GLAECONOMICS

# London's Economy Today

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## In this issue



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# Bank of England raises UK growth forecast for 2017

By **Emma Christie**, Economist, **Gordon Douglass,** Supervisory Economist and **Mark Wingham**, Economist

**The Bank of England published their latest Inflation Report and economic forecast in February which upgraded their forecast for UK GDP growth in 2017. The Bank observed that the Monetary Policy Committee (MPC) "has increased its central expectation for growth in 2017 to 2.0% and expects growth of 1.6% in 2018 and 1.7% in 2019". This compares to the November forecast of 1.4 per cent in 2017, 1.5 per cent in 2018 and 1.7 per cent in 2019. In explaining the causes of this upgrade the Bank observed that "the upgraded outlook over the forecast period reflects the fiscal stimulus announced in the Chancellor's Autumn Statement, firmer momentum in global activity, higher global equity prices and more supportive credit conditions, particularly for households".**

The Bank also highlighted that, "inflation is expected to increase to 2.8% in the first half of 2018, before falling back gradually to 2.4% in three years' time. Inflation is judged likely to return to close to the target over the subsequent year".

## Latest news...


**London and Europe: Facts and figures**

On 23 June 2016 the UK voted to leave the EU. Since then there has been a high demand for data on various aspects of London's relationship with both the rest of the UK and Europe in light of the upcoming Article 50 negotiations.

Current Issues Note 51 sets out to summarise some of the extensive selection of data and surveys that cover this topic, helping to enlighten debate and decision making.

Download the the publication.

Other forecasters have been slightly less optimistic in their growth forecasts. The European Commission (EC) has predicted that the UK economy will grow by just 1.5 per cent in 2017, and 1.2 per cent in 2018. In their Winter Forecast, the EC said that the lower growth predicted for the UK was "based on the analysis that with time, business investment is likely to be adversely affected by persisting uncertainty, while private consumption growth is projected to weaken as growth in real disposable incomes declines". Still, this represents an improvement on their previous forecast made last November, which projected growth of just 1 per cent for 2017.



Meanwhile, the National Institute of Economic and Social Research (NIESR) has also revised up its forecasts for UK growth to 1.7 per cent this year and 1.9 per cent in 2018, which while representing a slowdown on the 2 per cent recorded by the NIESR for 2016, is more optimistic than their previous forecast.

## Inflation showing highest reading since June 2014

Turning to inflation, data released by the Office for National Statistics (ONS) showed Consumer Price Index (CPI) inflation rose by 1.8 per cent over the year to January, slightly shy of expectations of a 1.9 per cent increase. It is the highest reading since June 2014 and compares to an annual rate of 1.6 per cent in December. Looking forward, higher fuel prices and the effects of the depreciation of sterling are expected to exert ongoing upward pressure on inflation, potentially causing CPI to overshoot the Bank of England's central symmetrical target of 2 per cent in the next few months.

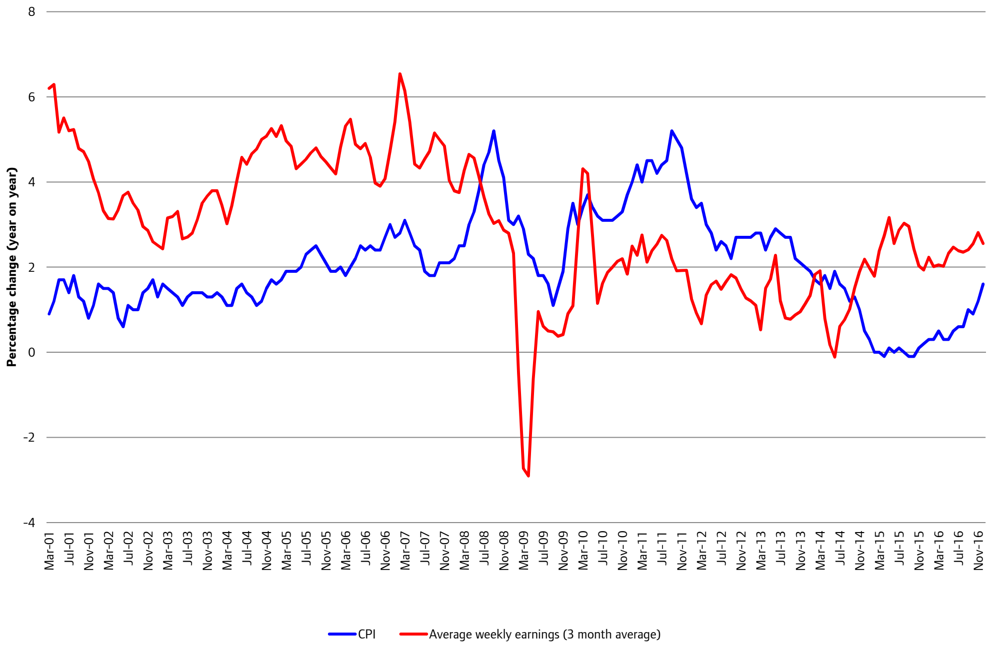
While consumer spending growth remained resilient throughout most of 2016, the upward pressure on inflation acts as a downside risk to continued growth in this area due to its impact on consumer's real wages and therefore spending power. Sir Charlie Bean of the Office for Budget Responsibility (OBR) and former deputy governor of the Bank of England has predicted a 'significant slowing' in consumer spending, but caveated that longer-term economic trends remained impossible to predict because there were "so many moving parts".

Still, as of yet, wage inflation remains above CPI inflation (see Figure 1) with data from the ONS showing that "between October to December 2015 and October to December 2016, in nominal terms, regular pay increased by 2.6%, slightly lower than the growth rate between September to November 2015 and September to November 2016 (2.7%)".

**Figure 1: CPI and wage inflation in the UK (2001 – 2016)**

Last Data Point: December 2016

*Source: ONS*




There is also some evidence that consumers may be reigning back their spending, with consumer spending weakening a touch at the end of 2016 and beginning of 2017. Data from the ONS showed that UK retail sales unexpectedly dropped by 0.3 per cent in January 2017, compared to a month earlier (and compared to an expected rise of 0.9 per cent). Compared to January 2016, sales increased by 1.5 per cent; this was the lowest growth rate since November 2013. The ONS also observed that “the underlying pattern as suggested by the 3 month on 3 month movement decreased by 0.4%; the first fall since December 2013”. Commenting on the results Kate Davies, ONS Senior Statistician said “in the three months to January, retail sales saw the first signs of a fall in the underlying trend since December 2013. We have seen falls in month-on-month seasonally adjusted retail sales, both in conventional stores and online, and the evidence suggests that increased prices in fuel and food are significant factors in this slowdown”.

## Parliament votes to trigger Article 50

In relation to the ongoing ‘Brexit’ process, Parliament has being voting in February on approving the triggering of Article 50. Meanwhile, the Government has published a White Paper setting out its aims for Brexit. With the passing of the votes in Parliament, it is now expected that the Government will meet its target of triggering Article 50 by the end of next month.

In further Brexit news, a survey by the Chartered Institute of Personnel and Development (CIPD) found that more than a quarter of employers believe EU staff are considering leaving their jobs, and possibly the UK, in 2017. The ONS also reported recently that growth in the number of EU workers had slowed noticeably since the Leave vote last June. Analysis of seasonally unadjusted ONS data, undertaken by the CIPD, shows that in the nine months leading up to the referendum, the increase in the number of EU workers was more than 60,000 a quarter. This fell to 30,000 in the three months to September 2016.

While in a recent business survey on the EU, market researcher Ipsos Mori found that 58 per cent of respondents said that last June's exit vote was already having a negative effect on their business; nearly a third thought the referendum had not made any difference; and 11 per cent felt it had been positive. However, 96 per cent of business leaders said that they were confident their company could adapt to the consequences of leaving the EU, and there is little evidence to suggest that business is currently suffering significant fallout from the Brexit vote.

Of more immediate concern to business are the impending changes to business rates. Many of the UK's biggest employer groups, including the Confederation of British Industry (CBI), the British Retail Consortium (BRC), and the Federation of Small Businesses (FSB), have written a letter calling for the government to drop plans which, they allege, could prevent firms from appealing against rate rises. According to the groups, tens of thousands of firms face uncertainty over their bills. Helen Dickinson, Chief Executive of the BRC, has called the tax unfit for purpose in the 21st Century.

Still in some positive news for the Government ahead of next month's Budget, EY Item Club said it expects the OBR to reduce its forecast for public sector net borrowing in 2016/17 by £3 billion to £65 billion due to stronger than expected economic growth. Although in less positive news for the Government the Institute for Fiscal Studies (IFS) in their Green Budget warned that tax as a share of national income is due by 2019/20 to reach its highest level since 1986/87.

## Eurozone growth continues

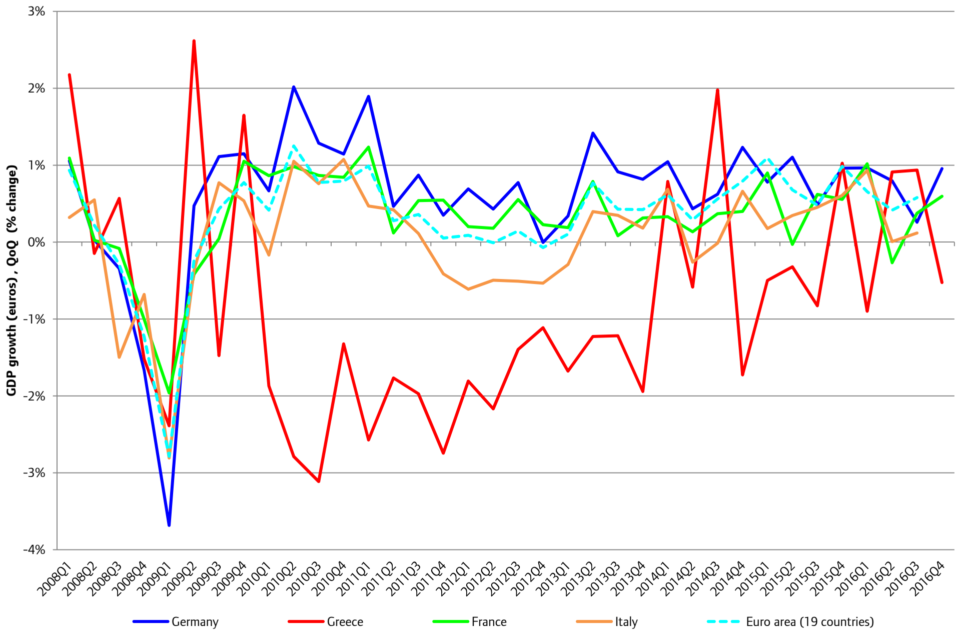
In international news data published within the last month showed that growth continued in a number of important trading partners in the final quarter of 2016 (see Figure 2). GDP in the Eurozone grew by 0.4 per cent in Q4 2016 compared to growth of 0.4 per cent in Q3 2016 and was 1.7 per cent higher compared to Q4 2015. The EC notes, in their Winter Forecast, that "For the first time in almost a decade, the economies of all EU member states are expected to grow for three consecutive years (2016 – 2018)". Eurozone inflation is also picking up, with annual inflation hitting 1.8 per cent in January, up from 1.1 per cent in December 2016. The main component of the rise in prices was fuels for transport, heating oil, and vegetables, while telecommunication, and bread and cereals had the biggest downward impact.

However, the Eurozone faces a looming crisis in the form of Greek debt, according to some at the IMF, who have warned that Greece is on an "explosive path" after years of failed attempts at austerity and economic reforms. Greek GDP unexpectedly fell in the final quarter of 2016 (GDP declined by 0.4 per cent compared to the previous quarter), but Dutch Finance Minister Jeroen Dijsselbloem, who chairs Eurozone meetings, described the IMF's view as "unnecessarily pessimistic".

**Figure 2: GDP growth in selected Eurozone countries (2008 – 2015)**

Last Data Point: Q4 2016

*Source: Eurostat and GLA Economics*




Although Eurozone growth continued in Q4 2016 at the same pace as the previous quarter, annualised GDP growth in the US slowed in that quarter to 1.9 per cent, lower than most forecasters had expected and lower than the 3.5 per cent annualised growth seen in Q3 2016. Over the course of 2016 US GDP increased by 1.6 per cent compared to an increase of 2.6 per cent in 2015.

Nevertheless, the Federal Reserve remains upbeat on the US economy, while markets expect further increases in the US interest rate over the coming months. Thus the Open Market Committee (FOMC) observed in February that "measures of consumer and business sentiment have improved of late". They further observed that the "Committee expects that, with gradual adjustments in the stance of monetary policy, economic activity will expand at a moderate pace, labour market conditions will strengthen somewhat further, and inflation will rise to 2 percent over the medium term. Near-term risks to the economic outlook appear roughly balanced". US Federal Reserve Chair, Janet Yellen, has said that it may be appropriate for the central bank to raise interest rates at their next meeting in March, citing that delaying the rates rise longer could later require the FOMC to raise rates rapidly, which, if disruptive to financial markets, could do damage to the economy in the long run.

In looking at the impact this may have for the UK, Ben Broadbent, the deputy governor for monetary policy at the Bank of England, has said that US economic policy could be beneficial. Global markets have continued to be boosted by the 'Trump effect', investor confidence increasing as a result of promised tax cuts and infrastructure spending to boost the US economy. However, trade barriers could reduce the positive knock-on effects of US growth and the full impact of such policies remains to be seen.

## London in a strong position to face challenges of Brexit

A number of statistics show continued growth in London's economy. London's employment rate (ie, the proportion of London's resident working age population in employment) in the three months to December 2016 increased by 0.1 percentage points on the previous quarter to 73.7 per cent. This is one of the highest rates of employment recorded in London since this measure began in 1992. It also represents a 0.8 percentage point increase on the previous year. Meanwhile, London's ILO unemployment rate in the three months to December 2016 was 5.5 per cent. This is down 0.2 percentage points on the previous quarter and down 0.8 percentage points on the previous year.

London businesses also appear optimistic about the future, with take-up of central London office space increasing in the final quarter of 2016, after six months of muted activity, according to Knight Frank. Continued office demand is highlighted by companies such as Lego, that announced it intends to double the size of its London offices. The toy manufacturer said it wanted to send a "clear signal" the city was central to its growth plans. Technology giant Apple is also "very optimistic" about the UK's future post-Brexit. Having previously announced plans to build a new UK headquarters in London, Apple's chief executive Tim Cook met Theresa May at Downing Street and said he thought the UK would be "just fine"' outside the European Union. Thus, although some UK data points to a slowdown nationally, as of yet, this has not shown itself to a large degree at the London level.

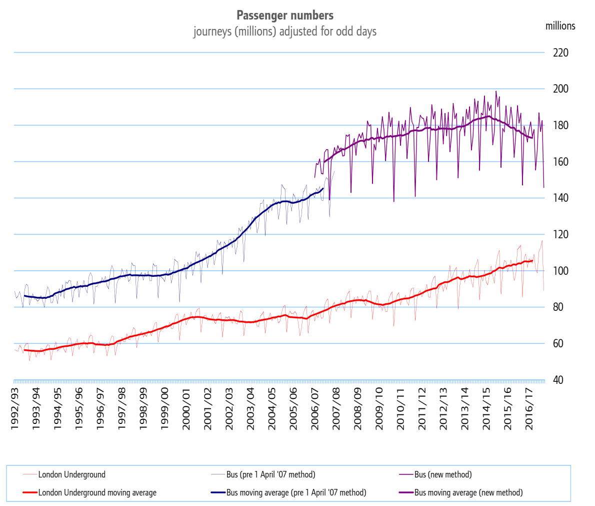
# Economic indicators



## Broadly no change in average number of passenger journeys

- The latest 28-day period covered 11 December 2016 to 7 January 2017. After adjusting for odd days, there were 89.0 million London Underground and 145.7 million bus passenger journeys, giving a total of 234.8 million passenger journeys.
- Overall, the 12-month moving average of passengers remained broadly stable at 278.6 million. While the average number of bus passenger journeys was largely unchanged at 173.1 million, the 12-month moving average of London Underground passengers rose slightly to 105.5 million.
- The methodology used to calculate the number of bus passenger journeys was changed by TfL on 1 April 2007. For a detailed explanation, please see LET issue 58 (June 2007).

*Latest release: February 2017*
*Next release: March 2017*

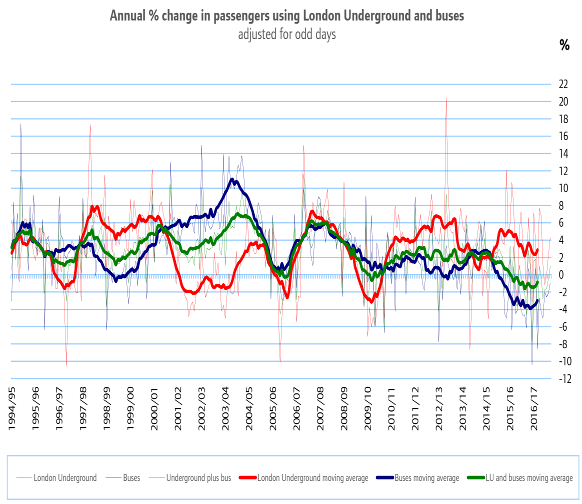



*Source: Transport for London*

## Average annual rate of decline in total passenger journeys slows

- While the moving average annual rate of change in total passenger journeys remained negative, the rate of decline slowed from -1.3 per cent to -0.9 per cent.
- Focussing on bus passenger journeys, the moving average annual rate of decline slowed to -3.0 per cent – it's joint-highest (ie, least negative) in 11 periods.
- The moving average annual rate of growth in London Underground passenger journey numbers strengthened from 2.4 per cent in the previous period to 2.8 per cent.

*Latest release: February 2017*
*Next release: March 2017*




*Source: Transport for London*

## London's unemployment rate remains at record lows

- London's unemployment rate (using the ILO definition) stood at 5.5 per cent in Q4 2016. That was down 0.2 percentage points from Q3 2016 and 0.8 percentage points lower than a year earlier.
- The unemployment rate for the UK as a whole was also lower at 4.8 per cent in the three months to December 2016. While that was unchanged from the three months to September 2016, it was lower than the 5.1 per cent registered in the three months to December 2015.
- In terms of number of people, there were 260,000 unemployed people in London and 1.6 million unemployed people across the UK as a whole in Q4 2016. That was down 6,000 and 7,000 from Q3 2016 respectively.

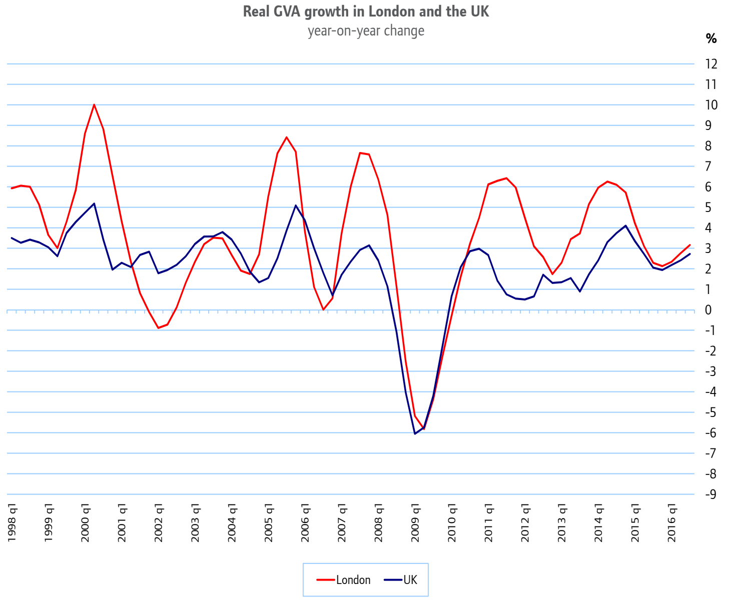
*Latest release: February 2017*
*Next release: March 2017*


*Source: Labour Force Survey - ONS*

## Annual output growth increases in London in Q3 2016

- London's annual growth in output increased to 3.2 per cent in Q3 2016 from a downwardly revised 2.8 per cent in Q2 2016.
- Annual output growth in the UK increased to 2.7 per cent in Q3 2016 from 2.4 per cent in Q2 2016. In Q3 2016, London's annual output growth was higher than the UK as a whole.
- From LET Issue 165 (May 2016), GLA Economics now reports our own GVA estimates for London and ONS data for the UK.

*Latest release: January 2017*
*Next release: April 2017*

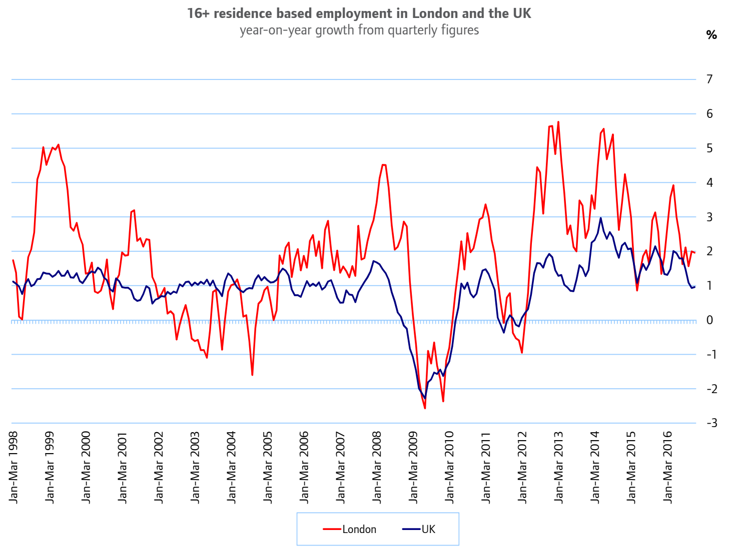



*Source: GLA Economics and ONS*

## Further growth in London's employment

- The number of London residents aged 16 years and over in employment was 4.5 million in the three months to December 2016. That was up 27,000 from the previous quarter.
- London's employment growth was 2.0 per cent on an annual basis in Q4 2016. While that was broadly on par with that recorded for Q3 2016 (2.1 per cent), it was slower than the 3.0 per cent expansion registered in Q2 2016.
- The UK as a whole similarly saw an increase in employment in Q4 2016, up 37,000 from the previous quarter to 31.8 million. The annual rate of growth (1.0 per cent) was nonetheless slower than London.

*Latest release: February 2017*
*Next release: March 2017*

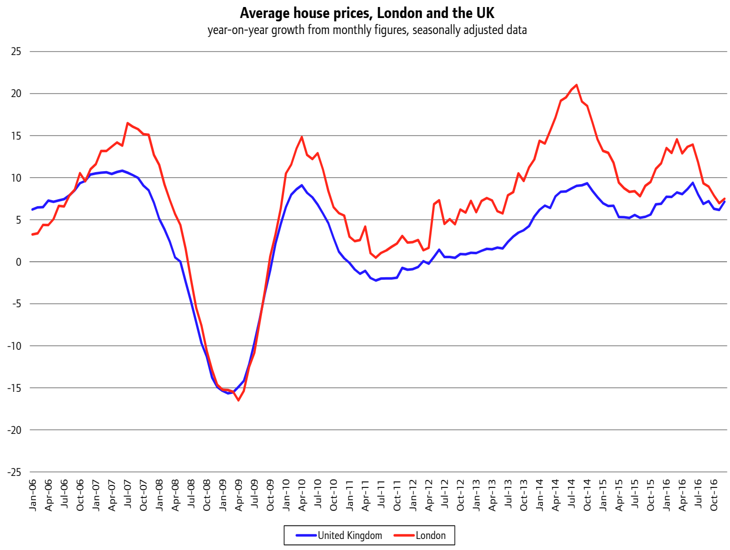



*Source: Labour Force Survey - ONS*

## House prices continued to rise in London, but at a slower pace

- House prices in London continued to rise in December 2016, according to data collected by the Land Registry.
- While annual house price inflation in London was 7.5 per cent in December, it was much slower than the rates of growth recorded at the start of the year.
- Nonetheless, London continued to post a faster rate of annual house price inflation than the UK as a whole (7.1 per cent).

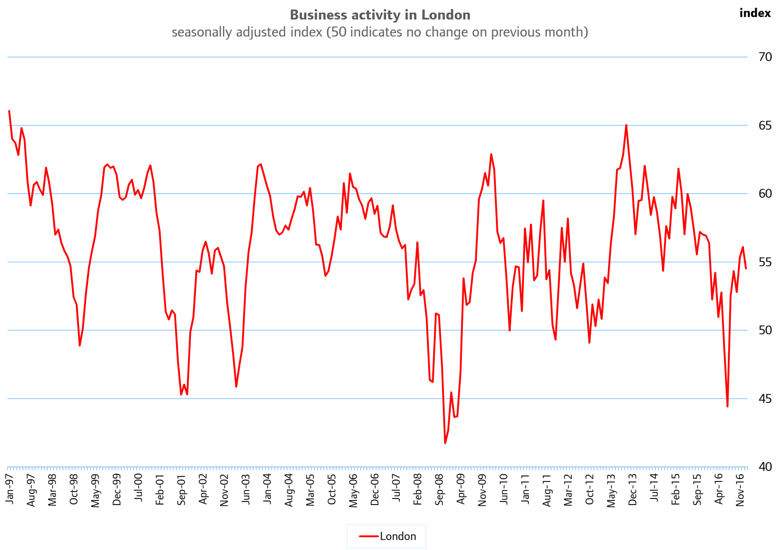
*Latest release: February 2017*
*Next release: March 2017*




*Source: Land Registry and ONS*

## Sustained growth in the output of London's businesses

- Private sector firms in London reported a further rise in business activity in January 2017. This was indicated by the Purchasing Managers' Index (PMI) for Business Activity registering at 54.5 – above the 50.0 no change mark.
- Although the Index was down from 56.1 in December 2016 suggesting a slower rate of expansion, growth remained solid.
- The PMI shows the monthly change in business activity. Index readings above 50.0 suggest an increase in output, while readings below indicate a decrease in activity.



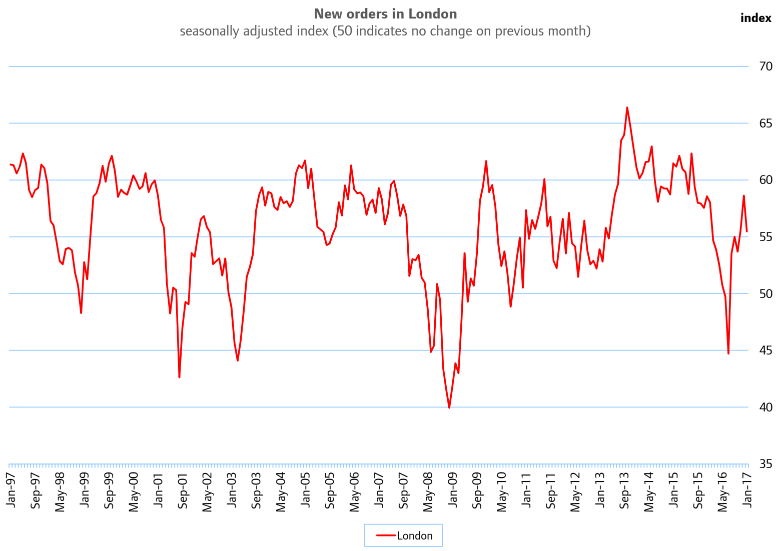

*Source: IHS Markit*

*Latest release: February 2017*
*Next release: March 2017*

## London firms continue to report an increase in new work

- New business at London firms continued to rise in January 2017.
- The New Business Index recorded 55.5, down slightly from December's reading of 58.6.
- An Index above 50.0 indicates an increase in new orders from the previous month.

*Latest release: February 2017*
*Next release: March 2017*




*Source: IHS Markit*

## Businesses report a marginal rise in employment.

- Firms in London's private sector reported a marginal increase in employment in January 2017.
- The rate of job creation slowed since December 2016, with the Employment Index falling from 52.3 to 50.6 in January 2017.
- That was only slightly above the 50 no change mark that indicates whether employment increased or decreased from the previous month.

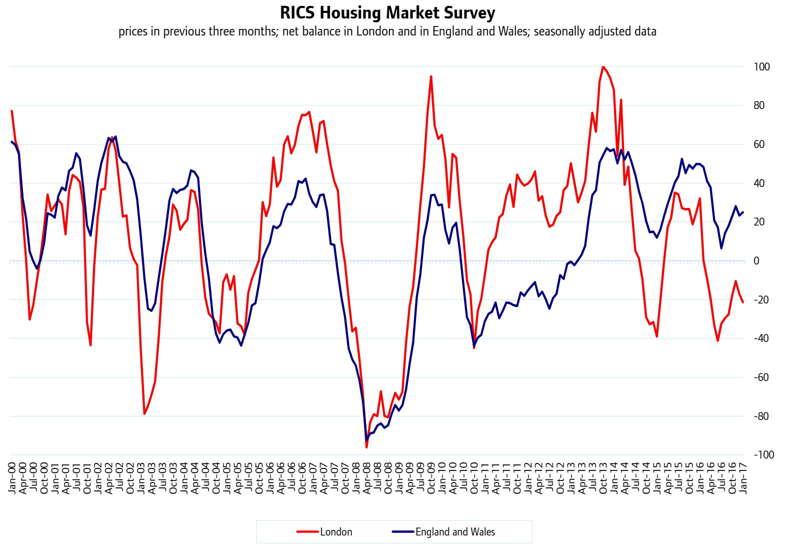

*Source: IHS Markit*

*Latest release: February 2017*
*Next release: March 2017*

## Surveyors report another fall in London's house prices

- London's house prices fell during the three months to January 2017, with the RICS Residential Market Survey showing a negative net balance of -21.
- In comparison, house prices rose across England and Wales as a whole as indicated by a positive net balance of +25.
- Only two other regions saw a decrease in house prices, namely the North of England (-13) and Wales (-1).

*Latest release: February 2017*
*Next release: March 2017*

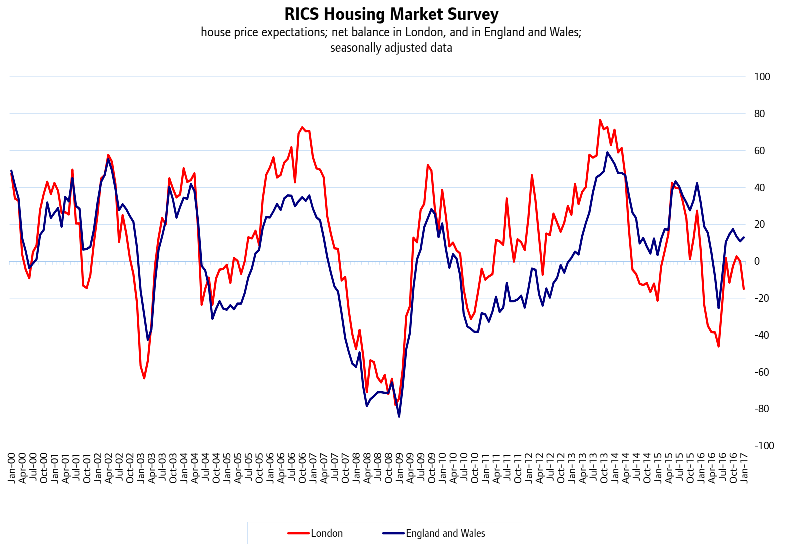



*Source: Royal Institution of Chartered Surveyors*

## A further fall in London's house prices expected

- Respondents to the RICS Residential Market Survey expected London's house prices to fall further between February and April 2017 (net balance of -15).
- In contrast, house prices are expected to rise across England and Wales with the net balance at +13.
- London was the only region in England and Wales with negative price expectations.

*Latest release: February 2017*
*Next release: March 2017*

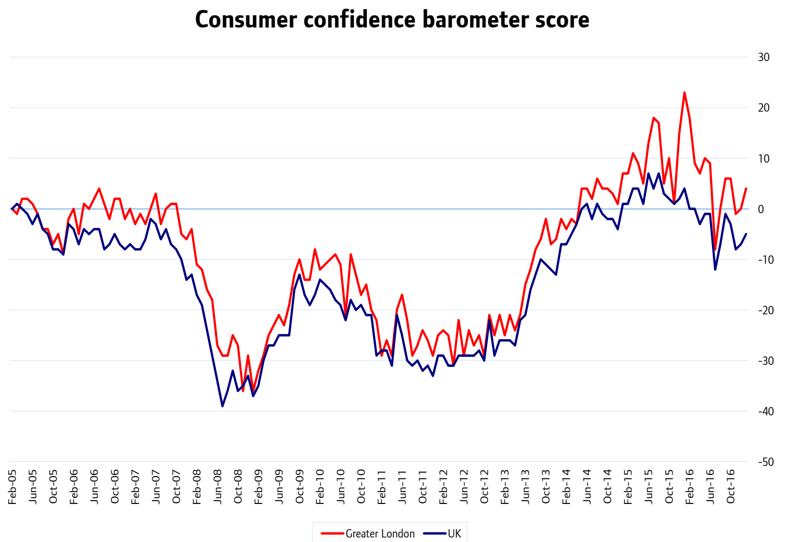



*Source: Royal Institution of Chartered Surveyors*

## Positive consumer confidence in London

- The GfK index of consumer confidence reflects people's views on their financial position and the generational economic over the past year and in the next 12 months. A score above zero suggests positive opinions; a score below zero indicates negative sentiment.
- Consumer confidence in Greater London was positive in January 2017. At +4, this was up from -1 and 0 in November and December 2016 respectively.
- In contrast, the consumer confidence score remained negative for the UK as a whole in January 2017 at -5.

*Latest release: January 2017*
*Next release: February 2017*




*Source: GfK NOP on behalf of the European Commission*

# Fiscal devolution for London



By **Mark Wingham,**
Economist

**The Mayor of London, Sadiq Khan, re-formed the London Finance Commission (LFC) in July 2016 to further consider the tax and spend arrangements of the capital, particularly in the wake of the EU referendum result in June 2016 and of the evolving process of devolution in the UK since the first report of the LFC, Raising the Capital[1], in May 2013.**

The LFC's findings and recommendations were recently published in its report, Devolution: a capital idea[2]. Overall, the LFC proposed a comprehensive devolution package for London which, amongst other things, included:

- Devolving to London the full suite of property taxes (council tax, business rates, stamp duty, annual tax on enveloped dwellings and property related capital gains tax) – as per the LFC's original recommendations;
- Initially assigning a modest percentage of London's income tax yield to London's government – to increase as and when service devolution occurs or in order to fund major capital projects;
- Consider assigning a proportion of VAT if a large share of public expenditure were devolved to London;
- Devolving the apprenticeship levy to London's government in order to fund a wide range of skills and employment initiatives;
- Providing London government with the power to introduce smaller taxes and fees, such as a tourism levy; and that,
- Any new tax powers for London should be neutral on 'day one' – with arrangements in place to guarantee this neutrality.

To support the LFC's work, GLA Economics produced a series of working papers examining options for greater fiscal devolution. In particular, these working papers looked at…

## … the property tax system

There are a number of issues associated with the current property tax system. The LFC highlighted that fiscal devolution provides an opportunity to consider improvements to several elements of the property tax system in the city.

Focussing on council tax[3], it is regressive by design. That is, a property in the top council tax band (Band H) pays only three times as much tax than a house in the lowest band (Band A), despite being worth at least eight times more. Secondly, in being set by local authorities, council tax also exhibits a spatial inequity. For instance, the Band D council tax in 2015/16 varied from £673 in Westminster to £1,675 in Kingston – almost two-and-a-half times larger. These differences are more apparent when looking across bands. For example, a £10 million house in Westminster pays less council tax (Band H: £1,345) than

1 London Finance Commission (2013). Raising the capital, the report of the London Finance Commission, May 2013.
2 London Finance Commission (2017). Devolution: a capital idea, the report of the London Finance Commission, January 2017.
3 Wingham, M (2017). Council tax in London, GLA Economics Working Paper 80, January 2017.

a £240,000 flat in Harrow would do (Band C: £1,359). In addition, the level of council tax paid bears no resemblance to the value of 'consuming' housing because the tax is based on outdated prices. The consequence of this is that it promotes the inefficient use of property.



Stamp duty[4] similarly promotes the inefficient use of housing as it raises the cost of moving. The tax yield is also volatile, reflective of cyclical housing market trends, which makes it an unpredictable funding source for infrastructure projects for example.

There are a number of potential alternative scenarios considered in the individual working papers and modelling has been undertaken to understand the potential impact of these alternative scenarios. For council tax, this ranged from considering new council tax bands to scrapping the bands altogether and considering a flat tax rate as an alternative. Modelling suggested that a flat tax rate of 0.2 per cent would be fiscally neutral in London, yet four out of five households would pay less council tax. For stamp duty, potential alternative scenarios included a flat tax rate, and replacing the tax with commensurate changes in council tax or capital gains tax.

## ...how national taxes might be devolved to London

The LFC recommended that London should be assigned a proportion of its receipts of national taxes like income tax and VAT. GLA Economics consequently looked at estimates of the revenues raised by income tax, payroll levies, corporation tax and VAT[5] in London and the key costs and benefits that could arise if they were to be devolved. For instance, if London was to retain 10p in the pound of income tax – similar to Scotland's devolution package – between £15.3 billion and £15.8 billion could be retained in London in 2016/17. However, as the LFC recommended, this would need to be accompanied by a decrease in government grant to remain fiscally neutral.

## ...a possible tourism levy

The LFC identified the potential for a tourism levy in London. The rationale for such a levy is that foreign tourists are able to 'free ride' – enjoying many cultural attractions often with free entry without bearing the same costs to UK and London taxpayers. Similarly, tourists enjoy many public goods such as parks, policing and elements of the transport network, but do not bear the full social costs. For these and other reasons, many European and global cities already impose tourism taxes or levies (although in many instances these additional local charges are accompanied by a reduced rate of VAT).

GLA Economics produced a range of estimates of the revenue that could, potentially, be generated from a tourism levy[6] in London under different systems. Although this is subject to a number of assumptions, particularly around the impact on demand, a tourism levy could raise £140 million per annum with a Paris star rating style system or £240 million per annum with a Berlin flat rate style system for example.

4 Christie, E (2017). Stamp duty in London, GLA Economics Working Paper 81, January 2017.
5 Morrill, F (2017). Devolving other national taxes to London, GLA Economics Working Paper 82, January 2017.
6 Daley, M (2017). Options for a tourism levy for London, GLA Economics Working Paper 83, January 2017.

## …the relationship between devolution and economic growth

While the LFC sets out several arguments for a devolution package for London such as increased accountability, one of these is about providing London government with the tools to support growth. Given this, GLA Economics updated a previous literature review looking at the impact of fiscal devolution on economic growth[7], and conducted some rudimentary analysis looking at this relationship on growth and productivity. Overall, this showed that while there may be a link between certain types of devolution (ie revenue or expenditure) and economic growth, the magnitude of this effect, the causal link and the strength of the relationship is uncertain.

These working papers and other GLA Economics analysis can be downloaded from our publications website.

7 Wingham, M (2017). Devolution and economic growth, GLA Economics Working Paper 84, January 2017.

# Additional information



## Data sources

| | |
|---|---|
| **Tube and bus ridership** | Transport for London on 020 7222 5600 or email: enquire@tfl.gov.uk |
| **GVA growth** | Experian Economics on 020 7746 8260 |
| **Unemployment rates** | www.statistics.gov.uk |

## Glossary

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

**ILO unemployment**
The International Labour Organization (ILO) measure of unemployment assesses the number of jobless people who want to work, are available to work and are actively seeking employment.

**Residence-based employment**
Employment measures the number of people in work rather than the total number of jobs (as people may have more than one job). It consists of employees, self-employed as well as unpaid family workers and those on government supported training and employment programmes. The measure included here is residence-based.

**Gross domestic product (GDP)**
A measure of the total economic activity in the economy.

**Gross value added (GVA)**
Used in the estimation of GDP. The link between GVA and GDP is that GVA plus taxes on products minus subsidies on products is equal to GDP.

**Tube ridership**
Transport for London's measure of the number of passengers using London Underground in a given period. There are 13 periods in a year. In 2016/17 there are eleven 28-day periods, one 27-day period and one 30-day period. Period 1 started on 1 April 2016.

**Bus ridership**
Transport for London's measure of the number of passengers using buses in London in a given period. There are 13 periods in a year. In 2016/17 there are eleven 28-day periods, one 27-day period and one 30-day period. Period 1 started on 1 April 2016.

## Acronyms

| | |
|---|---|
| **BCC** | British Chamber of Commerce |
| **BRES** | Business Register and Employment Survey |
| **CAA** | Civil Aviation Authority |
| **CBI** | Confederation of British Industry |
| **CLG** | Communities and Local Government |
| **GDP** | Gross domestic product |
| **GVA** | Gross value added |
| **ILO** | International Labour Organisation |
| **IMF** | International Monetary Fund |
| **LCCI** | London Chamber of Commerce and Industry |
| **LET** | London's Economy Today |
| **MPC** | Monetary Policy Committee |
| **ONS** | Office for National Statistics |
| **PMI** | Purchasing Managers' Index |
| **PWC** | PricewaterhouseCoopers |
| **RICS** | Royal Institution of Chartered Surveyors |

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