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Expansionary mini-Budget risks stimulating inflationary economic boom

By **Mike Hope**, Economist, **James Watson**, Economist and **Jasmine Farquharson**, Project Management Apprentice

Last Friday 23 September, the Chancellor, Kwasi Kwarteng, presented his first fiscal statement. The policies were very expansionary with cuts to income tax and national insurance, stamp duty reductions, and cancelling of the proposed increases in corporation tax. Net permanent tax cuts as a share of GDP are set to be more than 1.5%, estimates the Institute for Fiscal Studies (IFS). That is more than the amount in the Lawson Budget of 1988, but less than Barber Budget of 1972, which stimulated the eponymous boom. Despite these cuts the tax burden remains at its highest sustained level since the 1950s.

On the day, and prior to the market reaction, the National Institute for Economic and Social Research (NIESR) forecast that that these measures, combined with the energy support measures also announced last week and discussed in the next section would boost economic growth. Their analysis showed that the economy will come out of recession earlier now with it expected to be the fourth quarter of this year, and GDP could grow around 2% over 2023/24.

The Government has justified the tax cuts on the grounds that it will help raise the low rate of growth in the UK since the financial crisis towards its ambition of 2.5%. However, with an economy near capacity these tax cuts are likely to be inflationary.

Also in this issue

Datastore

The main economic indicators for London are available to download from the London Datastore.

In response to these pressures, NIESR predicted that the Bank of England (BoE) will increase interest rates more aggressively, peaking at 5% next year. Market pricing on the day of the statement is consistent with expectations of a 1 percentage point interest rate rise from the BoE in November.

There is a risk that the spending measures will place the economy on an unsustainable fiscal trajectory. The IFS estimated that medium-term borrowing is likely to be up by more than £100 billion. This raised concerns for financial markets, especially as the UK relies on lending from overseas, (see below). On the day of the statement sterling fell below $1.10 for the first time since 1985, and below $1.04 over the weekend, hitting an all-time low, before recovering slightly. The 10-year gilt yield surged 0.27 percentage points on heavy selling to hit 3.77% on the day, bringing its rise for the week to more than half a percentage point. It continued rising over the following days. The turmoil in the gilt market has also hit the UK housing sector. Around 1,000 mortgage deals have been withdrawn from the housing market in response to soaring yields and volatility as mortgage lenders face uncertainty about the long-term path of interest rates.

The Chancellor of the Exchequer and the Governor of the BoE have issued statements that they have no plans to make further fiscal or monetary statements until November when there will be a Budget and a decision on interest rates. Market movements would indicate that they have doubts that these positions can be maintained. Paul Johnson, the Director of the IFS, has commented, "It seems almost inconceivable that [expenditure] plans made last year, when inflation was expected to peak around 3%, will not need topping up at some point, unless the government is willing to allow a (further) deterioration in the range and quality of public services." Any credible plan for higher growth will take time to implement. So, there is no obvious other mechanism for the government to use in its fiscal statement to place the economy on a sustainable fiscal trajectory of falling debt to GDP in the short term, and to reassure the markets.

The market reaction will raise the Exchequer costs of the mini-Budget, and add to the Budget deficit. Higher gilt yields raise the cost of borrowing to pay for tax cuts. The financial risk of the Energy Price Guarantee, more on which below, is with the Government – as energy prices are in dollars so the cost rises with an exchange rate depreciation. While on 28 September, and despite its previous announcement, the BoE announced it will intervene in the bond markets to buy unlimited quantities of long-term debt in order to offset a "material risk to financial stability".

Unusually, the International Monetary Fund has commented on the mini-Budget. "Given elevated inflation pressures in many countries, including the UK, we do not recommend large and untargeted fiscal packages at this juncture … It is important that fiscal policy does not work at cross purposes to monetary policy."

In terms of UK sub-regional impacts it is likely that the announced measures will be of more benefit to London and the South East of the UK because incomes and wealth in these areas are disproportionately higher, on average - that is, more people will benefit from cuts to income tax and stamp duty in these regions. Households in London or the South East will on average have three times the gains of those in the North East, Wales and Yorkshire. Further, the Resolution Foundation estimates almost half the gains will go to the richest 5% of households, compared with 12% of the gains for the lower half.

Beyond this there were a few announcements in the fiscal statement of interest for London:

- Overseas visitors will no longer need to pay VAT on goods shopping. In 2019, there were 21.7 million overseas visitors to London who spent £15.7 billion, according to the Office for National Statistics (ONS). London is the third most visited city in the world. As a comparison, 40.9 million overseas visitors came to the UK, and spent £28.4 billion.
- There are plans for new Investment Zones. The chosen sites will have time-limited lower taxes, and planning liberalisation to accelerate development. The Government is in early discussions with 38 Mayoral Combined Authorities and Upper Tier Local Authorities, including the GLA.
- The Government has committed to accelerate some infrastructure projects. These include the A13 London Safer Road Scheme, and the A23 Croydon Safer Road Scheme.

The Government announces measures to address the cost of living crisis

The key cost of living development this month was not the latest data, discussed below, but instead the announcement of the Energy Price Guarantee. From October, the scheme will cap household energy bills at an annual average of £2,500. If the Government had not acted, soaring wholesale costs meant the Ofgem price cap would have been set at a much higher £3,500. Industry estimates projected that the cap would then rise to £4,650 in January 2023 and over £5,300 in April. The BoE projected, prior to the mini-Budget, an October inflation peak of just under 11% year-on-year, quite close to current levels. This may seem like a relatively modest revision from August's projected inflation peak of just over 13%. However, energy price movements between the two meetings might otherwise have pointed to an inflation peak closer to 20%.

Vitally, the Government will also introduce a cap for business' energy bills corresponding to wholesale prices of £211 per MWh for electricity and £75 per MWh for gas. This is likely around half the cost that firms would have faced over winter without any government measures. If business energy costs were left uncontrolled, firms would likely have been forced to pass these on to consumers in higher prices – or else go out of business, resulting in layoffs.

Nevertheless, inflation remains very high by the standards of the last 30 to 40 years and the outlook is still uncertain. Households still face a 25% increase in already-high energy bills in October. Lower-income households tend to devote a higher share of spending to energy, meaning they will be the hardest hit by continuing cost increases. The business energy price cap is only set to last six months for most firms. Only "vulnerable" companies and charities will receive further help beyond that point – and the Government has not yet defined who will qualify.

The household and business energy price caps will also be immensely costly for the Exchequer. It estimates that over the first six months the household scheme will cost £31 billion, and the business scheme will cost £29 billion.

Overall, the latest policy announcements are clearly a boost for households and businesses in the near term. Inflation is unlikely to keep soaring upwards by as much, instead peaking soon at a pace close to current levels other things being equal. Yet households will still face an energy price cap roughly double its level last October. Other essential costs like food and housing continue to rise. And there is no guarantee that gas prices will be below the new cap in two years' time – let alone in six months when business support expires. To fight the cost of living crisis on a sustainable basis, policy still needs to do much. Energy policy will need to step up efforts to reduce dependency on imported natural gas. Monetary policy will need to continue to fight domestic inflationary pressures. And other areas of policy are likely needed to support many households this winter.

The Bank of England raises interest rates again

At its September meeting the Monetary Policy Committee (MPC) of the BoE raised interest rates by 0.5% to 2.25%, the highest level for 14 years. This is the seventh consecutive meeting of the MPC to raise interest rates from 0.1% in December 2021. It was on a split vote with five members voting to increase rates by 0.5%, three by 0.75%, and one by 0.25%. In the words of the MPC minutes, "a tight labour market with wage growth and domestic inflation well above target-consistent rates justified a further, forceful response from monetary policy." There is likely to be further interest rate increases as Government action to increase demand through the Energy Price Guarantee and tax cuts will otherwise raise prices where labour supply is tight.

The BoE notes that, "In the near term, the Guarantee would lower and bring forward the expected peak in Consumer Price inflation (CPI). This should restrain expectations of above-target inflation further ahead". In August, there was a modest fall in annual CPI to 9.9% from 10.1% in July, reports the ONS. There will be a further rise in inflation when the Energy Price Guarantee comes into effect, as this is set higher than the current price cap. The ONS has concluded that the energy rebate which is taken off bills from October will not be reflected in the CPI.

Typically, earnings rise faster than prices, and so living standards improve. It remains the case that earnings have not kept pace with CPI this year, with earnings growth perhaps being lower in London than the UK, (Figure 1). This ongoing contraction in real earnings is contributing to the cost of living crisis.

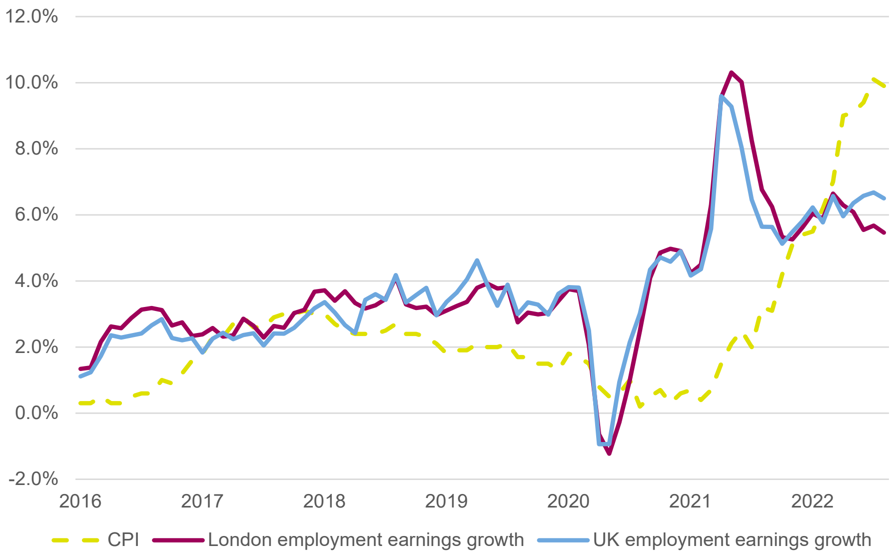


Figure 1: Annual UK CPI and median London and UK employment earnings growth, January 2016 – August 2022

Source: ONS and HMRC Real-Time Information System

Jobs exceed pre-pandemic levels

Perhaps because of falling real earnings the unemployment rates in London and the UK remain low, UK vacancies remain high, and the number of jobs has been recovering. In the quarter to June 2022 the number of jobs in both London and the UK exceeded pre-pandemic levels (at December 2019) for the first time, according to ONS figures, (Figure 2).

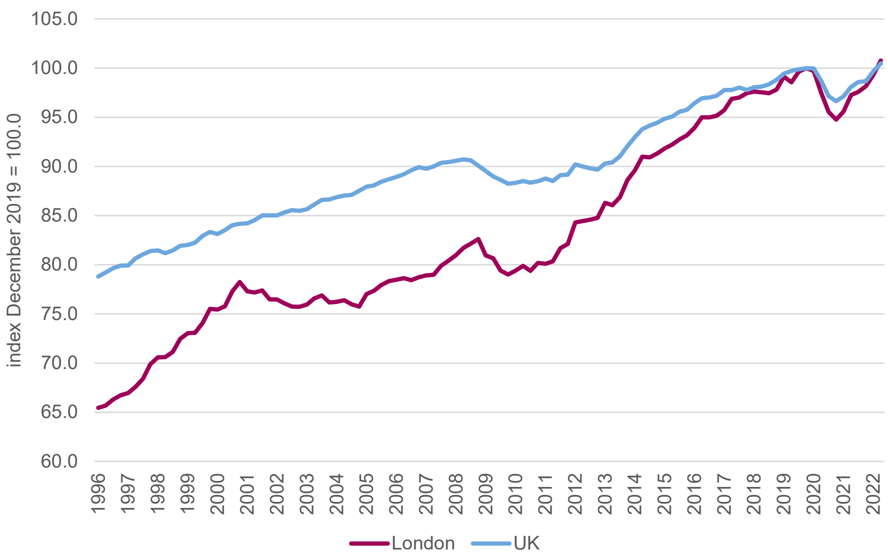


Figure 2: Workforce jobs, UK and London, March 1996 – June 2022, index numbers

Source: ONS Workforce jobs

Historically, London's job numbers had been growing faster than across the UK, while they also fell further during the pandemic. In that time there has been some restructuring of the London economy. Jobs fell across many sectors before re-bounding. For example, the share of London jobs in Construction fell from 5.2% in December 2019 to 4.2% a year later before recovering to 5.0% in June 2022. On the other hand, in Wholesale and retail there was growth in the share from 10.8% to 11.7% in December 2022 before retrenchment to 11.1%. Accommodation and food services saw a decline in the share of London jobs from 7.6% to 6.5% between December 2019 and 2020, and its share remained unchanged at June 2022. Professional services has seen a steady rise in its share of London jobs from 13.4% to 14.2% to 14.9% over the two and a half years.

The UK economy is weakening

Even prior to the mini-Budget the latest data from the ONS was that the UK economy was stagnating. GDP was flat in the three months to July compared with the previous three months. It was estimated to have grown by 0.2% in July. Services was the main driver of the rise in GDP, and grew by 0.4% over the month – some of this is a recovery from the reduction in COVID-19 health activities in the previous period. Within the services sector, Information and communications grew by 1.5%.

More worrying for the financial markets were ONS retail sales figures which showed that retail sales volumes fell by 1.6% in August and provided evidence that the UK economy may be heading for recession. This continued a downward trend since Summer 2021, following the lifting of restrictions on hospitality and a shift in household spending towards services, and away from retail goods. More recently, the effects of rising inflation are apparent with retail sales volumes falling by 5.1% in the three months to August, and sales values rising by 5.6%. This implies an annual growth rate in retail prices of 10.7%. It is likely that it has been the impact of rising prices that over the month to August retail sales volumes fell across all the sectors of non-food stores, non-store retailing (predominantly internet sales), food stores, and fuel.

Fears about the strength of the economy, and rising public debt levels, had already led to a sell off of sterling prior to the mini-Budget. At one point after the retail sales publication, sterling fell more than 1% against the US dollar to $1.1351, its lowest at the time since 1985. Over the month of September to the 20th, the pound had fallen by 1.9% against the dollar, and by 1.3% against the Euro, (Figure 3). It is also a concern that the trade deficit widened by £1.2bn to £27.0bn in the three months to July, compared with the three months to April, according to the ONS. Reduced international competitiveness of the UK economy would require a currency depreciation if the economy became less attractive to overseas investors. Interest rate increases are a means to maintain the attractiveness of sterling.

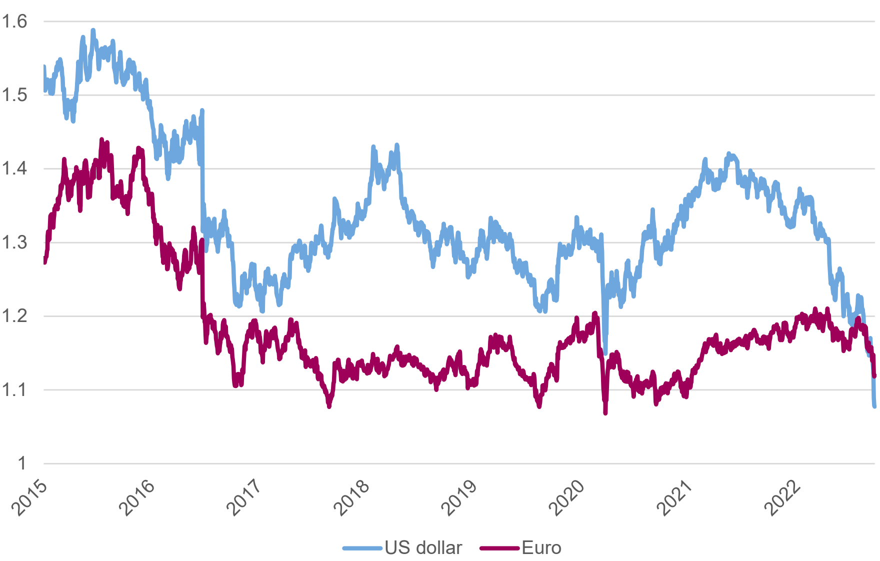


Figure 3: Sterling-US dollar and Euro exchange rates, 2015 - 2022

Source: Bank of England exchange rate database

International economies also facing pressures

The impacts of energy shortages and rising prices are impacting the world economy more than previously expected according to the latest forecast from the Organisation for Economic Cooperation and Development (OECD). It now estimates that global GDP in 2023 will be $2.8 trillion lower than its December 2021 forecast before Russia's invasion of Ukraine, although the OECD is still estimating growth at 2.2%.

Inflation has become more widespread. The US Federal reserve increased interest rates by 0.75% to between 3% and 3.25% - this is the highest level for 14 years. Borrowing costs are expected to climb more and remain high the Fed said. The increases in interest rates will slow down economic activity and may tip the US economy into recession. The OECD, though, is expecting growth of 0.5% in 2023.

The OECD 2023 forecast for the Eurozone is lower at 0.3%. The economic pressures are also being felt particularly strongly in Germany as it was reliant on Russian energy supplies – there is an expectation that gas use should fall by a fifth this winter to avoid shortages as the Nord Stream 1 gas pipeline is operating at a fifth of capacity. While the country is filling its gas storage facilities to maintain supplies economic growth has stagnated, according to Eurostat, and the ZEW Institute gauge of investor expectations has fallen to -55.3, its lowest level since 2011. The OECD is forecasting the Germany economy to shrink by 0.7% in 2023.

The OECD has also slightly trimmed its China forecast by 0.2% to 4.7% for 2023. The World Bank is predicting growth of 2.8% in 2022 and 4.5% in 2023 for China. The zero-COVID policy, and the public health measures to limit mobility, and contain the spread of the virus, have constrained consumption this year. China's real estate turmoil, as evidenced by problems in financing loans to the property company Evergrand and falling house prices across 70 major cities, is being accentuated by the tightening of financial conditions with interest rate rises.

For completeness the OECD is forecasting UK growth at 0.0% in 2023. This analysis was conducted before the mini-Budget announcement.

London's businesses continue to prosper, although consumer confidence is worsening

The current evidence points to the conclusion that London's economy continues to grow. As reported earlier the service sector, which accounts for 90% of London's economy, is growing. The latest Global Financial Centres Index, from Z/Yen in collaboration with the China Development Institute, finds that London continues to be the second most important financial centre behind New York.

The LET indicators, reported below, are mostly positive with increases in ridership on tubes and buses, a tight labour market, rising house prices, and positive business confidence. More negatively there are expectations of falling house prices in the next few months, and there is negative and worsening consumer confidence. Consumer confidence in London reached levels last seen during the financial crisis, although for the UK they are the worst since records began in 1974.

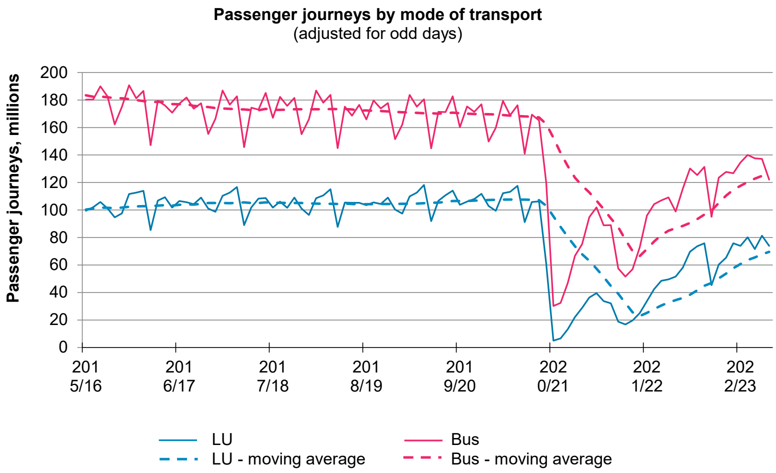
GLA Economics will continue to monitor these and other aspects of London's economy over the coming months in our analysis and publications, which can be found on our publications page and on the London Datastore.

Economic indicators

The underlying trend in passenger journeys on London public transport remains upward

- 195.9 million passenger journeys were registered between 24 July 2022 and 20 August 2022, 22.5 million journeys fewer than in the previous period (26 June 2022 – 23 July 2022).
- In the latest period, 73.9 million of all journeys were underground journeys and 122.0 million were bus journeys.
- The 13-period-moving average in the total number of passenger journeys rose from 192.8 in the previous period to 196.3 in the latest period.

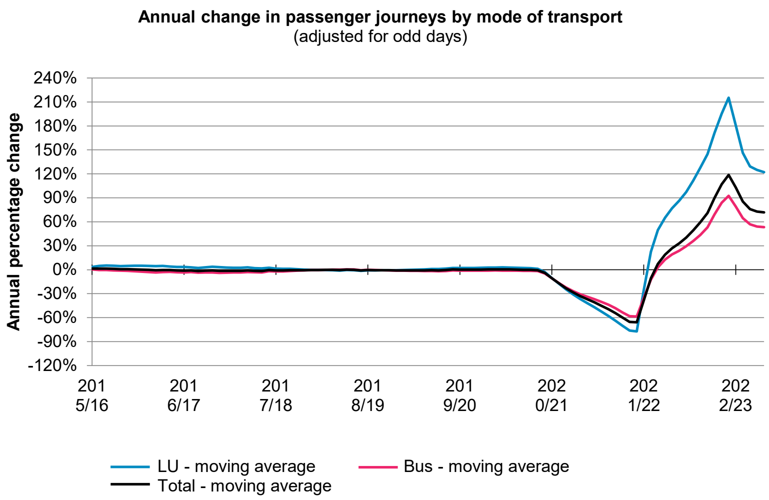
Source: Transport for London
Latest release: September 2022, Next release: October 2022



Annual growth in passenger journeys remained strongly positive, if slowing

- The 13-period moving average annual growth rate in the total number of passenger journeys was 71.7% between 24 July 2022 and 20 August 2022, down from 72.8% from 26 June 2022 to 23 July 2022.
- The moving average annual growth rate of bus journeys decreased from to 54.0% to 53.4% between the above-mentioned periods.
- Likewise, the moving annual average of underground passenger journeys decreased from 124.9% to 122.1% between those periods.

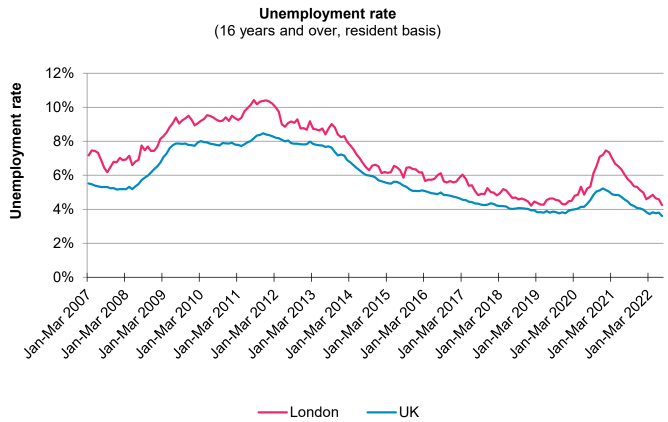
Source: Transport for London
Latest release: September 2022, Next release: October 2022



London's unemployment rate remains low at 4.2% in the quarter to July 2022

- Around 212,000 residents 16 years and over were unemployed in London in May – July 2022.
- The unemployment rate in London was 4.2% in that period, less than in the previous quarter, February – April 2022 at 4.8%.
- The UK's unemployment rate also fell, from 3.8% February – April 2022 to 3.6% May – July 2022.

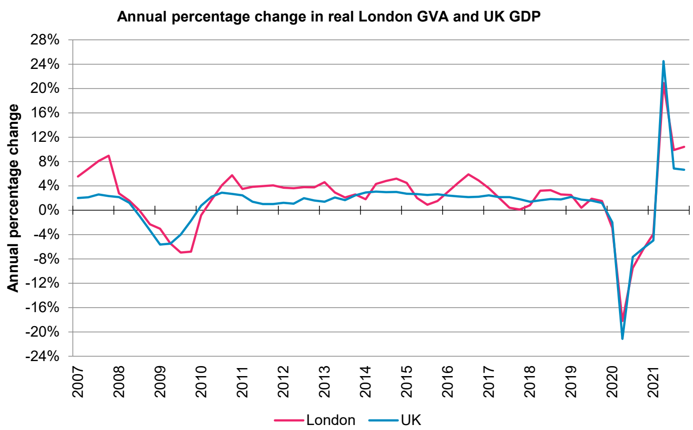
Source: ONS Labour Force Survey
Latest release: September 2022, Next release: October 2022



London's economy had surpassed pre-pandemic levels of output by Q4 2021

- By Q4 2021 London's GVA was 3.2% above its pre-pandemic level (Q4 2019), and UK GDP was 0.1% below.
- London's real GVA increased by 2.8% in Q4 2021 - compared with Q3 2021 - after increasing by 1.5% in the previous quarter.
- The UK's real GDP quarterly growth rate for Q4 2021 was 1.3% after increasing by 0.9% in the previous quarter.
- While GDP and GVA are different measures in output their trends have been comparable. UK GDP estimates incorporate a broader range of data than GVA estimates, and so should be more robust.
- London's real GVA quarterly estimates for the period Q1 1999 to Q4 2012 have been produced by GLA Economics. Estimates for the intervening period are outturn data from the ONS, which does not publish quarterly estimates for London's real GVA prior to 2013.

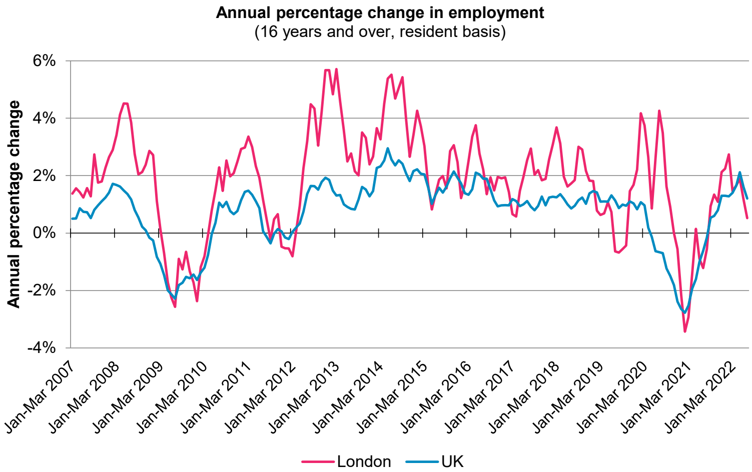
Source: ONS and GLA Economics calculations
Latest release: September 2022, Next release: December 2022



London's year-on-year employment growth rate was 0.5% in the quarter to July 2022

- Around 4.8 million London residents over 16 years old were in employment during the three-month period of May – July 2022.
- The rate of employment growth in the capital was 0.5% in the year to this quarter, slower than the rate of 1.7% in the previous quarter to April 2022.
- The change in the UK's employment annual growth rate was 1.2% in the most recent quarter, slower than the rate of 1.7% in the previous quarter.

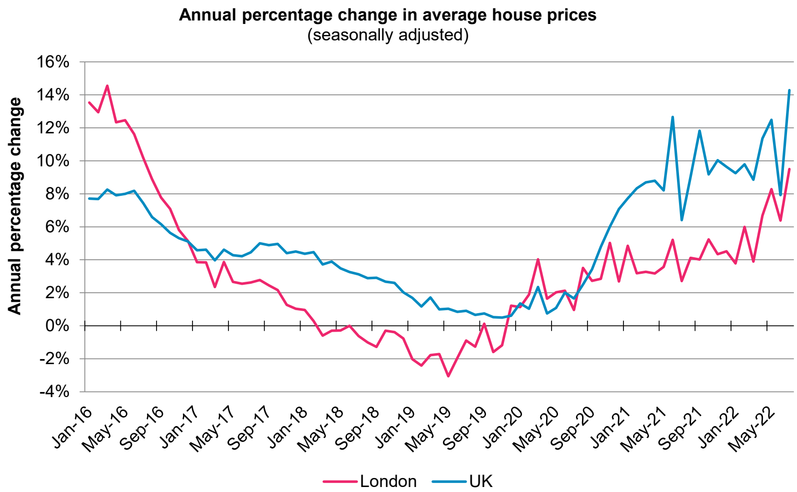
Source: ONS Labour Force Survey
Latest release: September 2022, Next release: October 2022



House prices in London continued to grow in July

- In July 2022, the average house price in London was £536,000 while for the UK it was £283,000.
- Average house prices in London rose by 9.5% year-on-year in July more than the rate of 6.4% in June.
- Average house prices in the UK rose by 14.3% in July on an annual basis, more than the rate of 7.9% in June.

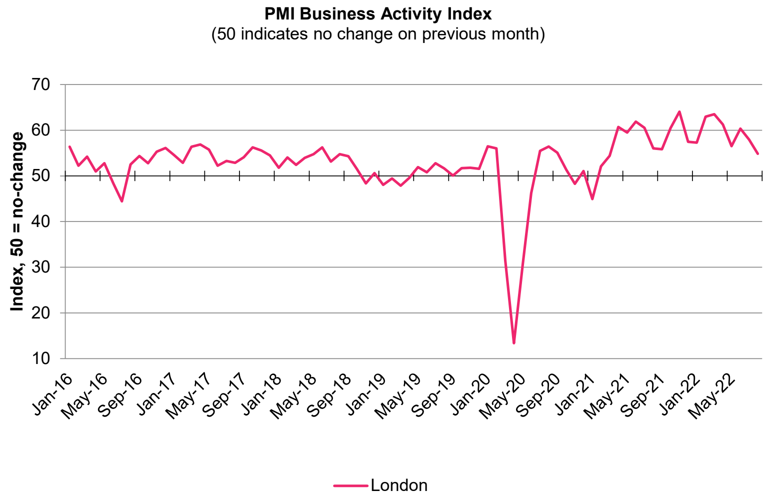
Source: Land Registry and ONS
Latest release: September 2022, Next release: October 2022



In August, the sentiment of London's PMI business activity index decreased but remained positive

- The business activity PMI index for London private firms decreased from 58.0 in July to 54.9 in August.
- The Purchasing Managers' Index (PMI) survey shows the monthly business trends at private sector firms. Index readings above 50 suggest a month-on-month increase in activity on average across firms, while readings below 50 indicate a decrease.

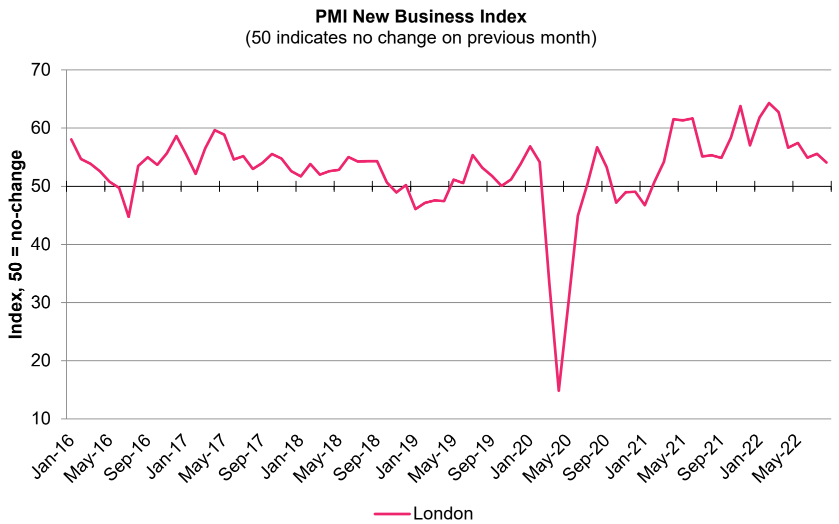
Source: IHS Markit for NatWest
Latest release: September 2022, Next release: October 2022



In August the sentiment of London's PMI new business activity index decreased slightly, but remained positive

- The PMI new business index in London decreased slightly from 55.6 in July to 54.1 in August.
- An index reading above 50.0 indicates an increase in new orders on average across firms from the previous month.

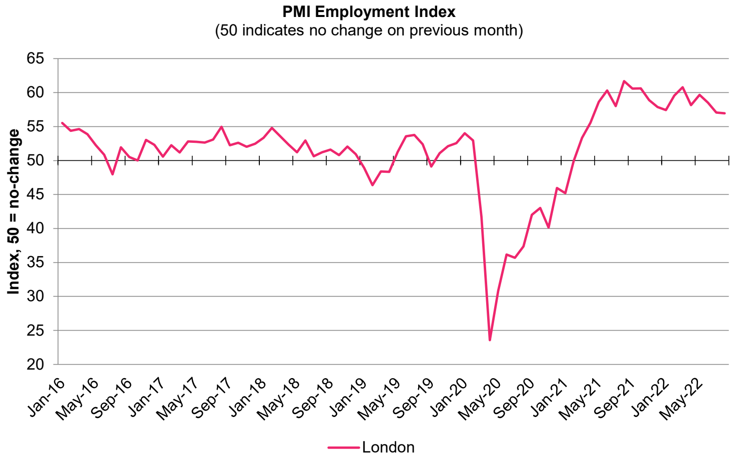
Source: IHS Markit for NatWest
Latest release: September 2022, Next release: October 2022



In August, the sentiment of the PMI employment index in London decreased slightly but remained positive

- The Employment Index for London decreased slightly from 57.1 in July to 56.9 in August.
- The PMI Employment Index shows the net balance of private sector firms of the monthly change in employment prospects. Readings above 50.0 suggests an increase, whereas a reading below 50.0 indicates a decrease in employment prospects from the previous month.

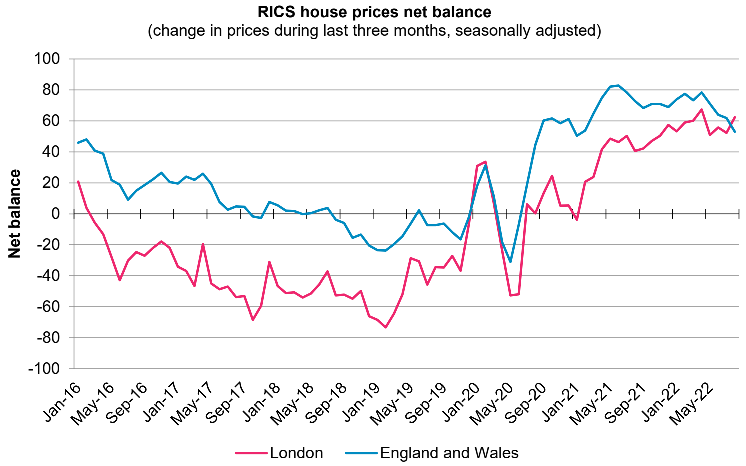
Source: IHS Markit for NatWest
Latest release: September 2022, Next release: October 2022



A significant majority of property surveyors reported an increase in house prices in London in August

- In August, property surveyors in London saw an increase in the net balance of those reporting rising prices. The net balance index was 62, and in July it was 52.
- For England and Wales, the RICS house prices net balance index decreased from 62 in July to 53 in August.
- The net balance index measures the proportion of property surveyors reporting a rise in prices minus those reporting a decline.

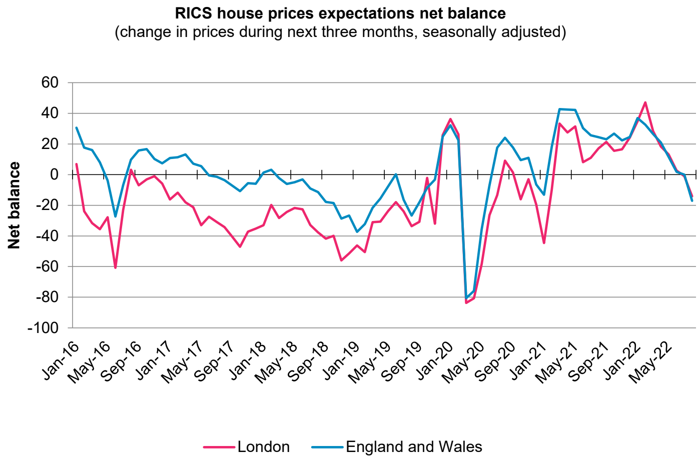
Source: Royal Institution of Chartered Surveyors
Latest release: September 2022, Next release: October 2022



In August, net expectations for house prices in London for the next three months became more negative, according to surveyors

- The net balance of house prices expectations in London was -14 in August, lower than the balance of -1 in July.
- The index for England and Wales was -17 in August, lower than the value of 0 in July.
- The net balance index measures the proportion of property surveyors reporting a rise in prices minus those reporting a decline.

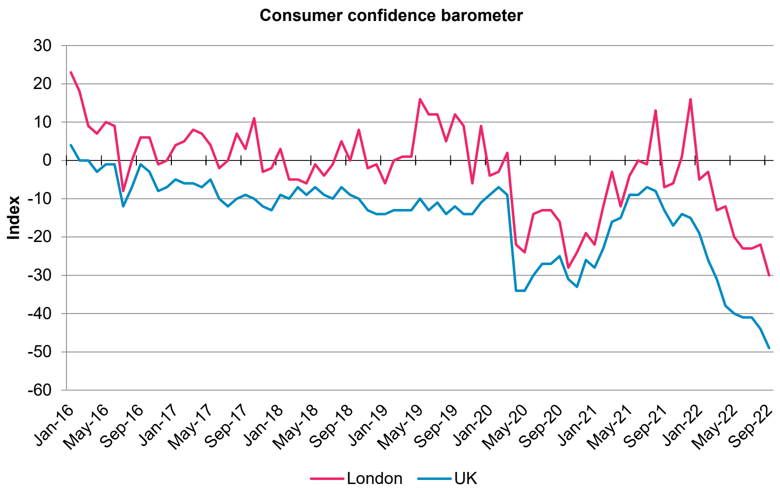
Source: Royal Institution of Chartered Surveyors
Latest release: September 2022, Next release: October 2022



Consumer confidence in London went further negative in September

- The consumer confidence index in London decreased from -22 in August to -30 in September. This is the lowest level since the financial crisis.
- The sentiment for the UK decreased from -44 in August to -49 in September. The UK has not seen a positive index score since January 2016, and is the worse score since records began in 1974.
- The GfK index of consumer confidence reflects people's views on their financial position and the general economy over the past year and in the next 12 months. A score above zero suggests positive opinions; a score below zero indicates negative sentiment.

Source: GfK
Latest release: September 2022, Next release: October 2022



An update on how the cost of living crisis is affecting Londoners

By **James Watson**, Economist

GLA Economics and the City Intelligence Unit have been tracking the cost of living crisis through polling and reports. An update to the initial report in January was published in August. This note summarises the evidence from that release on perceptions of Londoners, price data for London, and wage pressures.

How Londoners perceive the cost of living

- 90% of adults in London say overall their household cost of living has risen over the last six months.
- 19% of Londoners are 'financially struggling', having to go without basic needs, rely on debt or struggle to make ends meet. Another 30% are 'just about managing'.
- Just under half of Londoners have struggled or fallen behind on financial commitments. Forty-six per cent said this applied to their rent or mortgage payments, 47% to their bills and 49% to their credit commitments
- 12% of Londoners said they have regularly or occasionally been unable to buy food or essential items or relied on outside support in the last six months. This proportion almost doubles amongst deaf and/or disabled Londoners (22%), and triples (39%) among Londoners who say they are 'financially struggling'.
- The most popular actions to help manage living costs are buying cheaper products (47%) and spending less on non-essentials (46%). Over a third (35%) are using less water, energy or fuel and over a quarter (29%) are buying less food and essentials.

Londoners are increasingly experiencing cost of living increases, with a rising proportion impacted and a growing proportion saying that the increases have been large. In July, 90% of Londoners believed they had experienced increases in their cost of living over the last six months[1] compared to 79% in January. The proportion seeing large changes is also increasing with half of Londoners (52%) thinking the cost of living had increased a lot in July compared to just less than a third (29%) who thought it had increased a lot in January.

In the July poll of Londoners, 19% are 'financially struggling'[2], that is going without their basic needs and/ or relying on debt or struggling to make ends meet. This is an increase of 6 percentage points compared to January (Figure 1A). Among social renters, the proportion who are 'financially struggling' is now at a third (34%) up from a quarter in January (26%), and for private renters the proportion has increased from 16% to just over a quarter (27%). These figures contrast to homeowners where 9% are 'financially struggling', up just 3 percentage points from January.

Deaf and disabled Londoners also continue to face a disproportionate impact, with a third (31%) saying they were 'financially struggling' in July, up 8 percentage points from January. We also see that whilst the proportion of households with a gross income of less than £20,000 a year that are 'financially struggling' is at 30% this is similar to the 26% who were struggling in January. Whereas amongst households with an income between £20,000 and £39,999 the proportion 'financially struggling' has increased from 14% in January to 26% in July. Asian and Black Londoners are also more likely to be impacted. In July 31% of Black Londoners are 'financially struggling'; this is comprised of 5% who are going without their basic needs or relying on debt for them and 26% who are struggling to make ends meet. Amongst Asian Londoners 24% are 'financially struggling'[3], comprised of 9% going without their basic needs and 16% struggling.

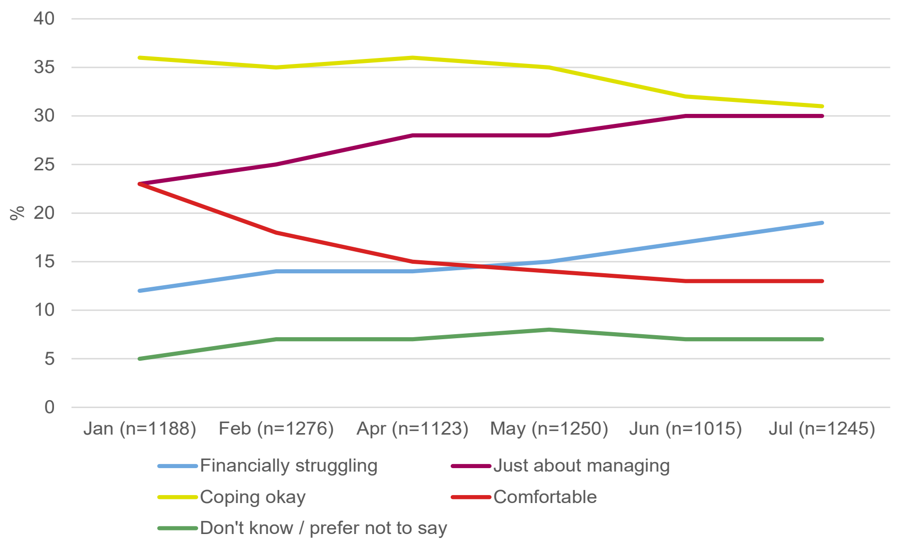


Figure 1A: Londoners' financial situation across 2022

Source: Polling by YouGov on behalf of GLA. Total sample size for each wave shown in brackets

This increase in the proportion of Londoners who are struggling financially or just about managing can also be seen in the proportion who are falling behind on key financial commitments such as rent, mortgage, household bills or credit payments. Compared to January the proportion of Londoners who have struggled or fallen behind on some or all of their payments has increased, but the extent to which Londoners are struggling differs by commitment. Those who have kept up with their rent or mortgage payments without difficulty in the last six months has dropped from 63% in January to 54% in July, with the proportion who've struggled to make payments increasing (30% in January versus 39% in July) rather than those who've fallen

1 YouGov on behalf of GLA. All figures, unless otherwise stated, are from YouGov Plc. Total sample size was 1245 adults. Fieldwork was undertaken between 15th - 20th July 2022. The survey was carried out online. The figures have been weighted and are representative of all London adults (aged 18+)

2 Those who identified as 'having to go without basic needs and / or rely on debt to pay for them' or 'were struggling to make ends meet'

3 Those who identified as 'having to go without basic needs and / or rely on debt to pay for them' or 'were struggling to make ends meet'

behind (7% in January versus 8% in July). For bills it is a similar picture, 31% were struggling to some extent in January increasing to 38% in July, with the proportion who've fallen behind at 8% in January and 9% in July. For credit commitments there have been increases in those who've struggled to keep up with payments (31% in January versus 35% in July) and those who've fallen behind (10% in January to 14% in July).

Price trends in London

- Evidence suggests that some prices in London are rising faster than in the wider UK.
- Food is one of the key pressures pushing our estimate of the capital's inflation above the national average. This will affect the lowest-income Londoners the hardest.
- Some key inflation drivers are less of a concern for Londoners, such as energy, petrol and vehicle prices. But Londoners tend to spend more on other items like rental costs where other evidence suggests price pressures may be building in the capital.
- These findings are based on the Office for National Statistics (ONS) locally-collected prices. The main findings remain true if we include centrally-collected prices, though the disparity between London and the UK is lower.

To understand better cost of living pressures we need to understand whether prices are following different trends for the same item in London compared to the wider UK. To understand these patterns, we use the ONS' locally-collected price quotes data to build an inflation measure for London. The results for the last few years are plotted in Figure 2A. Ordinarily, London prices tend to grow at a similar pace to national prices. There is clearly some volatility in the data from the pandemic period as lockdowns and social distancing disrupted data collection. However, over the last year, the capital's underlying inflation has consistently pushed ahead of the UK average. In June 2022, London's trimmed mean annual inflation rate of 8% was around 1.5 percentage points above the average for the UK. This is in line with the average gap over the last six months.

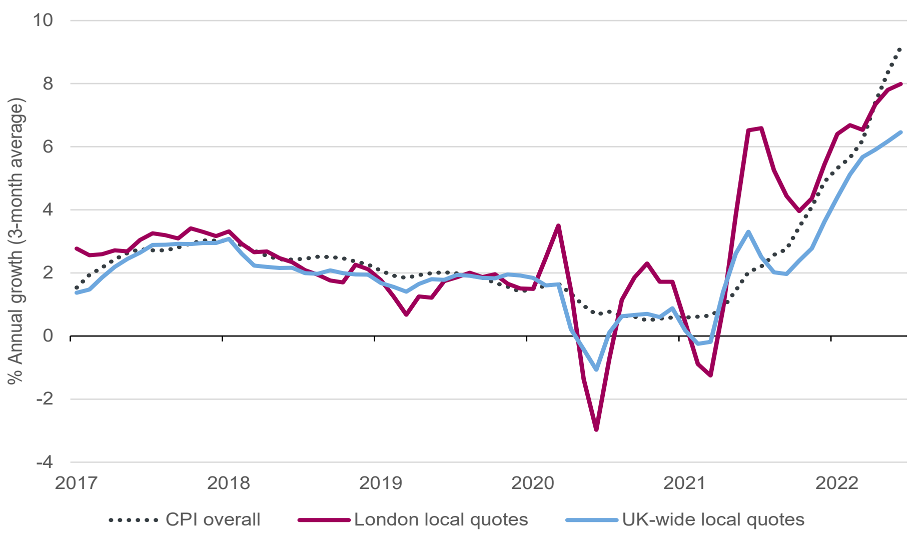


Figure 2A: Measure of inflation pressures for London and the UK

Source: GLA calculations, ONS price quotes data, as compiled in the Long-Run Price Database by Professor. Richard Davies

Looking at the contributions to both the London and UK trimmed mean inflation measures, some categories stand out in explaining the gap. Figure 3A plots the top five and bottom five categories in terms of the difference between their London and UK contributions.

Food prices are the largest contributor to the wedge between London inflation and UK inflation. Nearly 0.2 percentage points of the 1.5 percentage point gap between the capital's inflation measure and the UK average is explained by food. Meanwhile, operating transport equipment, which includes the cost of petrol for personal vehicles, and social protection (childcare, retirement homes and care in the home) both contribute between 0.1 and 0.2 percentage points less to the London measure than the UK average.

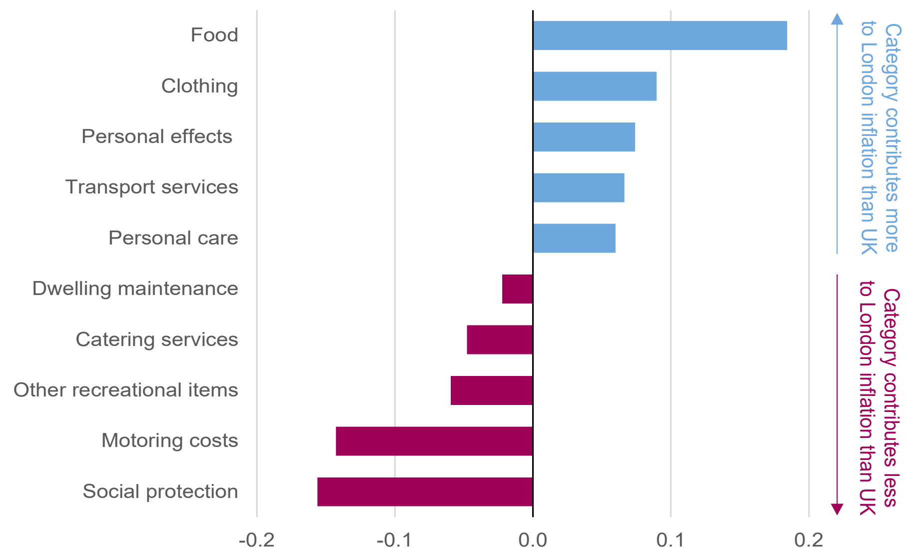


Figure 3A: Highest and lowest differences between London and UK category contributions

Source: GLA calculations, ONS price quotes, as compiled in the Long-Run Price Database by Professor Richard Davies

While the negative difference for motoring costs is in line with the fact that the average Londoner devotes less of their spending to cars and driving, the positive difference for food is different. On average, Londoners tend to devote slightly less of their spending to food than in the rest of the UK, meaning this difference must be entirely due to a more rapid rise in London's food prices compared to food prices elsewhere.

There are some mitigating pressures from differences in Londoners' spending patterns from the national average for goods whose prices are collected centrally by the ONS for the whole UK. Londoners tend to spend less on energy and vehicles than the average household across the UK, and this effect is likely to narrow the gap between UK and London inflation. If we imagine an offsetting contribution to CPI inflation based on the difference between London and UK consumption patterns, energy bills would narrow the gap by around 0.6 percentage points, with vehicle costs pulling back another 0.6 percentage points.

Summing up all the contributions to headline CPI from centrally-collected prices would probably leave London's inflation around 1 percentage point closer to the national average. However, this is still less than the overall gap from the price quotes data. And since we cannot apply the trimmed mean method to the individual item quotes for centrally-collected prices, it is unclear whether this full influence would feed through.

One remaining data gap is around rent, where the ONS collect prices centrally, but there are major differences by region. The ONS' Index of Private Housing Rental Prices[4] has London annual rent growth as the lowest in the UK at 1.7% in June. However, the Rightmove Rental Price Tracker[5] indicates asking rents for new rentals in London are growing the fastest in the UK, up as much as 15.8% annually in Q2. This suggests rent will be increasingly important for London inflation going ahead.

4 ONS, Index of Private Housing Rental Prices, (June 2022)
5 Rightmove, Rental Price Tracker, accessed 11 August 2022

Pay trends in London

- While pay in London recovered very strongly from late 2020 to early 2021, real wages have started to go into reverse as inflation picks up.
- Across the recovery, pay growth in London has tended to be strongest in the best-paid sectors, reinforcing income inequalities. Meanwhile hospitality, the lowest-paid industry in the private sector, has seen nominal pay fall 1% since February 2020.
- Labour productivity growth has been weak in London and the UK since 2019, limiting the ability of firms to absorb higher wage costs. But evidence of higher wage bids is limited.

Recent news on real wages in the UK has been ominous with the combination of accelerating inflation and slowing nominal pay growth leading to annual measures of inflation-adjusted pay growth turning negative.

Figure 4A shows how nominal pay, inflation and real pay have changed since the start of 2020 in London. The year-on-year pace of growth of nominal pay has eased (and in the latest single-month data, nominal pay in London actually fell month-on-month) while inflation has accelerated. In annual terms, we are now starting to see real pay declining.

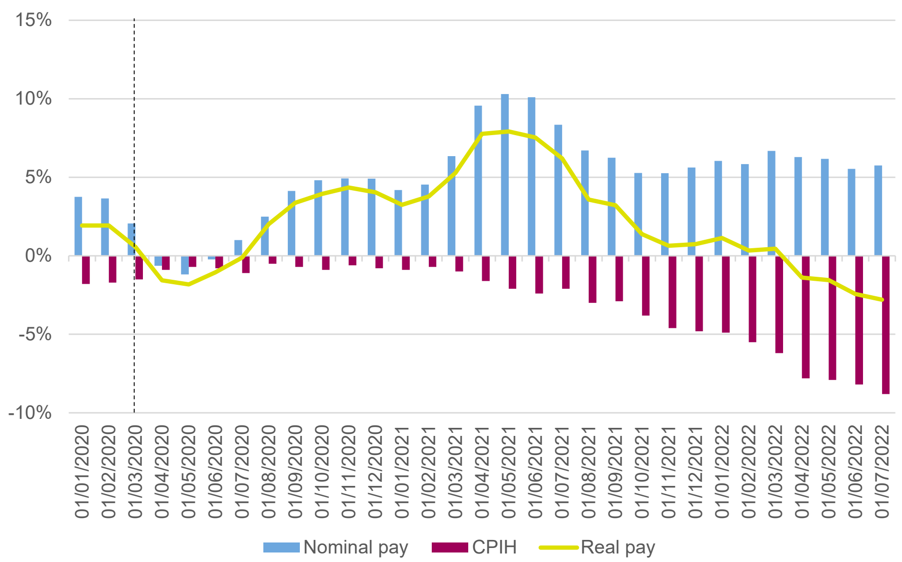


Figure 4A: Real median pay growth in London, broken down into nominal pay and inflation

Decomposition of real median pay in London, % annual change

Effect from nominal pay change and CPIH inflation, to July 2022

Source: Source: HM Revenue and Customs - Pay As You Earn Real Time Information, ONS.

Note: March 2020 indicated by dotted line. Inflation measure does not account for region-specific housing costs. Sign of inflation rates has been reversed (higher inflation rates are associated with lower real pay growth).

London also continues to see an uneven pattern of pay growth, with mostly high-paying sectors seeing the fastest wage growth, and lower-paying sectors seeing slower growth (Figure 5A). In the top right quadrant, Finance, Media & IT and Professional services were three of the highest-paying sectors in February 2020 and have since enjoyed median pay growth of above 15%, more than any other sector. Sectors with low median pay – notably Hospitality – have seen much smaller pay rises. Some of this pattern might be related to changes in the composition of employee jobs in the capital. For instance, more highly-paid but previously self-employed managers and contractors in finance and media may have become employees or employers may do more to retain highly qualified employees. But we do not have enough data to further understand the reasons.

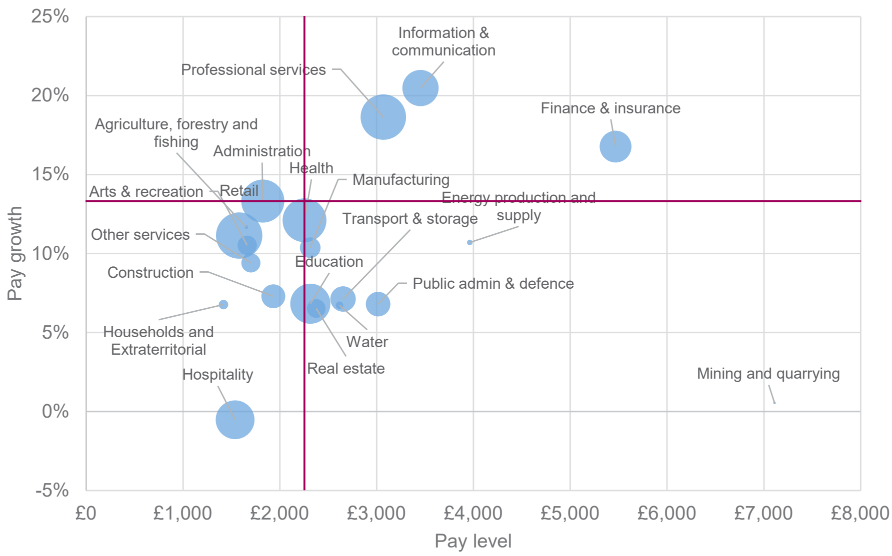


Figure 5A: Median pay growth by sector, compared to pay levels in each sector
Median pay level (horizontal axis) vs. median pay growth (vertical axis) to July 2022, London
Relative to February 2020, bubble size represents size of sector

Source: HM Revenue and Customs - Pay As You Earn Real Time Information.
Note: Estimates are based on where employees live. Vertical line indicates level of median pay in London in February 2020: horizontal line indicates change in London median pay February 2020-July 2022

Our data shows that employees in London working in sectors with the lowest levels of pay have seen the smallest pay rises since the start of the pandemic. Median pay in hospitality – which employs around 375,000 Londoners and has the lowest median pay in the private sector – has fallen by 1% since February 2020 even before rising prices are taken into account. This stands in stark contrast to pay trends in the Information and communications sector, where median employee pay was over 50% more than the London average before the pandemic, and yet grew by 20% up to July this year.

When energy prices surged after the Russian invasion of Ukraine, many commentators expressed concern over a wage-price spiral. While those concerns look less convincing as nominal pay growth has failed to keep pace with inflation, we can also look at changes in labour productivity – measured by real output per hour worked, a close approximation to firms' unit labour costs – to assess how much pressure rising wages may have on employers.

London saw similar labour productivity growth to the UK, of about 2% since 2019 and up to the second quarter of 2021, according to GLA Economics calculations based on ONS data. This low level of productivity growth means firms might have to reduce other costs or profits to pay higher wages if they are not to raise prices.

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Download the full publication.

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GLA Economics provides expert advice and analysis on London's economy and the economic issues facing the capital. Data and analysis from GLA Economics provide a sound basis for the policy and investment decisions facing the Mayor of London and the GLA group. The unit was set up in May 2002.

MAYOR OF LONDON