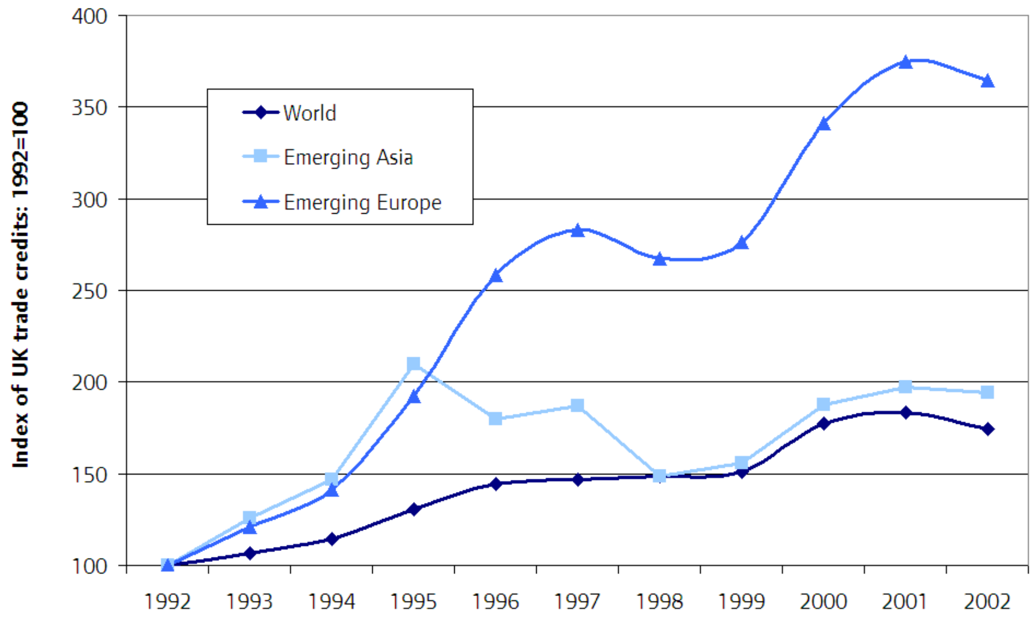
- the two populous giants of China and India
- the main south-east Asian tiger economies of Taiwan, South Korea, Malaysia, Indonesia, Thailand and Philippines.

Expanding EU consists of:

- the three Baltic states of Latvia, Lithuania and Estonia
- five central European states of Poland, Czech Republic, Slovakia, Hungary and Slovenia.

- it will not include the Mediterranean islands of Cyprus and Malta, which are joining the EU but with whom trade flows are marginal and data is not available.

Chart 4.11: Index of growth in UK's trade credits



Source: ONS, The Pink Book 2003

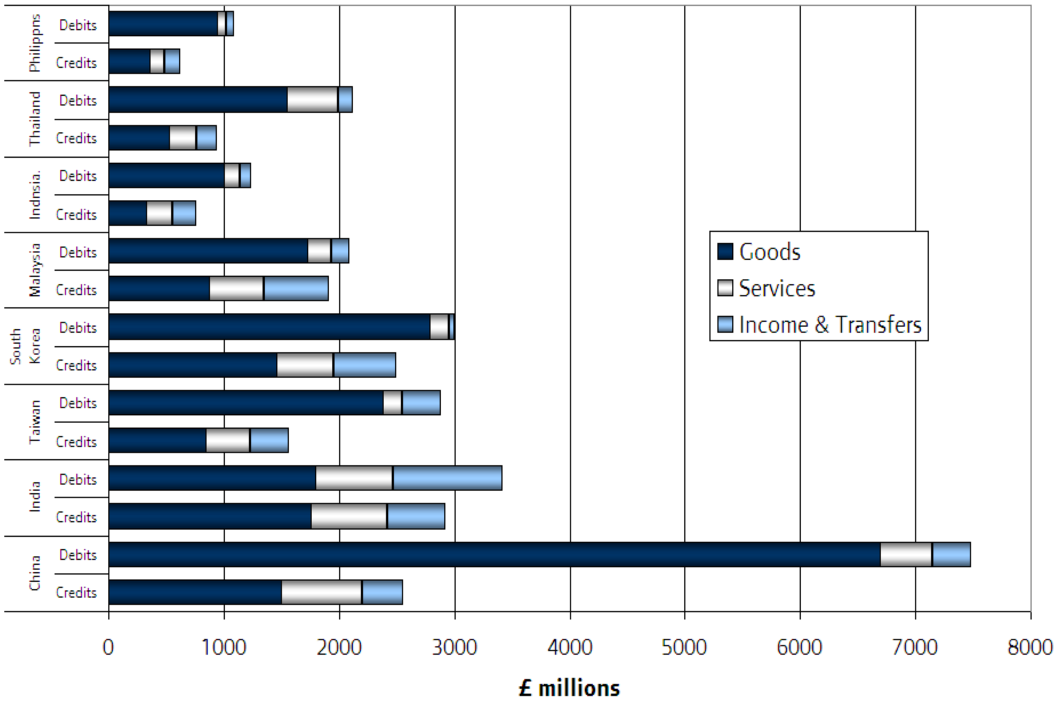
- The nominal value of UK exports to the world grew by 70 per cent between 1992 and 2002, peaking in 2001. UK export growth to emerging markets grew at a faster than to the whole world.
- Exports to Emerging Asia grew by 95 per cent with its share of UK exports rising from 3 per cent in 1992 to 3.4 per cent in 2002. This peaked in 1995 but trade fell away up until the Asian financial crisis in 1998. The market then recovered with strong export growth up until 2001.
- Exports to Expanding Europe grew by over 260 per cent with the share of UK exports doubling from 0.6 per cent in 1992 to 1.3 per cent in 2002.

Emerging Asia

Emerging Asia in an important export market for the UK. This is likely to continue given the growing role of China, India and other South East Asian economies. In 2002, Emerging Asia accounted for £13.8 billion of UK trade credits, 3.4 per cent of the total, and £23.3 billion of debits, 5.5 per cent, The UK had current account deficit with Emerging Asia of £9.5 billion.

The composition of UK trade with Emerging Asia differs from the established markets. Over 80 per cent of the UK's debits with Emerging Asia are the import of goods, with just 10 per cent from importing services. The UK records a trade deficit in goods of £11 billion with Emerging Asia but has a small surplus in both services and income.

Chart 4.12: UK's current account by emerging Asian Country 2002



Source: ONS, The Pink Book 2003

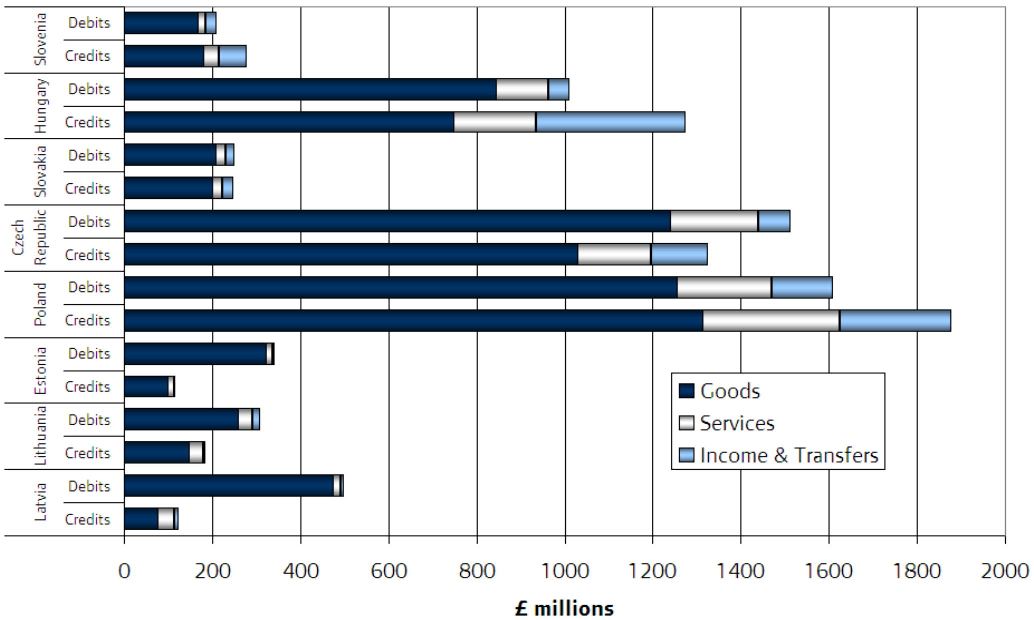
The key markets with Emerging Asia are:

- China, which is the UK's largest trading partner in the group. China is the ninth largest importer of goods into the UK, worth £6.7 billion in 2002 out of £7.5 billion in total debits The UK has credits of £2.5 billion with a total trade deficit of £5 billion. China is the UK's fastest growing trading partner in Asia. Over 1992 to 2002, UK imports from China grew by 470 per cent and UK exports to China grew by 280 per cent.
- India, which has very different trade with the UK from China. UK credits with India are £3 billion with debits of £3.4 billion. The trade of goods is largely in balance at £1.8 billion, as is trade in services at £700 million. However the UK has a deficit in income and transfers. Over 1992 to 2002, credits from India increased by 100 per cent and debits by 150 per cent.
- South Korea, which like China, is a country from which the UK imports goods – £2.9 billion in 2002. The UK partially offsets a deficit in goods with strong surpluses in service exports and income. The value of credits grew by 130 per cent and debits by 180 per cent over 1992 to 2002.
- Malaysia, Indonesia, Thailand and the Philippines, which are all characterised as large importers of goods to the UK. Therefore, the UK has a current account deficit with all four countries. However, the UK has surpluses in trade in services and in income and performs particularly well in Malaysia.

Expanding Europe

In 2002, Expanding Europe accounted for £5.4 billion of trade credits, 1.3 per cent of the UK total, and £5.4 billion of debits, 1.3 per cent, giving the UK a current account deficit of only £300 million.

Chart 4.13: UK's current account by Expanding Europe 2002



Source: ONS, The Pink Book 2003

The composition of UK trade with Expanding Europe is such that 83 per cent of the UK's debits are the import of goods, with 11 per cent from services and 6 per cent from income. The UK's credits are 70 per cent from goods, 15 per cent for services and 15 per cent from income. Therefore, the composition of trade with Expanding Europe is comparable with the existing EU.

The key markets are:

- Poland, which is the largest market. In 2002, the UK had a surplus with Poland with £1.9 billions of credits to £1.6 billion of debits. This surplus was in goods, services and income. The growth of trade with Poland has been slower that the other emerging European countries but still grew by more than 150 per cent over 1992 to 2002.
- The Czech Republic, which is the second largest market with credits from the UK of £1.3 billion and debits of £1.5 billion. The deficit is attributable to trade in goods. Trade growth with the Czech Republic is rapid with growth in exports and imports of over 340 per cent from 1992 to 2002.
- Hungary, which is a strong market for the UK with credits of £1.3 billion giving a surplus over deficits of £1 billion. The UK's surplus is largely though the export of services and transfer of income with Hungary.

- Slovakia, Slovenia and the Baltic States which are smaller markets for the UK but have recorded some of the fastest growth for UK exports. Trade with these countries is currently heavily concentrated in goods.

The opportunity for London

There are two key assertions that this analysis illustrates for London's role in UK exports:

- London's exports are more dependent on services
- London's economy is more internationally exposed than other UK regions.

London's exports of services in 2002 is estimated at almost £21 billion. Additionally, London had tourism exports of £9 billion, which is half of the spending of overseas visitors in the UK. London's services exports totalled over £29 billion, contrasting with its export of goods of under £9 billion. London's pattern of exports is the reverse of that for the UK in which goods are more significant than services. Excluding London, the pattern for the rest of the UK is £177 billion for goods and £57 billion for services. While in London, the value of exports in services outnumbers that of goods by three to one, in the rest the UK exports of goods out-numbers services by three to one.

Over 1992 to 2002, the share of UK exports continued to shift from goods to services. The increasing significance of services highlights the increasing role of London in UK exports. Those services in which London is strongest had the most rapid export growth of all sectors. Finance and insurance and business services had growth of over 200 per cent. The UK has a current account surplus in these sectors, which are heavily concentrated in London.

London's concentration of exports in services means its trade orientation is more diverse and less European than other regions of the UK. For London's key export sectors, in business services around 38 per cent of exports go to the EU and 24 per cent to US while in finance and insurance around 45 per cent is destined for the EU and 20 per cent for US. This contrasts with overall UK exports in which 50 per cent is for EU and 19 per cent for US. Therefore, in these sectors the EU remains the main source of trade for London but it is also relatively more exposed to markets in the US.

Emerging Asia is a vast and diverse market. It is growing rapidly as a source of imports to the UK, generating a large deficit in the trade of goods. But a small surplus in the trade of services shows that the economic growth of these countries stimulates their demand for UK based services. UK service exports to Emerging Asia increased by 112 per cent between 1992 and 2002. The UK is establishing a presence in these markets. The growth of Emerging Asia is good for London with increasing demand for those services in which London has a competitive advantage.

Similarly the EU expansion extends the single European market. The transition to economic liberalisation by these central and eastern European countries has meant that they have rapidly grown as a source of trade since the early 1990s. UK services exports to them grew by 240 per cent. UK exports to these accession countries are mostly in goods, but markets such as Poland and Czech Republic are becoming markets for UK services. Between 1992 and

2002, UK exports in services grew by 245 per cent to Poland and 350 per cent to Czech Republic. Again this offers opportunities for London's exporters. As these economies grow there will be an increasing demand for services. London's position as the predominant international provider of many services should mean it benefits from the growth of world markets in global trade.

The risk of exchange rates

The past two years (January 2002 to January 2004) have seen a significant change in the currency exchange rates between the UK and its two major trading partners.

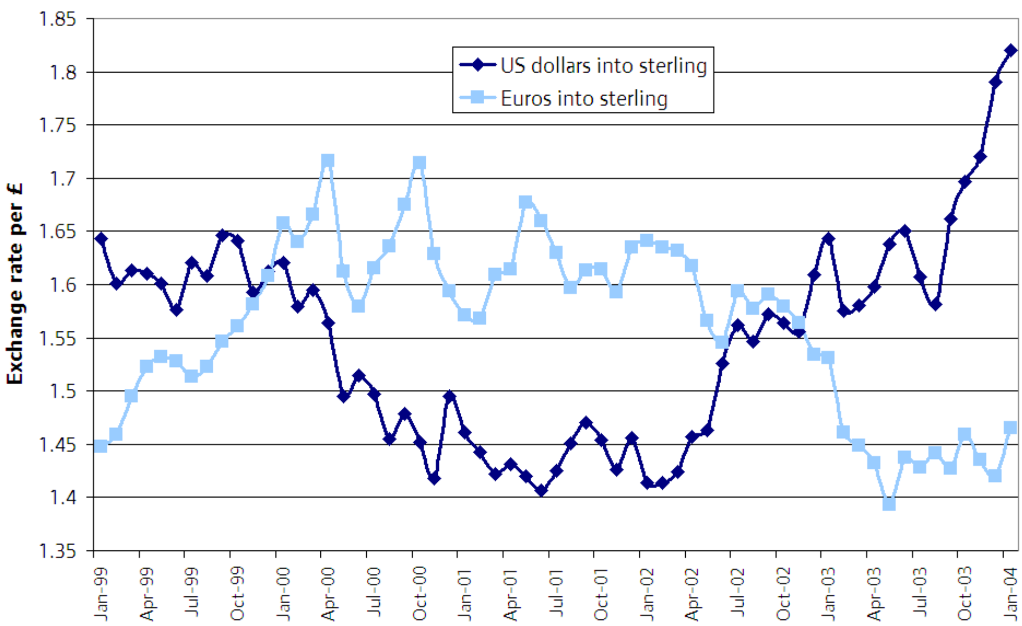
The depreciating exchange rate of the US dollar

Two years ago, £1 exchanged at $1.4, it now exchanges for $1.8. This effectively raises the price of UK exports to the US by over a fifth.

The appreciating exchange rate of the EU euro

Two years ago £1 exchanged for around €1.65 while today exchanges for €1.45.

Chart 4.14: Recent sterling exchange rates with US$ and EU€



Source: Bank of England

These exchange rates raise the price of London's services sold to the US but reduce the price within the EU. As London's services are more exposed to the US than the UK generally then London is relatively vulnerable to a depreciating dollar. However, many of these services are high in value. Their competitive advantage depends on the specialist skills that are only found in major financial and business centre such as London. In the short term, these services are likely to continue to be sold to the US. Over the longer-term, as economic recovery in the US gathers pace, there is likely to be increasing demand from the US for business and financial services in London. This could offset the impact of a change in exchange rates.

The increasing value of the euro also offers opportunities for London's exporters in business and financial services. Despite the significance of the US market, the EU continues to be the destination for most of London's services exports, particularly Germany, France and the Netherlands. A more competitive exchange rate with these Euro economies also offers opportunities for London's exporters.

Conclusion

This analysis looks purely at the big picture of trade flows as presented through the ONS Pink Book data and helps to explore how much of this trade can be attributed to, and have an impact upon, London.

To fully comprehend London's trade, we need to understand who is exporting. Trade between nations is often trade within multinational enterprises – a single UK company may outsource part of its production to China and then import it to the UK. Similarly, many UK exports are a result of inward investors, such as US IT businesses using the UK as a base for the EU market. It is often a few major companies that drive the pattern of trade, and it is necessary to consider this ownership of global trade and the extent to which this is concentrated in London.

Appendix A: Explanation of terms and some sources – definitions, differences, and revisions

As mentioned in the Introduction, forecasting organisations use varying definitions of the regional indicators they supply. It is not therefore always possible to assign a completely consistent meaning to the terms used.

Throughout this report, as far as is compatible with the individual definitions applied by the forecasters, 'employment' refers to 'workforce employment' as defined in *Labour Market Trends*. The GLA's last forecast, *London's Economic Outlook,* from December 2003 and *The GLA's Workforce Employment Series* provide a more detailed explanation of this term.

Forecasters' definitions are broadly compatible with this but in some cases differences arise from the treatment of small items such as participants in government training schemes or the Armed Forces.

Output refers to gross value added (GVA), a term introduced by the 1995 revision of the European System of Accounts (ESA95). Some forecasters still estimate gross domestic product (GDP) which can differ slightly from GVA. Imputed rental income from the ownership of property is in some case included, and some not. The GLA's last forecast provides a more detailed explanation of this term.

All forecasters now produce estimates of real output which are weighted to the year 2000, following the publication, by the ONS, of chain-linked and reweighted estimates of UK output.

Estimates of nominal regional GVA are available up to 2001 from the ONS. No official estimates of real regional GVA are available because of the difficulties in producing authoritative regional price deflators, although the ONS has now produced regional price indexes for the year 2003. Most regional forecasters supply their own estimates of London's GDP. The London GVA figures used to estimate the forecast, and the forecasts themselves, use estimates supplied by EBS which coincide with those of the ONS for 2000. In this year the nominal and real figures are the same apart from a minor adjustment to reflect the ONS's revisions to estimated UK GVA in 2000

GVA estimates are less reliable than employment estimates because there is no independent source of information from which to judge the size of total sales by London-based agents. ONS estimates are calculated by the factor incomes method, beginning from wages paid to people with workforce jobs located in London. Profits are imputed on the basis of these earnings estimates from knowledge of national sectors of employment. Most regional forecasters adopt a variant of this technique.

Consumption refers to private consumption, otherwise known as household expenditure; in some cases the expenditure of non-profit organisations is included and in some, it is not.

'Distribution' refers to Retail, Hotels and Catering; 'Public Services' refers to the Defence, Health, Education and Other Services, and all other sectors have their standard meaning.

Appendix B. Trade and employment classifications

GOODS		
Primary	Agriculture	01: Agriculture, hunting, etc; 02: Forestry, logging, etc
	Fishing	05: Fishing, operation fish hatcheries/farms
	Mining and quarrying	10 - 14: Mining coal etc; extraction natural gas, uranium and thorium ores, metal ores, Other mining and quarrying
Manufacturing	Food and drink	15: Manufacture of food products and beverages, 16: Manufacture of tobacco products
	Textiles	17: Manufacture of textiles
	Clothing	18: Manufacture of apparel; dressing/dyeing fur
	Leather	19: Tanning/dressing of leather, etc
	Wood products	20: Manufacture of wood/products/cork, etc
	Pulp and paper	21: Manufacture of pulp, paper and paper products
	Publishing and printing	22: Publishing, printing, repro recorded media
	Petroleum products	23: Manufacture of coke, refined petroleum products
	Chemical products	241 - 243: Manufacture of basic chemicals, pesticides etc, paints, varnishes etc
	Pharmaceuticals	244: Manufacture of pharmaceuticals etc
	Rubber and plastic products	25: Manufacture of rubber and plastic goods
	Non-metallic products	26: Manufacture of other non-metallic products
	Basic metal products	27: Manufacture of basic metals
	Fabricated metal products	28: Manufacture of fabricated metal products, etc
	Machinery and equipment	29: Manufacture of machinery and equipment nec
	Office machinery	30: Manufacture of office machinery and computers
	Electrical machinery	31: Manufacture of electrical machinery/apparatus nec
	Communications	32: Manufacture of radio, tv/communications equipment
	Medical instruments	33: Manufacture of medical, precision instruments, etc
	Motor vehicles	34: Manufacture of motor vehicles, trailers, etc
	Other transport	35: Manufacture of other transport equipment
	Furniture	36: Manufacture of furniture; manufacturing nec

SERVICES		
Transport	Sea	611: Sea and coastal water transport
	Air	621: Scheduled air transport, 622: Non-scheduled air transport
	Rail, road and pipe	601: Transport via railways, 602: Other land transport, 603: Transport via pipelines
Communications	Post and courier	641: Post and courier activities
	Telecoms	642: Telecommunications
Insurance	Insurance	660: Insurance and pension funding, 6720: Activ. auxil. to insur./pension funding
Finance	Monetary finance	6511: Central banking, 6512: Other monetary intermediation, 6523: Other financial intermediation
	Fund management	6712: Security broking and fund management
	Other finance	6711: Administration of financial markets, 6713: Activ. auxil. to fin. intermediation nec
Computer	Computer	721: Hardware consultancy, 722: Software consultancy and supply, 724: Data base activities, 726: Other computer activities
Business Services	Trade related	631: Cargo handling, 632: Supporting transport activities, 633: Activities of travel agencies, 634: Other transport agencies
	Leasing	71: Renting of machinery and equipment
	Legal	7411: Legal activities
	Accounting	7412: Accounting/book-keeping activities etc
	Management consulting	7414: Business/management consultancy activity
	Advertising	7440: Advertising
	Research and development	7310: Research: natural sciences/engineering, 7320: Research: social sciences/humanities
	Engineering and architecture	7420: Architectural/engineering activities
	Other business services	748: Other business activities nec
Cultural	Audio-visual	921: Motion picture and video activities, 922: Radio and television activities
	Recreational	923: Other entertainment activities, 924: News agency activities, 925: Library, archives, museums etc, 927: Other recreation
Government	Foreign affairs	7521: Foreign affairs
	Military	7522: Defence activities
	Other	7511: General public service activities, 7523: Justice and judicial activities, 7524: Public security/law/order activities

Appendix C. Calculations

Credits in Goods 2002		Employee Jobs		London share of jobs	Exports £ million	
		UK	**London**		**UK**	**London***
Primary	Agriculture	230656	2598	1%	1013	11
	Fishing	6724	23	0%	310	1
	Mining and quarrying	63263	2560	4%	15219	616
Manufacturing	Food and drink	463143	29350	6%	8346	529
	Textiles	114211	2908	3%	2834	72
	Clothing	63953	8911	14%	2149	299
	Leather	17117	1244	7%	900	65
	Wood products	82101	3446	4%	337	14
	Pulp and paper	88706	3591	4%	2170	88
	Publishing and printing	344697	90397	26%	2585	678
	Petroleum products	24410	195	1%	5728	46
	Chemical products	90262	3336	4%	7329	271
	Pharmaceuticals	73325	5467	7%	21438	1598
	Rubber and plastic products	217434	8142	4%	4047	152
	Non-metallic products	123833	3555	3%	1751	50
	Basic metal products	94402	1802	2%	6508	124
	Fabricated metal products	358968	13080	4%	3756	137
	Machinery and equipment	310218	11742	4%	15825	599
	Office machinery	40476	1905	5%	11253	530
	Electrical machinery	146638	8323	6%	6422	365
	Communications	89584	4077	5%	19798	901
	Medical instruments	127408	6911	5%	7307	396
	Motor vehicles	209819	7469	4%	18699	666
	Other transport	157737	2996	2%	12589	239
	Furniture	191369	11241	6%	3805	224
		3730454	**235269**	**6%**	**182118**	**8671**

Credits in Services 2002		Employee Jobs		London share of jobs	Exports £ million	
		UK	**London**		**UK**	**London**
Transport	Sea	15261	2033	13%	4306	574
	Air	87702	40556	46%	6750	3121
	Rail, road and pipe	506482	72375	14%	963	138
Communications	Post and courier	306721	53517	17%	175	31
	Telecoms	255648	52953	21%	1943	402
Insurance	Insurance	354614	76219	21%	6922	1488
Finance	Monetary finance	571366	180038	32%	3793	1195
	Fund management	56972	39617	70%	5306	3690
	Other finance	57684	26037	45%	3464	1564
Computer	Computer	417871	93261	22%	2978	665
Business Services	Trade related	305208	75884	25%	2098	522
	Leasing	148661	19947	13%	187	25
	Legal	256275	83793	33%	1838	601
	Accounting	197859	55136	28%	701	195
	Management consulting	226814	67161	30%	2579	764
	Advertising	84977	33129	39%	1796	700
	Research and development	108010	13751	13%	2870	365
	Engineering and architecture	304694	59811	20%	5129	1007
	Other business services	353659	97982	28%	8673	2403
Cultural	Audio-visual	111672	58434	52%	1194	625
	Recreational	332282	88473	27%	400	107
Government	Government	948798	154285	16%	1578	411
		6009230	1444392	24%	65643	20591

** London's exports £ million is London share of jobs multiplied by UK exports £ million*

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Vietnamese

Tiếng Việt
Nếu bạn muốn bản sao của tài liệu này bằng ngôn ngữ của bạn, hãy gọi điện theo số hoặc liên lạc với địa chỉ dưới đây.

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আপনি যদি আপনার ভাষায় এই দলিলের প্রতিলিপি (কপি) চান, তা হলে নীচের ফোন্ নম্বরে বা ঠিকানায় অনুগ্রহ করে যোগাযোগ করুন।

Greek

Αν θα θέλατε ένα αντίγραφο του παρόντος εγγράφου στη γλώσσα σας, παρακαλώ να τηλεφωνήσετε στον αριθμό ή να επικοινωνήσετε στην παρακάτω διεύθυνση.

Urdu

اگر آپ اِس دستاویز کی نقل اپنی زبان میں چاہتے ہیں، تو براہِ کرم نیچے دیئے گئے نمبر پر فون کریں یا دیئے گئے پتے پر رابطہ قائم کریں.

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Punjabi

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