GLAECONOMICS

London's Economic Outlook: Autumn 2008

The GLA's medium-term planning projections

Transport for London

LONDON DEVELOPMENT AGENCY

MAYOR OF 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 form a basis for the policy and investment decisions facing the Mayor of London and the GLA group. The unit is funded by the Greater London Authority, Transport for London and the London Development Agency.

Contents

1. Executive summary

GLA Economics' (GLA) thirteenth London forecast[i] suggests that:

- London's Gross Value Added (GVA) growth rate should slow to 0.8 per cent in 2008, falling to 0.2 per cent in 2009 before rising to 1.9 per cent by 2010.

- London is likely to see contractions in employment in 2008 and 2009, followed by stabilisation in 2010.

- London household spending will probably fall in 2008 and 2009 before growing slowly in 2010. Household spending is forecast to grow more slowly than household income throughout the forecast period.

Table 1.1 summarises this report's forecasts and provides an average of independent forecasts.

Table 1.1: Summary of forecasts

Annual growth rates (per cent)	**2007**	**2008**	**2009**	**2010**
London GVA (constant 2003 £ billion)	4.3	0.8	0.2	1.9
Consensus (average of independent forecasts)		1.6	1.8	3.2
London civilian workforce jobs	1.1	-0.7	-1.1	0.0
Consensus (average of independent forecasts)		0.4	0.3	1.3
London household spending (constant 2003 £ billion)	3.7	-0.8	-0.6	1.0
Consensus (average of independent forecasts)		1.3	1.5	2.8
London household income (constant 2003 £ billion)	0.3	1.2	1.0	2.0
Memo: Projected UK RPI[ii] (Inflation rate)	4.3	4.4	3.2	2.8
Projected UK CPI[iii] (Inflation rate)	2.3	3.5	2.8	2.3

Sources: GLA Economics' Autumn 2008 forecast and consensus calculated by GLA Economics.

2. Introduction

The autumn 2008 edition of *London's Economic Outlook* (LEO) is GLA Economics' thirteenth London forecast. The forecasts are issued every six months to assist those preparing planning projections for London in the medium term. The report contains the following:

- An overview of recent economic conditions in London, the UK and the world economies with analysis of important events, trends and risks to short and medium-term growth (Section 3).

- The 'consensus forecast' – a review of independent forecasts indicating the range of views about London's economy and the possible upside and downside risk (Section 4). In this document, 'consensus forecast' refers to the average of the four independent forecasters listed under Section 2.1.

- The GLA Economics forecast for output, employment, household expenditure and household income in London (Section 5).

- An in-depth assessment of a topic of particular importance (Section 6). This issue features a supplement on the evolution of London and the UK's employment rates.

2.1 Note on the forecast

Any economic forecast is what the forecaster views as the economy's most likely future path and as such is inherently uncertain. Both model and data uncertainty as well as unpredictable events contribute to the potential for forecast error. GLA Economics' forecast is based on an in-house model built by Volterra Consulting Limited. GLA Economics' review of independent forecasts provides an overview of the range of alternative opinions. Independent forecasts are supplied to the GLA for the main macroeconomic variables by the following organisations:

- Cambridge Econometrics (CE)
- The Centre for Economic and Business Research (CEBR)
- Experian Business Strategies (EBS)
- Oxford Economics (OE)

Only the most likely outcomes, which the different forecasting organisations provide, are recorded. Each forecaster may also prepare scenarios they consider less likely but these are not shown here. The low and high forecasts combine the lowest and highest forecasts respectively taken from each year separately and which, may therefore, come from different forecasters. High and low estimates therefore 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 most *likely* to happen, not what will *definitely* happen.

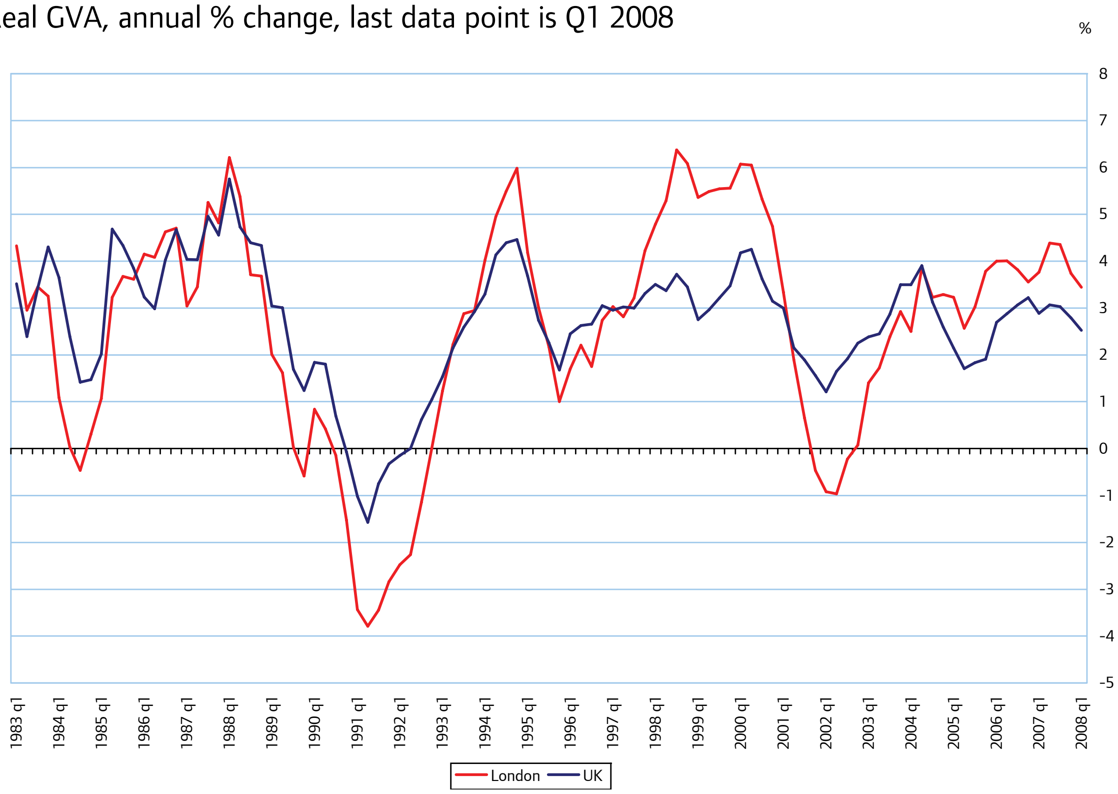
3. Economic background: UK faces recession as turmoil in financial markets continues

This section provides an overview of recent developments in the London, UK and world economies.

3.1 The London economy

London's annual economic output growth was 3.4 per cent in quarter one of 2008 compared to 2.5 per cent in the UK. Annual economic growth has been positive in London since 2002 and stronger than the UK as a whole since the third quarter of 2004.

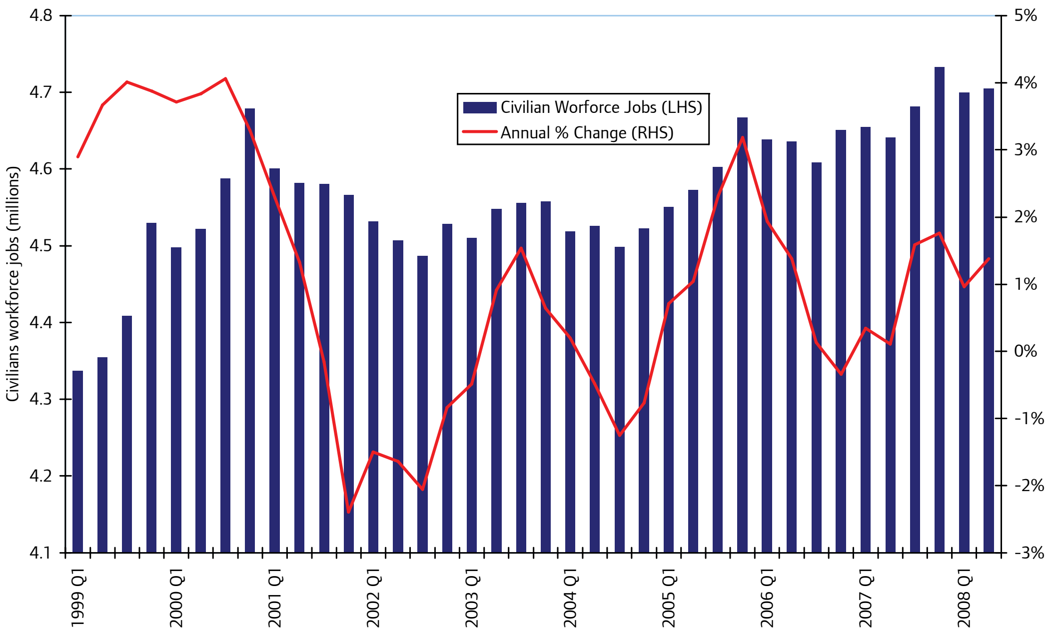
Figure 3.1: Output growth – London and UK
Real GVA, annual % change, last data point is Q1 2008



Source: Experian Business Strategies

Annual employment growth in London picked up in the second quarter of 2008 to 1.4 per cent from 1 per cent in the first quarter. The total number of workforce jobs in London was around 4.7 million in quarter two 2008 (see Figure 3.2).

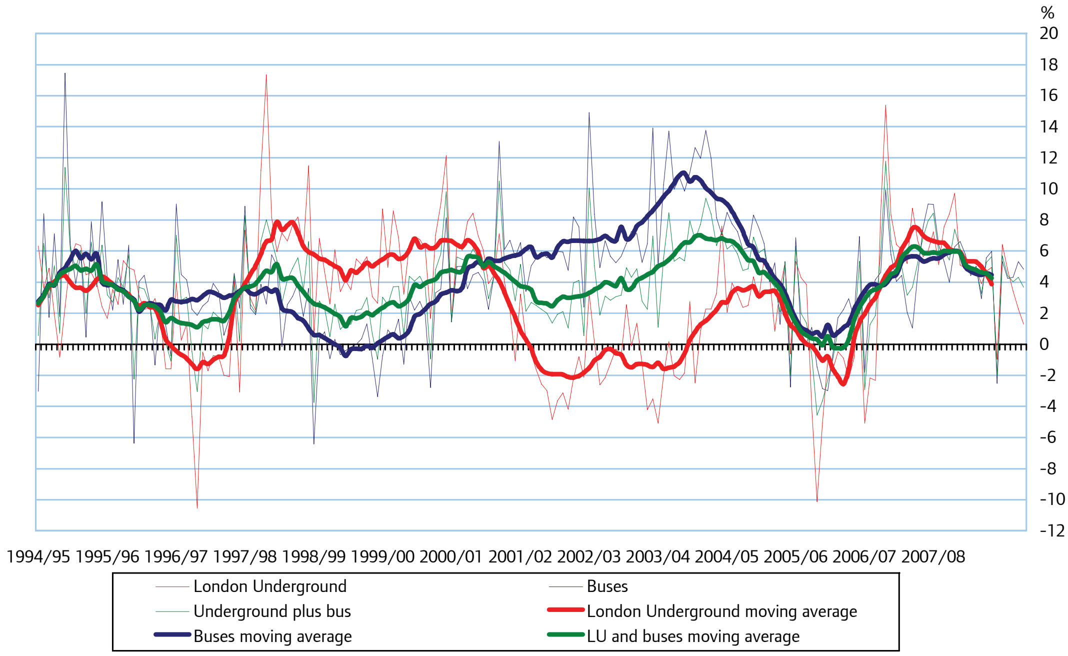
Figure 3.2: London civilian workforce jobs
Level and annual % change, last data point is Q2 2008



Source: Office for National Statistics

Public transport usage is a useful and timely indicator of economic activity in London. Figure 3.3 shows there has been continued annual growth in both bus and underground usage in the first half of 2008, although this has slowed compared to late 2007.

Figure 3.3: London public transport usage
Annual % change in passengers using London Underground and buses (adjusted for odd days). Last data point is the 28-day period ending 16/08/08.

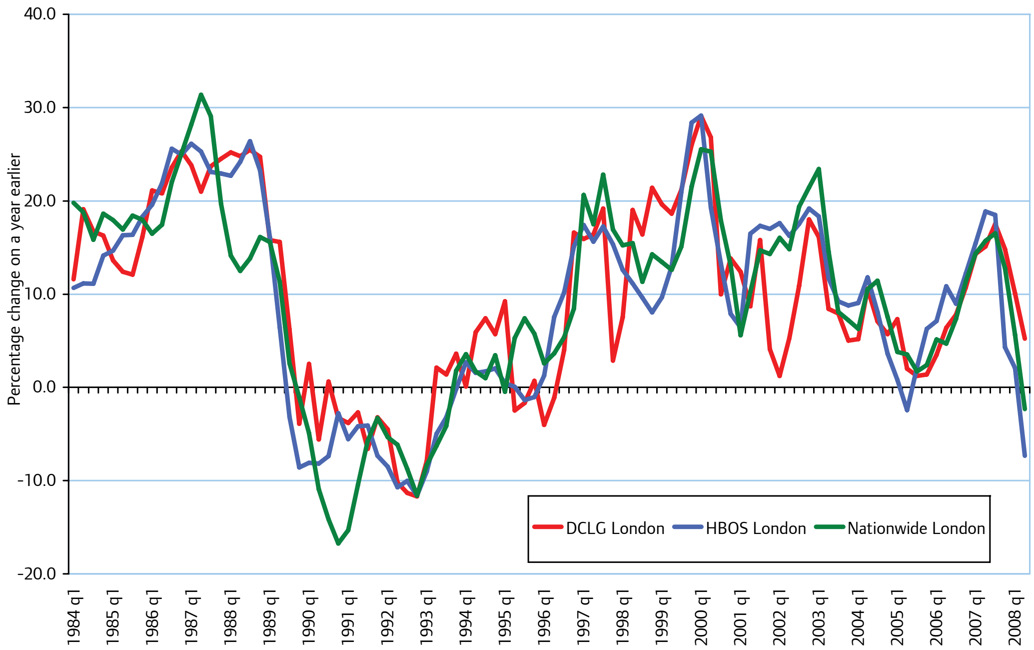


Source: Transport for London

Annual house price inflation in London slowed in the second half of 2007 and turned negative in Q2 of 2008 on most measures. Economic concerns, the belief that a house price bubble has burst and tightened lending criteria have weakened the market. In order to aid the housing market, the Chancellor announced in September that stamp duty would not be payable for at least 12 months on properties worth less than £175,000. However as only 14 per cent of London properties sold between Q3 2007 and Q2 2008 were worth less than this figure[iv], it is unlikely to have much of an impact on the London market. Annual house price inflation in London as measured by HBOS and Nationwide was negative in the second quarter of 2008 and is now closer to the picture seen in the rest of the UK, although DCLG's figure was still positive (see Figure 3.4).

Figure 3.4 House price inflation in London

Last data point Q2 2008

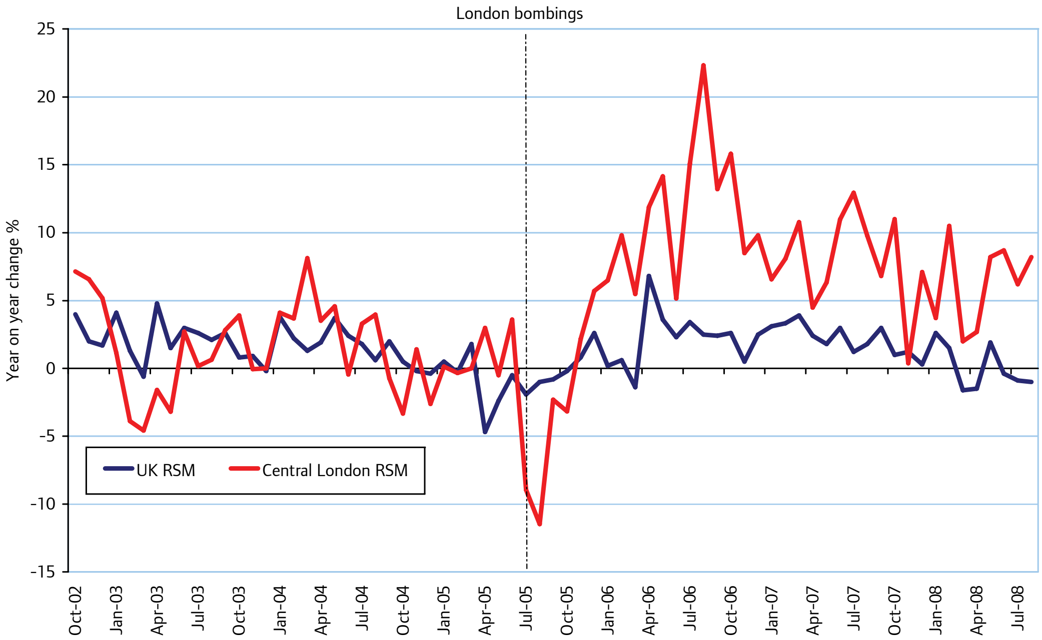


Sources: DCLG, Halifax Bank of Scotland, Nationwide

London's commercial property market also continued to slow in the second quarter of 2008[v]. Take-up in the City was below average levels due to the cooling economy; however take-up in the West End held up well due to "two significant deals" by Marks and Spencer and Fladgate Fielder.

The retail sector in Central London held up reasonably well in the first half of 2008. Retail sales were up 8.2 per cent in August 2008 compared with a year earlier, as monitored by the London Retail Consortium (Figure 3.5). Meanwhile UK retail sales fell by 1 per cent in August 2008 compared to August 2007. Since November 2005 annual retail sales growth in the UK has remained below that of Central London apart from in November 2007.

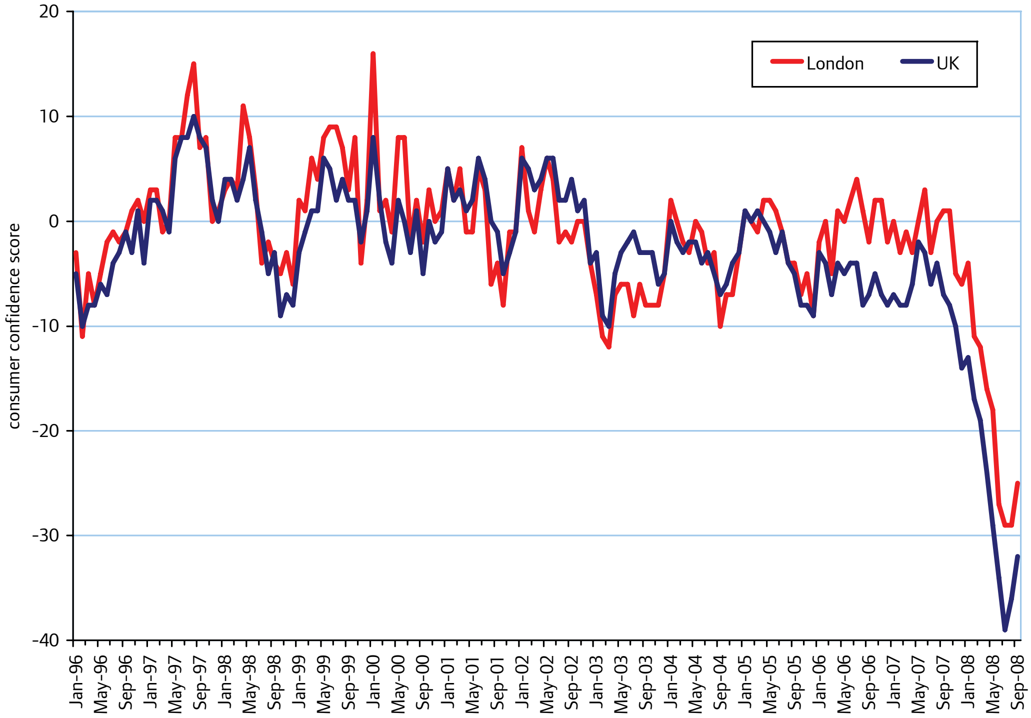
Figure 3.5: Retail sales growth – Central London and the UK
Annual % change, last data point is August 2008



Sources: UK Retail Sales Monitor – BRC/KPMG, Central London Retail Sales Monitor – London Retail Consortium

GfK NOP's regional consumer confidence index (Figure 3.6) shows that consumer confidence remains higher in London than in the UK as a whole; however there was a significant downturn in confidence in both London and even more markedly in the UK since summer 2007. Confidence in July 2008 for the UK hit a low of –39, before improving slightly in August and September, indicating that the current economic slowdown is significantly impacting UK consumers' expectations. The index reflects people's views on their financial position and the general economic situation over the past year and their expectations for the next 12 months.

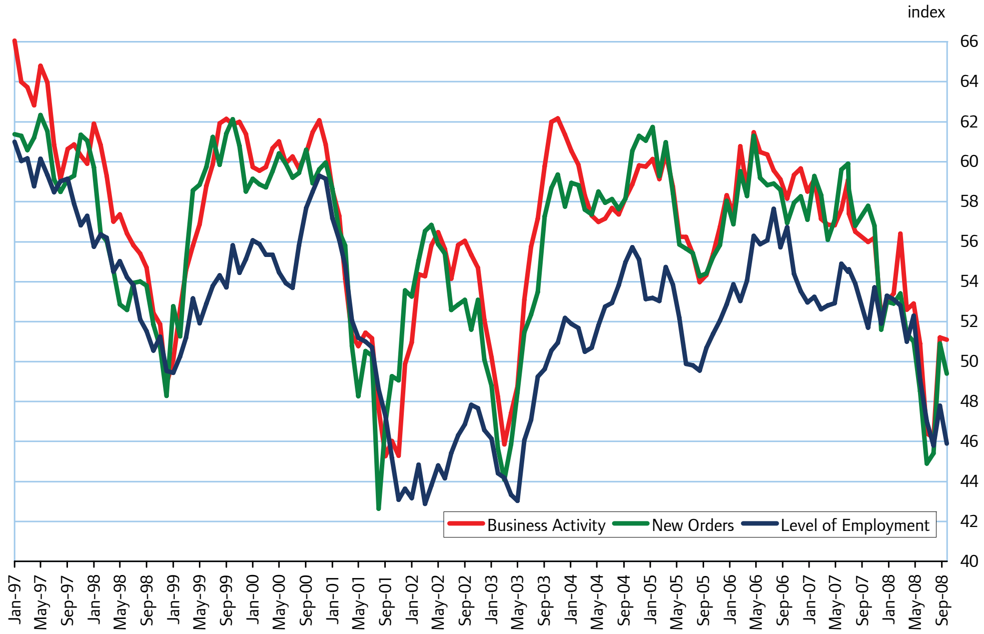
Figure 3.6: GfK NOP's regional consumer confidence index
Last data point is September 2008



Sources: GfK NOP on behalf of the European Commission, EcoWin

Business survey results indicate that London's expansion came to a halt this summer. Figure 3.7 shows PMI's surveys of seasonally adjusted business activity, new orders and level of employment with figures above 50 indicating growth and below 50 indicating contraction.

Figure 3.7: Recent survey evidence on London's economic climate
Purchasing Manager's Index (PMI) survey, last data point is September 2008
Seasonally adjusted index (above 50 indicates increase, below 50 indicates decrease)



Sources: Royal Bank of Scotland/NTC Economics

3.2 The UK economy

UK Gross Domestic Product (GDP) quarterly growth was 0.0 per cent in the second quarter of 2008, below the rate of 0.3 per cent in the previous quarter. The stagnation in Q2 2008 was driven by a 0.5 per cent fall in construction output, mainly due to a fall in new housing construction, and a 0.9 per cent fall in manufacturing, whilst growth in the service sector, which had been supporting GDP growth, slowed to 0.2 per cent. The annual GDP growth rate in the second quarter of 2008 slowed to 1.5 per cent from 2.3 per cent.

Table 3.1: HM Treasury and consensus forecasts for the UK economy
Annual % change, unless otherwise indicated

	Average of Independent Forecasters		Budget March 2008	
	2008	2009	2008	2009
GDP growth (per cent)	1.1	0.1	1¾ - 2¼	2¼ - 2¾
Claimant unemployment (Q4: mn)	0.97	1.24	-	-
Current account (£bn)	-42.2	-42.0	-72½	-71
PSNB (2008-09, 2009-10: £bn)	57.2	68.0	43	38

Note: mn = million, bn = billion

Sources: HM Treasury Comparison of Independent Forecasts, October 2008.
HM Treasury Financial Statement and Budget report Chapter B: The Economy, and Chapter C: The Public Finances.

Many forecasters are predicting the possibility of some quarters of negative growth during the end of 2008 and at the beginning of 2009 as the UK economy slows due to the credit crunch, weaker domestic expenditure and deteriorating international conditions. The IMF projects growth in the UK of only 1 per cent in 2008 and –0.1 per cent in 2009[vi] and the OECD has forecast that the UK will enter a recession in the third and fourth quarter of 2008 with GDP contracting by 0.3 per cent in Q3 2008 and 0.4 per cent in Q4 2008[vii].

As can be seen in Table 3.2 annual growth in business services and finance was extremely strong throughout 2007, however since the beginning of 2008 it has begun to slow. Annual construction growth slowed sharply in the second quarter of 2008. The slowdown in these sectors is expected to continue throughout the rest of 2008 and into 2009 due to the continuing credit crunch, the downturn in the housing market and the rapidly cooling commercial construction sector.

Table 3.2: Recent growth in broad industrial sectors of UK economy
Annual % change

	2007				2008	
Industrial sectors	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**
Agriculture, forestry, and fishing	-1.8%	0.0%	-2.3%	0.7%	1.5%	1.8%
Mining & quarrying inc oil & gas extraction	-7.3%	-0.3%	-0.5%	1.6%	-5.1%	-5.8%
Manufacturing	0.9%	1.1%	0.3%	0.3%	1.1%	-0.9%
Electricity gas and water supply	-3.9%	0.2%	2.2%	6.4%	2.3%	2.0%
Construction	2.8%	3.3%	2.9%	2.8%	3.5%	2.0%
Distribution hotels and catering	3.2%	3.2%	4.1%	2.8%	1.8%	1.2%
Transport, storage and communication	4.3%	3.3%	2.9%	2.1%	0.7%	1.8%
Business services and finance	5.5%	5.5%	6.8%	5.8%	4.5%	3.2%
Government and other services	1.4%	1.0%	0.9%	0.9%	1.1%	1.3%

Source: Office for National Statistics (as of end-September 2008)

Table 3.3 shows that annual household spending growth weakened in the second quarter of 2008, whilst investment fell. The continuing dislocation of the credit market is likely to bear down on investment and household spending in the second half of 2008.

Table 3.3: UK domestic expenditure growth

Annual % change

	2007				2008	
Expenditure	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**
Households	2.6%	2.3%	3.4%	3.6%	3.6%	2.5%
Non-profit institutions	4.3%	3.2%	2.7%	3.7%	5.0%	6.4%
General Government	1.5%	2.2%	1.8%	1.6%	2.1%	2.1%
Gross fixed capital formation	11.3%	7.8%	5.7%	3.9%	0.3%	-2.1%

Source: Office for National Statistics (as of end-September 2008)

UK official base interest rates have been cut by 50 basis points since GLA Economics' Spring 2008 London's Economic Outlook to 4.5 per cent. However, the continuing problems in the money markets has not led to the interest rate cuts at the beginning of 2008 being fully passed onto consumers and industry by banks. Costs associated with mortgages have risen and higher deposits are required from house buyers[viii]. The tightening lending conditions to households and firms is highlighted in the Bank of England's Q3 2008 Credit Conditions Survey, which finds that lenders had tightened secured household lending and corporate credit availability more than expected in Q2 2008, with further tightening expected in Q3[ix]. At the same time demand for secured lending for house purchases and for re-mortgaging, and demand for credit from private non-financial corporations had declined, whilst default rates on secured and unsecured lending to households was up. The tightening in lending is in part due to the continuing worldwide financial sector losses. The IMF forecasts "writedowns based on global holdings of US-originated and securitized mortgage, consumer, and corporate debt has risen to $1.4 trillion"[x].

Box 3.1: The recent financial market turmoil (as of 14 October 2008)

The global financial turmoil of September and October started with the US government having to put mortgage lenders Fannie Mae and Freddie Mac into "conservatorship" on 8 September taking control of the companies and suspending the dividend, thus effectively nationalising them. The companies, which had been shareholder owned but mandated by the US Congress, guarantee or own over $5 trillion in mortgages issued by other institutions[xi]. They had been severely damaged by the continued dislocation in the US housing market. The "conservatorship" will insure that the companies can continue to provide financing to the US housing market.

Global financial markets then experienced one of the most turbulent weeks in living memory starting on 14 September when Lehman Brothers, the fourth largest US investment bank, filed for bankruptcy protection under chapter 11 of the US bankruptcy code. The 158 year old bank, which had seen its share price plunge, was hit by $6.6 billion of credit crunch-related losses so far this year and the failure to raise investment from Korea Development Bank, with which it had been in discussions. Emergency talks had taken place over the weekend of 13-14

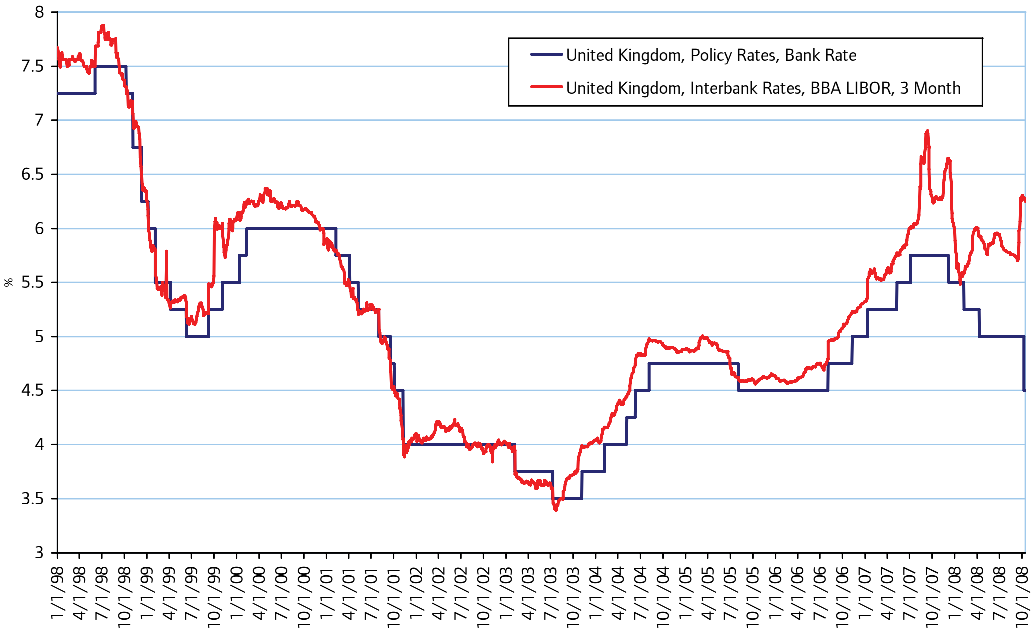
September with a number of banks involved[xii], including Barclays which has now agreed a deal to buy its US-based investment banking and capital markets business (and since then Japanese bank Nomura has bought some of its European and Asian operations). These talks however faltered as the US Treasury indicated that it was strongly opposed to using government money to support the deal. The US government's non intervention is believed to be due to a number of factors, including the moral hazard of supporting failing banks, a belief, at the time, that the bank's failure would not completely undermine the wider financial system and that enough time had elapsed since the start of the credit crunch for market participants to deal with its outcomes. The collapse of Lehman Brothers intensified the credit crunch, as the liquidation of its assets is likely to reduce the value of similar assets of other financial institutions thereby reducing their capital base.

American International Group (AIG), which had been heavily involved in investing in mortgage backed securities, also came under pressure with the news that its credit rating had been cut by Standard and Poor's from AA minus to A minus on the 15 September[xiii] and that it required emergency capital. This led to the Federal Reserve (Fed) announcing an $85 billion bridge loan rescue package for the company in exchange for 79.9 per cent of the company[xiv]. The Fed announced that it had acted in order to avoid "a disorderly failure" of the company. Given its involvement in insuring bank loans around the world a collapse of AIG would have significantly damaged a number of financial institutions as they would have had to raise a large amount of new capital to cover the risk of these loans[xv]. Thus in this case, unlike in the case of Lehman Brothers, AIG was considered 'too big to fail'[xvi], although significant restructuring of the business is now likely to occur. As worries emerged that Lehman's problems could spread to the rest of the investment-banking sector Merrill Lynch agreed on the 14 September a takeover by the Bank of America[xvii]. Washington Mutual was also affected by the collapse in confidence in banks with it being taken over by the US banking regulators and sold to JPMorgan Chase on 25 September[xviii].

The financial market turbulence and collapse of confidence between banks, as shown by the jump in the spread between inter-bank lending rates and the Bank of England's base rate to their largest level since the onset of the credit crunch (a sign that banks are unwilling to lend to each other), see Figure 3.8, also led to the European Central Bank (ECB), Federal Reserve, the Bank of England and the central banks of Canada, Japan and Switzerland intervening in the money markets to improve liquidity conditions. On the 18 September these central banks pumped $180 billion of Fed money into the money markets in a coordinated move to lift the amount of funds available and reduce the inter bank lending rates[xix]. Further intervention by the Bank of England, ECB, Fed and Swiss National Bank was undertaken on the 26 September[xx], with yet further action announced on the 29 September[xxi]. This came on the back of other liquidity-providing actions. On the 17 September the Bank of England extended its Special Liquidity Scheme until 30 January 2009 in light of the current market turmoil. On 26 September the Bank of England announced that its "long-term repo (repurchase agreement) operations against extended collateral, including mortgage securities, will for a period be held weekly and enlarged"[xxii] with the first operation of £40 billion being held on the 29 September. In addition, a group of 10 banks including JP Morgan and Goldman Sachs have created a $70 billion collaborative fund, which the member banks will be able to borrow against in order to support their liquidity under times of stress[xxiii].

Figure 3.8: Bank of England's Repo rate and the 3 month London Inter-Bank Offered Rate (LIBOR)

Last data point is 14/10/08

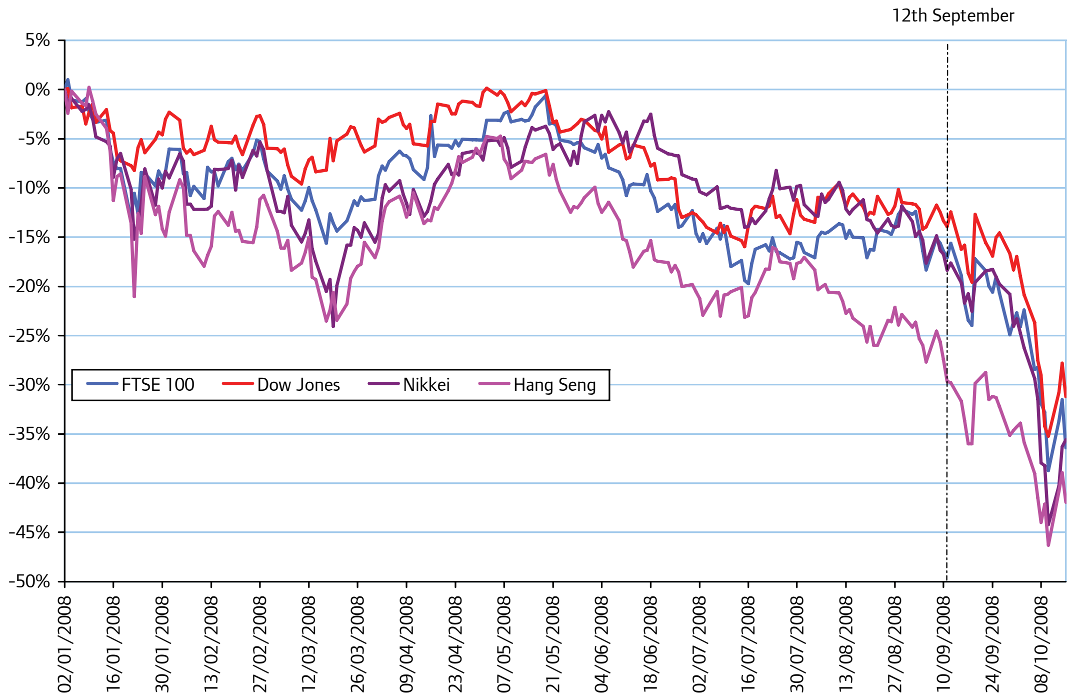


Source: EcoWin

Overall, the recent financial turmoil has caused significant falls in global stock markets (see Figure 3.9), as investors have lost confidence in the banking and insurance sectors and sold these shares. Some of this selling was originally believed to have been caused by banking stock being short sold, the practice of selling a borrowed share in the anticipation that the share price will fall and that the share can then be bought back at a profit. This led on the 19 September to the US Securities and Exchange Commission (SEC) banning the short selling of 799 companies until 2 October, with the ban extended on the 1 October till no later than 17 October[xxiv]. The Financial Services Authority (FSA) reacted similarly by banning, until 16th January 2009, the short selling of 29 financial companies shares. Sir Callum McCarthy the FSA's outgoing chair said, "This is a measure which reflects the present turbulence in markets. It is designed to have a calming effect – something which the equity markets for financial firms badly need" [xxv]. However, world stock markets have remained extremely volatile with both huge one day losses and one day gains. Overall the losses have outweighed the gains.

The US Government has also created a $700 billion (approx.) rescue plan to remove illiquid mortgage-backed assets from the financial system. The House of Representatives on the 29 September rejected the initially proposed legislation, the Emergency Economic Stabilization Act of 2008, which was negotiated between the White House and Congressional leaders over the weekend of the 27-28 September. On 1 October the US Senate did back amended proposed legislation with the House of Representatives voting in favour of the amended bill on 3 October. The deal sees the US Treasury receiving $250 billion straight away, with $100 billion being released at the request of the White House and the remaining $350 billion being under the possibility of a congressional veto[xxvi]. The US government will take shares in any bank that accepts the funds.

Figure 3.9: Stock market performance since January 2008 (percentage change)
Last data point is 15/10/08



Source: EcoWin, FT

In further signs of the ongoing restructuring in the banking sector the Fed announced on the 21 September that Goldman Sachs and Morgan Stanley would be allowed to change their status from investment banks into banking holding companies. This effectively ends the big stand-alone investment banking industry. The Fed will now regulate these banks, subjecting them to bank capital requirements, which will be phased in over a transition period. The banks themselves will now be able to greatly increase their ability to take deposits from savers, thereby reducing their dependence on the short-term money markets. On the 23 September it was announced that Warren Buffett's company (Berkshire Hathaway) would be investing $5 billion in Goldman Sachs, which should help to fortify its capital base[xxvii]. As of 3 October Wachovia, the fourth biggest retail bank in the US, will be bought by Wells Fargo in a $15.1 billion deal.

A major casualty of the financial market turmoil in the UK has been HBOS, which agreed on the 18 September to a takeover by Lloyds TSB, subject to shareholder approval, after its share price came under concerted pressure. The deal, which would normally contravene competition rules due to the fact that the combined bank will have about one third of the UK savings and mortgage market, will be allowed by the government on public interest grounds, given the high costs to the UK financial system and the economy associated with HBOS failing. The FSA said the deal was "likely to enhance stability within financial markets and improve confidence among customers and investors in the UK financial sector" [xxviii]; however a number of reports note that there are likely to be many job losses from the new bank as it restructures. Jobs in Halifax and Scotland look especially vulnerable.

On the 29 September Bradford and Bingley was nationalised, with the government taking control of the bank's £50 billion worth of mortgages and loans, whilst the owner of the

Abbey, Santander, took control of Bradford and Bingley's savings unit and branches for about £600 million[xxix], with the savings accounts backed by HM Treasury and the Financial Services Compensation Scheme (FSCS). The move came after a large fall in Bradford and Bingley's share price and worries of a run on the bank as "tens of millions of pounds" [xxx] were withdrawn in the days leading up to the nationalisation. Concerns about the bank had been growing for a number of weeks with speculation that it was facing a funding crisis due to the credit crunch removing its access to the global financial markets and also due to its exposure to the UK buy-to-let market, which has seen a large rise in bad debts due to the fall in UK house prices. The nationalisation could lead to hefty losses for the UK banking system, as any initial un-recovered costs on the government action (including interest on the government's loan to Santander) will be covered by the FSCS, which is funded by all deposit takers (i.e. banks and building societies.) The move is likely to see branch closures as Santander streamlines its UK operations. In other news of the continuing restructuring in the UK financial sector the Nationwide building society announced that it would take control of the Cheshire and Derbyshire building societies that had been experiencing strains due to the ongoing credit squeeze. Britannia building society (the UK's second largest building society) also looks set to lose its independent status.

Recent financial market turmoil has not been limited to the UK and US, as shown by the announcement on the 29 September that, after talks with the European Central Bank (ECB), the governments of Belgium, Luxemburg and the Netherlands would invest €11.2 billion in Fortis, taking a 49 per cent equity stake and thus partially nationalising it[xxxi]. However, this deal soon broke down and the Netherlands announced that it would take control of Fortis' Dutch operations for €16.8 billion[xxxii], with BNP Paribas taking over 75 per cent of its Belgian and Luxemburg operations for $14.5 billion[xxxiii] with the countries governments taking minority stakes. The governments were forced to part nationalise the bank due to it being hit by rumours concerning funding fuelled by the fact that the bank needed to raise €5 billion in the next year to complete its €24 billion part of the takeover of ABN Amro[xxxiv]. The presence of the ECB chief, Jean-Claude Trichet, at the initial talks indicates that Fortis was too important to the Eurozone economy and therefore was 'too big to fail'. The main rival of Fortis, Dexia, also saw its shares fall on the back of newspaper reports that it would require extra funding, which led to the Belgian, French and Luxembourg governments injecting €6.4 billion[xxxv] into the bank, in exchange for equity, on the 30 September. On the 29 September the Icelandic government purchased 75 per cent of Glitnir bank to ensure the stability of the third largest Icelandic bank[xxxvi], with Landsbanki also being nationalised on 7 October. Meanwhile one of Germany's biggest lenders, Hypo Real Estate, has had to be rescued. In response to a slide in Irish bank shares on the 29 September the Irish government stated on the 30 September that it would guarantee all retail, commercial and dated subordinated debt in certain Irish banks and building societies for two years, estimated at a worth of €400 billion[xxxvii]. Greece has guaranteed all the deposits at its banks[xxxviii].

Then in a coordinated response to continuing financial market turmoil the Bank of England, European Central Bank (ECB), and Federal Reserve, along with the centrals banks of Canada, Sweden and Switzerland, cut interests rates by 50 basis points on 8 October. The Chinese central bank cut rates by 27 basis points. This cut took UK interest rates to 4.5 per cent, with the Eurozone's standing at 3.75 per cent and the US at 1.5 per cent.

The Chancellor announced on 8 October that all UK retail depositors with Icesave, a UK subsidiary of Landsbanki, the second largest Icelandic bank, which had been taken over by the Icelandic government on 7 October and declared insolvent, would receive all their savings, including that part above the £50,000 limit of the FSCS. This followed concerns that the Icelandic authorities might renege on their obligations under the Icelandic Depositors and Investors' Guarantee Fund[xxxix]. A further subsidiary of Landsbanki, Heritable Bank and Kaupthing Edge, a subsidiary of Iceland's biggest bank, were sold to ING Direct. A number of UK local authorities and other governmental agencies, along with businesses and charities have deposited money (approximately £1 billion) with Icelandic banks and there are concerns that they may loose out; a number of London councils, the Metropolitan Police Authority and TfL are amongst those that could be affected.

On 12 October a meeting in Paris between European governments ended with the Eurozone countries agreeing to offer hundreds of billions of euros in guarantees on new medium-term bank debt. This saw Germany announce on the 13 October a bill that would allow it to guarantee €400 billion of inter-bank lending and inject €70 billion of capital into German banks and insurance companies[xl], with a maximum of €10 billion also being spent on acquiring illiquid assets. Meanwhile France announced an around €360 billion package[xli] with €320 billion of loan guarantees to run until the end of 2009 and €40 billion to buy stakes in French banks, with Spain announcing that it would provide guarantees for €100 billion of new debt issued by banks in 2008[xlii]. The Netherlands, Italy, Austria, Portugal and Norway also joined the effort with the total amount of money pledged by European governments on 13 October totalling €1.87 trillion[xliii]. The US announced on the 14 October that it will purchase preffered shares in a number of banks, in a move that will use $250 billion from the $700 billion US bailout package and that the Federal Deposit Insurance Corp. will temporarily guarantee most new debt issued by insured banks[xliv]. US financial institutions will have until mid November to decide if they want to take part in the recapitilisation plan, with the minimum capital injection being 2 per cent of the risk-weighted assets of the company and the maximum being 3 per cent, with an overall cap at $25 billion[xlv].

On 13 October it was announced that RBS, HBOS and Lloyds TSB would raise £37 billion (probably all from the government). Meanwhile Barclays intends to raise £6.6 billion from private sources and would scrap its final 2008 dividend and Santander injected £1 billion into its UK businesses. If existing shareholders do not buy any of the shares issued by RBS, HBOS and Lloyds TSB then the government will end up owning 60 per cent of RBS and 43.5 per cent of a combined HBOS and Lloyds TSB (with a renegotiated deal of 0.605 Lloyds TSB share for each HBOS share also announced on 13 October). It seems that RBS, HBOS and Lloyds TSB will pay no dividend until £9 billion worth of preference shares issued as part of the deal are repaid and have promised to increase their mortgage and small business lending availability to 2007 levels. This recapitalisation of commercial banks comes on top of announcements on 13 October by the Bank of England, ECB, Federal Reserve and Swiss National Bank that they are prepared to take whatever measures are necessary to provide sufficient liquidity in the short-term funding markets. The Bank of England has now amended its swap lines with the Federal Reserve so that there is no fixed limit to the amount of dollar liquidity that can be supplied to the banking system.

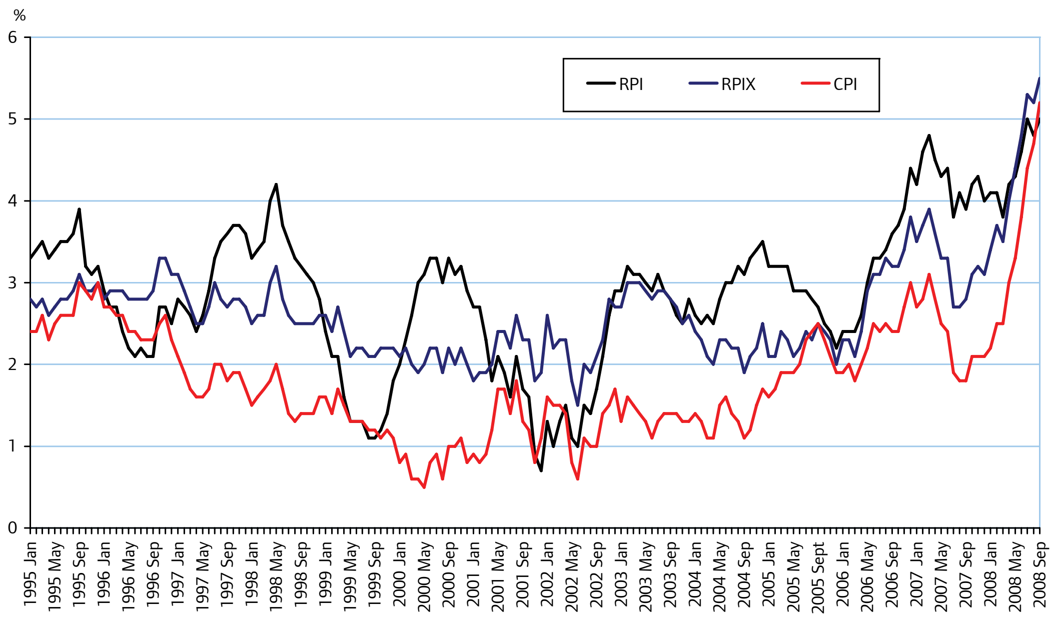
Annual consumer price index (CPI) inflation rose to 5.2 per cent in September 2008 the fifth month in a row that inflation was above 3 per cent (see Box 3.2). The main upside risk to inflation is the recent large depreciation of sterling. The main downside risk to inflation is spare capacity due to a slowing national and global economy.

Box 3.2: Current inflationary pressures at, or close to, their peak

Inflationary pressures are currently a worldwide phenomenon and, alongside the credit crunch, are placing major strains on economies across the globe. UK CPI annual inflation rose from 4.7 per cent in August to 5.2 per cent in September (see Figure 3.10). The increase in CPI inflation from 2.1 per cent in December 2007 to 5.2 per cent in September can be attributed to a rise in fuel, food and commodities prices. For example, the six main energy providers in the UK all announced large increases in gas and electricity prices over the summer. Cross commodity price linkages have exacerbated inflationary pressures, with rises in the cost of fuel impacting on food prices[xlvi]. This inflationary pressure has limited the ability of the Bank of England to slash interest rates to support the slowing economy.

Figure 3.10: UK price indices

Annual % change, last data point is September 2008.



Source: ONS Crown Copyright

With annual CPI inflation more than 1 per cent above the Government's 2 per cent symmetrical target for four consecutive months in August, the Governor of the Bank of England, Mervyn King, was required to write another open letter to the Chancellor of the Exchequer explaining why inflation had moved away from the target. The letter stated[xlvii] that inflation was likely to peak around 5 per cent in the second half of this year, but would remain markedly above the 2 per cent target well into 2009. With inflation remaining above target for so long, the Bank of England is concerned that inflation expectations will continue to rise and become hard to dislodge.

August's Bank of England/GfK NOP Inflation Attitudes survey[xlviii] showed that household perceptions of inflation over the past year and their expectations for inflation over the next year had risen to their highest levels since the survey began in 1999. The perception of the current level of annual inflation was 5.4 per cent and the expectation of annual inflation in a year's time was 4.4 per cent. This suggests that inflationary expectations are widespread, which makes aggressive cuts in UK interest rates more difficult than would otherwise be the case. However, evidence that raw material inflationary pressures are moderating and in light of the intensification of the financial market turmoil, which had "augmented the downside risks to growth"[xlix], the Bank cut interest rates from 5 per cent to 4.5 per cent on 8 October.

RPI inflation, which includes housing costs, was 5.0 per cent in September. With overall inflation at its highest since the early 1990s and with RPI inflation often being used as a benchmark in many wage negotiations there is a risk that higher wage claims could cause a wage-price spiral. However, so far annual earnings growth has remained constrained, and with unemployment rising in the UK along with concerns about jobs, upward pressure on wages may be less of a concern in 2009.

Recent inflation has been a worldwide phenomenon due in part to strong demand for oil, food and other commodities by China and India. This has put upward pressure on world prices and is constraining the ability of central banks to slash interest rates to support growth at a time when economies are slowing down. In the Eurozone the ECB raised interest rates from 4 to 4.25 per cent on 3 July due to inflation hitting 4 per cent in June, before cutting rates to 3.75 per cent on 8 October in light of the global slowdown. US annual inflation rose from 5 per cent in June to 5.6 per cent in July, the highest level since 1991, before abating slightly in August to 5.4 per cent.

UK inflation is expected to fall later in the year and during next year especially as oil prices have fallen from their record high levels. Brent crude oil has fallen by around 50 per cent from its high of over $145 per barrel in early July to below $75 per barrel during October due to weakening demand prospects, particularly from industrialised countries (see Figure 3.11). The reduction in oil prices will help reduce overall inflation.

Figure 3.11: Brent crude oil price (US $ per barrel)
Last data point is 13/10/08

Source: FT.com

In August the Bank of England expected inflation to peak around 5 per cent in 2008 before settling around the 2 per cent target in the medium term[l]. The likelihood is that the slow down in the economy and the recent reduction in the price for oil will mean that inflation will start to ease quite rapidly. This will give an opportunity for the Bank to further cut interest rates to help stimulate the economy and prevent inflation from actually undershooting the 2 per cent target in a couple of years time.

Business confidence has been hit by the slowdown in the economy with the business confidence measure produced by the Institute of Charted Accountants in England and Wales[li] reaching record lows after declining for the fifth consecutive quarter. Businesses are facing huge challenges from the ongoing credit crunch. Meanwhile unemployment has begun to increase in the UK with the ILO measure of the unemployment rate rising to 5.7 per cent in the three months to August 2008, the highest rate since 2000[lii].

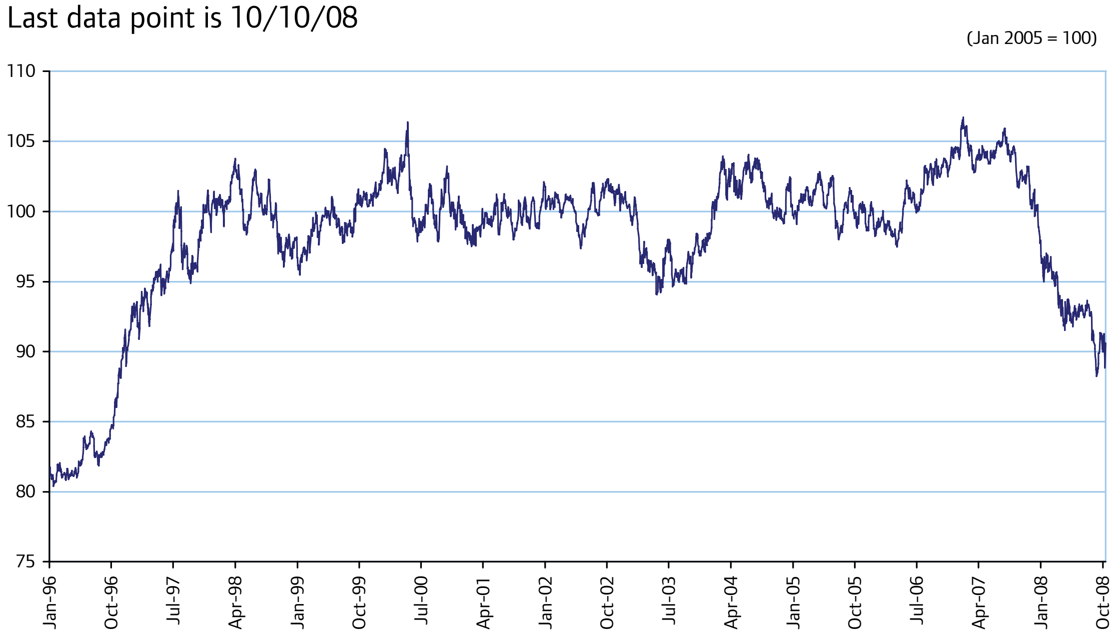
Since GLA Economics' Spring 2008 London's Economic Outlook, sterling has weakened against the dollar (see Figure 3.12), falling by over 10 per cent by early September, before behaving erratically in light of financial market turmoil. Against the euro sterling has recently been trading around 1.25 euros per pound, nearly 20 per cent below its recent peak in January 2007.

Figure 3.12: £ to $ and £ to euro exchange rates
Last data point is 10/10/08

Source: EcoWin

The weakness of the pound is illustrated by sterling's effective exchange rate index (EERI)[liii] (see Figure 3.13) that has fallen since the last edition of GLA Economics' London's Economic Outlook and is at levels last seen in December 1996. The depreciation of the pound against a basket of currencies may well provide some support to the UK economy via an improvement in net export growth.

Figure 3.13: Sterling EERI rate
Last data point is 10/10/08



Source: Bank of England

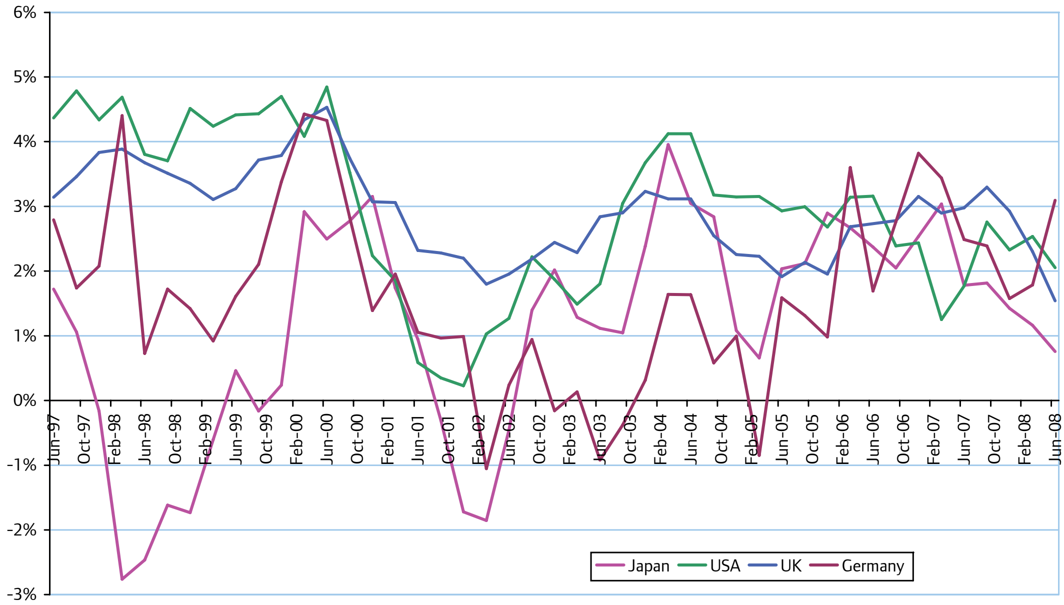
3.3 The world economy

Despite economic uncertainty in developed countries and financial turbulence the IMF projected in October that the world economy would grow by 3.9 per cent in 2008 and 3.0 per cent in 2009 down from 5 per cent in 2007[liv].

Growth in the developed economies is forecast to slow markedly with the US projected to grow at 1.6 per cent in 2008 and 0.1 per cent in 2009, down from 2 per cent in 2007. The Eurozone is projected to slow from 2.6 per cent in 2007 to 1.3 per cent in 2008 and 0.2 per cent in 2009. However, growth in developing economies is expected to only ease from 8 per cent in 2007 to 6.9 per cent and 6.1 per cent in 2008 and 2009 respectively with China projected to slow from 11.9 per cent in 2007 to 9.7 per cent in 2008 and 9.3 per cent in 2009.

After contracting by 0.2 per cent in the final quarter of 2007[lv], the **US** economy rebounded somewhat in the first half of 2008. However, unemployment did rise to a five year high of 6.1 per cent in September[lvi] and the September edition of the Federal Reserves' Beige book indicated that the US economy remains weak[lvii]. The economy continues to be battered by the fallout from the declining housing market and ensuing credit crunch. Inflation is high, leading to weaker consumer spending as consumers' purchasing power is hit[lviii]. The Federal Reserve has cut interest rates by 50 basis points to 1.5 per cent since GLA Economics' Spring 2008 London's Economic Outlook. In the near term the Fed's interest rate decisions will depend on balancing the contradictory demands placed upon it of high inflation, a weak economy as well as precarious financial markets.

Figure 3.14: GDP growth in selected industrialised countries
Real GDP, annual % change



Source: Ecowin

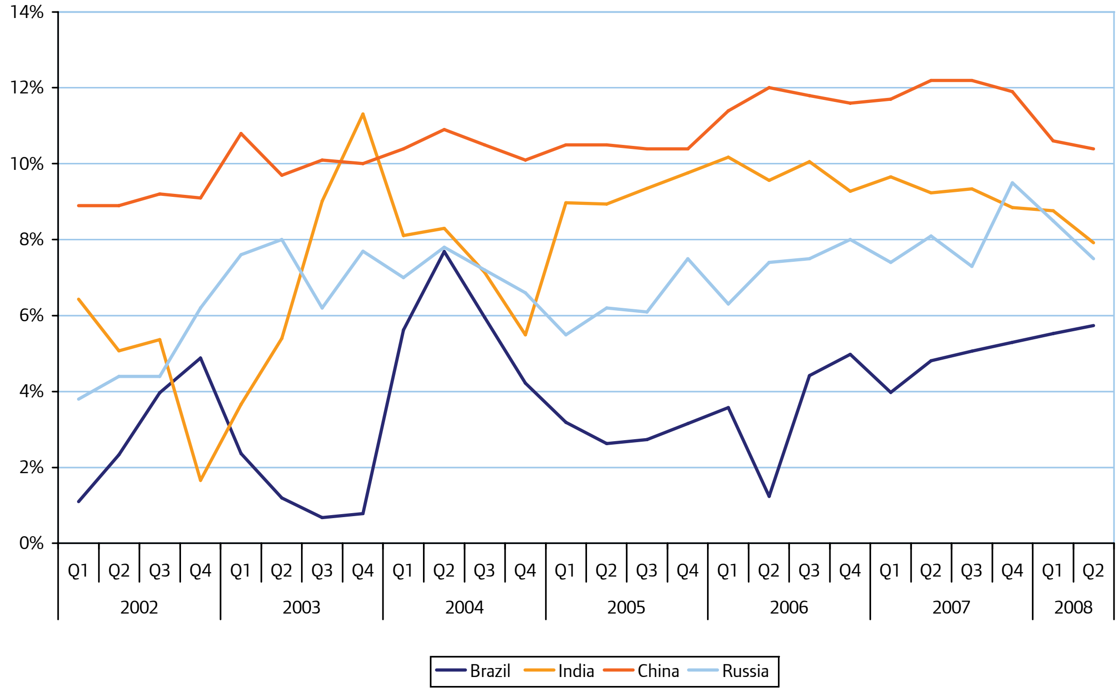
The **Eurozone** contracted by 0.2 per cent in the second quarter of 2008[lix], after remaining relatively strong in the first quarter. The German economy contracted by 0.5 per cent in the second quarter of 2008 whilst the French and Italian economies contracted by 0.3 per cent[lx]. The Irish economy entered a recession in the second quarter[lxi] (defined as two consecutive quarters of negative economic growth.) Consumer spending, a key driver of the economy, has been dented by high fuel and food costs. Business confidence is also low with the German IFO business expectations index at its weakest level since the recession of the early 1990s[lxii]. Meanwhile a number of banks in member states have been hit by the credit crunch[lxiii].

Japan's economy showed signs of a slowdown in the second quarter of 2008 and industrial production has declined for two consecutive quarters[lxiv]. The Bank of Japan has lowered its growth forecast for the year to March 2009 to 1.2 per cent down from a previous forecast of 1.5 per cent[lxv].

3.4 Emerging market economies

China's economic expansion continued at a fast pace during the first half of 2008, although constrained overseas demand has slowed growth compared to that seen in 2007 with output increasing by an annualised 10.1 per cent in the second quarter of 2008 compared with 11.9 per cent in 2007[lxvi]. Consumer spending and investment both remained robust in the first half of 2008[lxvii], and the trade surplus hit a record high of $28.7 billion in August[lxviii]. There has been evidence that inflationary pressures may be abating.

Figure 3.15: GDP growth in selected emerging market economies
Annual % change



Source: Ecowin

India's economy grew by a slower than expected 7.9 per cent annual rate in the second quarter of 2008 compared to 8.8 per cent in the first quarter[lxix]. Inflation, which was over 12 per cent as measured by the wholesale price index in August[lxx], has forced the Indian central bank to increase interest rates[lxxi].

Russia's economy has continued its recent strong growth with the IMF forecasting it to grow by 7 per cent in 2008, but it is then expected to slow in 2009 to a rate of growth of 5.5 per cent[lxxii]. However, the Russian RTS share index has fallen sharply since its May peak, partly due to foreign investors having been unnerved by the recent conflict with Georgia[lxxiii] and partly due to the ongoing credit crunch.

Brazil's economy has continued its fast pace of expansion, with the IMF predicting that its economy will grow by 5.2 per cent in 2008 only slightly down from the 5.4 per cent growth it experienced in 2007[lxxiv].

3.5 Risks to the world economy

Downside risks dominate the world economic outlook. In GLA Economics' Autumn 2007 and Spring 2008 editions of London's Economic Outlook, the global credit crunch was highlighted as a downside risk and the uncertainty associated with this continues to plague the global financial system. Risks associated with problems in financial institutions thus remain a major concern for the global economy. Some developed countries such as Denmark[lxxv] and Ireland have already entered a recession, whilst the

US economy remains weak and the UK and Eurozone seem set to go into official recessions shortly (defined as two consecutive quarters of negative economic growth).

At least the recent fall in many commodity prices may provide some relief to the world economy. The falling oil price, which has recently abated from record highs, should provide some easing of inflation in the near future. However, the nominal oil price is still high compared to recent historical levels due to continued geopolitical tensions in a number of producer states and is thus unlikely to drop back to levels seen at the beginning of the decade. Capacity constraints are also likely to reduce the scope for oil and other commodities prices to collapse despite weakening global demand.

3.6 Summary

The London economy performed well on an annualised basis at the start of 2008 and continued to outperform the rest of the UK. The outlook however is for a significant slowdown during the rest of 2008 and at the beginning of 2009. There is a possibility of a number of quarters of negative growth for London at the end of this year and at the beginning of next. A slow recovery is then expected in the latter half of 2009 before picking up slightly in 2010. London's economic performance may well be more sensitive to the ongoing dislocation and job losses in the financial markets than the rest of the UK.

The UK economy is expected to face difficult times over the next year or so. Both consumption and investment are expected to weaken as the effects of the dislocation in lending caused by the ongoing credit crunch continue to feed through to the real economy. The impact of falling housing market activity and expectations of higher unemployment are also likely to effect purchasing decisions. Unlike the slowdown following the dot-com bust and 9/11 UK government spending looks to be constrained due to the worsening nature of the current fiscal outlook. Government borrowing has increased by about 70 per cent compared to a year earlier in the five months from April 2008 to £28.2 billion[lxxvi]. The governments' fiscal rules now seem in tatters. Inflation has risen sharply but is now expected to fall back over 2009. Inflationary risks would be heightened if higher compensating wage demands increased, although as yet there is little evidence of this occurring, especially with unemployment now rising quickly. The global economy has slowed due mainly to developed economies, as growth in the emerging market economies remains strong although it is moderating slightly. A downside risk to the world economy remains that the full economic effect of the ongoing credit crunch could be even more severe than currently expected.

The main downside risk to the London and UK economies remains the ongoing credit crunch and its effects on global financial markets leading to tighter credit conditions to both businesses and consumers. In particular London's exposure to the financial services sector poses downside risks for the London economy should a downturn in this sector prove prolonged. Liquidity in financial markets remains tight with the situation having yet to return to normal as shown by the continued wide spread between the Bank of England's base rate and the three month LIBOR rate. Deleveraging in the banking sector still has some way to go and liquidity problems have become solvency problems in some cases. At least sterling's recent depreciation against a basket of currencies should support overall economic activity via improved net export growth and this will also help to rebalance the economy. Overall during the next couple of years falling employment and below trend output growth should be expected for the London economy.

4. Review of independent forecasts

What the forecasts provide

In Chapter 5, GLA Economics' forecast of four economic indicators is provided: workforce employment, real output, private consumption (household expenditure) and household income in London. In this chapter the consensus view on the first three of these indicators is summarised, drawing on forecasts from outside (independent) organisations[lxxvii]. Both annual growth rates and 'standardised' absolute levels are reported. All the data is in real terms (constant prices).

Additionally, both the consensus and GLA Economics' own forecasts provide predictions of employment and output growth in six broad sectors:

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

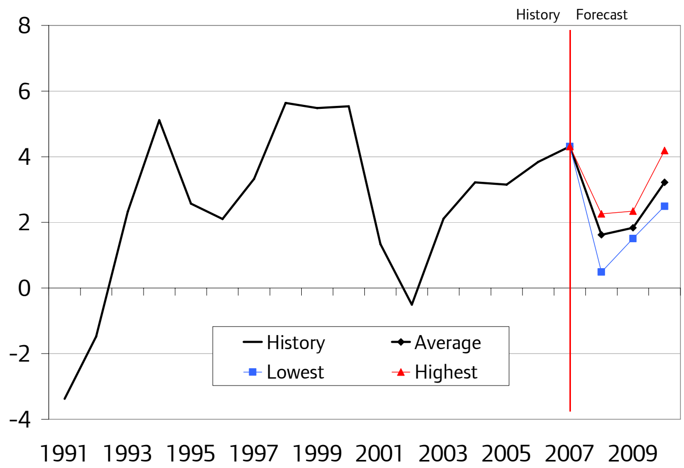
Output

(London GVA, constant prices (2003 base year), £ billion)

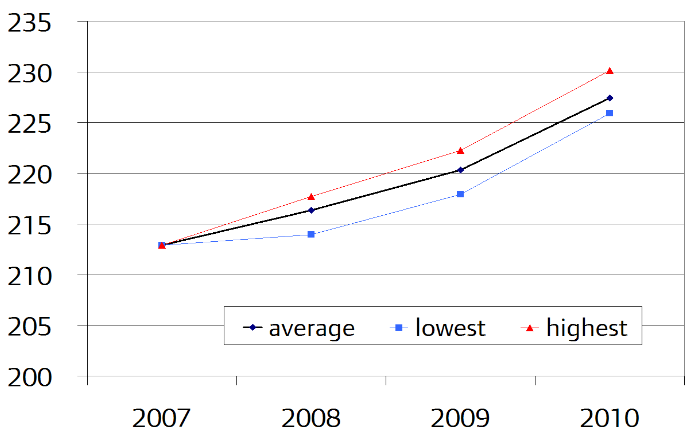
The consensus (mean average view) is for real output growth to slow from its recent high level to below trend over the coming year, with growth below 2 per cent for 2008 and 2009 before rebounding to 3.2 per cent in 2010.

The spread of predicted growth rates is relatively wide in 2008, with one forecaster predicting growth of 0.5 per cent whereas another forecasts 2.3 per cent.

Annual growth (per cent)



Level (constant year 2003, £ billion)



Annual growth (per cent)			
	2008	2009	2010
Average	1.6	1.8	3.2
Lowest	0.5	1.5	2.5
Highest	2.3	2.3	4.2

Level (constant year 2003, £ billion)			
	2008	2009	2010
Average	216	220	227
Lowest	214	218	226
Highest	218	222	230

History: Annual growth (per cent)

1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
-3.4	-1.5	2.3	5.1	2.6	2.1	3.3	5.6	5.5	5.5	1.3	-0.5	2.1	3.2	3.2	3.8	4.3

History: Level (constant year 2003, £ billion)

1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
133.0	131.0	134.0	140.9	144.5	147.5	152.5	161.1	169.9	179.3	181.7	180.8	184.6	190.5	196.5	204.1	212.9

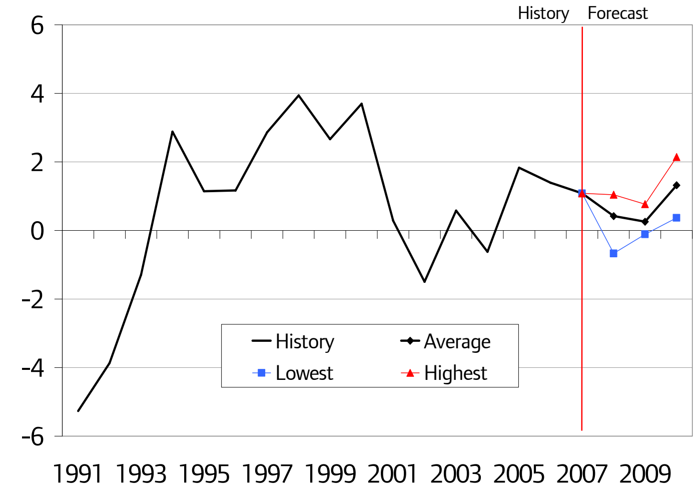
Employment
(London workforce jobs)

London's labour market showed solid growth in 2007 with workforce jobs growth at 1.1 per cent.

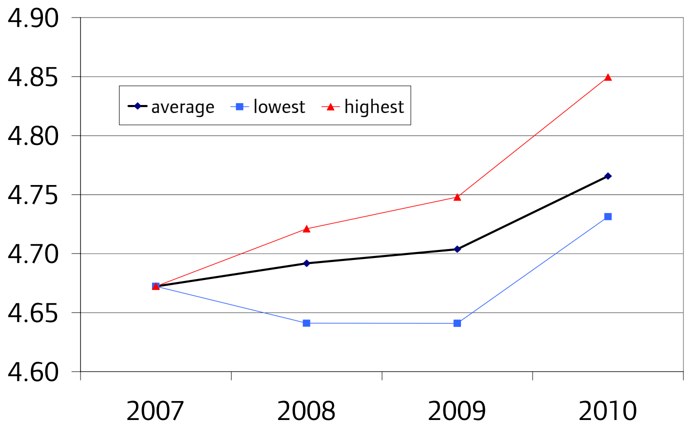
The consensus view is for workplace jobs to grow more slowly over the next two years: 0.4 per cent in 2008 and 0.3 per cent in 2009.

The spread of workforce jobs estimates for 2010 ranges from 4.73 million to 4.85 million.

Annual growth (per cent)



Level (millions)



Annual growth (per cent)			
	2008	2009	2010
Average	0.4	0.3	1.3
Lowest	-0.7	-0.1	0.4
Highest	1.0	0.8	2.1

Level (millions)			
	2008	2009	2010
Average	4.69	4.70	4.77
Lowest	4.64	4.64	4.73
Highest	4.72	4.75	4.85

History: Annual growth (per cent)

1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
-5.3	-3.9	-1.3	2.9	1.1	1.2	2.9	3.9	2.7	3.7	0.3	-1.5	0.6	-0.6	1.8	1.4	1.1

History: Level (millions)

1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
3.99	3.83	3.78	3.89	3.94	3.98	4.10	4.26	4.37	4.53	4.55	4.48	4.51	4.48	4.56	4.62	4.67

Household expenditure

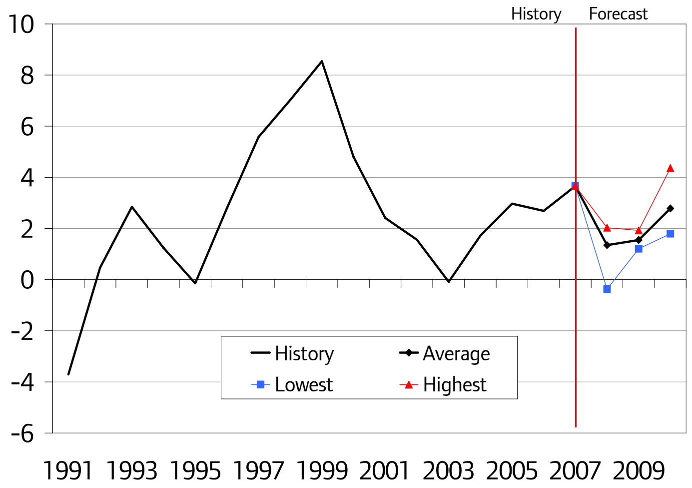
(London household spending, constant year 2003, £ billion)

Growth in household expenditure was strong at 3.7 per cent in 2007.

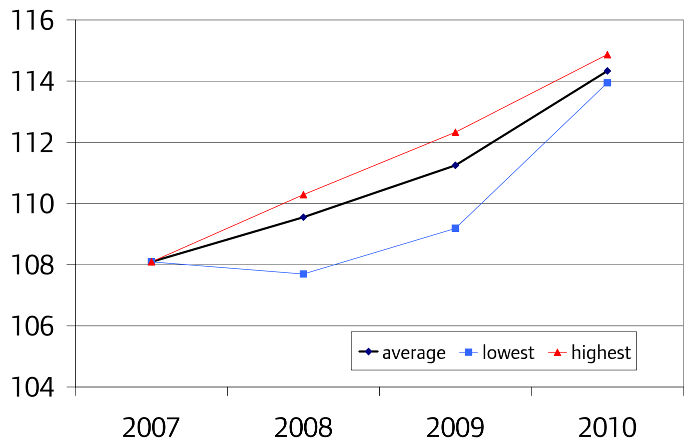
The consensus view is for household expenditure growth to slow down: 1.3 per cent in 2008, 1.5 per cent in 2009 and 2.8 per cent in 2010.

Household expenditure is expected to be around £115 billion by 2010.

Annual growth (per cent)



Level (constant year 2003 £ billion)



Annual growth (per cent)			
	2008	2009	2010
Average	1.3	1.5	2.8
Lowest	-0.4	1.2	1.8
Highest	2.0	1.9	4.4

Level (constant year 2003, £ billion)			
	2008	2009	2010
Average	110	111	114
Lowest	108	109	114
Highest	110	112	115

History: Annual growth (per cent)

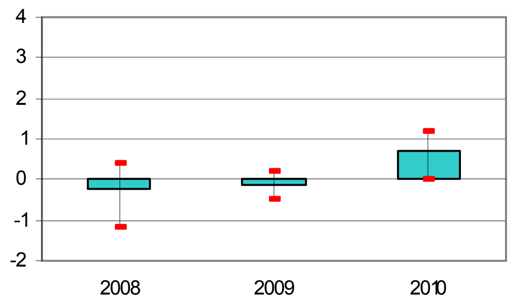
1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
-3.7	0.5	2.8	1.2	-0.1	2.8	5.6	7.0	8.5	4.8	2.4	1.6	-0.1	1.7	3.0	2.7	3.7

History: Level (constant year 2003, £ billion)

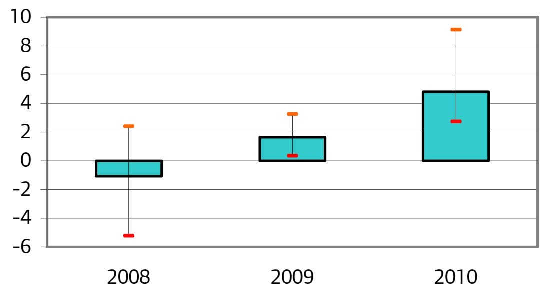
1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
67.6	67.9	69.9	70.7	70.6	72.6	76.6	82.0	89.0	93.3	95.6	97.0	97.0	98.6	101.5	104.3	108.1

Output growth by sector (per cent annual change)
Growth is expected across nearly all sectors over the medium term. The highest growth is expected in the financial and business services sector and the transport and communications sector.

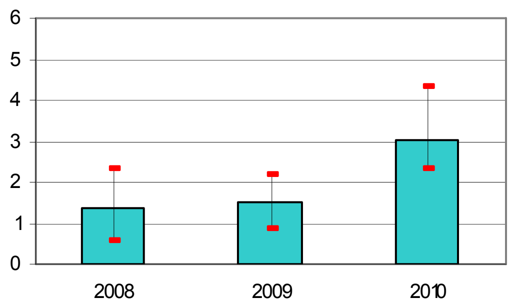
Manufacturing



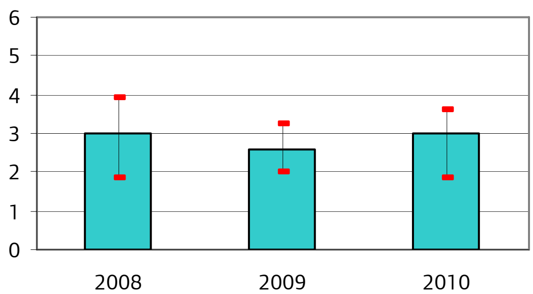
Construction



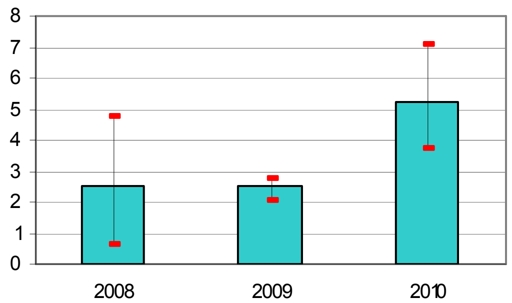
Distribution, hotels and catering



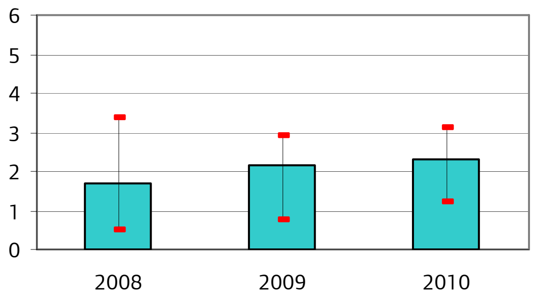
Transport and communications



Finance and business



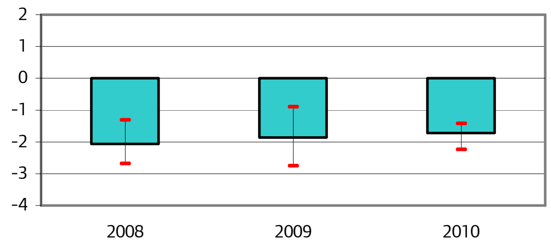
Other (mainly public) services



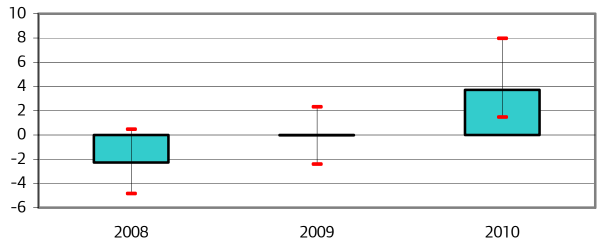
		2008	2009	2010			2008	2009	2010
Manufacturing	*Average*	-0.2	-0.1	0.7	**Construction**	*Average*	-1.1	1.6	4.8
	Lowest	-1.2	-0.5	0.0		*Lowest*	-5.2	0.3	2.7
	Highest	0.4	0.2	1.2		*Highest*	2.4	3.2	9.1
Distribution, hotels and catering	*Average*	1.3	1.5	3.0	**Transport and communications**	*Average*	3.0	2.6	3.0
	Lowest	0.6	0.9	2.3		*Lowest*	1.9	2.0	1.9
	Highest	2.4	2.2	4.3		*Highest*	3.9	3.3	3.6
Finance and business	*Average*	2.5	2.5	5.2	**Other (mainly public) services**	*Average*	1.7	2.2	2.3
	Lowest	0.6	2.1	3.7		*Lowest*	0.5	0.8	1.2
	Highest	4.8	2.7	7.1		*Highest*	3.4	2.9	3.1

Employment growth by sector (per cent annual change)
Forecasted employment growth shows a mixed pattern across the sectors. Reasonable employment growth is expected in financial and business services. Slow or negative employment growth is expected in most sectors.

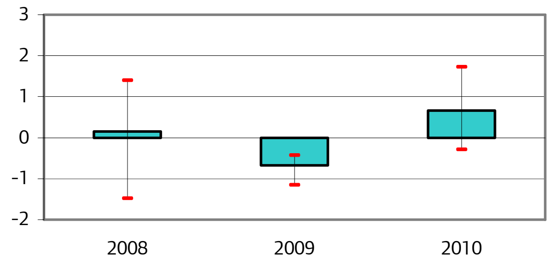
Manufacturing



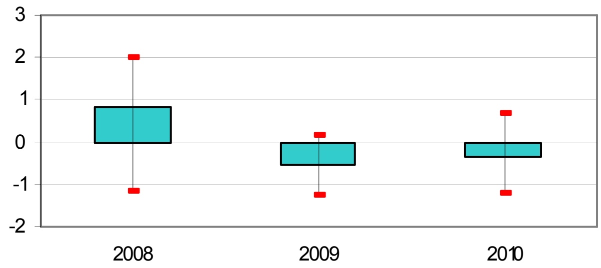
Construction



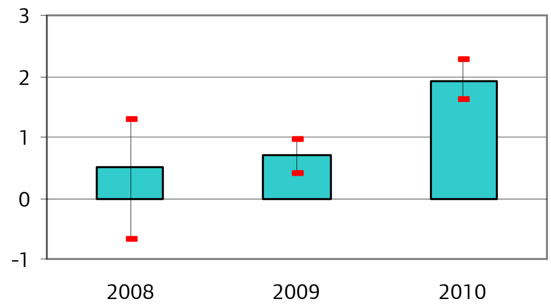
Distribution, hotels and catering



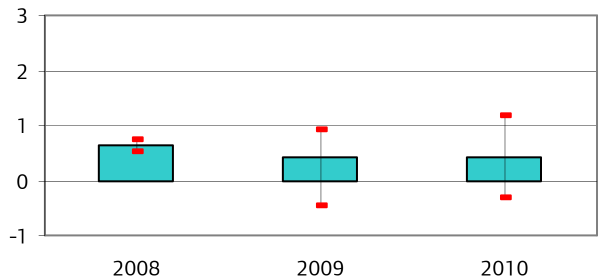
Transport and communication



Finance and business



Other (mainly public) services



		2008	2009	2010			2008	2009	2010
Manufacturing	*Average*	-2.1	-1.9	-1.7	**Construction**	*Average*	-2.3	0.0	3.7
	Lowest	-2.7	-2.8	-2.2		*Lowest*	-4.8	-2.4	1.5
	Highest	-1.3	-0.9	-1.4		*Highest*	0.5	2.3	8.0
Distribution, hotels and catering	*Average*	0.2	-0.7	0.7	**Transport and communications**	*Average*	0.8	-0.6	-0.4
	Lowest	-1.5	-1.1	-0.3		*Lowest*	-1.2	-1.2	-1.2
	Highest	1.4	-0.4	1.7		*Highest*	2.0	0.2	0.7
Finance and business	*Average*	0.5	0.7	1.9	**Other (mainly public) services**	*Average*	0.6	0.4	0.4
	Lowest	-0.7	0.4	1.6		*Lowest*	0.5	-0.4	-0.3
	Highest	1.3	1.0	2.3		*Highest*	0.8	0.9	1.2

5. The GLA Economics forecast

5.1 Assumptions and methods

This forecast combines the GLA's long-term trend projections for employment and population with medium-term assumptions about the growth of the UK economy. Note that the GLA forecast is based on assumptions up to 2026, though the forecast itself only goes up to 2010.

The model is constrained for the year 2026 to London-based employment projections derived from the long-term growth rate of London's workforce. The UK assumptions comprise the medium-term growth rates of UK total output. An update of the GLA's long-term employment projections for London is currently being worked on.

5.2 Projections and forecasts

It is necessary to distinguish carefully between the GLA's long-term employment projections and this forecast, which contains the GLA's medium-term planning projections. 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, 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 turning points in the data; whether underlying trends are continuing or new trends are being established. While the forecast is calibrated to the GLA's employment projections for 2026, it provides early warnings of significant deviations from these projections because it accounts for the most recent data and incorporates the latest estimates of UK growth rates.

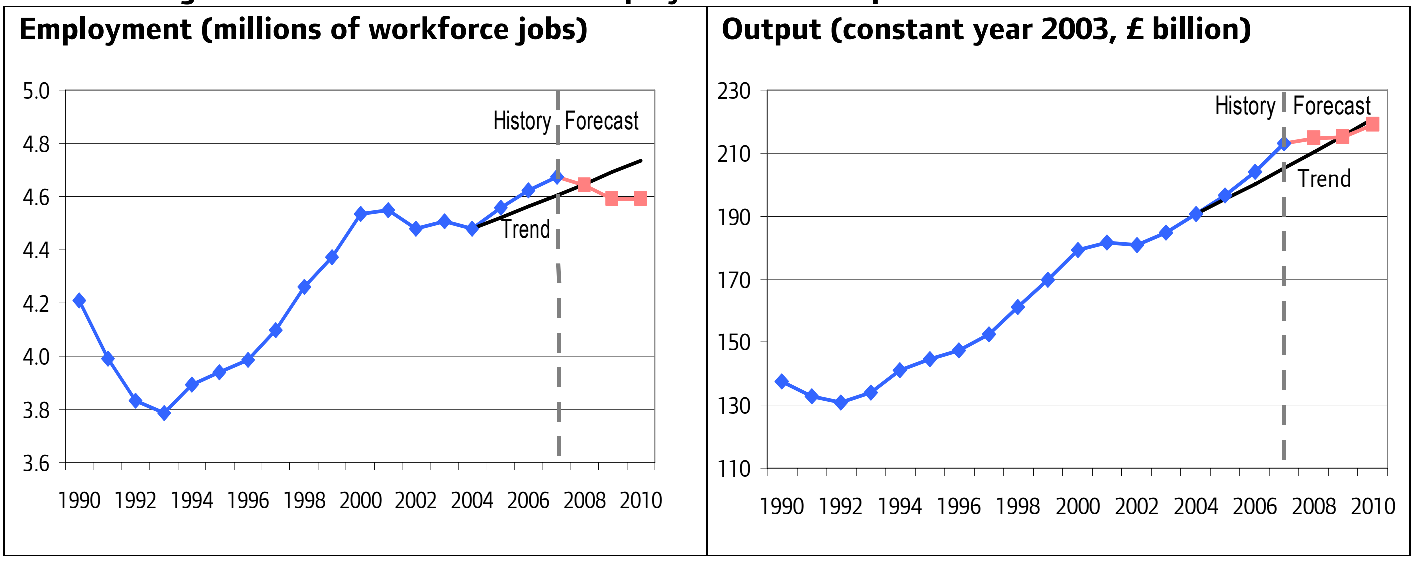
In 2007 the GLA commissioned new employment projections from Volterra Consulting, which now form the trend projection on which the medium-term forecast is based. The start point for the trend projection is 2004. For this reason 2004 is taken as the start point for all trend (long-term) projections. For comparison purposes, absolute (level) trend projections were derived by applying the trend growth rates to the historical data available in 2004. These levels may differ from the absolute levels for GVA, employment and household expenditure published elsewhere as a result of revisions to historical data as better information becomes available.

5.3 Results

Following strong growth in 2007 output is expected to grow at a rate below the long-term trend throughout 2008-2010, with a significant slowdown in 2008 and 2009. Employment is forecast to fall in 2008 and 2009 before stabilising in 2010.

Household spending grew at a quick pace in 2007, but it is expected to fall in 2008 and 2009, before a slight recovery in 2010. Household income growth is forecast to be moderate throughout the forecast period.

Figure 5.1: Trend and forecast employment and output



Source: GLA Economics' calculations

Table 5.1: Forecast and historical growth rates

Annual % change

	2002	2003	2004	2005	2006	2007	2008	2009	2010
GVA	-0.5	2.1	3.2	3.2	3.8	4.3	0.8	0.2	1.9
Workforce jobs	-1.5	0.6	-0.6	1.8	1.4	1.1	-0.7	-1.1	0.0
Household spending	1.6	-0.1	1.7	3.0	2.7	3.7	-0.8	-0.6	1.0
Household income	1.3	2.8	0.6	3.5	0.4	0.3	1.2	1.0	2.0

Table 5.2: Forecast and historical levels

(constant year 2003, £ billion except jobs)

	2002	2003	2004	2005	2006	2007	2008	2009	2010
GVA	180.8	184.6	190.5	196.5	204.1	212.9	214.6	215.1	219.1
Workforce jobs (millions)	4.48	4.51	4.48	4.56	4.62	4.67	4.64	4.59	4.59
Household spending	97.0	97.0	98.6	101.5	104.3	108.1	107.2	106.6	107.6
Household income	108.2	111.3	111.9	115.8	116.3	116.6	118.0	119.1	121.5

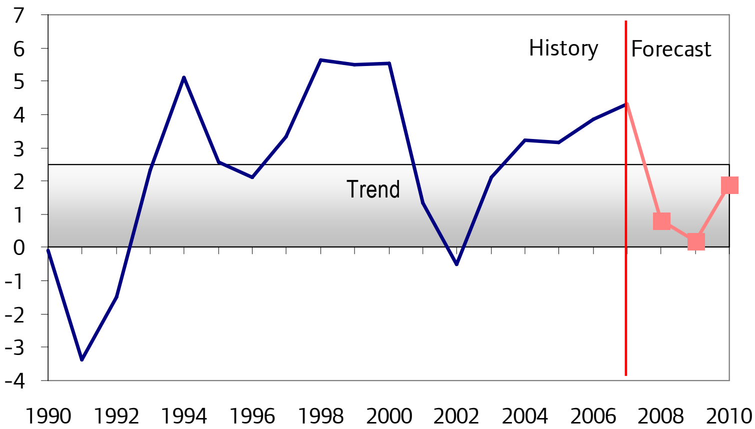
Output

(London GVA, constant year 2003, £ billion)

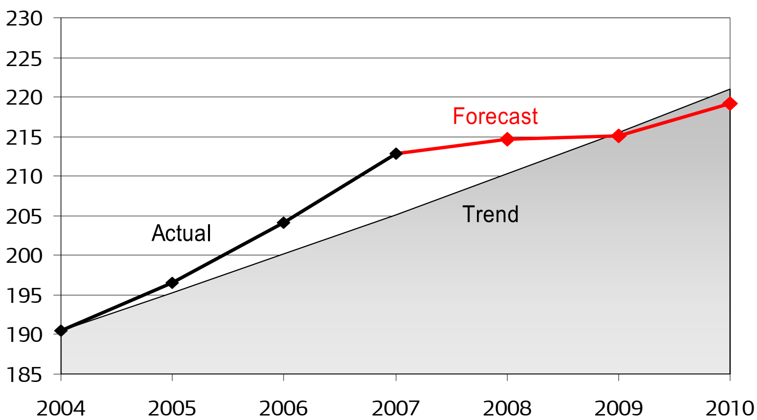
London's real GVA growth is forecast to be below trend over the medium term. Forecast growth rates are 0.8 per cent in 2008, 0.2 per cent in 2009, rising to 1.9 per cent in 2010.

The GLA forecast is below the consensus average growth forecast throughout 2008-10.

Annual growth (per cent)



Level (constant year 2003, £ billion)



Growth (annual per cent)				
	2007	**2008**	**2009**	**2010**
GLA	4.3	0.8	0.2	1.9
Consensus		1.6	1.8	3.2

Level (constant year 2003, £ billion)				
	2007	**2008**	**2009**	**2010**
GLA	213	215	215	219
Consensus		216	220	227

History: Annual growth (per cent)

1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
-3.4	-1.5	2.3	5.1	2.6	2.1	3.3	5.6	5.5	5.5	1.3	-0.5	2.1	3.2	3.2	3.8	4.3

History: Level (constant year 2003, £ billion)

1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
133.0	131.0	134.0	140.9	144.5	147.5	152.5	161.1	169.9	179.3	181.7	180.8	184.6	190.5	196.5	204.1	212.9

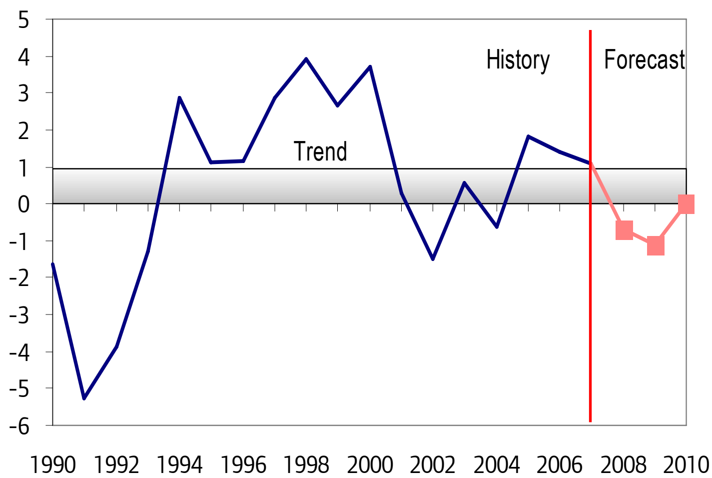
Employment
(London workforce jobs)

London's employment is forecast to fall in both 2008 and 2009, before stabilising in 2010.

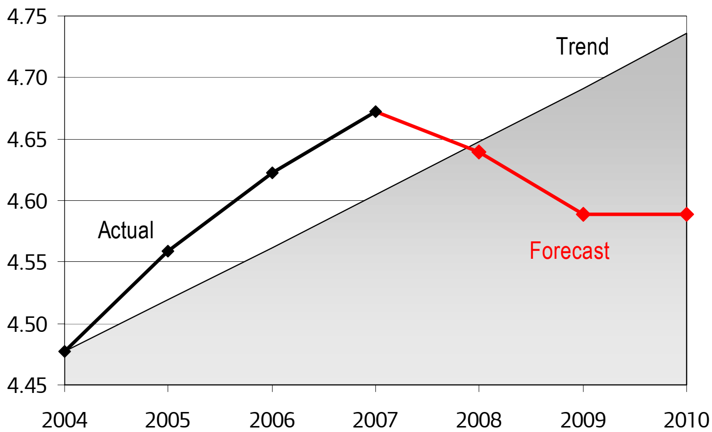
The GLA forecast for employment growth is lower than the consensus average in 2008-2010.

By 2010, London is expected to have 4.59 million workforce jobs, less than in 2007.

Annual growth (per cent)



Level (millions of workforce jobs)



Growth (annual per cent)				
	2007	2008	2009	2010
GLA	1.1	-0.7	-1.1	0.0
Consensus		0.4	0.2	1.3

Level (millions of workforce jobs)				
	2007	2008	2009	2010
GLA	4.67	4.64	4.59	4.59
Consensus		4.69	4.70	4.77

History: Annual growth (per cent)

1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
-5.3	-3.9	-1.3	2.9	1.1	1.2	2.9	3.9	2.7	3.7	0.3	-1.5	0.6	-0.6	1.8	1.4	1.1

History: Level (millions)

1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
3.99	3.83	3.78	3.89	3.94	3.98	4.10	4.26	4.37	4.53	4.55	4.48	4.51	4.48	4.56	4.62	4.67

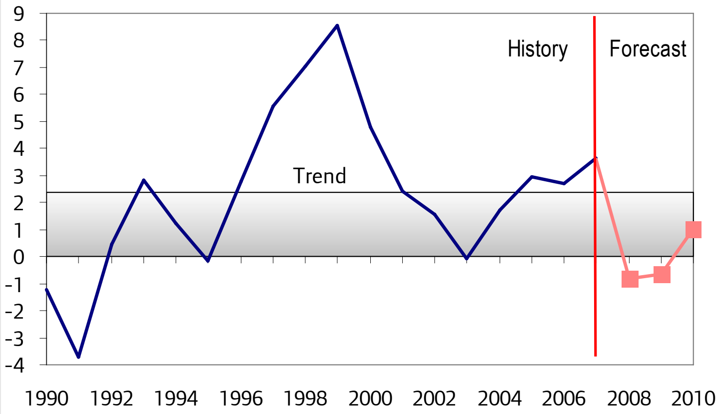
Household expenditure

(London household spending, constant year 2003, £ billion)

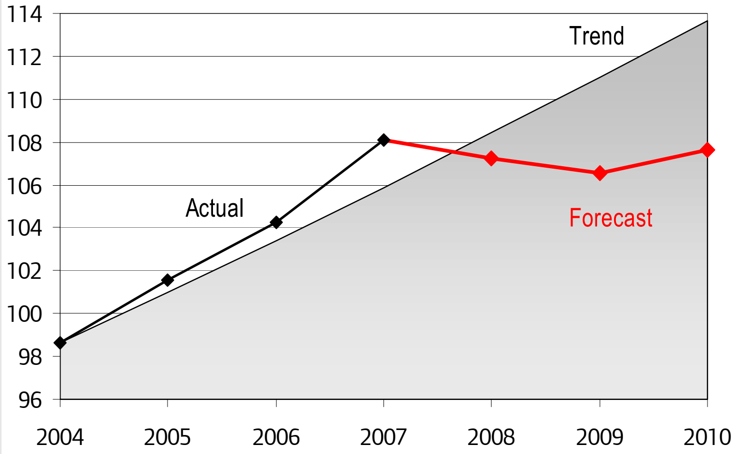
Growth in London's household spending is forecast to be negative in 2008 and 2009, before recovering slightly to 1.0 per cent growth in 2010.

This places the GLA forecast below the consensus average.

Annual growth (per cent)



Level (constant year 2003, £ billion)



Growth (annual per cent)				
	2007	**2008**	**2009**	**2010**
GLA	3.7	-0.8	-0.6	1.0
Consensus		1.3	1.5	2.8

Level (constant year 2003, £ billion)				
	2007	**2008**	**2009**	**2010**
GLA	108	107	107	108
Consensus		110	111	114

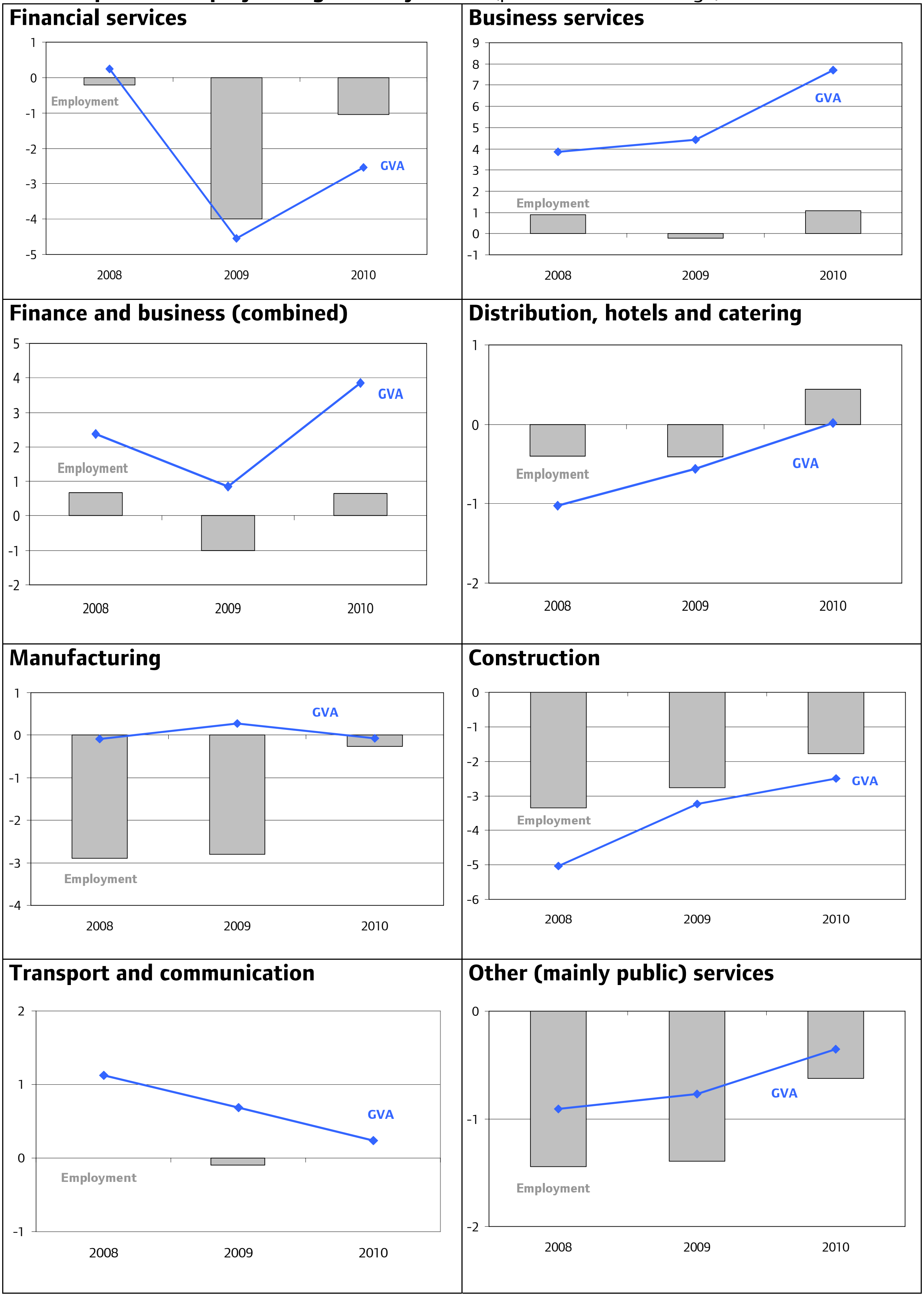
History: Annual growth (per cent)

1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
-3.7	0.5	2.8	1.2	-0.1	2.8	5.6	7.0	8.5	4.8	2.4	1.6	-0.1	1.7	3.0	2.7	3.7

History: Level (constant year 2003, £ billion)

1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
67.6	67.9	69.9	70.7	70.6	72.6	76.6	82.0	89.0	93.3	95.6	97.0	97.0	98.6	101.5	104.3	108.1

Output and employment growth by sector (per cent annual change)



Output and employment growth by sector (per cent annual change)

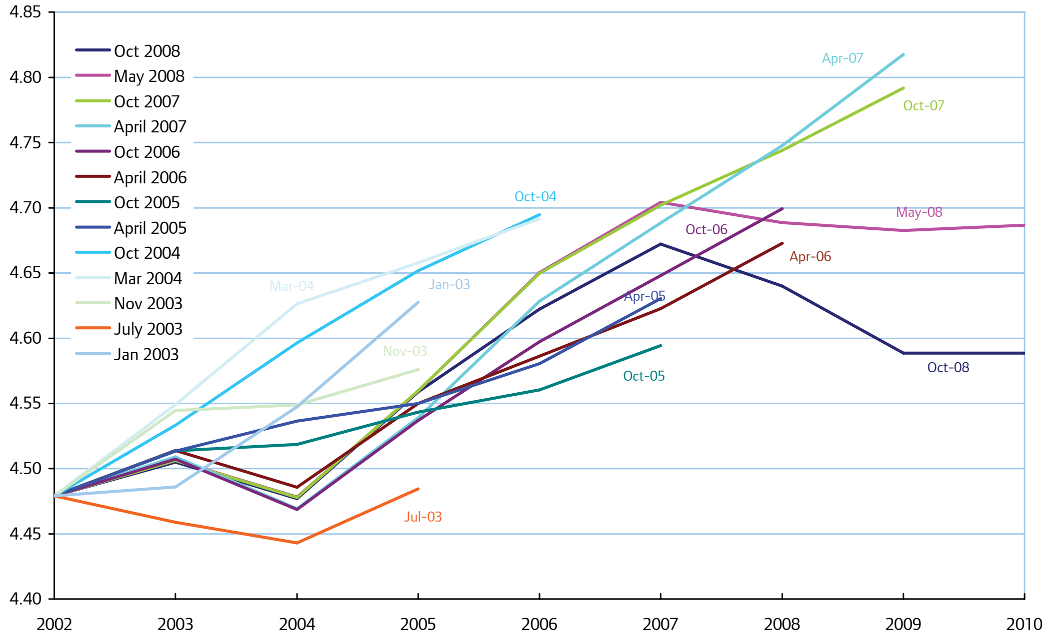
	2008	2009	2010
Financial services			
Output	0.2	-4.5	-2.5
Employment	-0.2	-4.0	-1.0
Business services			
Output	3.9	4.4	7.7
Employment	0.9	-0.2	1.1
Financial and business services combined			
Output	2.4	0.8	3.9
Employment	0.7	-1.0	0.6
Distribution, hotels and catering			
Output	-1.0	-0.6	0.0
Employment	-0.4	-0.4	0.4
Transport and communications			
Output	1.1	0.7	0.2
Employment	0.0	-0.1	0.0
Other (mainly public) services			
Output	-0.9	-0.8	-0.4
Employment	-1.4	-1.4	-0.6
Manufacturing			
Output	-0.1	0.3	-0.1
Employment	-2.9	-2.8	-0.3
Construction			
Output	-5.0	-3.2	-2.5
Employment	-3.4	-2.8	-1.8
(Memo: non-manufacturing)			
Output	0.9	0.2	2.0
Employment	-0.6	-1.0	0.0

5.4 Comparison with previous forecasts

This section compares the current forecast with previous forecasts in this series. Since the base years for the forecasts change and the base data is continuously revised, the forecasts have been rebased into a common base year for the comparison in Figures 5.2 and 5.3.

The most recent forecast for London's workforce jobs growth and output is lower than in previous forecasts.

Figure 5.2: Employment – latest forecast compared with previous forecasts
(millions of workforce jobs)

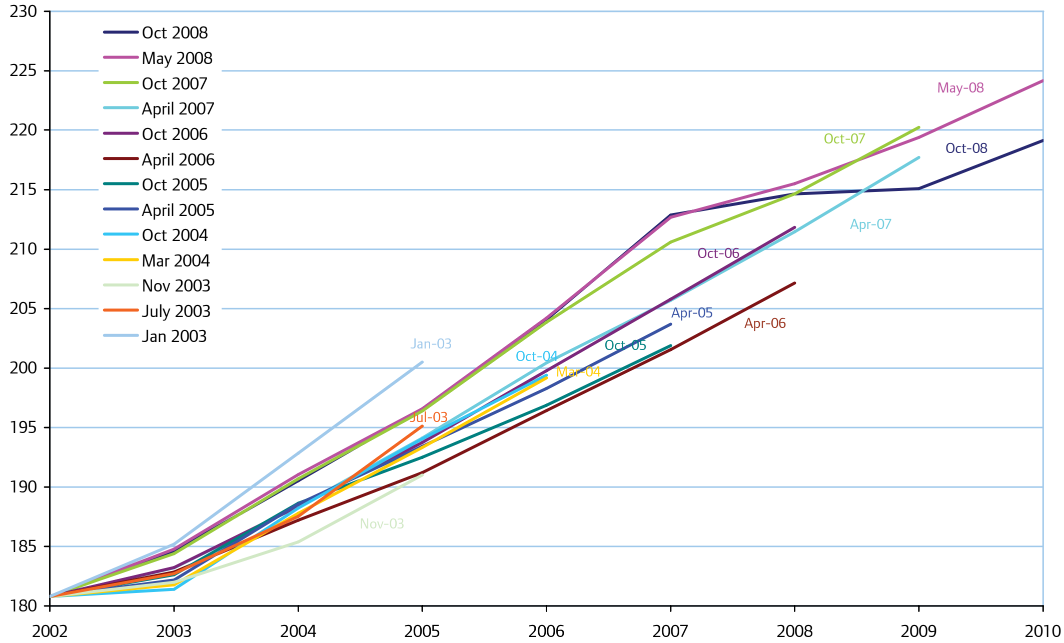


Source: Various London's Economic Outlooks

Table 5.3: Comparisons with previous published forecasts
(London workforce jobs, per cent annual growth)

Forecast	2003	2004	2005	2006	2007	2008	2009	2010
Oct 2008	**0.6%**	**-0.6%**	**1.8%**	**1.4%**	**1.1%**	-0.7%	-1.1%	0.0%
May 2008						-0.3%	-0.1%	0.1%
Oct 2007					1.2%	0.9%	1.0%	
April 2007					1.2%	1.4%	1.5%	
Oct 2006				1.3%	1.1%	1.1%		
April 2006				0.8%	0.8%	1.1%		
Oct 2005			0.6%	0.4%	0.8%			
April 2005			0.3%	0.7%	1.1%			
Oct 2004		1.4%	1.2%	0.9%				
Mar 2004		1.7%	0.7%	0.7%				
Nov 2003	1.5%	0.1%	0.6%					
July 2003	-0.5%	-0.4%	0.9%					
Jan 2003	0.2%	1.4%	1.8%					

Figure 5.3: Output – latest forecast compared with previous forecasts
(constant year 2003, £ billion)



Source: Various London's Economic Outlooks

Table 5.4: Comparisons with previous published forecasts
(London GVA, per cent annual growth)

Forecast	2003	2004	2005	2006	2007	2008	2009	2010
Oct 2008	**2.1%**	**3.2%**	**3.2%**	**3.8%**	**4.3%**	0.8%	0.2%	1.9%
May 2008						1.3%	1.8%	2.2%
Oct 2007					3.3%	2.0%	2.6%	
April 2007					2.6%	2.8%	3.0%	
Oct 2006				3.1%	3.0%	3.0%		
April 2006				2.7%	2.6%	2.8%		
Oct 2005			2.0%	2.3%	2.6%			
April 2005			2.6%	2.5%	2.7%			
Oct 2004		3.8%	3.1%	2.7%				
Mar 2004		3.3%	2.9%	3.0%				
Nov 2003	0.7%	1.9%	3.0%					
July 2003	1.1%	2.6%	4.1%					
Jan 2003	2.4%	4.1%	4.0%					

6. The evolution of UK and London employment rates

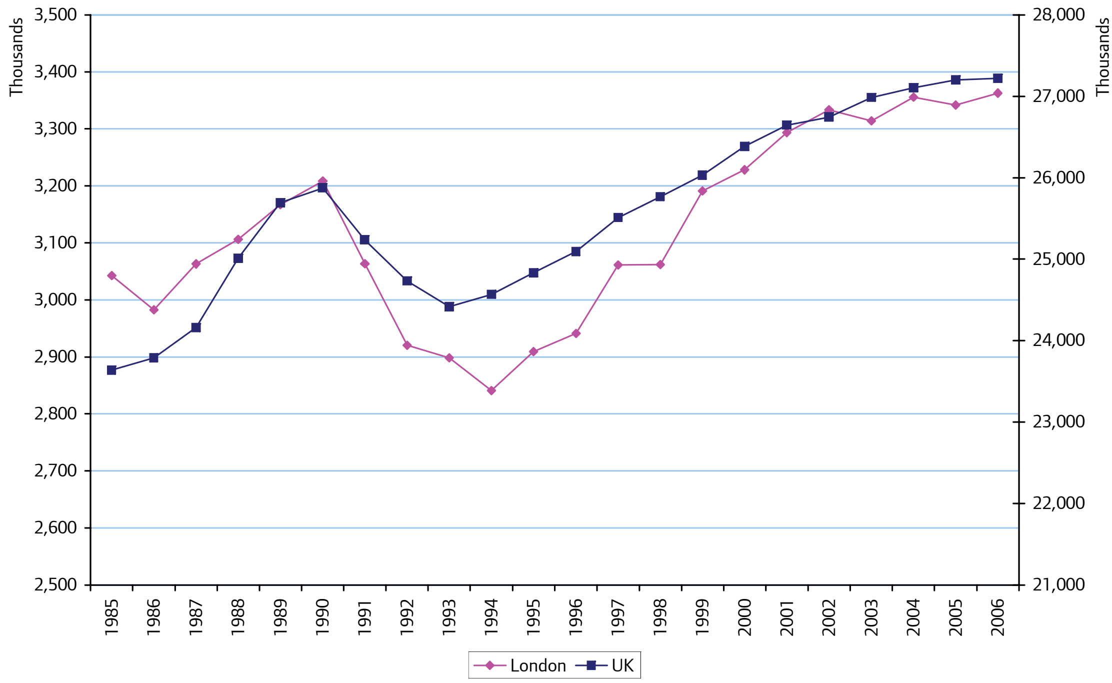
This supplement focuses on the development of UK and London employment rates over the 1985-2006 period[lxxviii]. It is important to note that over the past two decades employment rates in London and the UK have evolved differently. The employment rate in London was higher than the UK rate between 1985 and 1990, then sharply declined between 1990 and 1994, falling below the UK employment rate. After a short period of convergence (1994-1999), the gap between the employment rates in the UK and London widened again, with the UK employment rate five percentage points higher than London's in 2006.

In order to take a long-term view of the evolution of UK and London employment rates, the analysis uses historic data up to 2006 from the residence-based Labour Force Survey (LFS), the workplace-based 'Making sense of the ABI dataset' from Experian Business Strategies (MSABI) and the Office for National Statistics' (ONS) regular population census. Since 2006, the gap between London's employment rate and that for the UK as a whole has closed to just below 4 percentage points. However, with the London economy due to grow well below trend over the next couple of years, whether the reduction in the gap is sustained or not remains to be seen.

6.1 London and UK employment trends

Figure 6.1 shows the level of employment in London (residents in employment) and the UK from 1985-2006. The number of London residents in employment increased from around three million in 1985 to almost 3.4 million in 2006. A similar upward trend in employment is observed for the UK, with the number of employed increasing from 23.6 million in 1985 to 27.2 million in 2006. Both London and the UK experienced a sharp decrease in employment between 1990 and 1994.

Figure 6.1: Employment trends in London and the UK

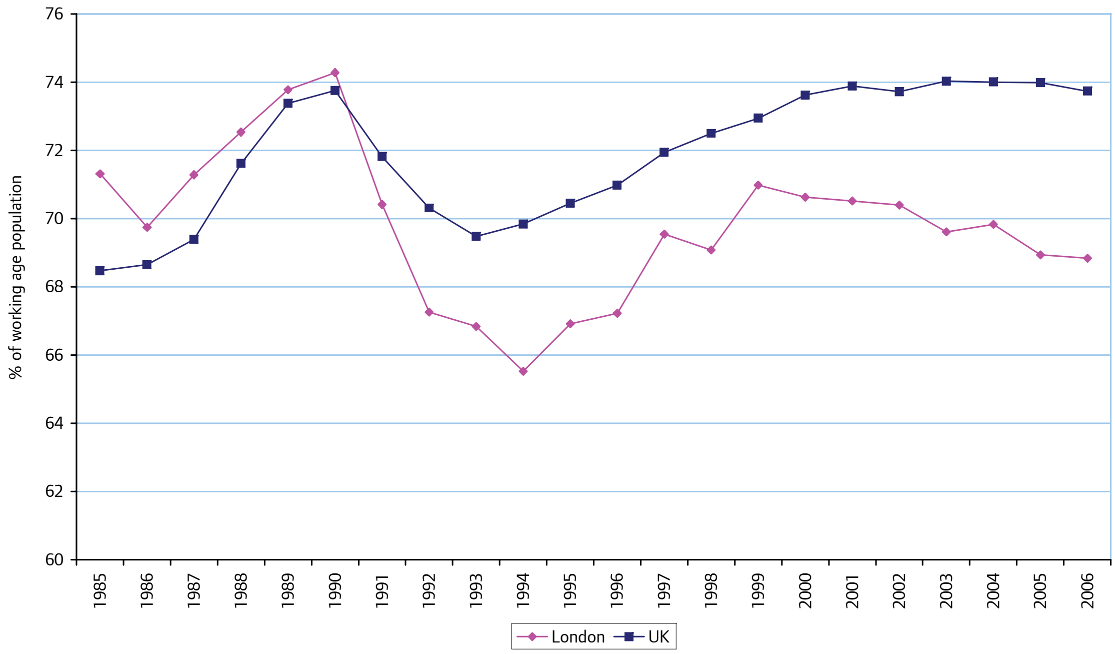


Source: LFS, UK data archive

Note: Numbers for London are on the left axis, while numbers for UK are on the right axis

Figure 6.2 shows that while London's employment rate (the number of London residents employed as a percentage of London's resident working age population) exceeded the UK's until 1990, it declined much faster from 1990 to 1994. After a short period of convergence (1995-1999), the gap between the employment rates in London and the UK continued to increase reaching a five-percentage points gap in the UK's favour in 2006. Thus in the twenty one years between 1985 and 2006 the employment rate in London decreased from 71.3 per cent to 68.8 per cent, while in the UK as a whole it increased from 68.5 per cent to 73.7 per cent.

Figure 6.2: Employment rates 1985-2006

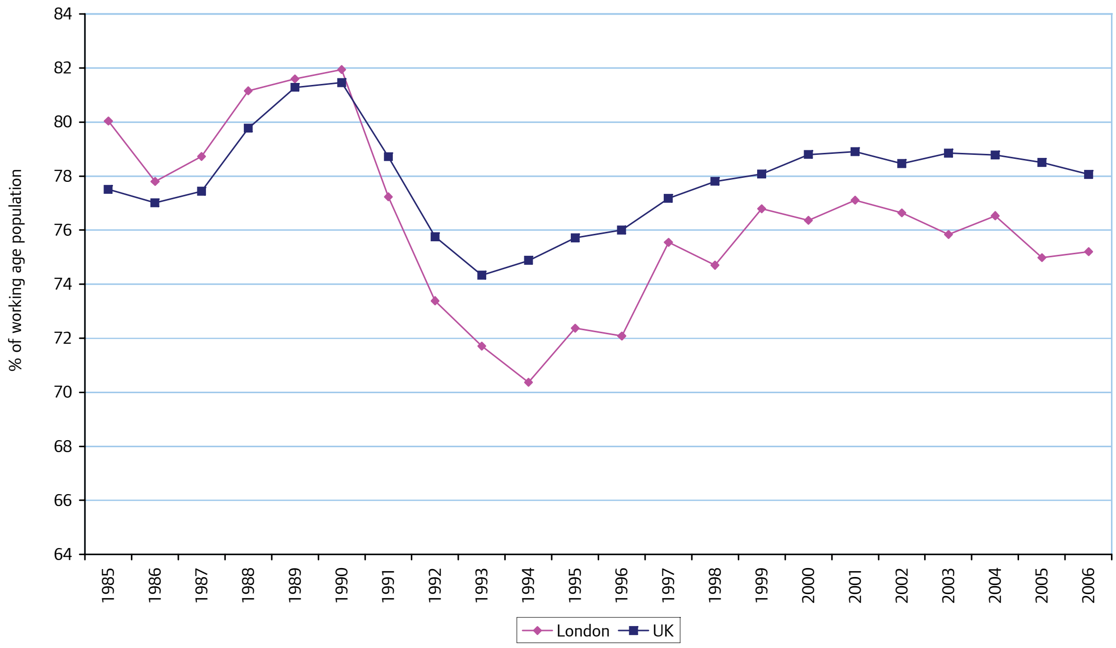


Source: LFS, UK data archive

An analysis of male and female employment rates provides a useful insight into the dynamics of labour market trends in London and the UK. While for men the gap between UK and London employment rates has been relatively stable since the mid 1990s, for women this gap has steadily increased over time. As a result, whilst the decrease in London's employment rate is linked to the substantial fall of both male and female employment rates between 1990 and 1994, female employment rates are responsible for the continuing divergence of London and UK employment rates.

Figure 6.3 shows that according to LFS data male employment rates in London declined by 11.5 percentage points between 1990 and 1994, which is a much larger fall than the UK as a whole experienced (7.5 percentage points). The gap between UK and London male employment rates reduced after 1994, but nonetheless has remained significant and has slightly widened between 2001 and 2006.

Figure 6.3: Employment rates of males, 1985-2006

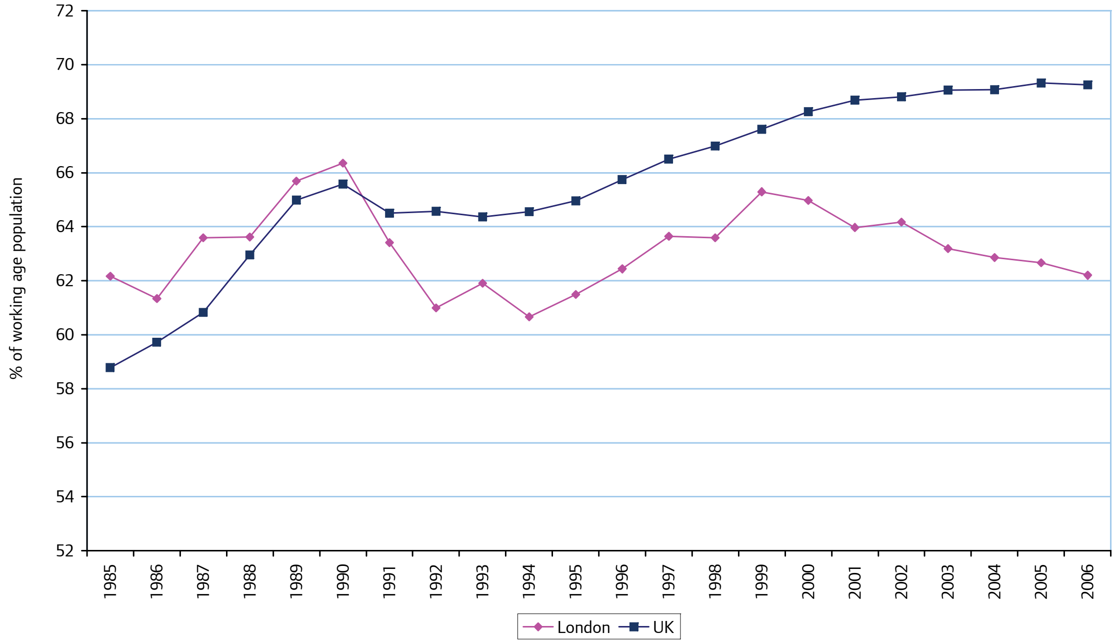


Source: LFS, UK data archive

Figure 6.4 shows that the female employment rate is driving the recent (2000-2006) divergence in aggregate employment rates presented in Figure 6.2. Similarly to male employment rates, the female employment rate in London fell by more than the UK employment rate in the 1990-1994 period.

The female employment rate in London, however, is mainly responsible for the divergence between UK and London rates from 2000 and 2006, because the female employment rate in London has fallen by more than the UK female employment rate increase since 1999. The female employment rate in London was 62 per cent in 2006 compared to 69 per cent in the UK.

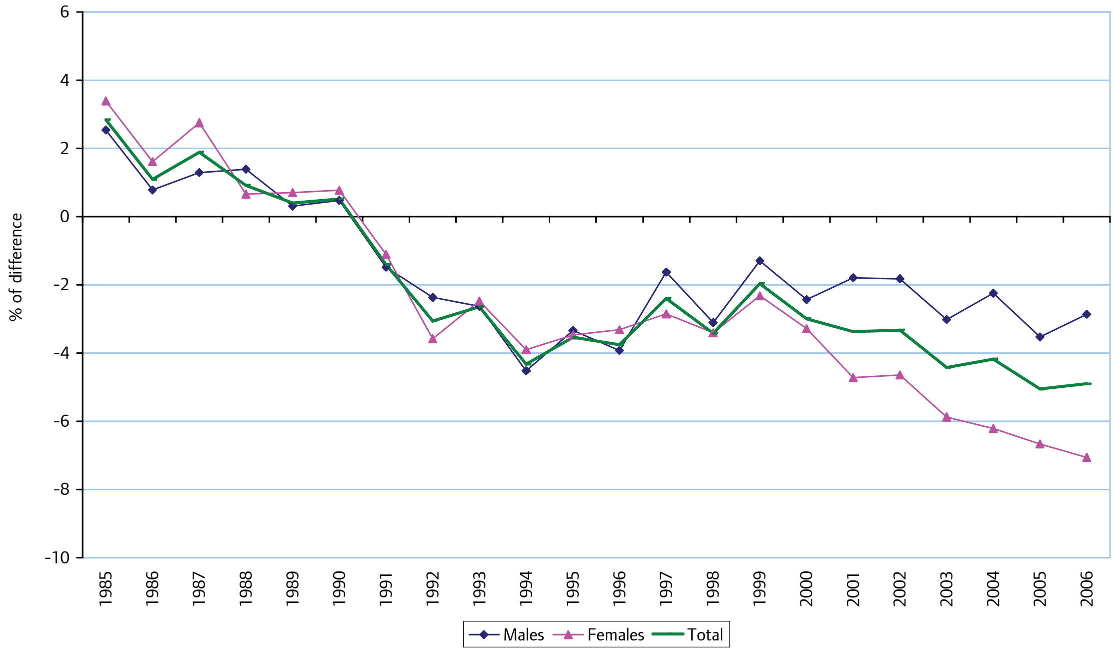
Figure 6.4: Employment rates of females, 1985-2006



Source: LFS, UK data archive

Figure 6.5 shows the difference in total employment rates between London and the UK expressed in percentage points as well as the employment rate gaps for males and females. From 1985 to 1990, London's employment rate was higher than that for the UK, while from 1991 to 2006 London's employment rate fell below that for the UK. As shown in Figure 6.5, the deterioration in the employment rate gap between London and the UK can be associated with deteriorations in the employment rate gap between London and the UK for both males and females in the 1990-1994 period. London's female employment rate (see also Figure 6.4) is responsible for the continuing divergence between UK and London's employment rates.

Figure 6.5: Employment rate gaps (London-UK) percentage points



Source: LFS, UK data archive

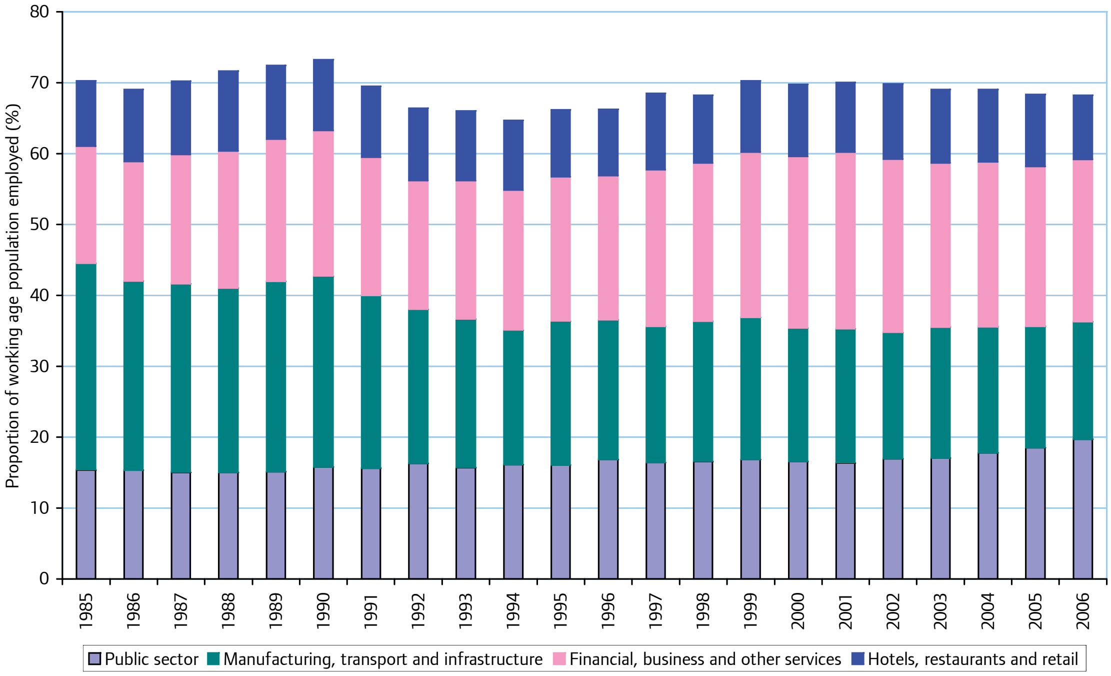
6.2 Sector Analysis

To provide information on the extent to which changes in industrial structure have affected London's employment rate and that for the UK as a whole, the analysis focuses mainly on employment across four major industrial sectors: manufacturing, transport and infrastructure; financial, business and other services; hotels, restaurants and retail; and the public sector.

To understand the relative contribution of each industrial sector to changes in London's labour market performance, employment of London residents in each sector is expressed as a proportion of the total working age population. This allows us to see how changes in industrial structure have contributed (in a strictly accounting sense) to the change in the overall employment rate for both London and the UK.

Figure 6.6 shows the relative contribution of each sector to London's overall employment rate. 'Manufacturing, transport and infrastructure' and 'financial, business and other services' are the two sectors that show the greatest change over time. From 1985 to 1991, the 'manufacturing, transport and infrastructure' sector contributed most to London's employment rate but fell sharply between 1990 and 1994. The subsequent period of 1995 to 2006 is characterised by a further decline in 'manufacturing, transport and infrastructure', an increase in 'financial, business and other services' between 1996 and 2001 and some public sector growth. The proportion of the working age population employed in the 'hotels, restaurants and retail' sector has remained stable at around ten per cent throughout.

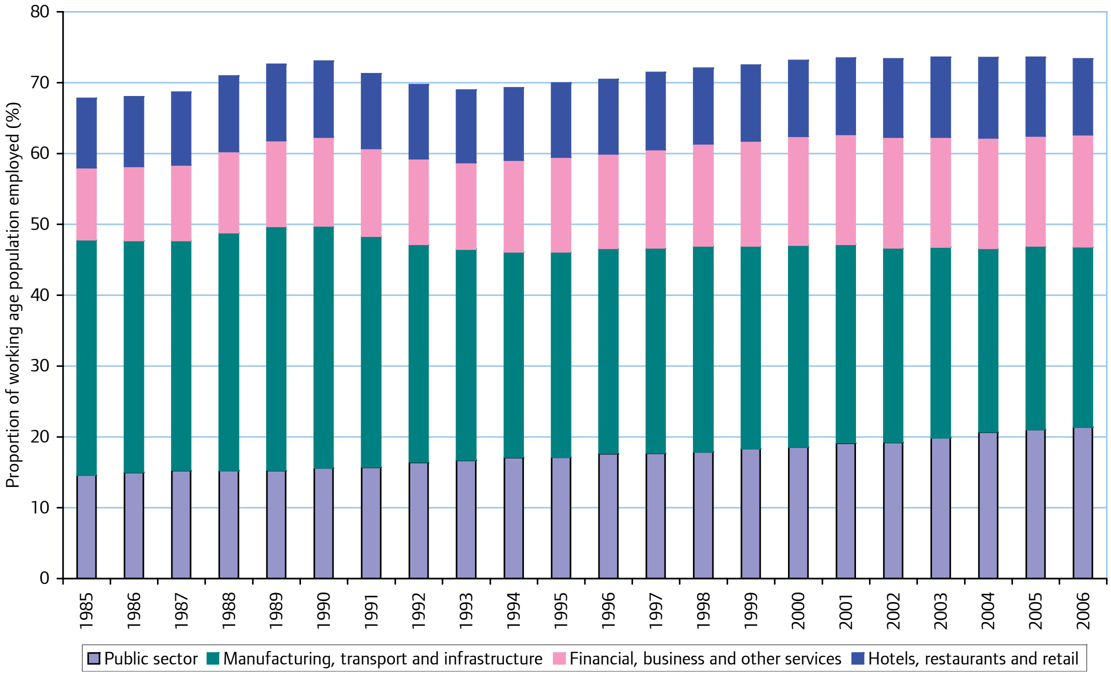
Figure 6.6: Trends in sectoral employment rates, London (per cent)



Source: LFS, UK data archive

The UK employment rate (Figure 6.7) shows a slightly different employment distribution across sectors. In contrast to London, 'manufacturing, transport and infrastructure' remains the most significant contributor to the UK employment rate, despite experiencing a sharp decline in the 1990-1994 period. The decline of the 'manufacturing, transport and infrastructure' sector in the UK was much less pronounced than for London. The contribution of the 'financial, business and other services' sector to the UK employment rate is lower than for London, while the proportion of the working age population employed in the public sector is higher in the UK than in London. The proportion of the working age population employed in the 'hotels, restaurants and retail' sector is similar in both London and the UK.

Figure 6.7: Trends in sectoral employment rates, UK (per cent)



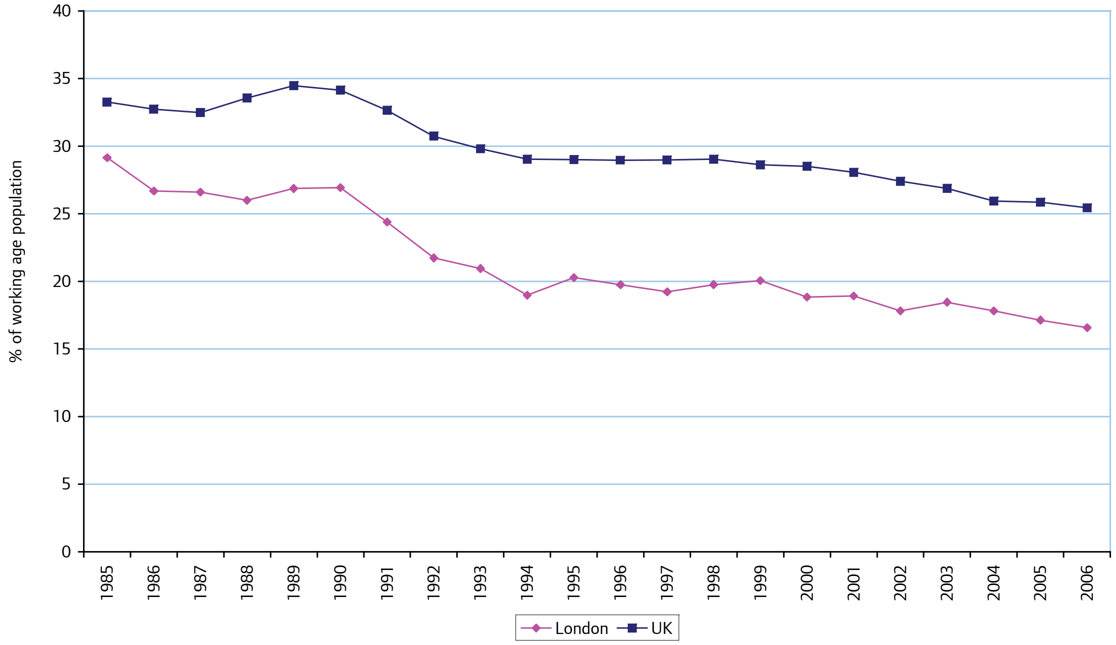
Source: LFS, UK data archive

6.2.1 Manufacturing, transport and infrastructure

The proportion of the working age population employed in London from 1985 to 2006 is marked by a sharp decline (12.6 percentage points) in the 'manufacturing, transport and infrastructure' sector. In the UK as a whole, the decline in the proportion of working age population employed in this sector is less pronounced (7.8 percentage points).

As shown in Figure 6.8, the proportion of working age population employed in 'manufacturing, transport and infrastructure' follow the same declining trend in London and the UK. However, the rate of decline was greater in London than in the UK from 1990 to 1994. As a result by 2006, whereas one in four of the UK's working age population is employed in 'manufacturing, transport and infrastructure' – in London it is only one in six.

Figure 6.8: Manufacturing, transport and infrastructure employment rates (per cent)



Source: LFS, UK data archive

6.2.2 Financial, business and other services

The proportion of London's working age population employed in the 'financial, business and other services' sector in London (Figure 6.9) increased by 6.4 percentage points over the 1985 to 2006 period and has been around seven percentage points higher than that for the UK throughout the past two decades. The proportion of the working age population employed in this sector in both London and the UK followed an upward trend between 1985 and 2001. While the proportion of the working age population employed in this sector in the UK has remained constant in the last few years, London experienced a slight decline in the 2001-2006 period.

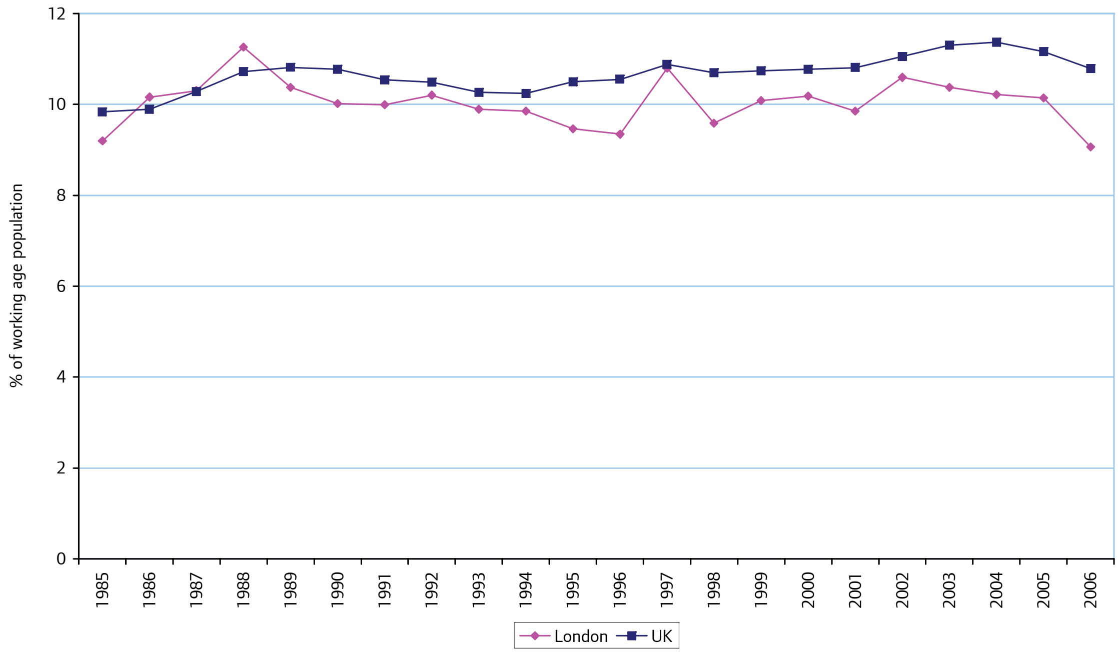
Figure 6.9: Financial, business and other services employment rates (per cent)

Source: LFS, UK data archive

6.2.3 Hotels, restaurants and retail

The proportion of the working age population in London and the UK employed in the 'hotels, restaurants and retail' sector has been similar over time, remaining close to ten per cent from 1985 to 2006 (see Figure 6.10).

Figure 6.10: Hotels, restaurants and retail employment rates (per cent)



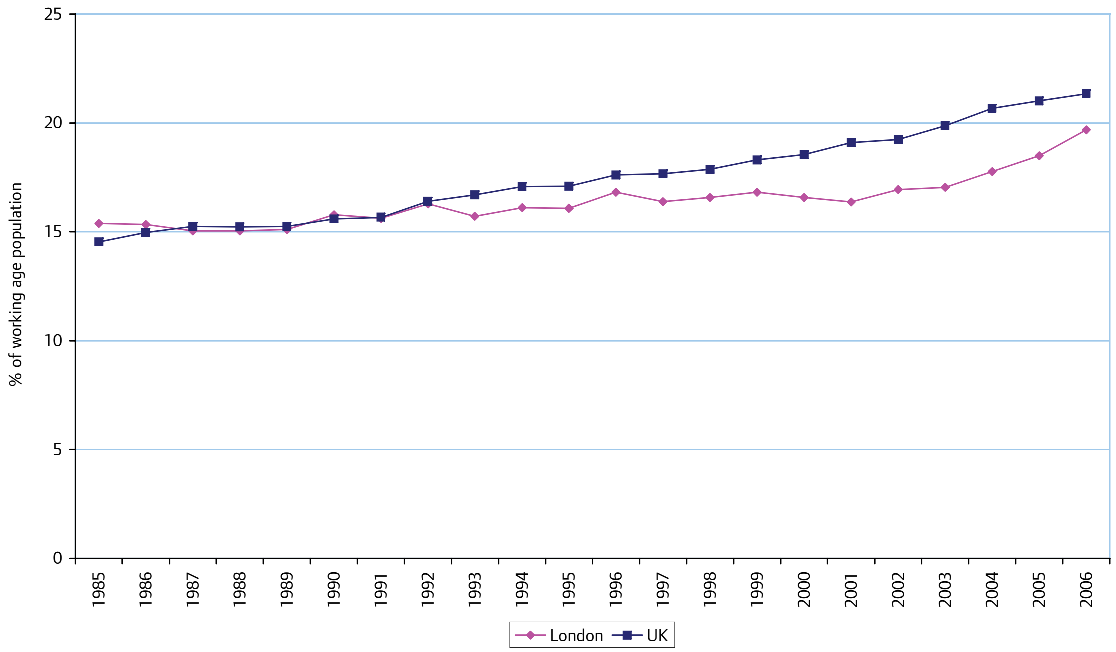
Source: LFS, UK data archive

6.2.4 Public sector

The public sector combines public administration and defence, health, and education. Public sector employers have traditionally dominated these activities, but it is important to note that while 90 per cent of the employees in this sector work in the public sector, around ten per cent actually work in the private sector. The proportion of London's working age population employed in the public sector increased by 4.3 percentage points from 1985 to 2006, while the increase for the UK was greater at 6.8 percentage points.

Figure 6.11 shows the proportion of the working age population employed in the public sector in London and the UK. The proportions for London and the UK almost fully overlapped until 1992. Between 1992 and 2004, however, the gap between the two expanded in favour of the UK. Recent data show some convergence between the two, but nevertheless the proportion of the working age population employed in this sector remains higher in the UK (21.3 per cent) than in London (19.7 per cent).

Figure 6.11: Public Sector employment rates (per cent)



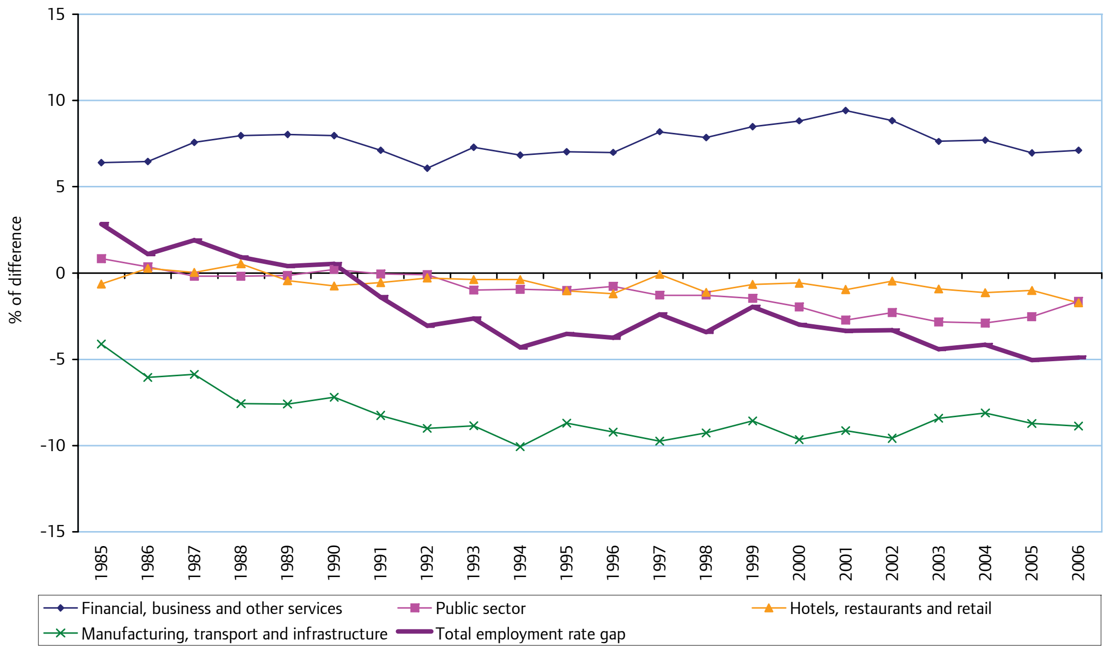
Source: LFS, UK data archive

6.3 London-UK employment rate gaps

Figure 6.12 presents an overall picture of the difference in the proportion of the working age population employed across the four broad sector groups for London and the UK over time. The gap in total employment rates between London and the UK has a general downward trend starting at 2.8 percentage points in 1985 in favour of London, and deteriorating to -4.9 percentage points in favour of the UK in 2006.

The employment rate gap in 'manufacturing, transport and infrastructure' deteriorated mainly between 1985 and 1994. Since 1994, the gap between the proportion of London's working age population employed in the 'manufacturing, transport and infrastructure' sector and that for the UK as a whole, has remained about the same (at around 9 percentage points).

Figure 6.12: Employment rate gaps (London-UK) (percentage points)



Source: LFS, UK data archive

Figure 6.9 showed that the proportion of the working age population employed in the 'financial, business and other services' in London was higher than that in the UK throughout the whole 1985-2006 period. This is reflected in Figure 6.12 above.

The proportion of the working age population employed in the 'hotels, restaurants and retail' sector in London has been similar to that for the UK for most of the period.

Whilst the proportion of the working age population employed in the public sector in both London and the UK was largely similar between 1985 and 1991, the data for the 1992-2006 period show that a higher proportion of the UK working age population was employed in the public sector than was the case for London.

In summary, the move from manufacturing to services combined with the early 1990s recession played a large part in the decline of London's employment rate relative to that for the UK as a whole. Furthermore, while the decrease in London's employment rate can be associated with the substantial fall of both male and female employment rates between 1990 and 1994, female employment rates are responsible for the continuing divergence of UK and London's employment rates.

Appendix A: Explanation of terms and some sources

Definitions, differences, and revisions

Forecasting organisations use varying definitions of the regional indicators they supply. It is therefore not 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. London's Economic Outlook: December 2003* and The GLA's *Workforce Employment Series* provides 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. The GLA uses civilian workforce employment throughout.

Output refers to GVA, a term introduced by the 1995 revision of the European System of Accounts (ESA95). Some forecasters still estimate GDP, which can differ slightly from GVA. Imputed rental income from the ownership of property is included in some cases but not in others. GLA Economics' *London's Economic Outlook: December 2003* provides a more detailed explanation of this term.

Estimates of nominal regional GVA are available up to 2006 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 produced regional price indexes for the year 2004[lxxix]. Most regional forecasters supply their own estimates of London's real GVA. The real London GVA figures used in the GLA Economics' forecast are supplied by EBS.

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 other cases it is not.

Appendix B: Glossary of acronyms

ABI	Annual Business Inquiry
bn	Billion
BRC	British Retail Consortium
CE	Cambridge Econometrics
CEBR	The Centre for Economic and Business Research
CIPS	The Chartered Institute of Purchasing and Supply
CPI	Consumer Price Index
DCLG	Department for Communities and Local Government
EBS	Experian Business Strategies
ECB	European Central Bank
EERI	Effective Exchange Rate Index
EU	European Union
FSA	Financial Services Authority
FT	Financial Times
GDP	Gross Domestic Product
GLA	Greater London Authority
GVA	Gross Value Added
HBOS	Halifax Bank of Scotland
HM Treasury	Her Majesty's Treasury
ILO	International Labour Organisation
IMF	International Monetary Fund
LEO	London's Economic Outlook
LFS	Labour Force Survey
LHS	Left Hand Scale
mn	Million
MPC	Monetary Policy Committee
OE	Oxford Economics
OECD	Organisation for Economic Co-operation and Development
ONS	Office for National Statistics
OPEC	Organisation of Petroleum Exporting Countries
PMI	Purchasing Managers' Index
Q2	Second Quarter
RHS	Right Hand Scale
RPIX	Retail Price Index (excluding mortgage interest payments)
RPI	Retail Price Index
TfL	Transport for London

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Footnotes

[i] The forecast is based on an in-house model built by Volterra Consulting Limited.
[ii] RPI = Retail price index. Although not part of the GLA Economics forecast for London, for reader information HM Treasury Consensus Forecast, August 2008 of the RPI UK inflation rate are reported.
[iii] CPI = Consumer Price Index. Although not part of the GLA Economics forecast for London, for reader information HM Treasury Consensus Forecast, August 2008 of the UK CPI inflation rate are reported. Since December 2003 the Bank of England's symmetrical inflation target has been annual CPI inflation at two per cent.
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other publications

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

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اگر آپ اِس دستاویز کی نقل اپنی زبان میں چاھتے ھیں، تو براہ کرم نیچے دئے گئے نمبر پر فون کریں یا دیئے گئے پتے پر رابطہ کریں

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