GLAECONOMICS

London's Economy Today

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In this issue

Modest UK economic growth as Greece receives second debt bailout

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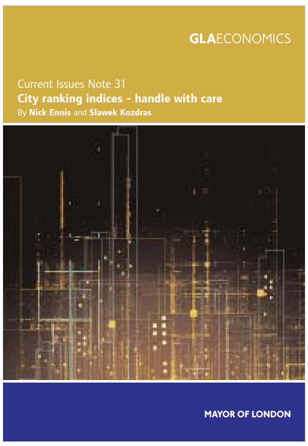
According to the preliminary estimate of GDP from the Office for National Statistics (ONS) the second quarter of 2011 saw UK GDP rise by 0.2 per cent after rising by 0.5 per cent in the first quarter of 2011 (see Figure 1). GDP is now still about 4 per cent below its pre-recession peak.

The ONS noted that a number of special events in Q2 2011 probably impacted on GDP. These were the extra bank holiday for the royal wedding, the royal wedding itself, the after effects of the Japanese tsunami, the first phase of Olympic ticket sales and record warm weather in April. Overall the ONS believes that these events combined had a net negative impact on growth in Q2 2011. Therefore the underlying state of the UK economy is stronger than the headline figure of only 0.2 per cent quarterly growth suggests. A rebound to higher growth in the second half of this year may well occur but over the whole of 2011 UK economic growth is likely to be modest.

Latest news...

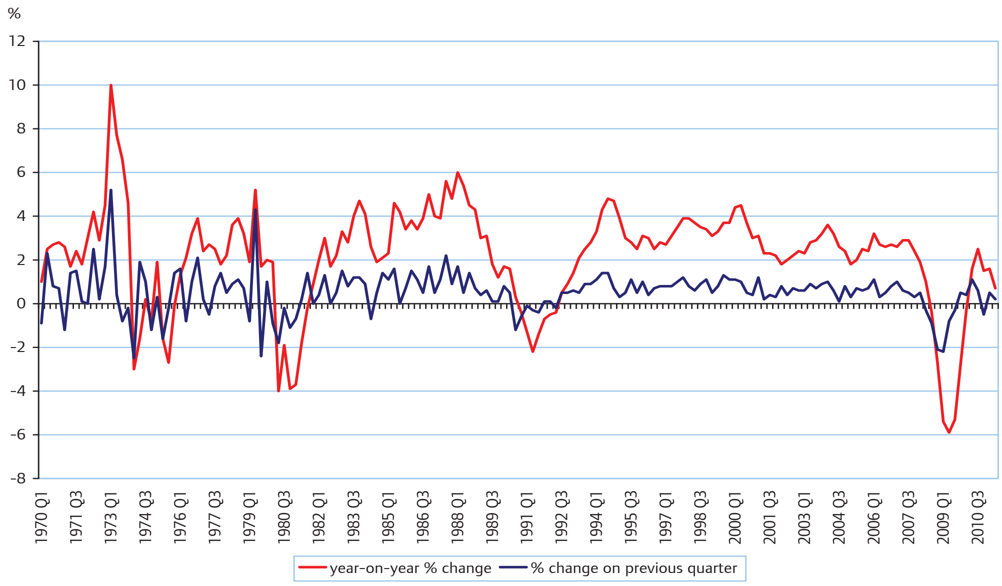


Current Issues Note 31: City ranking indices - handle with care

Ranking indices are great agents for generating interest and stimulating debate. But because an index must force a standard measure upon very different places, it cannot take account of all of the many factors that make different cities unique from one another. The contextual factors that indices leave out, whether the result of history, culture, or otherwise, are very important to understand in order to correctly interpret the rankings.
Please download the report from
http://www.london.gov.uk/publication/city-ranking-indices-handle-care

Figure 1: UK GDP Growth

Source: Office for National Statistics



The sectoral breakdown of the Q2 GDP figure shows that overall growth was dampened by a contraction in the production industries, where output declined by 1.4 per cent after falling by 0.1 per cent in Q1 2011. Total output in the services sector grew by 0.5 per cent in Q2 2011, after growing by 0.9 per cent in the previous quarter, whilst output in the construction sector also grew by 0.5 per cent in Q2 2011 after falling by 3.4 per cent in Q1 2011. Output in business services and finance, a sector in which London specialises, grew by 0.7 per cent in Q2 2011 after growing by 0.4 per cent in Q1 2011. Business services and finance made the largest contribution to the positive growth in GDP in Q2. GDP was 0.7 per cent higher in Q2 2011 compared with Q2 2010. Between Q2 2010 and Q2 2011 construction output fell by 1.4 per cent, output in the production industries fell by 0.6 per cent whereas output in the services sector increased by 1.2 per cent (and within this output in business services and finance increased by 0.8 per cent).

IMF and the Eurozone agree to a new €109 billion bailout for Greece

On 21 July Eurozone leaders and the IMF agreed a new €109bn bailout for Greece. This is on top of last year's €110bn bailout. The deal further pledges Eurozone nations to support Greece until it can return to raising debt in financial markets. It was agreed that the terms of loans to Greece, Ireland and Portugal would be eased with the interest rate on loans cut to 3.5% and maturities extended to up to 30 years.

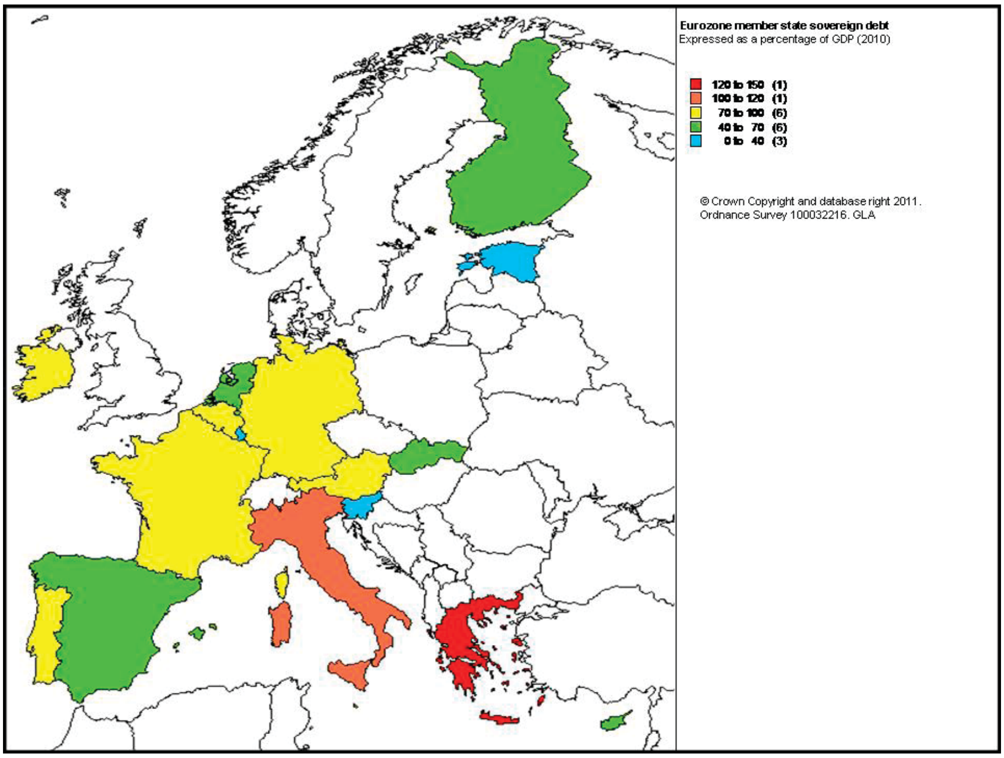
Under the rescue package agreed by the IMF and Eurozone leaders, private sector bondholders of Greek debt are also expected to participate 'voluntarily' for the first time with them having a contributing debt relief target of an extra €50 billion in total. Private sector bondholders will be offered options that include debt exchanges and debt rollovers with different interest rates and maturities. Private sector bondholders will be able to swap their existing Greek bonds into new bonds with a lower value underpinned by Eurozone taxpayer guarantees. The terms of the deal would amount to a 21 per cent loss in market value to private bondholders of current Greek debt.

Despite the orderly nature of this organised debt swap, credit rating Fitch has stated it will consider Greece to have selectively defaulted on its debt once old bonds have been swapped for new ones as an 'exchange that offers new securities with terms that are worse than the original contractual terms of the existing debt and where the sovereign is subject to financial distress, constitutes a default event under Fitch'. Meanwhile Moody's has cut Greece's credit rating to just two notches shy of a default and stated that a debt swap would constitute a default. It said the announced eurozone programme implies that the probability of a distressed exchange, and hence a technical default, on Greek Government bonds is virtually 100 per cent. However, the deal has generally been welcomed with Moody's stating that 'the support package for Greece also benefits all euro area sovereigns by containing the near-term severe contagion risk that would likely have followed a disorderly payment default or large haircut on existing Greek debt'.

Overall it is believed that the whole rescue package will reduce Greek debt by between 10 and 20 percentage points of Greek GDP from its current level of around 140 per cent (see Figure 2). However, currently Greece's debt to GDP ratio is still on the rise as the country is running large budget deficits. Austerity measures have been passed by the Greek Government but will take time to take effect. Eurozone leaders have also proposed to give the European Financial Stability Facility (EFSF) the ability to buy up government bonds and make credit available to banks and eurozone countries including the likes of Spain and Italy. The action taken by the eurozone leaders has not solved Greece's sovereign debt issues but has contained them and for now prevented a disorderly default. The 'voluntary' contribution of private sector bondholders to the rescue package will mean that credit agencies will announce a technical default but this can be coped with and is not the same as an unplanned, disorderly default.

Figure 2: Eurozone government debt to GDP ratios in 2010

Source: Eurostat



For now a disorderly Greek default has been avoided but how would such a disorderly default impact on London?

There exist a number of potential direct and indirect impacts on London from the continuing Eurozone sovereign debt problems. The greatest impact would come from disorderly, unplanned defaults (most likely to be by Greece). For the time being Greece's sovereign debt problems have been contained rather than solved by the action of the Eurozone leaders on 21 July. However, a disorderly, unplanned default by Greece some time in the future cannot be ruled out. The direct impact on the UK from a disorderly Greek default is low with our exposure to Greek public and private debt being only US$14 billion in December 2010. Even a knock-on to Portugal would have a limited direct impact on the UK. However if a disorderly default by Greece spread to a similar thing happening in Ireland and Spain then due to our exposure to these countries the direct impact on the UK would become significant.

The indirect impact of a disorderly Greek default on the London economy would probably be more severe than the direct impact. There would be a number of channels for these indirect impacts to flow which include:

a) Even if a disorderly default was just constrained to Greece this would hurt German and French banks that are heavily exposed to this market. This in turn would affect UK banks due to their exposure to German and French banks.

b) The possibility that inter banking money markets would freeze up creating a new 'credit crunch'. This would obviously impact on London although for now the risk of this scenario has been reduced due to the agreement on 21 July. Still the worse case scenario would be similar to what occurred after Lehman's collapse in September 2008 with banks not lending to each other due to uncertainty as to which banks remained sound (although there would be slightly less uncertainty this time as more is known about the counterparties to Greek/Portuguese/Irish/Spanish debt than was the case with Lehman Brothers).

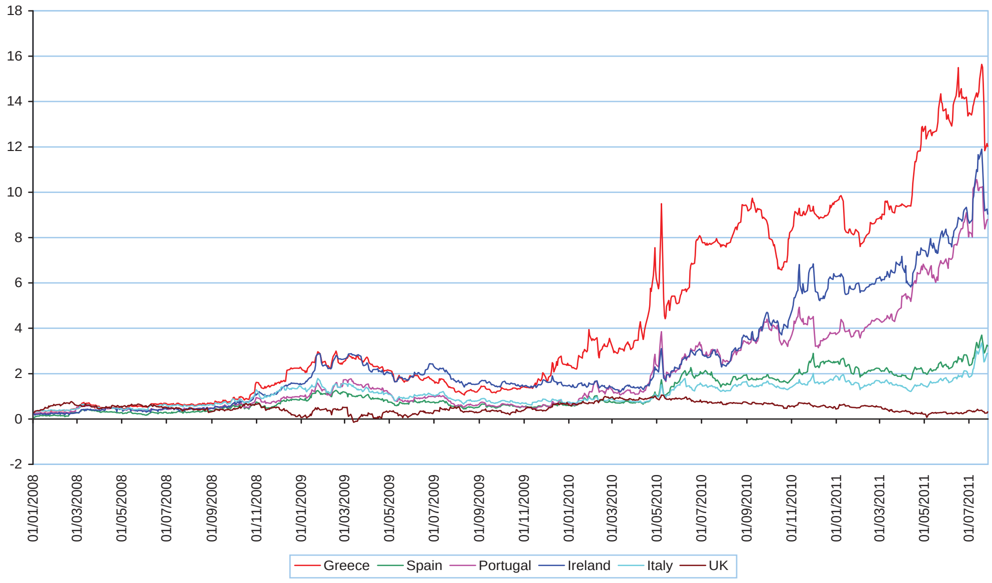
c) The general uncertainty in financial markets and the possible risk of contagion would impact negatively on business confidence and therefore investment decisions which would impact on London's growth. Consumer confidence would also likely to be negatively impacted.

d) It would probably slow Eurozone growth which due to our trading links would also slow London's growth.

The recent Greek rescue package has not solved the problems facing Greece. However, it is likely to have bought the Eurozone some breathing space. Still it is fundamentally difficult to see how Greece can deal with its huge debt burden as a proportion of GDP without even further radical action. This is fundamentally not the case in the UK where the tough action already taken by the UK Government means that UK Government bond interest rates still remain close to Germany's (see Figure 3). The UK's public finances have been put on a road back to sustainability that has been recognised by markets unlike the case in Greece and some other Eurozone countries. The Office for Budget Responsibility forecasts the UK Government debt to GDP ratio will peak at just over 70 per cent in 2013/14 and the current budget will be in surplus by 2014/15. Putting the UK economy back onto the path of fiscal sustainability through tough fiscal consolidation measures will benefit the London economy over the medium term.

Figure 3: Ten-year government bond spreads over German bonds, percentage points
Last data point is 26/07/2011

Source: EcoWin



Concerns mount over the deadlock in raising the US Government's debt ceiling

In the US deadlock continues concerning raising the legal limit on the US Government's debt ceiling (which has been raised 10 times since 2001). Markets still believe it is unlikely that Republicans and Democrats will fail to agree to raise the US' $14.3 trillion debt ceiling. However, time is running out for the parties to agree on a package of spending cuts and tax rises that has been linked to raising the debt ceiling. The US debt ceiling was reached in May but Treasury Secretary, Timothy Geithner, was able to extend the expected day of reckoning to after 2nd August by measures such as delaying payments into government pension schemes. Between 3-31 August US Government obligations are believed to be over $300bn whereas revenues will be under $200bn. On 15 August interest payments of around $30bn on US Treasury securities are also due. President Obama has warned that a failure to raise the debt limit will lead to a recession.

Any debt default by the US would have serious consequences for world financial markets and therefore London due to the prominence that US debt, for example US Treasuries and their supposed 'risk free' status, hold in financial markets. The shock to the global financial system would be huge and the negative impact on world economic growth large. Credit rating agencies have already discussed openly the possibility of downgrading US government debt. The political deadlock over raising the US Government's debt ceiling has been a contributory factor to the gold price hitting record nominal highs above $1600 an ounce. The price of gold rises in times of uncertainty as investors try to find a safe haven for their investments.

London's economy still recovering but global risks heighten

The retail sector is suffering a hard time across the UK but seems to be performing better in London. The West End continues to experience robust retail growth with the New West End Company reporting an 11 per cent rise in sales in June compared to a year earlier.

Internationally, the US economy remains sluggish, with employment only rising slowly in June and concerns regarding the failure to raise the Government's debt ceiling growing. Prospects for the US economy still remain reasonably healthy as long as a path for fiscal sustainability can be found but they are not as strong as had been hoped for earlier this year.

Germany and France are recovering well, however 'peripheral' members of the Eurozone are struggling with the debt ratings of Ireland and Portugal being downgraded to junk status by Moody's. Despite the 21 July rescue package for Greece, Eurozone sovereign debt problems still remain. Before the Greek bailout the Italian Government announced an austerity budget that aimed to reduce its budget deficit from about 4 per cent of GDP this year to balance in 2014 as worries heighten over its huge debt to GDP ratio. In relation to the stability of the European banking system the European Banking Authority recently published the results of its latest stress tests of the system to see if banks could survive another financial crisis. The results showed that 8 of the 90 banks that it tested failed, with 16 others only just passing. Spain accounted for 5 of the banks that failed the test with 2 in Greece and 1 in Austria. The tests though did not reassure markets as they were seen by many as not harsh enough.

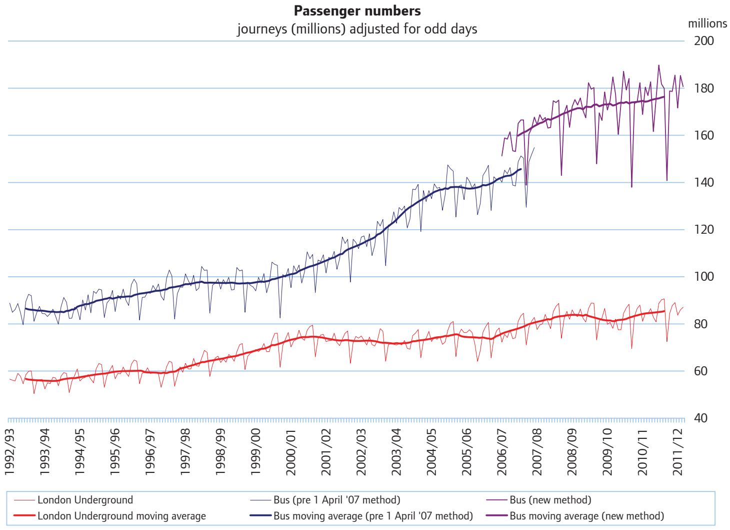
In the UK the Ernst & Young ITEM Club has downgraded its forecast for economic growth for 2011 and 2012 to 1.4 per cent and 2.2 per cent respectively. Meanwhile the London economy is still recovering well from recession though it faces an uncertain international economic environment. The Business in Britain study by Lloyds TSB found that firms in London were the most confident of any region. At the moment London's housing market is also stronger than the UK's. Overall, London's economy currently seems to be outperforming the UK as a whole but growth over the next year is unlikely to be strong or smooth.

Economic indicators

Increase in moving average of passenger numbers

- The most recent 28 day period is from 29 May 2011 to 25 June 2011. Adjusted for odd days, London's Underground and buses had 267.8 million passenger journeys; 180.7 million by bus and 87.1 million by Underground.
- The moving average of passengers every period increased to 261.8 million from 261.3 million in the previous period. The moving average for buses was 176.4 million. The moving average for the Underground was 85.4 million.
- The methodology used to calculate the number of bus passenger journeys was changed by TfL from 1 April 2007. For a detailed explanation please see LET issue 58 (June 2007).

Latest release: July 2011
Next release: August 2011

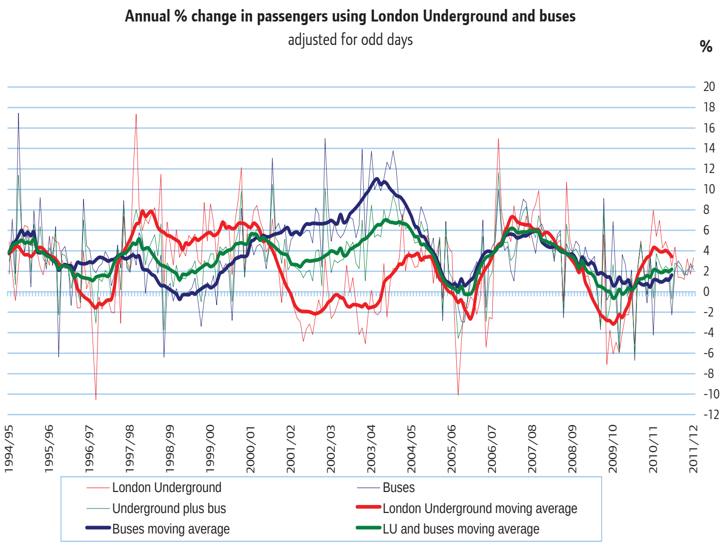


Source: Transport for London

Average annual growth rate of passengers increasing

- The moving average annual rate of growth in passenger journeys increased to 2.2% from 2.0% in the previous period.
- The moving average annual rate of growth in bus passenger journey numbers increased to 1.6% from 1.1% in the previous period.
- The moving average annual rate of growth in Underground passenger journey numbers decreased to 3.4% from 3.8% in the previous period.

Latest release: July 2011
Next release: August 2011

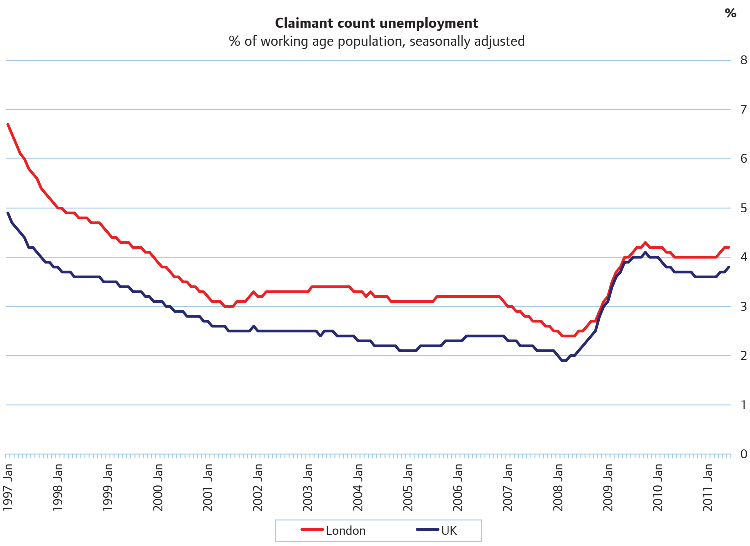


Source: Transport for London

Claimant count unemployment

- The percentage of the resident working age population who are unemployed and claiming Jobseekers' Allowance (seasonally adjusted) in London was 4.2% in June 2011.
- There were 226,400 seasonally adjusted unemployment claimants in London in June 2011 compared with an upwardly revised 223,600 in May 2011.
- There were 1,520,100 seasonally adjusted unemployment claimants in the UK in June 2011 compared with an upwardly revised 1,495,600 in May 2011.

Latest release: July 2011
Next release: August 2011

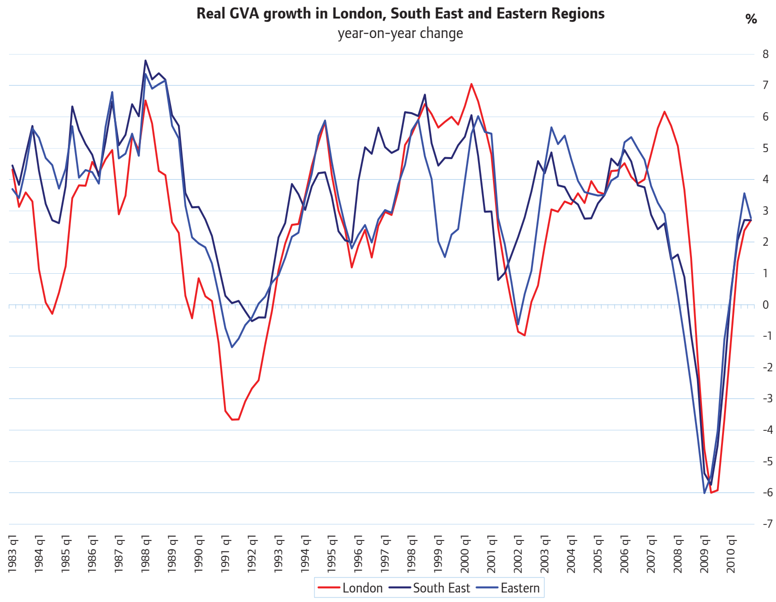


Source: Claimant Count, Nomis

Annual output growth in London increased in Q4 2010

- London's annual growth in output increased to 2.7% in Q4 2010 from a downwardly revised 2.4% in Q3 2010.
- Annual output growth in the South East was 2.7% in Q4 2010 unchanged from a downwardly revised 2.7% in Q3 2010.
- Annual output growth in the Eastern region decreased to 2.8% in Q4 2010 from an upwardly revised 3.6% in Q3 2010.

Latest release: May 2011
Next release: August 2011

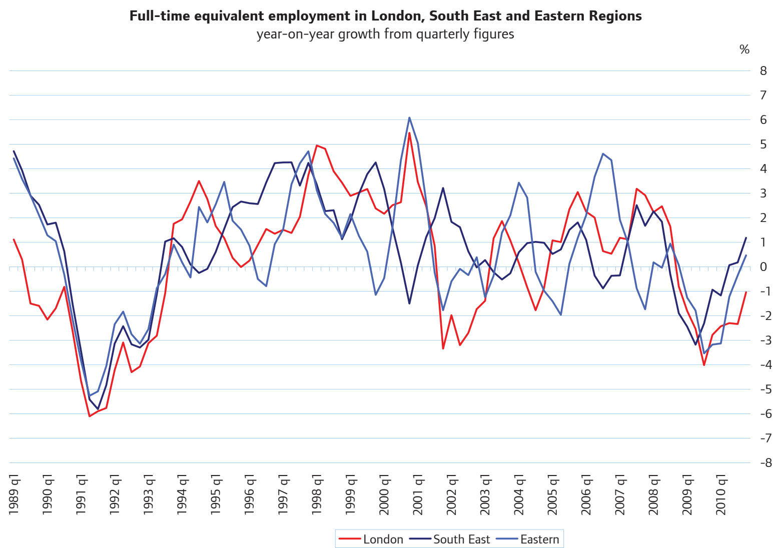


Source: Experian Economics

Negative annual employment growth in London in Q4 2010

- London's annual employment growth increased to -1.0% in Q4 2010 from a downwardly revised -2.3% in Q3 2010.
- Annual employment growth in the South East increased to 1.2% in Q4 2010 form an upwardly revised 0.2% in Q3 2010.
- Annual employment growth in the Eastern region increased to 0.5% in Q4 2010 from an upwardly revised -0.4% in Q3 2010.

Latest release: May 2011
Next release: August 2011

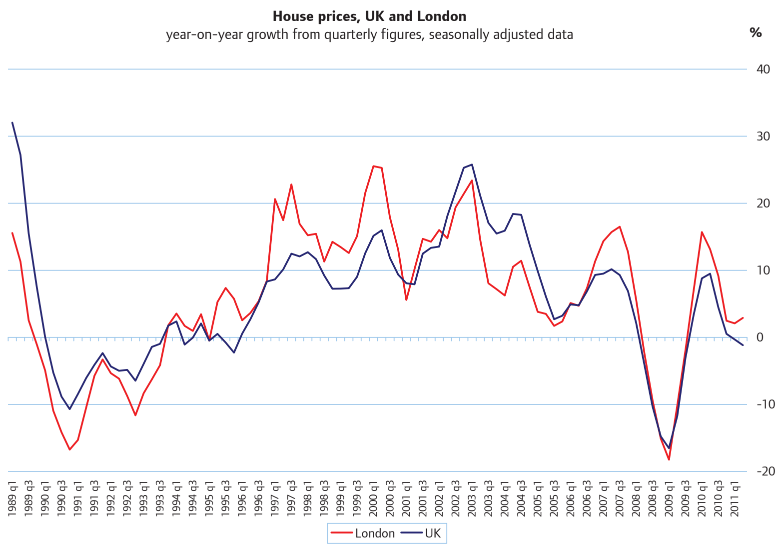


Source: Experian Economics

Annual house price inflation increasing in London

- House prices, as measured by Nationwide, were higher in Q2 2011 than in Q2 2010 in London but not in the UK.
- Annual house price inflation in London was 2.9% in Q2 2011, up from 2.1% in Q1 2011.
- Annual house price inflation in the UK was -1.2% in Q2 2011, down from -0.3% in Q1 2011.

Latest release: July 2011
Next release: October 2011

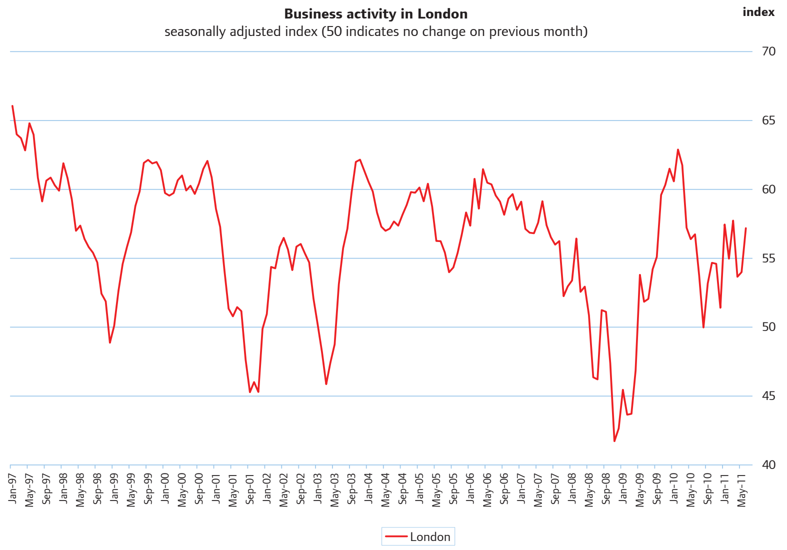


Source: Nationwide

London's business activity increasing

- London firms increased their output of goods and services in June 2011.
- The Purchasing Managers' Index (PMI) of business activity recorded 57.2 in June 2011 compared to 54.0 in May 2011.
- A rate of above 50 on the index indicates an increase in business activity from the previous month.

Latest release: July 2011
Next release: August 2011

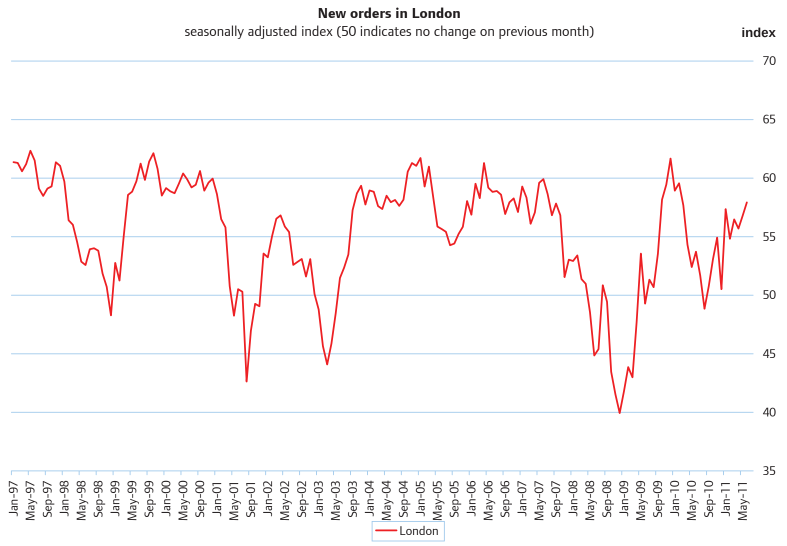


Source: Markit Economics

New orders in London rising

- June 2011 saw an increase in new orders for London firms.
- The PMI for new orders recorded 57.9 in June 2011 compared to 56.8 in May 2011.
- A rate of above 50 on the index indicates an increase in new orders from the previous month.

Latest release: July 2011
Next release: August 2011

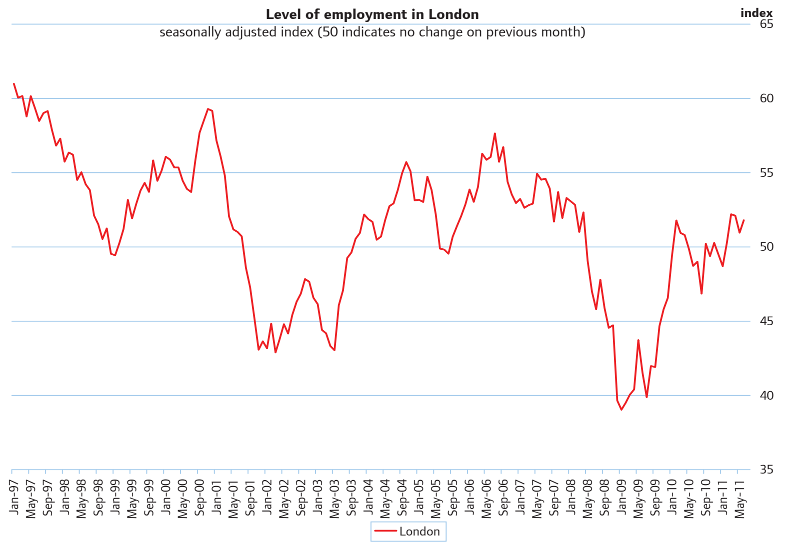


Source: Markit Economics

Businesses report higher employment in June

- The PMI shows that the level of employment in London firms increased in June 2011.
- The PMI for the level of employment was 51.8 in June 2011 compared to 51.0 in May 2011.
- A rate of above 50 on the index indicates an increase in the level of employment from the previous month.

Latest release: July 2011
Next release: August 2011

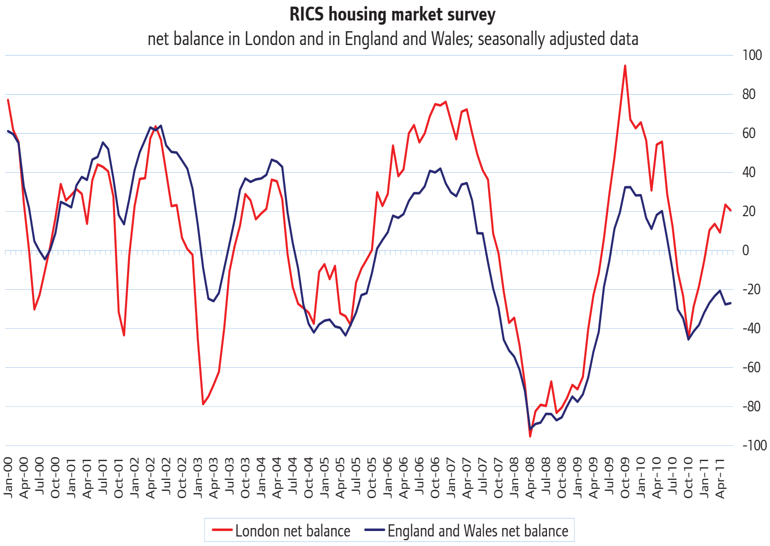


Source: Markit Economics

Surveyors report that house prices are rising in London

- The RICS survey shows a positive net balance of 21 for London house prices over the past three months to June 2011.
- Surveyors reported a negative net house price balance for England and Wales of -27 over the past three months to June 2011.
- London's net house price balance is higher than that of England and Wales.

Latest release: July 2011
Next release: August 2011

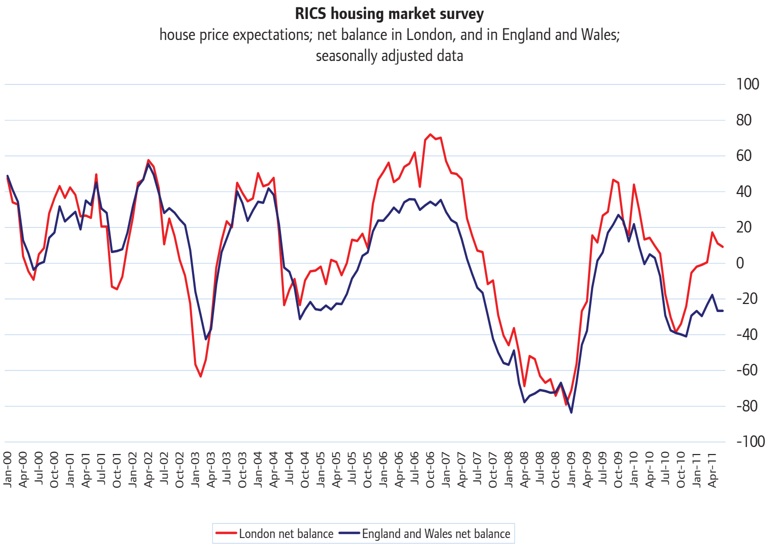


Source: Royal Institution of Chartered Surveyors

Surveyors expect house prices to rise in London

- The RICS survey shows that surveyors expect house prices in London to rise over the next three months but to continue to fall in England and Wales.
- The net house price expectations balance in London was 9 in June 2011.
- For England and Wales, the net house price expectations balance was -27 in June 2011.

Latest release: July 2011
Next release: August 2011

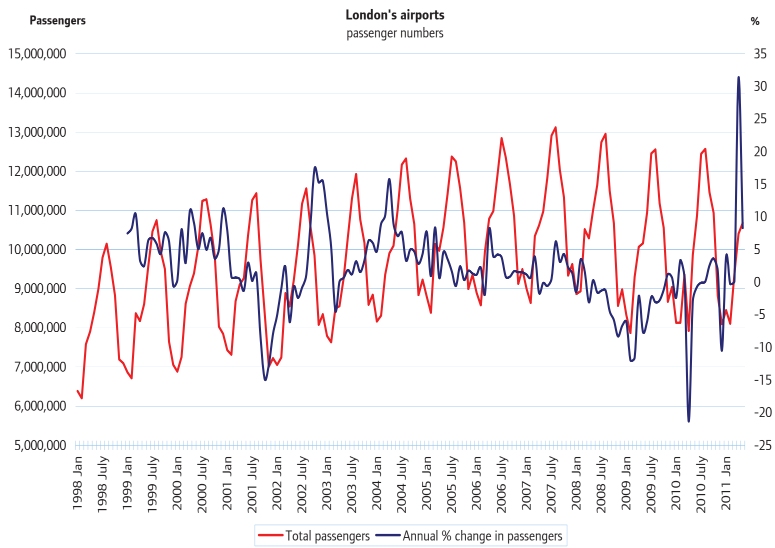


Source: Royal Institution of Chartered Surveyors

Increase in year-on-year airport passenger numbers

- 10.7 million passengers travelled through London's airports in May 2011.
- The number of passengers using London's airports increased by 8.3% from May 2010 to May 2011.
- Airport passenger numbers fell during the recession and are still below pre-recession levels.

Latest release: July 2011
Next release: August 2011



Source: Civil Aviation Authority

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.

Claimant count unemployment
Unemployment based on the number of people claiming unemployment benefits.

Employee jobs
Civilian jobs, including employees paid by employers running a PAYE scheme. Government employees and people on training schemes are included if they have a contract of employment. Armed forces are excluded.

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 2011/12 there are eleven 28-day periods, one 27-day period and one 30-day period. Period 1 started on 1 April 2011.

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 2011/12 there are eleven 28-day periods, one 27-day period and one 30-day period. Period 1 started on 1 April 2011.

Acronyms

ABI	Annual Business Inquiry
BAA	British Airports Authority
BCC	British Chamber of Commerce
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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