GLAECONOMICS

Forecast report

London's Economic Outlook: Spring 2023
The GLA's medium-term planning projections

June 2023

MAYOR OF LONDON

copyright

Published by
Greater London Authority
City Hall
Kamal Chunchie Way
London E16 1ZE

www.london.gov.uk
Tel 020 7983 4000

Minicom 020 7983 4000

Cover photograph

For more information about this publication, please contact:

GLA Economics

Tel 020 7983 4000

Email glaeconomics@london.gov.uk

GLA Economics provides expert advice and analysis on London's economy and the economic issues facing the capital. Data and analysis from GLA Economics form a basis for the policy and investment decisions facing the Mayor of London and the GLA group. GLA Economics uses a wide range of information and data sourced from third party suppliers within its analysis and reports. GLA Economics cannot be held responsible for the accuracy or timeliness of this information and data. The GLA will not be liable for any losses suffered or liabilities incurred by a party as a result of that party relying in any way on the information contained in this report.

Contents

1 Executive summary

GLA Economics' 42nd London forecast[1] suggests that:

- London's real Gross Value Added (GVA) growth rate is forecast to be 1.1% in 2023 as the cost of living crisis slows down the post-pandemic economic rebound. Growth is expected to improve to 1.8% in 2024 and 2.2% in 2025.
- London is forecast to see a 3.4% rise in the number of workforce jobs[2] in 2023, although this will slow sharply in 2024 (0.4%) and ease towards longer-term averages in 2025 (1.2%).
- Household income is forecast to decline this year by 0.5%, after a contraction in 2022, followed by a firm recovery, with growth of 2.5% in 2024 and 2.9% in 2025.
- Household spending barely grows in 2023 (up 0.3%), as despite the cost of living crisis households release savings accrued during the pandemic. Expenditure rises 1.6% in 2024 and 3.1% in 2025.

Table 1.1 summarises this report's forecast growth rates for GVA, jobs, household expenditure, and household income. Unprecedented levels of uncertainty prevail due to the cost of living crisis, the war in Ukraine and the aftermath of the pandemic. As a result, the forecasts presented in this document should be interpreted as a baseline scenario for London's economy in the medium-term. This is the most likely scenario in GLA Economics' judgement, but there are a wide range of plausible alternatives.

Table 1.1: Summary of economic forecasts under GLA Economics reference scenario

Annual growth rates (per cent)	2022[3]	2023	2024	2025
London GVA (constant 2019, £ billion)	7.2%	1.1%	1.8%	2.2%
Consensus (average of independent forecasts)		0.4%	1.3%	1.9%
London workforce jobs	4.6%	3.4%	0.4%	1.2%
Consensus (average of independent forecasts)		0.5%	1.0%	1.3%
London household expenditure (constant 2019, £ billion)	6.8%	0.3%	1.6%	3.1%
London household income (constant 2019, £ billion)	-0.5%	-0.5%	2.5%	2.9%
Memo: Projected UK RPI[4] (Inflation rate)	11.6%	9.1%	3.9%	2.6%
Projected UK CPI[5] (Inflation rate)	9.1%	6.8%	2.9%	2.0%

Source: GLA Economics' Spring 2023 forecast

Since the Autumn 2022 LEO[6], economic news has centred on two trends: inflation and economic activity both running higher than expected. Russia's invasion of Ukraine is a humanitarian disaster, and the disruption to energy supply it has created has had dire consequences for the global economy. In the UK, this

[1] The forecast is based on judgements and a recently updated econometric model built by GLA Economics. For more details see 'The new GLA Economics forecast models for London's economy, GLAE Working Paper n°98, June 2020'.
[2] Unless stated otherwise, any reference to jobs in the main text refers to total workforce jobs.
[3] Historic data for London's real GVA and workforce jobs are based on ONS actual data, while household spending and household income are based on GLA Economics estimates.
[4] RPI = Retail Price Index. Although not part of the GLA Economics forecast for London. Instead, the consensus forecasts provided by HM Treasury are reported here. See: HM Treasury (2023), 'Forecasts for the UK economy: a comparison of independent forecasts', May 2023. Data for 2022 is from the ONS and GLAE estimates, Inflation and price indices - Office for National Statistics.
[5] CPI = Consumer Price Index. Although not part of the GLA Economics forecast for London. Instead, the consensus forecasts provided by HM Treasury are reported here. See: HM Treasury (2023), 'Forecasts for the UK economy: a comparison of independent forecasts', May 2023. Data for 2022 is from the ONS and GLAE estimates, Inflation and price indices - Office for National Statistics. Since December 2003, the Bank of England's symmetrical inflation target is annual CPI inflation at 2%.
[6] GLA Economics (2022), London's Economic Outlook: Autumn 2022, December 2022

has led to a cost of living crisis as weaker purchasing power makes us all poorer. Yet UK economic data has shown continued resilience to this shock, leading to widespread near-term forecast upgrades. A strong labour market and a buffer of savings left over from the pandemic among richer households seem to be supporting consumer spending and overall activity. London has outperformed the wider UK in recent data, so upside surprises for the country should mean a resilient outlook in the capital.

But celebrations would be premature. While a UK recession now appears less likely, the outlook is still weak. Projections from the Bank of England and the Office for Budget Responsibility (OBR) point to little growth momentum this year. And medium-term challenges persist due to the UK's low investment compared to other major economies, a lingering increase in economic inactivity after the pandemic and slower trade growth after Brexit. London remains the UK's region with the highest productivity, and a hub for foreign investment and trade, but it is unlikely to escape these long-term challenges entirely.

The latest UK economic data demonstrate the balance between easing pessimism, but limited optimism. After contracting 11% in 2020 due to the pandemic shock, UK GDP grew 7.6% in 2021 and 4.1% in 2022. Yet this strong growth still leaves the UK economy slightly smaller than before the pandemic. Since Q2 2022, GDP has stagnated, with quarterly growth between +0.1% and -0.1%. So while the UK has avoided two successive quarters of contraction – technically dodging a recession – the cost of living crisis has ground the economy to a halt. The latest data show flagging momentum going into the spring, with GDP falling 0.3% in March 2023, after a flat month in February and 0.5% growth in January. While consumer spending overall increased in Q1 2023, consumer-facing sectors of the economy have struggled.

Employment data also reflect weaker momentum across the UK. The unemployment rate ticked down to 3.8% in the three months to April 2023, though this is higher than last summer's lows of 3.5%. Vacancies fell by 7% in the three months to May, suggesting the demand for workers is cooling. Yet the average number of unemployed people per vacancy, at 1.2, is still near record lows. Employment increased 0.8% in the three months to April, with a decline in economic inactivity making up part of the improvement. It is possible that some workers may be propelled back into the labour market as the cost of living makes joblessness unaffordable. The inactivity rate has fallen gently since last summer, but labour market participation remains lower than before the pandemic. Immigration may be another part of the explanation for higher participation and employment. Total UK net migration reached a record annual level of 606,000 in 2022, surprising on the upside.

The key reason for caution in the near term is rising prices. CPI inflation eased to 8.7% year on year in April, but this was higher than projected. Given that energy bills surged in April 2022, the year-on-year comparison in April 2023 should have sharply improved. But the upward surprise was broad-based. Food inflation is at its highest since the 1980s, and this is beginning to exceed the pressure from energy bills. Stripping away volatile price categories, core inflation reached a new 31-year high of nearly 7% in April. And the poorest households are hit hardest by the surging costs of essential goods. As a result, news of avoiding a recession may prove scant comfort for those on low incomes.

To fight these impacts, macroeconomic policy has had to respond dramatically. The Bank of England is engaged in its sharpest rate hiking cycle since the 1980s, and fiscal policy has seen another injection of spending to help protect households from the surge in energy costs. Both these are essential measures, but they may have challenging implications for the outlook. The longer inflation continues to outpace expectations, the higher interest rates are likely to go, dragging on the economy over time. To maintain fiscal credibility, the Government is raising taxes to their highest share of income since the 1960s, and plans painful spending cuts from next year onwards.

Tighter monetary policy is also affecting the financial sector. As interest rates rise and central banks unwind their post-pandemic asset purchases, some banks are seeing their balance sheets come under strain. Three medium-sized US banks have gone under, along with the collapse of Credit Suisse in Europe. These lenders stood out as risky, and a wider financial crisis may not be brewing. But less-regulated, non-bank parts of the financial system could pose risks. And the US Federal Reserve recently trimmed its forecast to suggest that tighter lending conditions will put the US into a mild recession later this year. International headwinds offer another reason for caution in the outlook. Box 3.1 discusses the macroeconomic and financial implications for London of tighter monetary policy in more depth.

London's economy shows more grounds for optimism, though it faces many of the same risks as the wider UK. The capital's economic output exceeded pre-pandemic levels by the end of 2021 in a rapid recovery. Revised figures show London's Gross Value Added (GVA) rose 7.8% in 2021, after a 10.6% drop in 2020. While this is only slightly better than the national average, experimental quarterly data suggest that the capital's momentum was very strong across 2021. The data has continued to show firm growth, with London's GDP up 6.8% year-on-year in Q3 2022. While we expect momentum to have pulled back in late 2022 and into 2023, our baseline sees London continuing to outpace the wider UK.

Jobs growth has been even more striking. With the Coronavirus Job Retention Scheme (CJRS), or 'furlough' cushioning the labour market, workforce jobs fell only 2.3% in London in 2020. While the 1.6% increase in 2021 was moderate, 2022 saw jobs surge 4.7%. At the start of 2023, jobs growth reached a record rate of increase of 6.4% on the year. Yet in London too, the unemployment rate has been rising, reaching 4.5% in April 2023, up from lows of 4% last summer. Inactivity rates have been volatile.

Survey data also point to greater resilience in London. Businesses in the capital have largely shrugged off the disruptions from higher inflation, with the headline PMI only dipping below neutral for two months in late 2022. The index is now back to its post-pandemic levels, and above long-term averages. Meanwhile households look surprisingly optimistic. Consumer confidence, where 0 indicates a neutral reading, rocketed from -19 in March to +13 by May. This is the fastest increase on record, and stands in stark contrast to the national average, still languishing at -27. The rapid improvement is even more surprising considering that the GLA's own polling shows that more than one in five Londoners (22%) are financially struggling, with the share increasing slightly in the last two months[7].

Given this background, the GLA Economics reference scenario for London sees the capital's output slowing this year, but to an upwardly-revised 1.1%. Growth should recover near to long-term rates in 2024. Employment growth is expected to outpace output this year given the momentum from 2022 (see Figures 1.1 & 1.2 and Chapter 5 for more detail). The continued effects of high inflation on incomes are likely to drag on consumer-facing sectors in the near term. Higher interest rates will hit manufacturing and real estate, and pose challenges to the financial sector. But we expect other core services to prove resilient due to an improved global outlook and London's continued agglomeration benefits. Neither jobs nor output are set to fall into a recession, let alone return below pre-pandemic levels (Figure 1.3).

The economic outlook for both London and the UK is subject to a high level of uncertainty. Inflation has likely peaked, but how long it takes to reach the 2% target is unclear. The slower this convergence, the harsher is the likely reaction from monetary policy, and the greater the risk of financial dislocations. An impending US recession could also affect London worse than the rest of the UK due to its higher trade exposure to the world's largest economy. And the housing market represents a risk to the outlook. London

[7] GLA (2023), "GLA cost of living polling", May 2023. YouGov on behalf of GLA. All figures, unless otherwise stated, are from YouGov Plc. See online for sample sizes and fieldwork dates. The survey was carried out online. Figures have been weighted and are representative of all London adults (aged 18+). 'Financially struggling' is a composite category of 'having to go without basic needs and / or rely on debt to pay for them' and 'struggling to make ends meet'.

house prices, which are down nearly 4% since last August[8], are a shock to owner-occupiers' household wealth, while average rents up nearly 5% on the year[9] cuts into other households' budgets.

In the longer term, the impact of Brexit continues to pose a risk to the economic outlook. The agreement of the Windsor framework on the movement of goods through Northern Ireland has eased the risk of a full-blown trade war. However, with the UK-EU trade agreement not covering services, non-tariff barriers (NTBs) making imports more expensive and the end of freedom of movement cutting EU migration, many issues remain. In particular, recent evidence suggests NTBs have raised the price of food[10], making Brexit a meaningful factor in the cost of living crisis. And while nationally, the fall in EU net migration has been outweighed by the rise in non-EU net migration, London has benefited less from this trend. Box 3.2 covers these issues in more depth.

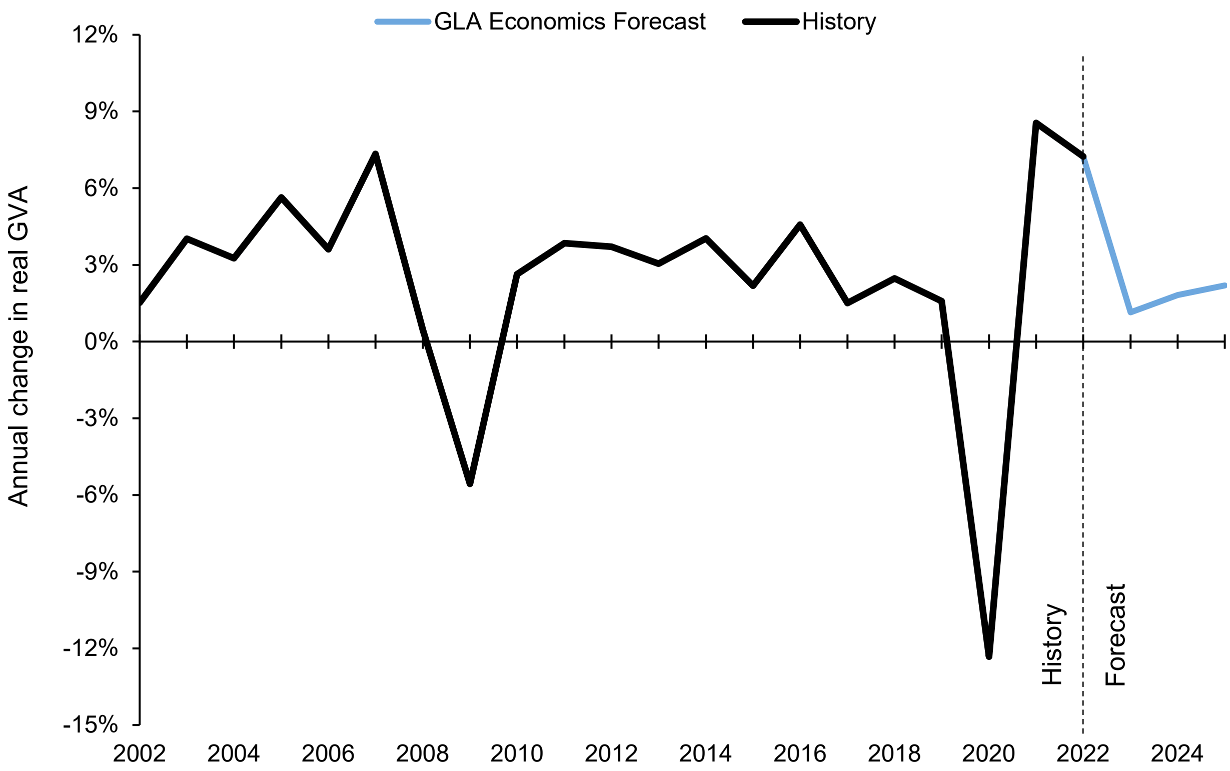
Other risks could also play a role in the medium term. At home, a large fiscal deficit and high levels of debt could prompt further tax rises and spending cuts, dragging on the economic recovery. And cuts to planned public investment projects could dent the economy's long-term potential. Productivity growth remains an issue for the UK economy, and London's has been even weaker than the national average since 2008. Further stagnation could put the capital's status as a global city and a business hub at risk. Across the world, US-China decoupling, slowing globalisation and a trend towards protectionism threaten global potential growth. The rise of green technologies offers upside potential in the medium term, but the race to cut carbon emissions also carries risks around trade, capital scrappage and sectoral reallocation. The war in Ukraine has shown how major conflicts can affect the global economy, so if rising geopolitical tensions spilled over into armed clashes, this could rapidly change the outlook. And the impact of Artificial Intelligence technologies on work and the economy remains unclear.

In response to elevated uncertainty, GLA Economics has developed macroeconomic scenarios[11] around our baseline, which we update regularly to reflect changing conditions. These are set out in Chapter 5.

In conclusion, the macroeconomic environment has improved, despite the cost of living crisis, as shown in the evolution of our London Forecast (Figures 1.4 & 1.5). After an unprecedented drop in output in 2020, there has been a good recovery. But growth is expected to slow significantly this year, and output looks unlikely to return to pre-pandemic trends. Jobs growth has been strong, and while we expect a sharp deceleration, employment looks unlikely to go into reverse. London, along with the UK, looks likely to avoid a recession, but many risks cloud the outlook. Inflation, the war in Ukraine, rising interest rates, Brexit and other pressures combine with the still-evolving fallout from the pandemic. As London's economy restructures in response, it is still unclear what the 'new normal' will look like.

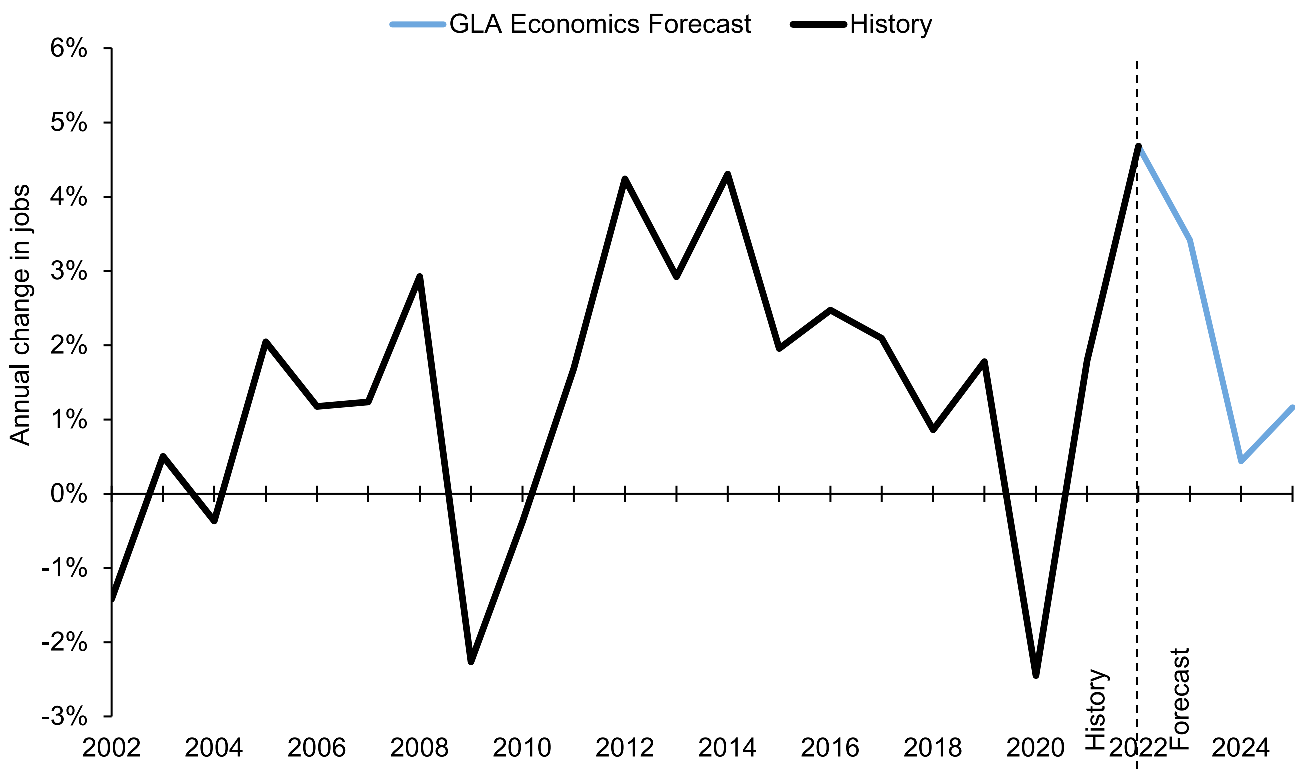
[8] ONS (2023), "UK House Price Index: March 2023", May 2023
[9] ONS (2023), "Index of Private Housing Rental Prices, UK: April 2023", May 2023.
[10] Bakker J et al (2023), Brexit and consumer food prices: May 2023 update, London School of Economics Centre for Economic Performance
[11] London Datastore (2023). 'Macroeconomic scenarios for London's economy post COVID-19'.

Figure 1.1: Historic and forecast output growth (GLA Economics reference scenario)



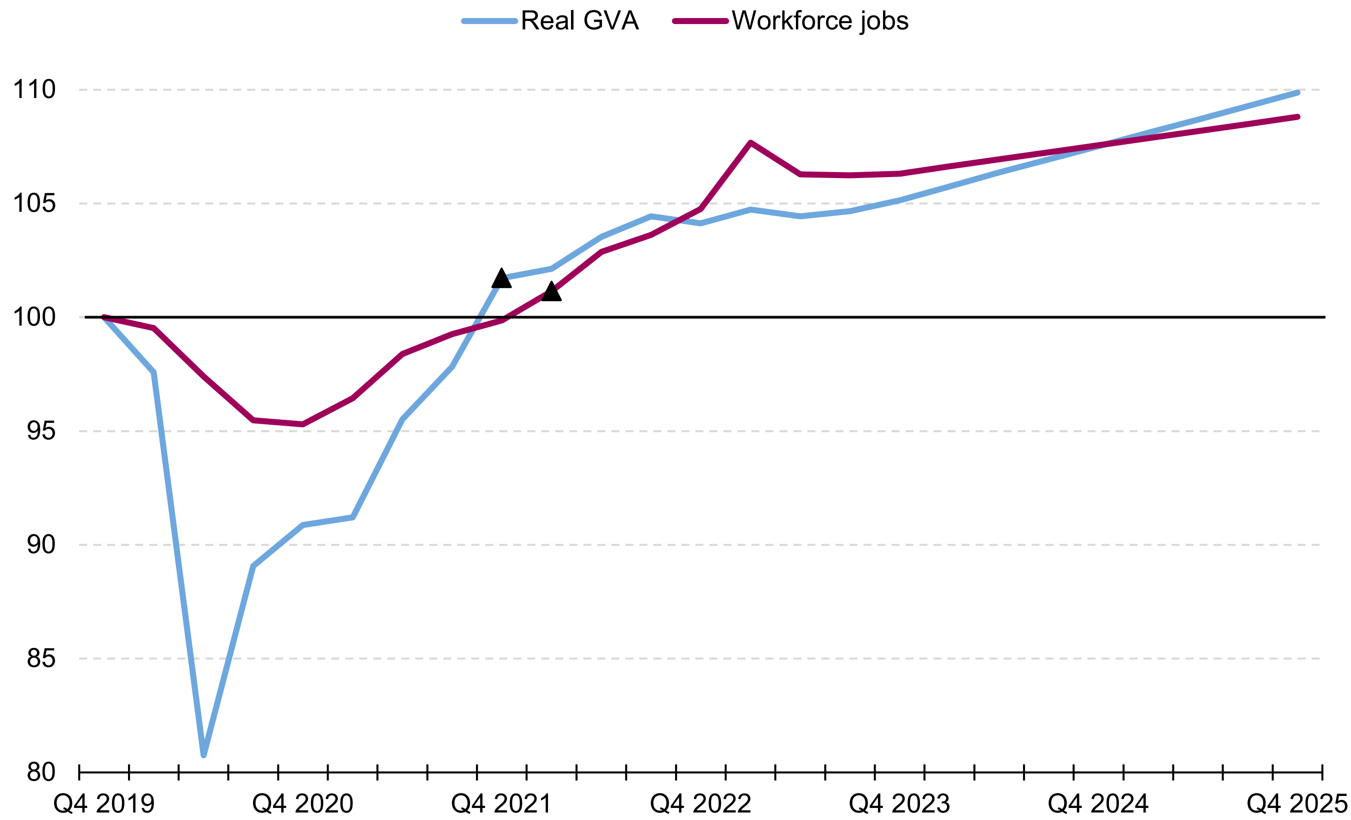
Source: GLA Economics estimates for historic data and GLA Economics' calculations for forecast

Figure 1.2: Historic and forecast employment growth (GLA Economics reference scenario)



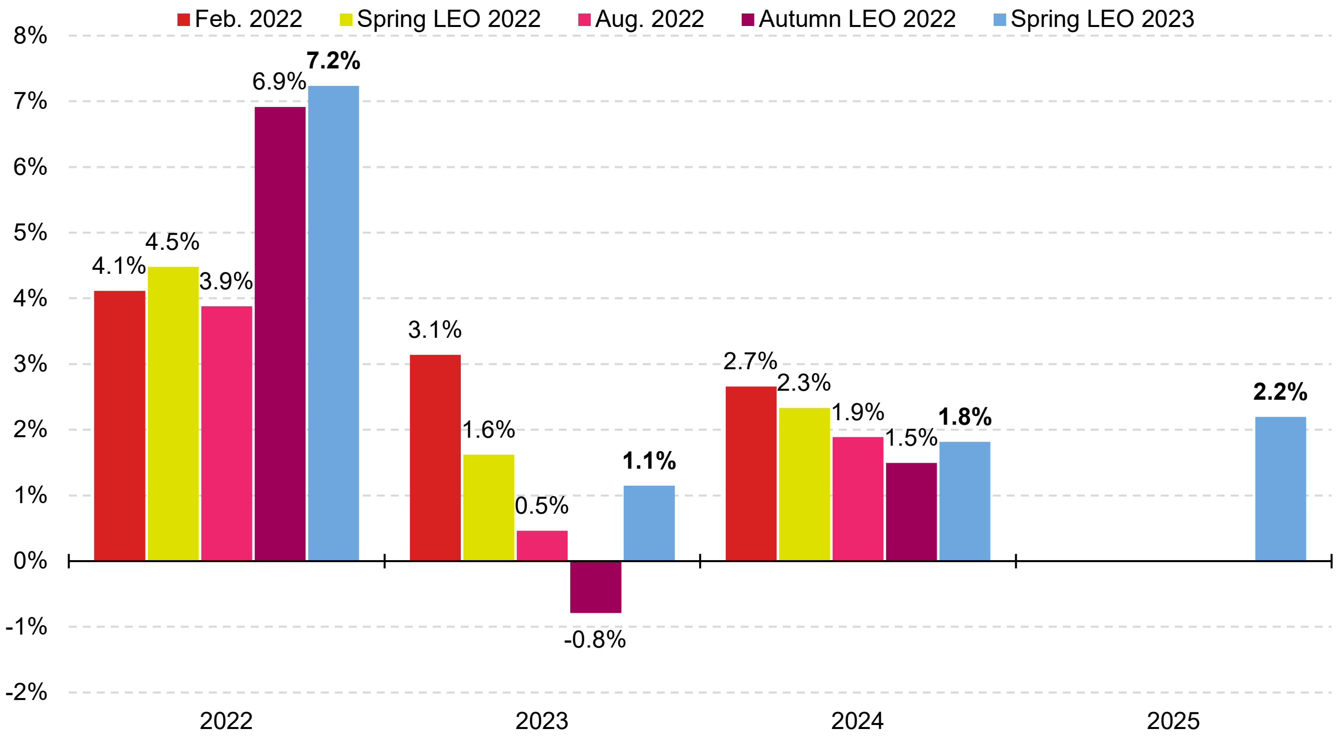
Source: GLA Economics estimates for historic data and GLA Economics' calculations for forecast

Figure 1.3: Expected shape of economic recovery under the GLA Economics reference scenario (index)



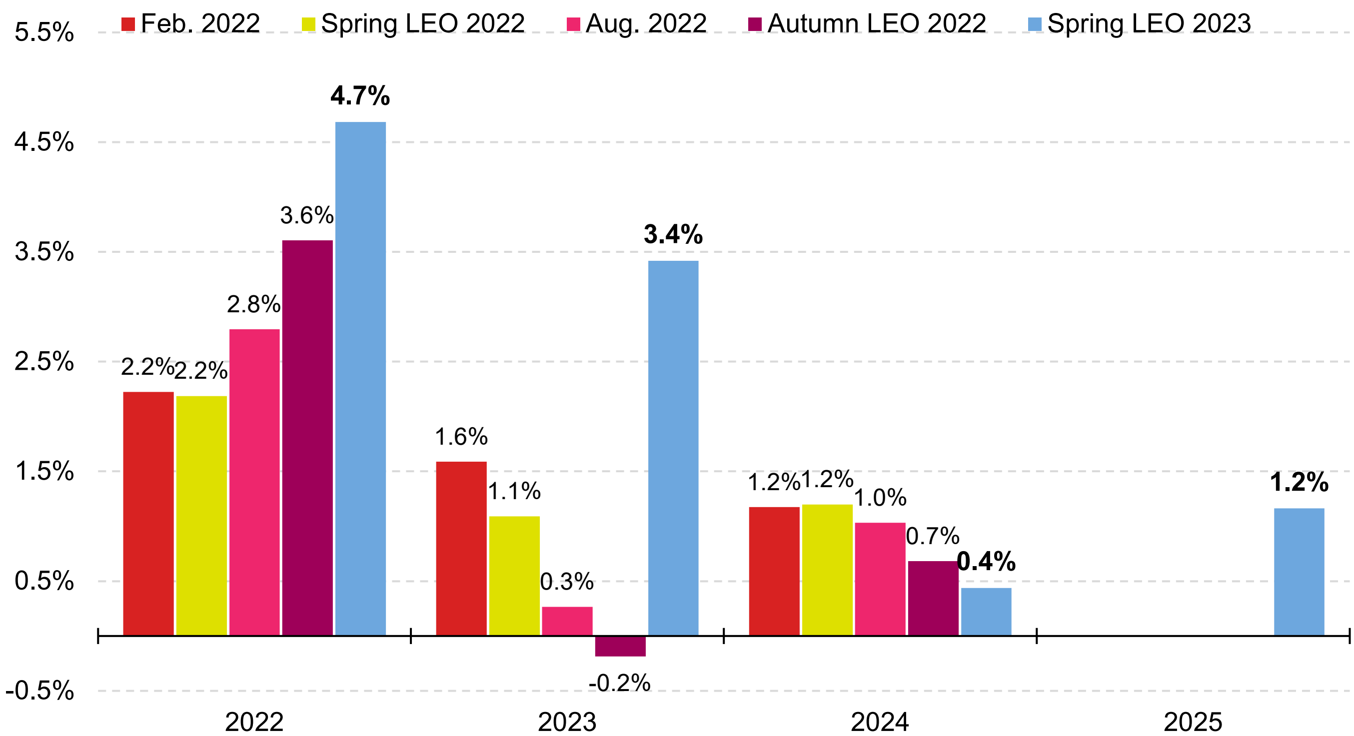
Source: GLA Economics; Note: Triangles mark the point at which pre-pandemic levels reached

Figure 1.4: Development of reference scenarios for London annual real GVA growth rates 2022-2024



Source: GLA Economics

Figure 1.5: Development of reference scenarios for London annual jobs growth rates 2022-2024



Source: GLA Economics

2 Introduction

The spring 2023 edition of London's Economic Outlook (LEO) is GLA Economics' 42nd London forecast. The forecasts are issued roughly every six months to assist those preparing planning projections for London in the medium term. The report contains the following:

- An overview of recent economic conditions in London, the UK and the world economy and includes analysis of important events, trends and risks to short and medium-term growth (Chapter 3).
- The 'consensus forecast' – a review of independent forecasts indicating the range of views about London's economy and the possible upside and downside risk (Chapter 4). In this document, 'consensus forecast' refers to the average of the independent forecasters listed under Section 2.1.
- The GLA Economics forecast for output, employment, household expenditure and household income in London (Chapter 5).

2.1 Note on the forecast

Any economic forecast represents the forecaster's view of most likely future path for the economy and is inherently uncertain as a result. Both modelling and data uncertainty, as well as unpredictable events, contribute to the potential for forecast error. Since the spring 2016 LEO, GLA Economics' forecast is based on a blend between an in-house model built by GLA Economics[12] and a set of judgements. Before 2016, previous forecasts were based on an in-house model built by Volterra Consulting Limited. GLA Economics' review of independent forecasts provides an overview of the range of alternative opinions. Independent forecasts are supplied to the GLA for the main macroeconomic variables by the following organisations:

- The Centre for Economic and Business Research (CEBR)
- Experian Economics (EE)
- Oxford Economics (OE)
- S&P Global (SP)[13]

Economic forecasting is not a precise science. Furthermore, the GLA designs these projections as a scenario consistent with the Bank of England's forecast published in May[14] and the OBR forecast published in March[15]. Our forecasts provide an indication of what is, in GLA Economics' view, most *likely* to happen, not what will *definitely* happen. As a result, there are significant risks, mainly on the downside, associated with this scenario.

[12] The forecast model used in this forecast has updated the model described in this publication: Douglass, G & van Lohuizen, A (2016). 'The historic performance of the GLA's medium-term economic forecast model', GLA Economics Current Issues Note 49, November 2016. A description of this new forecast model can be found in Orellana, E. (2020) 'The new GLA Economics forecast models for London's economy', GLA Economics Working Paper 98.
[13] S&P do not provide a forecast for household expenditure in London.
[14] Bank of England (2023), 'Monetary Policy Report', 11 May 2023.
[15] OBR (2023). 'Economic and fiscal outlook – March 2023', 15 March 2023.

3 Economic background: London recovers while the UK economy struggles

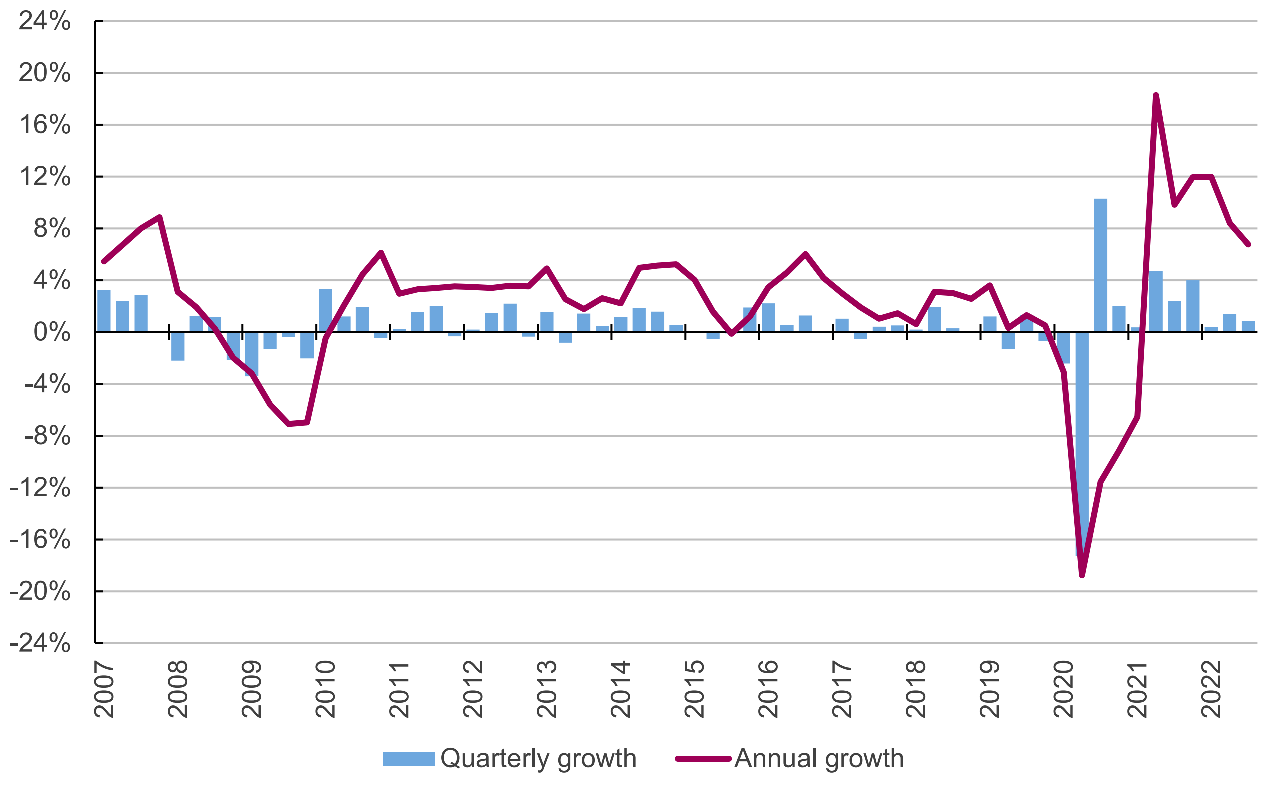
This Chapter provides an overview of recent developments in the London, UK and global economies, as well as risks to the London economy.

3.1 London's economy

According to the latest regional data by the ONS, London's economy – as measured by real gross value added (GVA) – rose by 0.9% between Q2 2022 and Q3 2022, while annual growth was at 6.8% in the third quarter of the year. The data, shown in Figure 3.1, indicate that London grew rapidly from spring 2021 through to the end of that year. The data shows that London largely shrugged off the 'Plan B' restrictions on activity in late 2021 and early 2022, putting the capital in a relatively strong position going into the cost of living crisis that now dominates the outlook.

By Q3 2022, London's economy reached 4.4% above its pre-pandemic peak in 2019 Q4. Despite a deep fall in output in Q2 2020, the capital exceeded its pre-pandemic level of output (Q4 2019) in Q4 2021. By comparison, the UK economy had yet to do this.

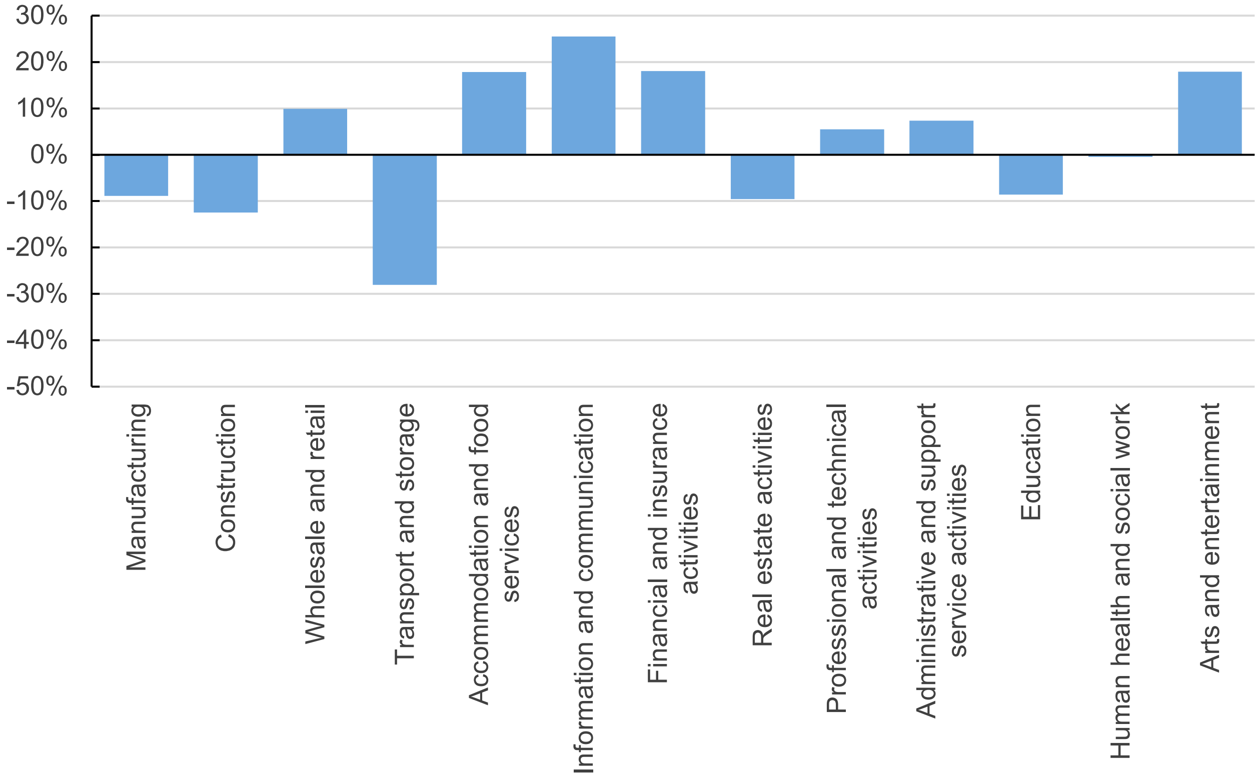
Figure 3.1: Real GVA in London (Q1 2007 – Q3 2022)



Source: GLA Economics based on ONS - UK regional GVA and GDP data.

The pandemic impact and recovery have been unevenly spread across sectors' output in London. Across the UK, in-person services suffered deep losses, demand for goods picked up and white-collar service sectors were often protected by the ability to do work from home. There was a similar pattern at a London level, but more recently there has been a shift in sector activity, perhaps reflecting the relative strength of London's economy. The capital's largest industries by output that were comfortably above their pre-pandemic levels of activity by Q3 2022 includes the consumer-facing sectors of Accommodation and food services, and the Arts. Some of the sectors in which London specialises, specifically Information and communication, and Finance, have also done well (Figure 3.2). At the same time, some other core sectors, namely Professional services and Real estate have done less well.

Figure 3.2: Proportionate change in real GVA by industry* in London Q4 2019 – Q3 2022



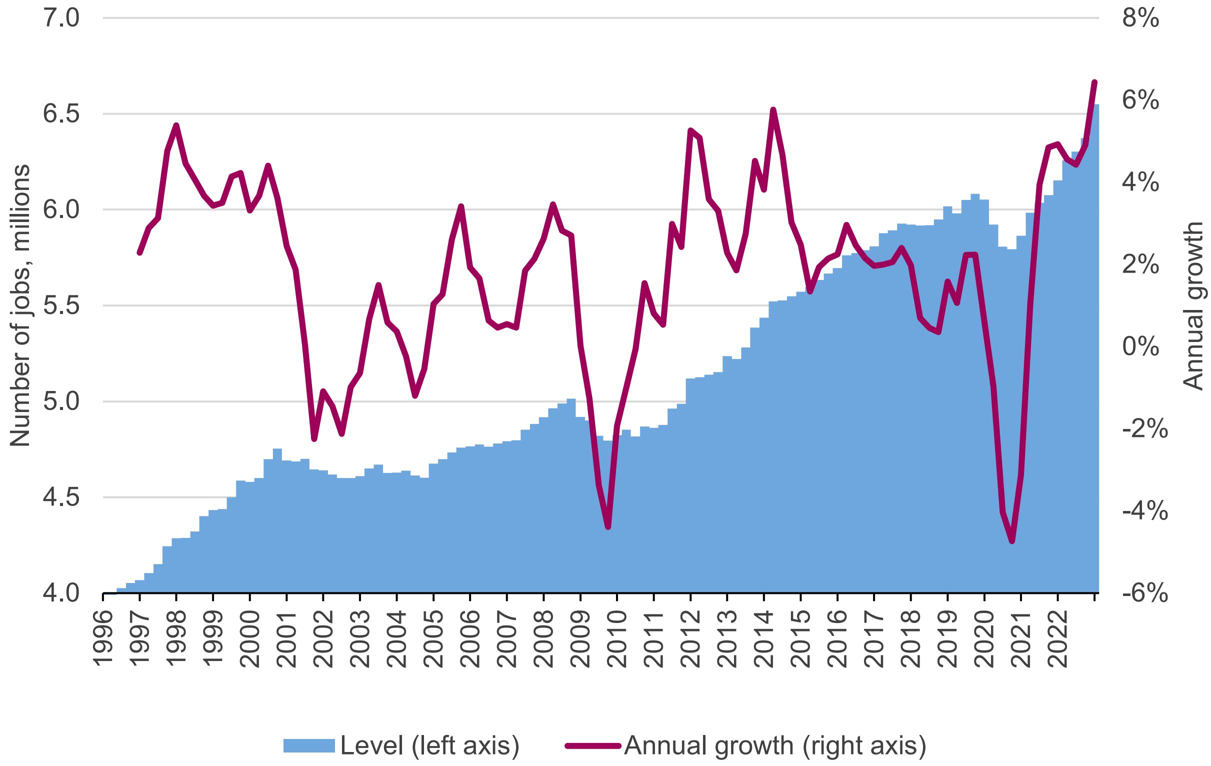
*Source: GLA Economics based on ONS – UK regional GVA and GDP data. *The following smaller industries have been excluded for simplification purposes: Primary sector and utilities, Public administration and defence, Other service activities, and Activities of households.*

While London's economy is through the downturn from the pandemic, there will be a legacy on its structure. The cost of living crisis is likely to exacerbate some of those effects, due to its primarily consumer-focused impact. As real incomes fall from higher taxes and lower wages after inflation, leisure activities and property purchases will become less affordable, putting continued pressure on Accommodation, the Arts and Real estate. At the same time, London's strength in some of its core sectors may be propping up the incomes of some, boosting spending on Accommodation and the Arts. For more detail on some of the major shocks affecting the outlook, Box 3.1 discusses the ongoing effects of rising interest rates on London's financial sector, while Box 3.2 looks at the ongoing impact of Brexit on London's economy.

The latest data on London's labour market is for April 2023. The employment rate shows the share of residents aged 16-64 who are in work. This figure stood at 75.6% in the three months to April, rising 0.5 percentage points on the year, but still 1.1 percentage points down from the three months to February 2020. The unemployment rate shows the share of the resident population aged 16 and over who are unemployed but who are seeking and available for work. This figure stood at 4.5% in the three months to April, 0.3 percentage points lower than a year earlier, and unchanged from the three months to February 2020. By comparison, the UK's employment rate stood at 76.0% in the three months to April and the unemployment rate was 3.8%.

The trend in the number of jobs in London's economy has been less volatile than the trend for output. Job numbers fell gradually over 2020 before picking up over 2021. The government's furlough scheme, officially known as the Coronavirus Job Retention Scheme, is credited with keeping workers attached to their employers during the crisis and enabled employers to give work to existing employees as the economy picked up, saving on redundancy and recruitment costs. The London labour market has now recovered and had 467,000 more workforce jobs in Q1 2023 than its pre-pandemic peak (Figure 3.3). The labour market remains tight with vacancy numbers holding up despite uncertain economic conditions.

Figure 3.3: Number of workforce jobs in London (Q1 1996 – Q1 2023)



Source: ONS Workforce Jobs

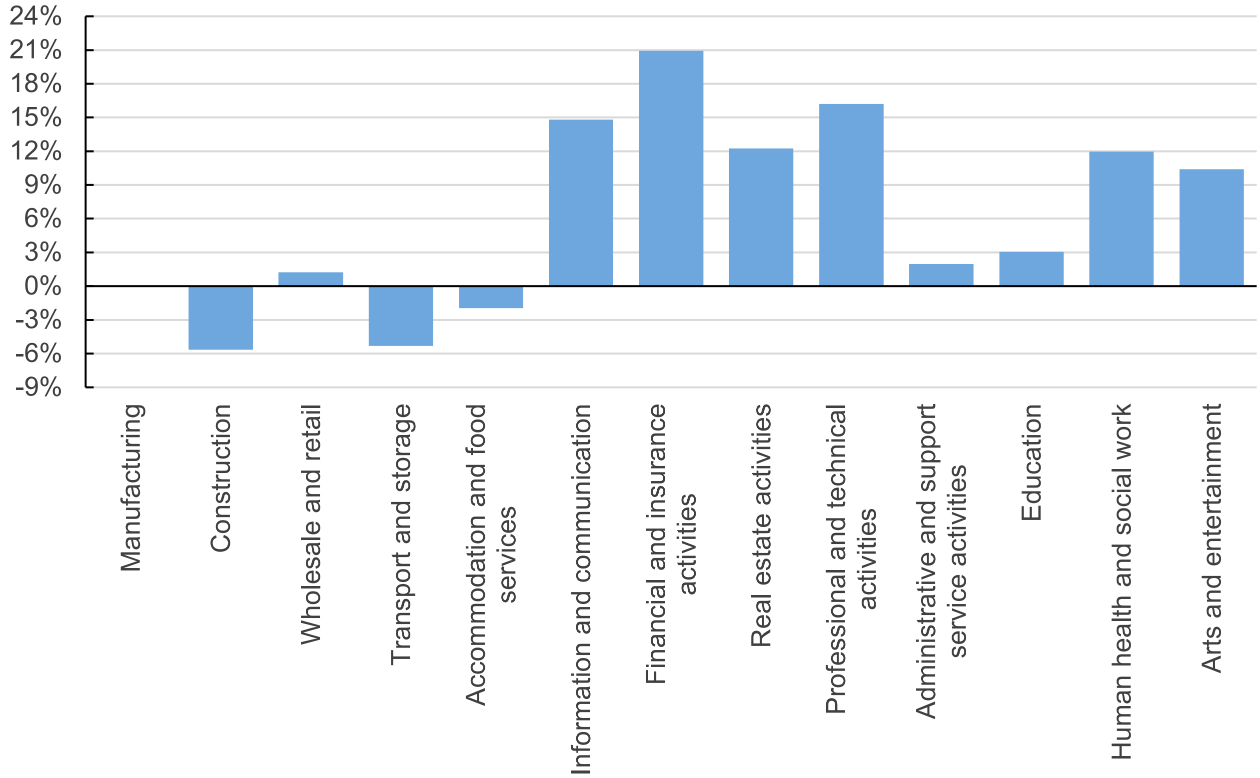
Other dynamics paint a less healthy picture for London's workers. Part of the tightness in the labour market is also due to a rising inactivity rate – the share of working-age adults who are not in work and not looking for work. After initially remaining low during the pandemic, this figure has now ticked up to 1.0 percentage points above its pre-pandemic level in the three months to February 2020. At 20.7% in the three months to April 2023, London's inactivity rate is close to the UK rate of 21.0%, having been lower from early 2020 to spring 2022. It has, though, come down this year from a rate of 21.9% in the quarter to January. While two-thirds of inactive Londoners said they were likely or certain to work again in the future, only one-fifth wanted work immediately. The number citing long-term illness as the reason for inactivity has risen, suggesting that the pandemic may be playing a more long-term role in the labour market. For more information on this GLA Economics has recently published a report on out-of-work trends[16].

As the economy restructures, with jobs moving into sectors which have benefited from the pandemic such as Digital activities, there are likely to be continued job losses in sectors which have done less well. The data in Figure 3.4 show that there has been solid jobs growth since the pandemic in the Finance, Professional

[16] GLA Economics (2022), "Out-of-work trends in London", November 2022. Accessible on the labour market analysis page.

services, Information and communication, Real estate, Health, and the Arts. In comparison, Transport and storage, and Construction all see jobs more than 5% below pre-pandemic levels. As for output, the pattern of the re-structuring of London's economy is changing as it recovers from the pandemic.

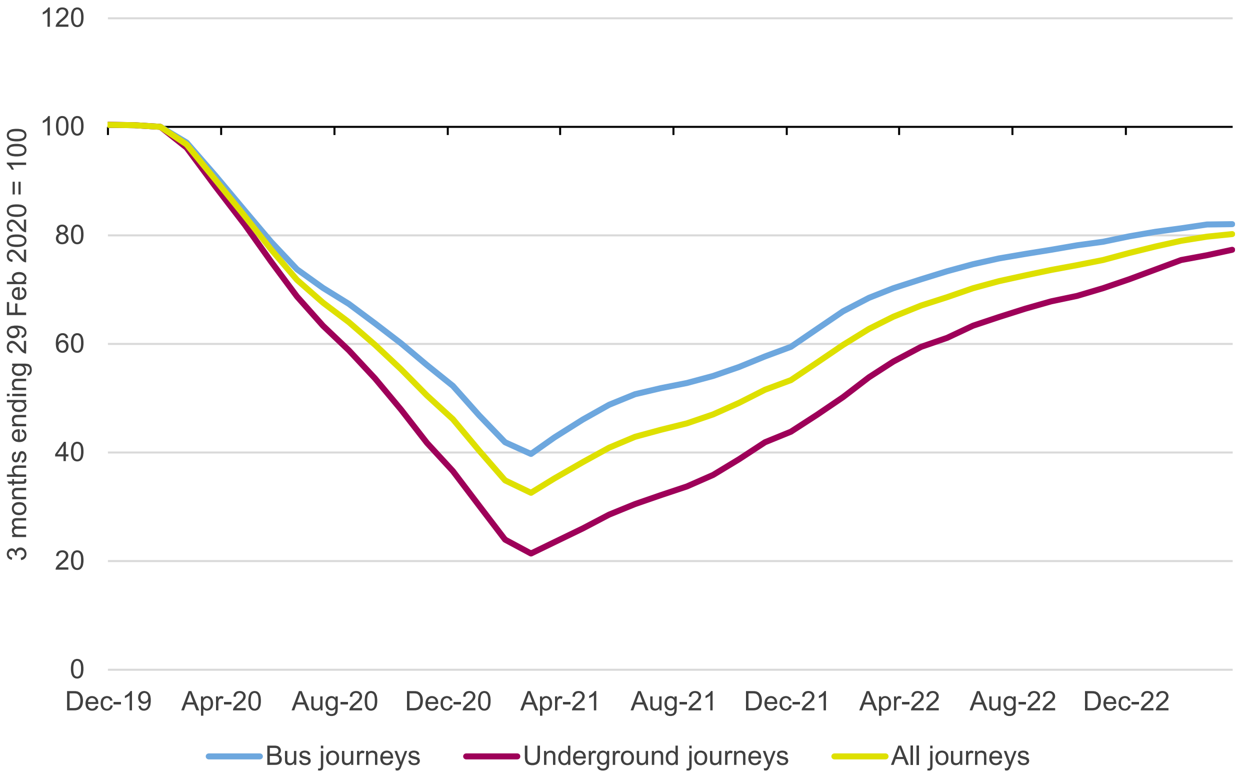
Figure 3.4: Proportionate change in workforce jobs by industry* in London Q4 2019 – Q1 2023



*Source: GLA Economics based on ONS – workforce jobs data. *The following smaller industries have been excluded for simplification purposes: Primary sector and utilities, Public administration and defence, Other service activities, and Activities of households.*

Outside the formal GVA and employment figures, we can get more timely indications of London's activity levels from weekly public transport use data. While the trends do not distinguish between journeys to work or journeys for leisure, both factors are key drivers of economic activity in London. While TfL journeys had been growing steadily in 2019, the first pandemic lockdown all but wiped out public transport use. There has, though, been a solid recovery and transport use is at around four-fifths of its former level (Figure 3.5). The decline in transport use reflects the shift to hybrid working, and the reduction in international travel. This negatively affects London's economy through lower spending in the Central Activities Zone.

Figure 3.5: Level of public transport passenger journeys in London relative to pre-pandemic



Source: GLA Economics based on Transport for London data. Notes: data is twelve-month moving average; each series uses the twelve-month moving average at 1 to 29 February 2020 as its index reference; Last data point is the 30-day period ending on 29 April 2023.

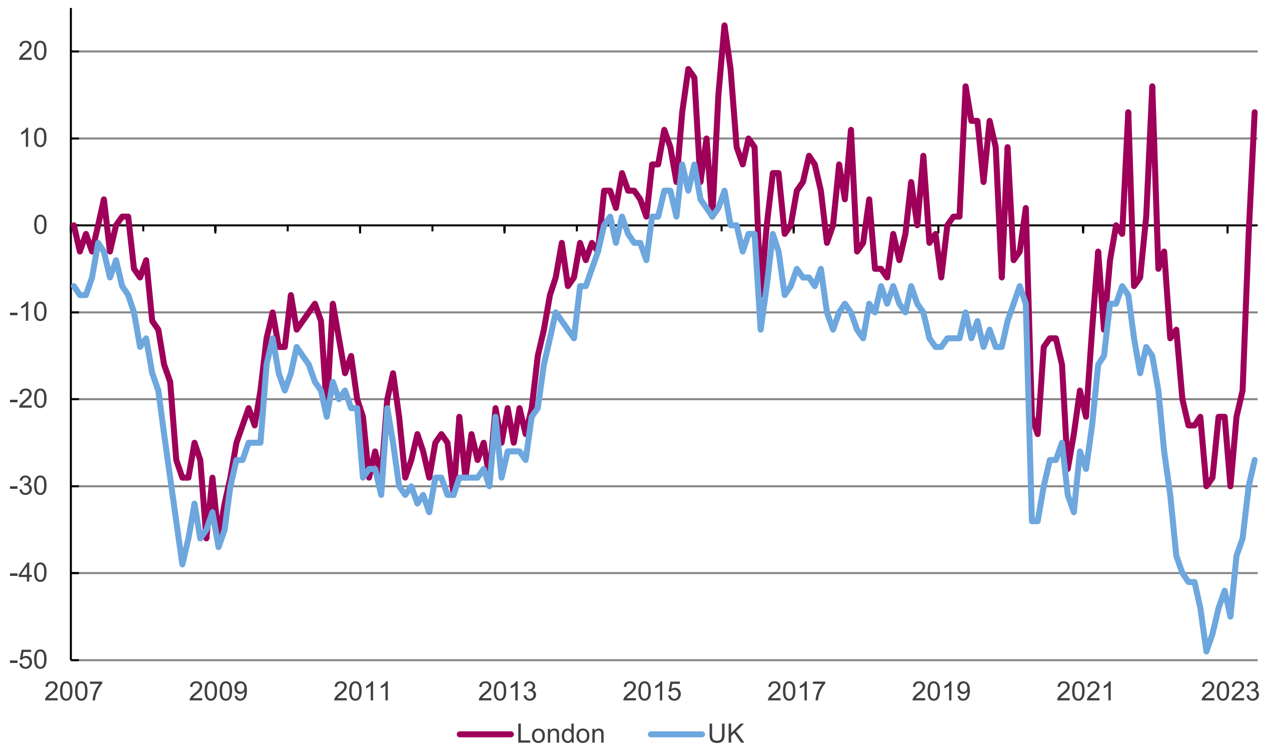
The GfK Consumer Confidence Barometer, a consumer confidence index, is a reliable indicator to measure how private consumption sentiment in London is being affected by overall uncertainty[17]. The data suggest that there has been a long-term trend of London households being more optimistic than national averages since 2016 (Figure 3.6). This trend held up during the pandemic. While consumer confidence dropped sharply in London and the wider UK in the immediate aftermath of the pandemic, London consumers did not drop to the levels of pessimism seen after the financial crisis – unlike the UK average. Both London and UK households saw confidence undergo a stop-start recovery after the first lockdown until reaching pre-pandemic levels by around July 2021. In London's case this meant a return to positive readings, while the UK figure has been negative since summer 2016.

This relief was short-lived, however, with sentiment turning negative during the third wave of the pandemic in late 2021. The losses over last winter only extended as inflation began to accelerate sharply and the rising cost of living came to the fore of consumers' minds. Strikingly, the UK gauge fell past the pessimism seen after the financial crisis, and hit record lows since the data series started in 1974. Still, households in the capital remained less pessimistic than the wider UK, with the London gauge never reaching the worst of the financial crisis lows. There was an uptick in sentiment in Autumn 2022, possibly due to the arrival of energy bill assistance from the government. This proved transient, although there has been a strong improvement in consumer sentiment through 2023, perhaps reflecting that households are adjusting to the persistence of

[17] The GfK Consumer Confidence Barometer reflects people's views on their financial position and the general economy over the past year and the next 12 months. A score above zero suggests positive opinions; a score below zero indicates negative sentiment.

the cost-of-living crisis. Consumer confidence in London is positive once again, although UK levels remain at those seen during the financial crisis.

Figure 3.6: GfK Consumer Confidence Barometer for London and the UK

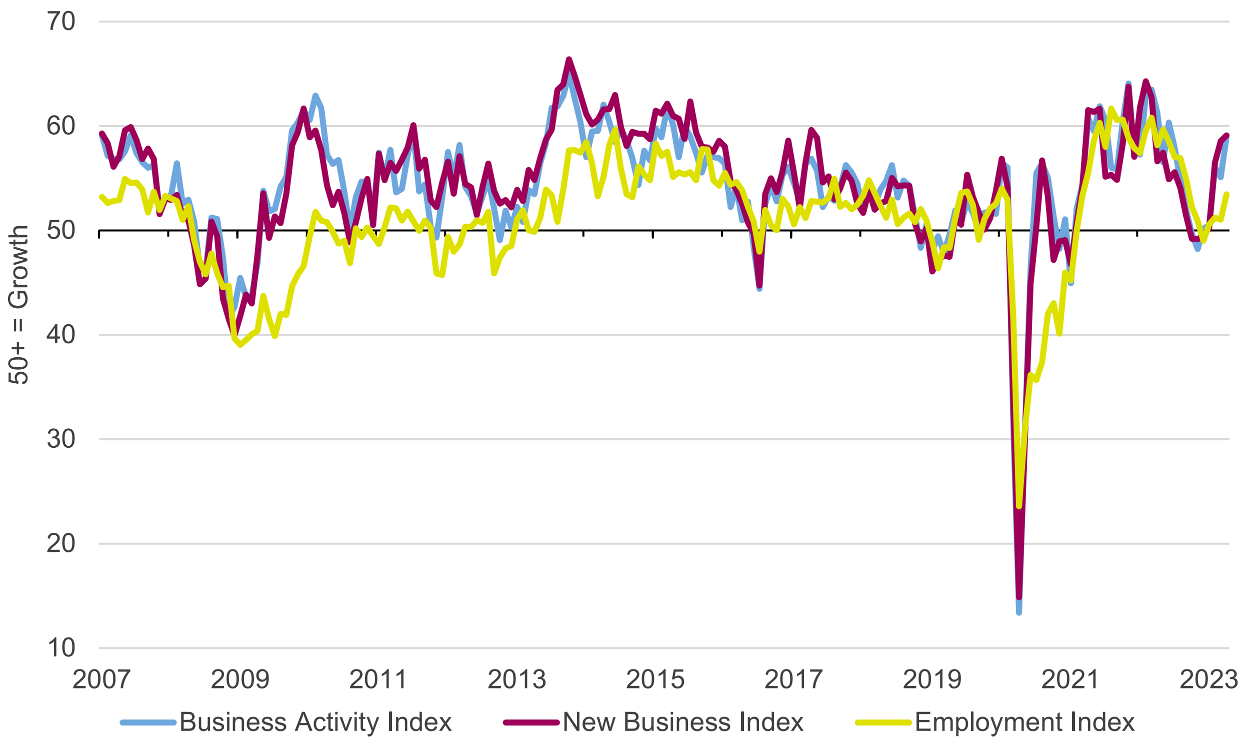


Source: GLA Economics based on GfK-NOP data. Last data point is May 2023.

Another high frequency indicator that correlates strongly with economic activity is the Natwest London Purchasing Managers' Index (PMI) survey, which focuses on the sentiment of businesses in the capital[18]. It does so by asking private sector firms about the month-on-month trends in a variety of business indicators like workload and employment. PMI data in 2019 prior to the pandemic held slightly above 50 on average – indicating slightly expanding conditions. With the emergence of COVID-19 these indicators were dragged down to all-time lows in March and April 2020. A rapid, if interrupted, recovery then began as soon as summer 2020. By spring 2021, the PMI figures had pushed well above pre-pandemic levels, indicating rapid growth for London businesses (Figure 3.7). While London business sentiment proved resilient in the third wave of the virus and the initial onset of the cost of living crisis, the gauges for overall business activity and new business subsequently fell below 50 again. Over 2023, sentiment has been positive, and improving gradually suggesting that businesses have managed the effects of the pandemic, and are learning to live with the cost of living crisis.

[18] PMI index readings are based around the 50 no-change mark. Readings above 50 suggest an overall increase in that variable, while readings below suggest an overall decline. Readings exactly at 50 suggest no-change in that variable compared with a month earlier. Moreover, the further the index reading is away from the 50 mark, the faster the rate of growth or decline.

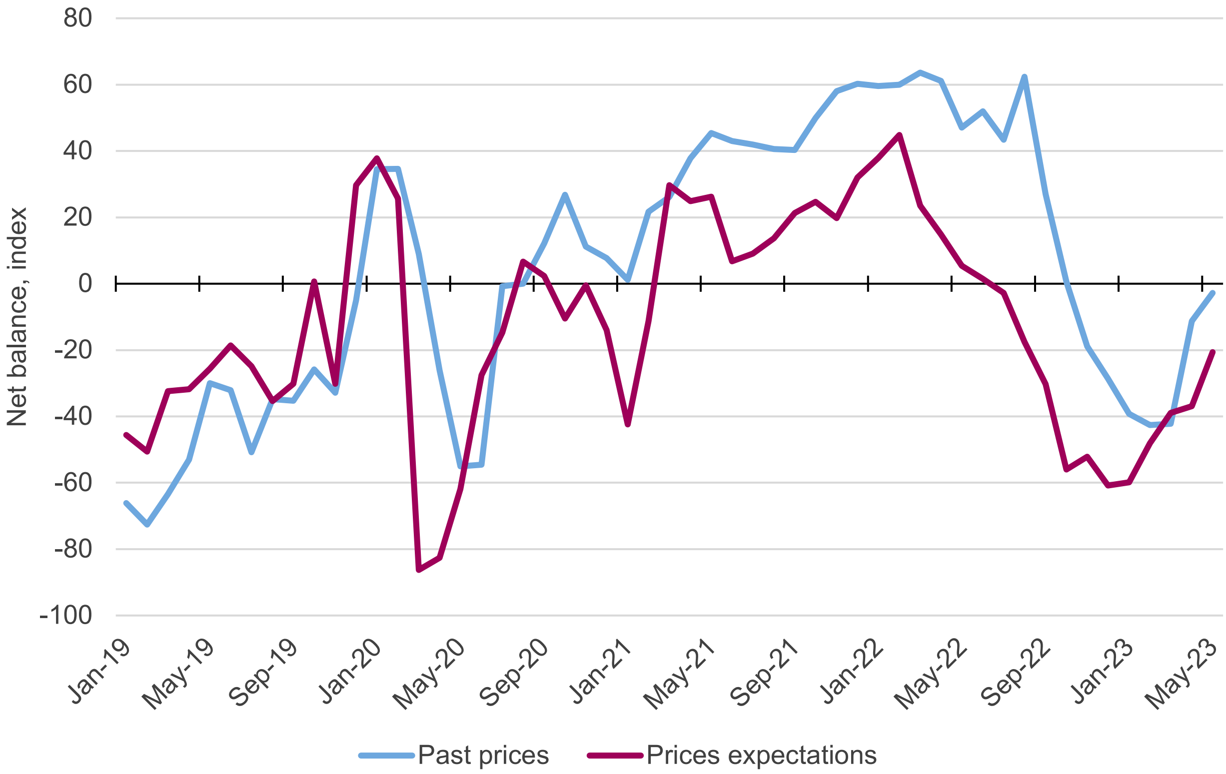
Figure 3.7: Natwest PMI Business Activity for London, New Business and Employment Indices



Source: GLA Economics based on IHS Markit data. Last data point is April 2023.

The housing market had been picking up prior to the onset of COVID-19 as gauges of recent and expected house prices had been rising through 2019. The pandemic immediately shocked both gauges, with the backward-looking measure falling to early 2019 levels and the forward-looking measure crashing to levels comparable with the financial crisis. Both gauges staged a volatile recovery from summer 2020 to spring 2021 as virus cases and activity restrictions fluctuated (Figure 3.8). The backward-looking measure remained strong through to August 2022, while the forward-looking gauge fell back in summer 2021 before rising again to a peak in February 2022 and then dropping once more. Both gauges have now turned negative amid affordability concerns due to mounting inflation, falling real incomes and rising interest rates. The measure for expected prices fell first, turning negative in July 2022, while for the measure of recent prices it was in October 2022. The measure of recent prices had returned to near neutral by May 2023.

Figure 3.8: RICS house prices net balance index for London, change during last three months



Source: GLA Economics based on RICS data. The net balance index measures monthly the proportion of property surveyors reporting a rise in prices minus those reporting a decline in the last three months. Last data point is May 2023.

Beyond the challenges that London's economy is facing in the immediate outlook, we expect that the combination of two economic shocks in quick succession is likely to result in permanent economic scarring. It is less clear how the scarring will roll out over the sectors of the economy and if increasingly tight liquidity leads to widespread closure of otherwise-solvent firms. As part of these trends the sectoral composition of London's economy appears also to be shifting as responses to the pandemic fade away, and some more familiar patterns re-assert themselves.

Box 3.1: The impact of rising interest rates and financial turbulence on London's economy

Higher interest rates and quantitative tightening are reversing the post-2008 global policy regime, with broad-ranging consequences. Massive pandemic policy stimulus combined with stretched supply chains to spark cost pressures around the world, which became a crisis when energy prices surged after Russia's invasion of Ukraine. Central banks have responded to these inflationary pressures by sharply tightening monetary policy. This shift will drag on economic activity, but the results may vary across UK regions and sectors. The sudden switch from easy money to tight lending is also generating turbulence in the financial sector, culminating in a set of bank failures. These trends look unlikely to overflow into a full financial crisis, but it is important to examine the risks, as financial services remain a major force in London's economy – making up more than 20p in every £1 of its output in 2021[19]. This box sets out the macroeconomic and financial consequences of rising interest rates for London and highlights potential vulnerabilities.

[19] ONS (2023), "Regional economic activity by gross domestic product, UK: 1998 to 2021", April 2023.

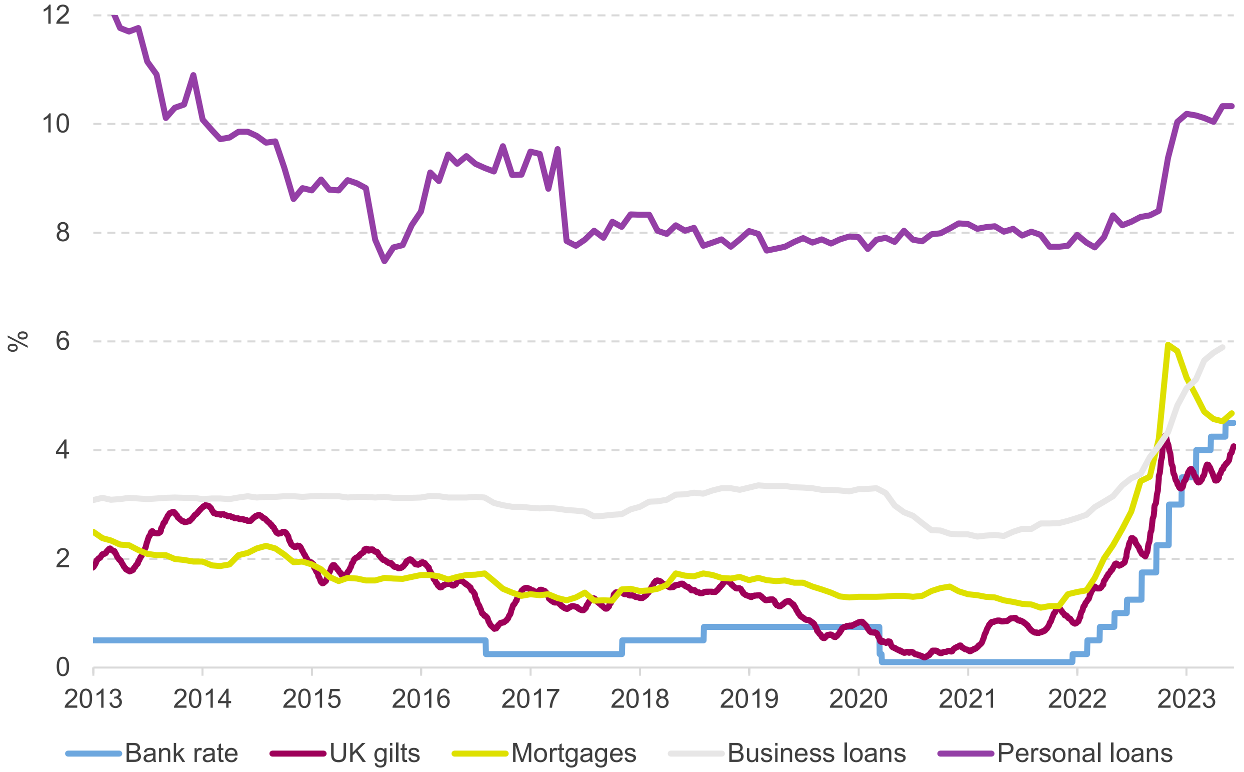
London's economy should be relatively shielded from the macro effects of higher rates

The Bank of England is not alone in hiking interest rates since the beginning of 2022. The European Central Bank (ECB) and the US Federal Reserve have hiked interest rates by 3.75 percentage points (ppts) and 5ppts respectively. Lying in the middle, the Bank has hiked from a policy rate of 0.1% to 4.5% in just over a year. This represents the sharpest rise in interest rates since the late 1980s[20], to match the largest UK inflation surge in over 40 years. While such a sharp tightening of policy should help inflation return to target sooner, this comes at the expense of slower economic activity. The transmission from interest rates to output is well-studied, and tends to come under four broad headings. There is a borrowing cost channel, a credit channel, an asset price channel and an exchange rate channel. The effects of the asset price channel are hard to differentiate at the regional level, and the exchange rate channel receives less conclusive support in data studies[21]. Exchange rate effects will also be hard to pick out when the pound is already fluctuating due to wider investor sentiment. As a result, we focus on the first two channels and what they could mean for London.

Borrowing costs are certainly up (Figure 3.9). UK government bond yields, after easing from the shock of last September's 'mini-budget'[22], have risen again after upside inflation surprises and Bank of England rate hikes[23]. This has had varied impacts across lending rates. Fixed-term mortgage rates are creeping up again, but are still below their peak from last September[24]. Yet personal loan interest rates never fell from their autumn spike. A loan for £5,000 averaged an interest rate of about 8% in the five years before September 2022, but this jumped to 10% by November, where rates have remained[25]. Business loan interest rates are averaging just under 6%, compared to a reasonably stable average of 3.1% from 2011 to 2019[26]. Higher borrowing costs will drag on significant parts of economic demand. For households, it is now much more expensive to borrow for major purchases, such as cars, furniture and appliances. For businesses, borrowing to invest is more costly.

[20] Bank of England database, Official Bank Rate series, indicators IUQABEDR and IUQLBEDR
[21] Choi, Willems & Yoo (2023), "Revisiting the monetary transmission mechanism through an industry-level differential approach", Bank of England Staff Working Paper No. 1,024, May 2023.
[22] Following the Truss Government's decision to announce a series of unfunded tax cuts without an official forecast in September 2022, UK government bond yields surged, also driving up mortgage interest rates.
[23] Bank of England database, 10 year nominal par yield on British Government securities, indicator IUDMNPY
[24] Bank of England database, 2 year fixed rate 60% LTV household mortgage interest rate, indicator IUMZICQ
[25] Bank of England database, Interest rate on personal loan of £5k to households, indicator IUMBX67
[26] Bank of England database, Interest on non-variable loans to non-financial corporations, indicator CFMHSDC

Figure 3.9: Interest rates have risen across the board



Source: Bank of England; Note: Bank rate is official Bank of England policy rate, daily; UK gilt rate is the 10-year yield, 4-week average; Mortgages is the 2-year fixed rate 60% Loan-to-Value interest rate, monthly; Business loans is the weighted average interest rate on outstanding loans to private non-financial corporations, monthly; Personal loans is the average interest rate on a £5,000 unsecured personal loan, monthly

Higher borrowing costs will have varying effects across the UK's regions. Studies have shown that the impacts are sharpest in areas where a larger share of output depends on durable goods[27]. While parts of the retail sector might be more vulnerable, the impact is strongest for durables manufacturing. London's very low share of output from manufacturing should therefore dampen the macroeconomic impact of higher interest rates. While the UK economy as a whole gets just over 11% of its output from manufacturing, that share in London is just 2%. Overall, London's output is less dependent on goods and production sectors, with services making up 92% of the capital's economy, compared to 78% at the national level. On the consumer side, wholesale and retail also makes up a smaller share of London's economy – just 6.4% compared to the UK average of 9.1%. And while London has the largest stock of household debt in the UK[28], its households also have a much higher average income[29]. At 94%, London's ratio of total household debt to gross disposable income is middle of the regional pack. In fact, the ratio between total non-mortgage debt of households in the capital and its total income is the lowest in the UK. Overall, higher interest rates may matter less for London's outlook, especially on the business side.

Meanwhile, borrowing will also become costlier through a credit channel. Higher interest rates lower firms' net worth by cutting equity valuations, which reduces the amount of collateral firms can offer up for their loans[30]. This makes them less exposed to losses, which could increase their risk tolerance. As a result, lenders tighten their standards and charge a premium to compensate for the extra risk, again raising borrowing costs. This translates into fewer approvals and a slower pace of consumer and business loans. Business loans were contracting 5.2% on an annualised basis in the first three months of 2023[31], while personal loans were close to no monthly growth[32]. Tighter lending standards will have a sharper effect on businesses with less collateral to offer up as insurance against default. This tends to mean smaller, younger firms[33].

The relative impact of the credit channel on London is tricky to isolate. Despite serving as a headquarter for many major national companies, overall London has a slightly larger than average share of small businesses by headcount. Across the UK, just over 78% of firms have less than five employees, while in London the figure is above 81%[34]. But this result may not be conclusive, as London's distribution of firms by turnover size largely mirrors the UK average. And while London has tended to see higher business birth rates than the national average, its new firms' survival rates tend to be in the middle of the regional pack[35]. London does seem to have a particularly larger-than-average share of small firms in manufacturing and construction. Two thirds of UK manufacturers employ fewer than five workers, but for London that share is over three quarters. So while those sectors matter less for London's overall economy, they may face a particularly difficult outlook compared to producers and builders elsewhere in the UK.

Rising interest rates are also creating financial turbulence, but not yet a crisis

But the impacts of the sharp tightening in monetary policy are not only macroeconomic. The global financial sector has been thrown into turbulence as credit has dried up, with some firms' business models exposed as unsustainable. The stress has culminated in a string of bank failures since March, with Silicon Valley Bank, Signature Bank and First Republic Bank going under in the US, while in Europe, Credit Suisse collapsed.

In the US, the failed banks were all mid-sized regional banks, which tend to have shared, unusual characteristics. Two key issues were rich clients with uninsured deposits, and an asset base too heavily dependant on government bonds. Silicon Valley Bank (SVB) is perhaps the starkest example. This bank was uniquely exposed to interest rate risks on both its assets and liabilities. SVB's clients came mostly from the tech sector, and deposits more than tripled between the start of 2020 and 2022[36] as loose monetary policy flooded the financial system with funding. Yet the bank invested the bulk of this fresh money into interest-bearing securities rather than expanding its loan book. Securities went from 40% of assets to 60% in two years[37]. As a result, when interest rates rose, this simultaneously dampened lending to the tech sector – threatening SVB's deposits – and cut the value of its bond holdings – threatening SVB's assets. With only 6% of its deposits covered by the $250,000 Federal Deposit Insurance Corp (FDIC) guarantee[38], SVB's clients were also unusually exposed to the bank failing. A ratings downgrade, a large bond sale, and a failed attempt to raise more capital[39] saw its clients increasingly withdraw their funds, generating a bank

[27] Durante, Ferrando & Vermeulen (2022), "Monetary policy, investment and firm heterogeneity", European Economic Review Vol. 148, September 2022.
[28] ONS (2022), "Personal financial & property debt by age and region: April 2018 to March 2020", January 2022.
[29] ONS (2022), "Regional gross disposable household income: all ITL level regions", October 2022.
[30] The foundational paper on this channel is Bernanke and Gertler (1989). "Agency costs, net worth, and business fluctuations." American Economic Review 79, no.1, March 1989: 14-31.
[31] Bank of England database, 3 month growth rate (annualised) of bank loans to business, indicator RPMZO8F
[32] Bank of England database, Monthly growth rate of lending to individuals, indicator LPMBZ2E
[33] Durante, Ferrando & Vermeulen (2022), "Monetary policy, investment and firm heterogeneity", European Economic Review Vol. 148, September 2022.
[34] ONS (2022), "UK business; activity, size and location: 2022", September 2022.
[35] ONS (2022), "Business demography, UK", November 2022.
[36] Robert Armstrong (2023), "SVB is not a canary in the banking coal mine", Financial Times, March 2023.
[37] Evgueni Ivantsov (2023), "Strategic risk failure is what unites Credit Suisse and SVB", FT, May 2023.
[38] Caitlin Gilbert, Alyssa Fowers, Jacob Bogage and Daniel Wolfe (2023), "These companies had billions of dollars at risk in Silicon Valley Bank", Washington Post, March 2023.
[39] Alexandra Scaggs (2023), "Silicon Valley Tank(s)", FT Alphaville, March 2023.

run. While Signature Bank and First Republic (the second-largest bank failure in US history) were less reliant on corporate deposits and bond assets, similar dynamics ultimately played out. Signature came under pressure partly due to its links with the cryptocurrency sector – itself under pressure following the collapse of crypto exchange FTX[40]. Meanwhile, First Republic stood out for having 68% of its deposits above the FDIC guarantee threshold[41].

More failures among regional or mid-sized US banks are plausible. Aside from tech exposure and under-insured deposits, two other risks stand out for these firms: exposure to commercial real estate (CRE) and a lack of stress tests. CRE stands out as an issue both because the future of offices is challenged by hybrid working, and because the sector is composed of illiquid, long-term assets, making it interest-sensitive. In its April 2023 Global Financial Stability Report (GFSR), the International Monetary Fund (IMF) remarked that "In the United States, banks with total assets less than $250 billion account for about three-quarters of CRE bank lending, so a deterioration in asset quality would have significant repercussions both for their profitability and lending appetite."[42]

Banks with assets under $250 billion may also have had their vulnerabilities hidden by changing banking rules. After 2008, the Dodd-Frank Act financial regulations meant that all US banks with assets above $50 billion were subject to strict capital and liquidity requirements, along with 'stress tests'. These involve banks running simulations for what would happen to their balance sheets under different macroeconomic shock scenarios that are set by the Federal Reserve. Such scenarios will usually include an interest rate shock. However, in 2018, new rules under the Trump administration meant US banks with assets below $250 billion were exempt from these rules. This meant mid-sized US banks could both increase their leverage and stop simulating how their balance sheets would react to an adverse economic shock. While this Trump-era deregulation is likely not the decisive factor in the recent string of failures, it made it harder to spot pockets of risk developing in mid-sized US banks. The KBW Regional Banking Index, which tracks US regional bank stocks, has seen prices fall by around 30% between February and May 2023[43]. More such firms could yet fail.

While mid-sized US banks have proven unusually vulnerable, the crisis has generated a global ripple effect. The broad S&P 500 stock index was roughly flat from February to May 2023[44], but the S&P 500 Banking sub-index fell nearly 20%[45]. This shows that the global banking sector is coming under close scrutiny, with fears of contagion.

There has been one major bank failure outside the US. In March, Credit Suisse (CS) was taken over by rival Swiss bank UBS as it began to collapse. Yet while CS, with assets of around $575 billion at the end of 2022, was a large enough bank to be judged a Global Systemically Important Bank by international banking regulators[46], it was also uniquely vulnerable. The bank posted its biggest annual losses since the financial crisis in 2022, while accusations of mismanagement, sanctions violations and links to tax evasion and money laundering have plagued the bank for years[47]. After an admission of 'material weaknesses' in its financial reporting, share prices turned from a long slide into a collapse[48]. These unique challenges

[40] IMF (2023), "A Financial System Tested by Higher Inflation and Interest Rates", GFSR, April 2023, page 4.
[41] Reuters (2023), "Factbox: Top five U.S. regional banks with most uninsured deposits", March 2023.
[42] IMF (2023), "A Financial System Tested by Higher Inflation and Interest Rates", GFSR, April 2023, page 4.
[43] MarketWatch, KBW Regional Banking Index data, Ticker KRX
[44] MarketWatch, S&P 500 Index data, Ticker SPX
[45] MarketWatch, S&P 500 Banks Industry Group Index data, Ticker SP625
[46] Financial Stability Board (2022), "2022 List of Global Systemically Important Banks", November 2022.
[47] Kalyeena Makortoff and David Pegg (2022), "Crooks, kleptocrats and crises: a timeline of Credit Suisse scandals", The Guardian, February 2022.
[48] Owen Walker, "Credit Suisse finds 'material weaknesses' in financial reporting controls", March 2023.

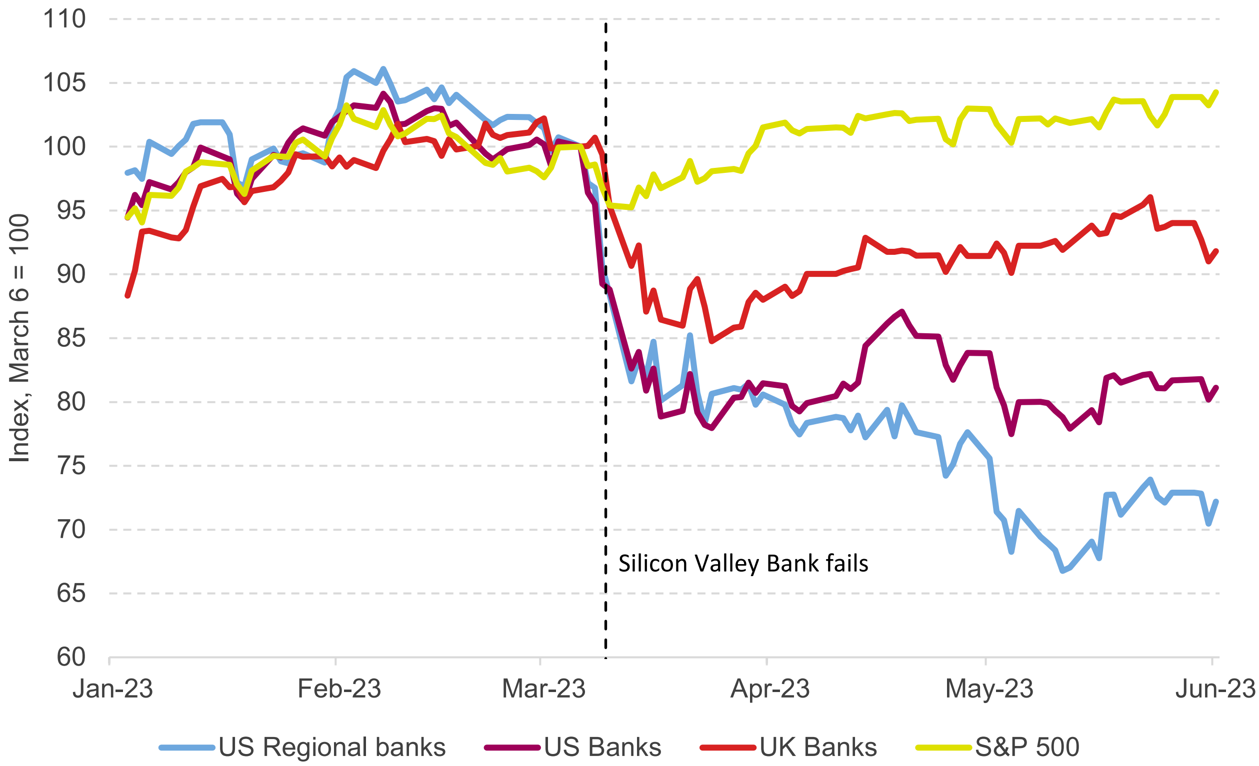
suggest that Credit Suisse's failure follows a logic of 'devil take the hindmost' in the global banking system, and other major European banks are less troubled.

Central banks around the world have also responded to the global ripple effect of banking sector turbulence. In the US, the government guaranteed all deposits at SVB and Signature, and allowed JP Morgan to purchase First Republic, moving all deposits into the US' largest bank. Meanwhile, the Federal Reserve opened a Bank Term Funding Program to back up liquidity requirements and help banks meet depositor needs[49]. In Europe, after approving the UBS purchase of Credit Suisse, regulators made up to $220 billion in extraordinary liquidity assistance available to the merged bank[50]. These activities seem to have stemmed the immediate crisis in both regions, but more bank failures remain a possibility. Indeed, the Federal Reserve recently warned of "a sharp contraction in the availability of credit" due to financial sector ructions[51]. Fed economists also warned that tighter financial conditions made a mild recession in the US later in 2023 likely[52]. So while central bank measures may have staved off a crisis, financial turbulence has a real impact on the global outlook.

Amid this global uncertainty, the UK financial system looks relatively resilient. Stocks for UK banks are down less than global averages, with the FTSE 350 Banking index falling 10% between February and May[53] (Figure 3.10). There are also many differences between UK banks and the US regional banks that have been most under pressure. In contrast to US deregulation, UK banks continue to be closely supervised, and stress tests indicate their balance sheets should be robust to rising interest rates[54]. Some estimates suggest commercial real estate makes up as much as 40% of loans from smaller US banks[55], while the share is just 6% for UK banks[56]. Overall, there are plenty of reasons why the Bank of England found the UK banking system "has the capacity to support the economy in a period of higher interest rates even if economic conditions are worse than expected"[57]. A UK generated banking crisis looks unlikely.

[49] Federal Reserve (2023), Press release, March 2023.
[50] IMF (2023), "A Financial System Tested by Higher Inflation and Interest Rates", GFSR, April 2023, page 8.
[51] Federal Reserve (2023), "Near-Term Risks to the Financial System", Financial Stability Report, May 2023.
[52] Federal Open Market Committee (2023), Staff Economic Outlook, FOMC Minutes, May 2023.
[53] MarketWatch, FTSE 350 Banks Index GBP, Ticker 189731
[54] Bank of England, "Banking sector resilience", Financial Policy Summary and Record, March 2023.
[55] Marc Jones (2023), "Europe's banks in 'better place' than U.S. in terms of commercial property risk – JPMorgan", Reuters, March 2023.
[56] Matthew Pointon, Capital Economics, via Julia Kollewe (2023), "Could office blocks be the next big casualty of the banking crisis?", The Guardian, March 2023.
[57] Bank of England, "Banking sector resilience", Financial Policy Summary and Record, March 2023.

Figure 3.10: UK bank stocks are under less pressure than global benchmarks



Source: MarketWatch, GLA Economics

Non-bank finance represents a further risk, with gaps in regulation and data

But crises rarely happen the same way twice, and there are other parts of the financial system that could spur a crash. Policymakers are turning attention to non-bank financial intermediaries (NBFIs). Sometimes referred to as 'shadow banking', these are the areas of the financial system where money managers look to generate yield on their clients' savings deposits by taking risks. The IMF's GFSR observes that "fragilities in the [non-bank finance] sector stem from the use of financial leverage, poor liquidity mismatches, and high levels of interconnectedness"[58]. Anil Kashyap of the Financial Policy Committee explained how 'liquidity multipliers' can build up cash claims in the sector in a 2020 speech[59]. He applies this framework to the March 2020 'dash for cash' when US bond markets see-sawed in response to the initial shock of the pandemic. These multipliers also explain why central bank liquidity measures needed to be larger than implied by the notional cashflow of the target markets.

Closer to home, the pension fund crisis in September 2022 also took place in market-based finance. As UK Gilt yields rocketed in response to the 'mini-budget', pension firms found themselves subject to large collateral calls to back up bond-based hedges as part of 'liability-driven' investment strategies[60]. Again, central bank action was required to stem a potential crisis. The Bank of England temporarily injected up to £5 billion a day into the Gilt market to ease forced selling, less than a week after announcing quantitative tightening bond sales[61]. With the Financial Policy Committee judging that inaction would have meant a "material risk to financial stability"[62], this episode again lays bare the risk from non-bank finance. And while UK banks issue the largest share of UK commercial real estate loans, non-bank involvement has tripled between 2012 and 2022[63]. This could create links between economically vulnerable sectors and non-bank financial instability as interest rates rise.

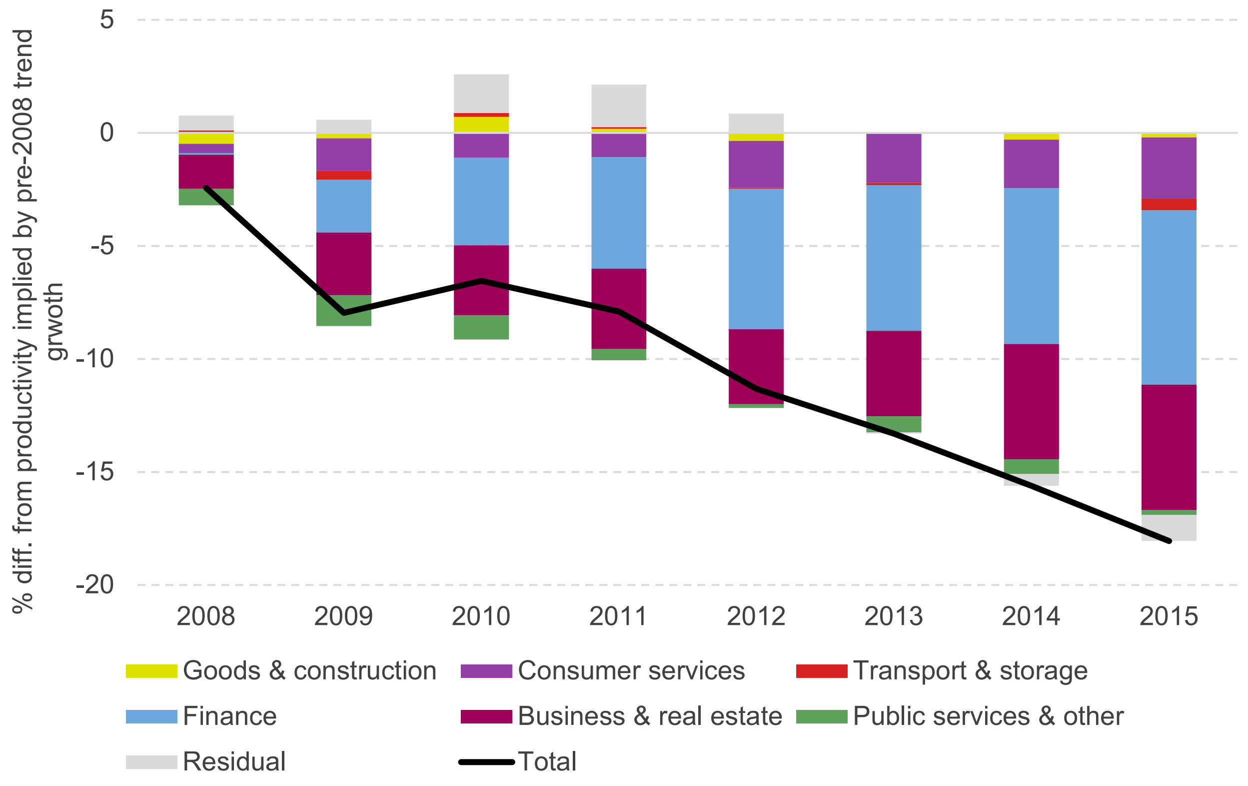
It is currently hard to quantify how serious the risk is from these sectors. Part of the issue is a lack of clear information. However, global financial regulators are now looking to build both a better understanding of the risks in market-based finance and fresh regulation to address the biggest hazards[64]. The IMF recommends surveillance, regulation and supervision as the "first line of defense"[65], but also points to central bank liquidity support as the way to contain a crisis. Temporary large-scale liquidity can help stem market-wide turbulence, heavily conditional standing lending facilities can help prevent spillovers between markets, and stepping up as the lender of last resort can stabilise systemically important NBFIs. While this playbook would not completely prevent stresses in market-based finance, it should help prevent market-specific instability spilling into a wider financial crisis.

A financial crisis would hit London's growth in both the near and long term

Given the possible pockets of risk, it is worth asking what impact a crisis would have on London. A useful starting point would be the effects of the last major crash. The global financial crisis of 2008 prompted a sharp recession across the UK, and trend growth has never fully recovered. London's job market recovered better than the rest of the UK[66], but GDP outperformed less. Trend growth was particularly affected for certain sectors. By 2015, Finance was still 20% below its pre-crisis output, Manufacturing 5% and Transport 4%. Whether due to reduced risk-taking in finance or labour hoarding in other sectors, output growth failed to keep up with the job recovery. London's productivity fell sharply below its previous trend growth rate. By 2015, London's output per job in the financial sector was still falling, reaching 22% below 2008 levels (Figure 3.11).

[58] IMF (2023), "A Financial System Tested by Higher Inflation and Interest Rates", GFSR, April 2023, page 15.
[59] Kashyap (2020), "The Dash for Cash and the Liquidity Multiplier: Lessons from March 2020", Speech at London Business School, November 2022.
[60] Breeden (2022), "Risks from leverage: how did a small corner of the pensions industry threaten financial stability?", Speech at ISDA & AIMA, November 2022.
[61] However, financial stability operations eventually amounted to less than £20 billion in total, compared to the nearly £900 billion total peak size of QE. See Bank of England (2022), News Release on unwinding financial stability gilt purchases, or for a graphical illustration, Hauser (2023), "Looking through a glass onion: lessons from the 2022 LDI intervention", Speech at University of Chicago Booth School of Business, March 2023.
[62] Bank of England (2022), News Release "Bank of England announces gilt market operation", November 2022.
[63] Daniel Cunningham (2023), "Strong lending volumes, more defaults: Bayes' key 2022 UK market findings", Real Estate Capital Europe, April 2023.
[64] Financial Stability Board (2022), "Enhancing the Resilience of Non-Bank Financial Intermediation: Progress Report", November 2022.
[65] IMF (2023), "A Financial System Tested by Higher Inflation and Interest Rates", GFSR, April 2023, page 46.
[66] ONS (2023), "JOBS05: Workforce jobs by region and industry", March 2023.

Figure 3.11: Real productivity compared to pre-2008 trend, broken down by sector



Source: ONS, GLA Economics; Note: residual is due to changing patterns of sector shares in real data

And any financial shock that sucks liquidity out of the system will add to the conventional investment-damping effects of tighter monetary policy. London's fastest-growing major sector in the five years before the pandemic was IT – a sector which has also recovered strongly since 2021[67]. Yet across the UK, this is also the most investment-hungry sector outside primary industries[68]. Excessive tightening of credit due to financial instability could therefore drag on the potential of sectors that underpin London's long-term growth.

The risks to London's economy from tighter monetary policy and financial sector turbulence are wide-ranging. Higher interest rates should drag on London less due to its low dependence on manufacturing. Yet there will still be a material drag, and higher interest rates will raise housing costs further in the middle of a cost of living crisis. But sectors exposed to durable goods may fare even worse in London than elsewhere due to a higher share of small firms. The evaporation of cheap credit and higher yields on safe assets have exposed cracks in the global financial system, but these look unlikely to prompt UK bank failures. At the same time, non-bank finance poses complex risks to stability, especially where it interacts with troubled real economy sectors like commercial real estate. A UK financial crisis still looks unlikely, but if one did emerge, it threatens another blow to London's long-term economic potential. While we do not think a new financial crisis currently warrants detailed modelling, our downside forecast scenario (see Chapter 5) incorporates some of the effects of further financial instability dragging on investment and output. We will be closely monitoring the impacts of rising interest rates, the vulnerability of different sectors and the implications for growth.

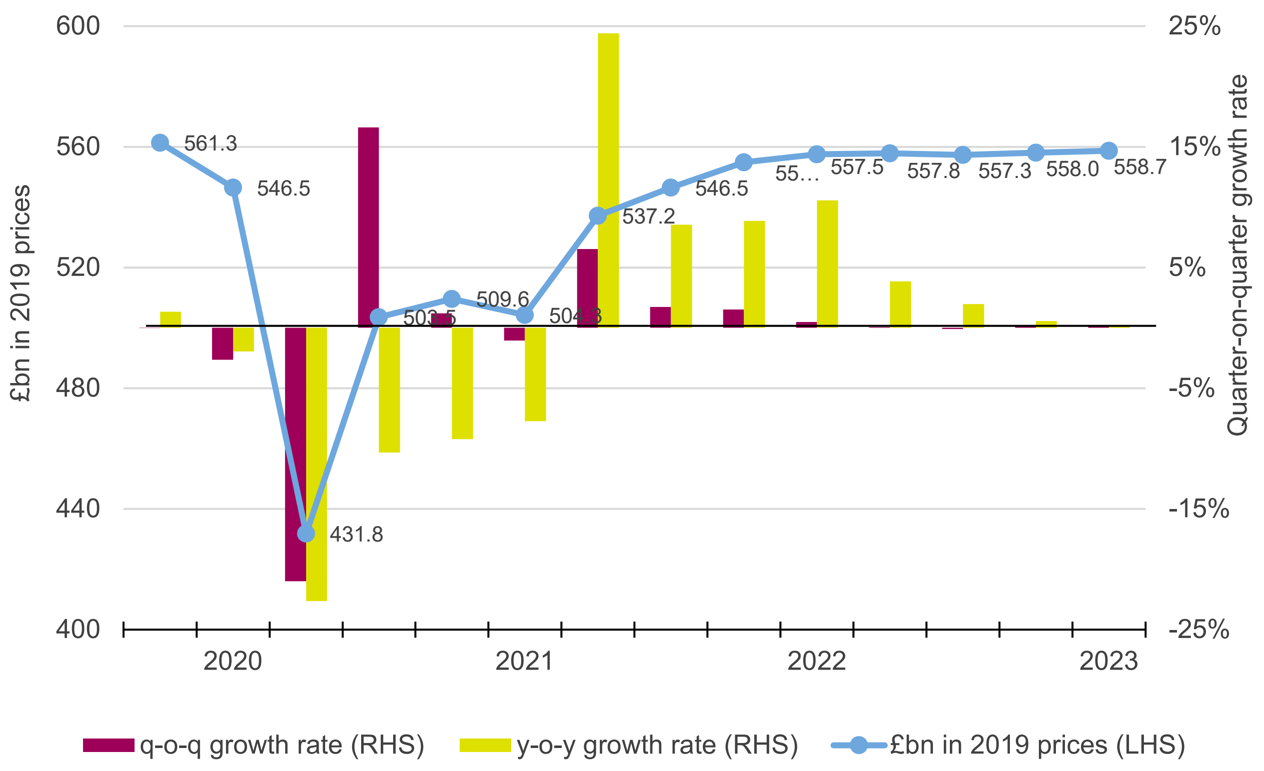
[67] ONS (2023), "Quarterly country and regional GDP", May 2023
[68] ONS (2022), "Business investment by industry and asset", August 2022.

3.2 The UK economy

The UK economy suffered an unprecedented drop in activity during the first part of 2020 as lockdown restrictions were introduced to contain the pandemic. From late March to late May, the UK economy experienced the largest contraction of real GDP for over 300 years (quarterly contractions of -2.6% in Q1 2020 and -21.0% in Q2 2020). The single-quarter decline in the economy by over a fifth compares with a peak-to-trough fall of 6% during the 2008-09 financial crisis. This historic decline in national output was the result of the initial outbreak of COVID-19 and the public restrictions taken to contain its spread.

The economy rebounded rapidly in Q3 2020, but was then hit by the second lockdown late in the year, with another contraction in Q1 2021. Another rapid rebound in Q2 2021 was followed by continued recovery, though at a more moderate pace. The economy was resilient to Plan B restrictions in late 2021 and early 2022, but has then stagnated across 2022 as the cost of living began to bite in consumer spending. The expected recession has not materialised, partly due to lower than expected energy prices, instead the economy flatlined over 2022 (Figure 3.12).

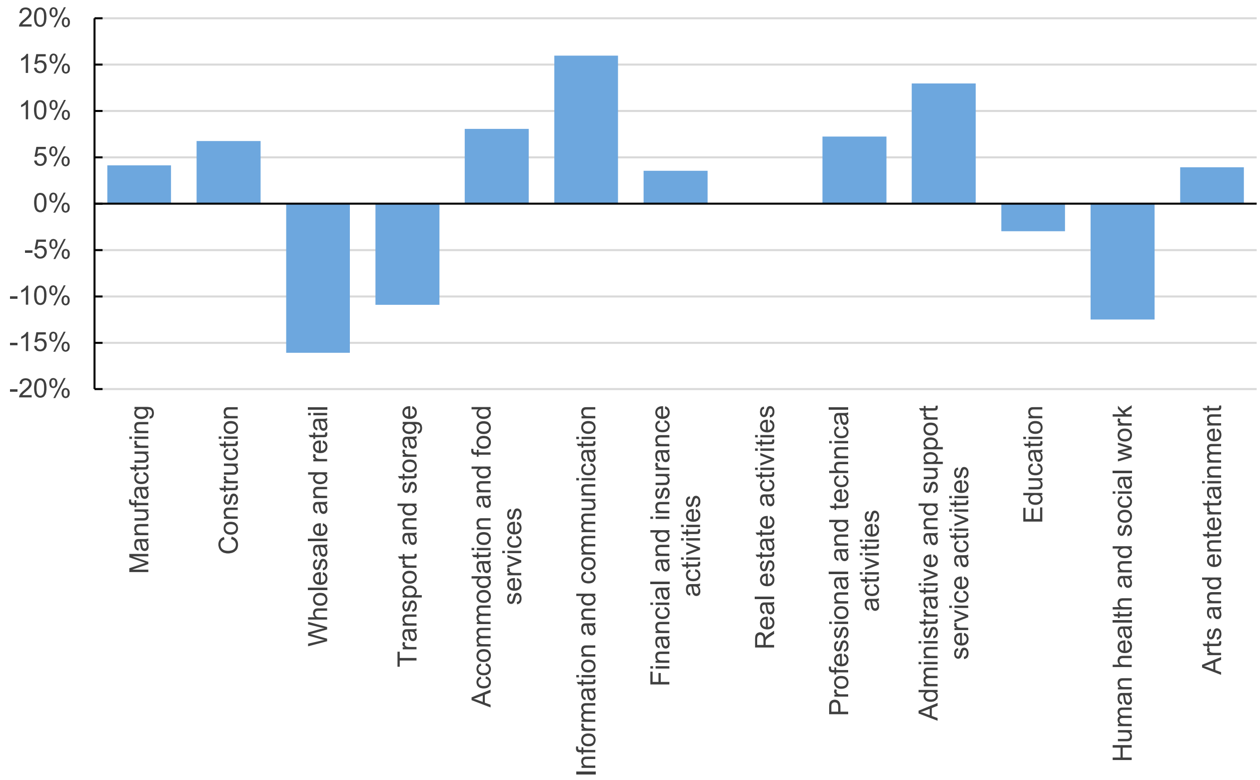
Figure 3.12: UK real GDP (Q4 2019 – Q1 2023)



Source: GLA Economics based on ONS – UK National Accounts data.

As with London, the wider UK's sectoral distribution of the impacts from the pandemic is uneven. The UK sectors still struggling the most by Q3 2022 compared to pre-pandemic levels were Wholesale and retail, Health, and Transport and storage. Unlike London, this pattern has not changed since the Autumn 2022 LEO. Education was also below pre-pandemic levels for the UK, while the remaining sectors have recovered to at least their Q4 2019 level of output. The UK's strongest sectors, compared to pre-pandemic levels, are Information and communication, Administrative services, Accommodation and food services, Professional services, and Construction (Figure 3.13).

Figure 3.13 Proportionate change in real GVA by industry* in the UK Q4 2019 – Q1 2023



*Source: GLA Economics based on ONS – UK GDP data. *The following smaller industries have been excluded for simplification purposes: Primary sector and utilities, Public administration and defence, Other service activities, and Activities of households.*

GDP data can also be split into different types of final expenditure. This includes final expenditure by households, general government and the non-profit institutions serving households, as well as expenditure used in gross capital formation (e.g. business investment)[69]. For the most recent period, the year to Q4 2022, there was growth across the private sector, but government spending was falling (Table 3.1).

Table 3.1: Annual rates of real growth in domestic final expenditure for the UK

	2021				2022			
Expenditure	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**
Households	-12.6%	24.9%	7.9%	9.7%	15.0%	4.6%	1.3%	1.4%
Non-profit institutions	-19.6%	28.4%	11.1%	8.7%	26.3%	11.5%	10.2%	10.2%
General Government	0.3%	31.9%	12.1%	9.3%	9.1%	-0.4%	-0.1%	-0.8%
Gross fixed capital formation	-4.4%	22.3%	6.6%	2.8%	13.5%	6.6%	6.8%	7.6%

Source: ONS (2023). 'GDP first quarterly estimate, UK: January to March 2023', 12 May 2023.

Household expenditure is the largest component of the UK economy, contributing three-fifths of UK GDP in 2022. Year-on-year there has been growth in spending from Q2 2021. There is a similar picture for other elements of domestic final expenditure in the private sector. Annual general government expenditure turned negative in Q2 2022.

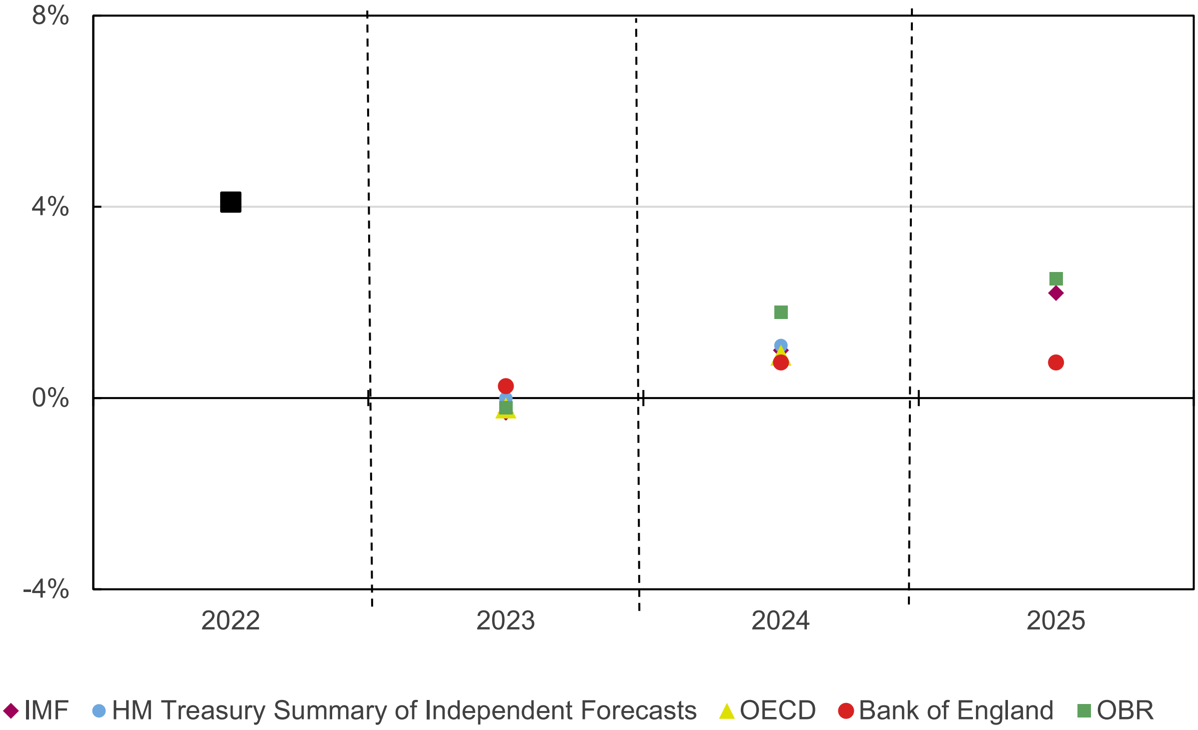
Forecasts of the UK economy

Looking to the outlook for the UK economy, the cost of living crisis, weak global growth, the continued impact of Brexit (see Box 3.2), rising interest rates (see Box 3.1), high government borrowing, and long-

[69] It also includes net trade in goods and services.

standing concerns on low productivity represent key downside risks. After the Mini-budget in September 2022 exacerbated a sharp increase in government borrowing costs, the Autumn Statement saw the Chancellor promise tax hikes and spending cuts to bring down government borrowing and calm markets. However, most of the spending cuts are deferred to after 2024, and support to households' energy bills, along with direct payments to low-income households, continued in 2022 and running in a less generous form to 2024. Figure 3.14 plots the distribution of official and private forecasts for the next three years. The consensus is that after still-firm growth on average for 2022, the economy will stagnate in 2023, with weak growth in 2024, and improved prospects in 2025. The Bank of England forecast is an outlier and emphasises the prominence of the downside risks.

Figure 3.14: External forecasts of UK real GDP growth for 2022-2025



Source: GLA Economics based on ONS, HM Treasury, Bank of England, OECD, IMF, and OBR projections

The OBR and HM Treasury also publish forecasts for other variables like the labour market and public-sector net borrowing (PSNB). These are shown in Table 3.2.

Table 3.2: Selected OBR and HM Treasury consensus forecasts for the UK economy

	HM Treasury's Average of Independent (May 2023)		Office for Budget Responsibility (March 2023)	
	2023	2024	2023	2024
Annual real GDP growth rate	0.0%	1.1%	-0.2%	1.8%
LFS unemployment rate	4.0%	4.3%	4.1%	4.4%
Current account	-£72.3bn	-£63.6bn	-£155.0bn	-£120.9bn
Public sector net borrowing (financial year)	£127.6bn	£91.7bn	£131.6bn	£85.4bn

Sources: HM Treasury (2023). 'Forecasts for the UK economy: a comparison of independent forecasts', May 2023; and OBR (2023). 'Economic and Fiscal Outlook – March 2023', March 2023.

Other UK economic indicators

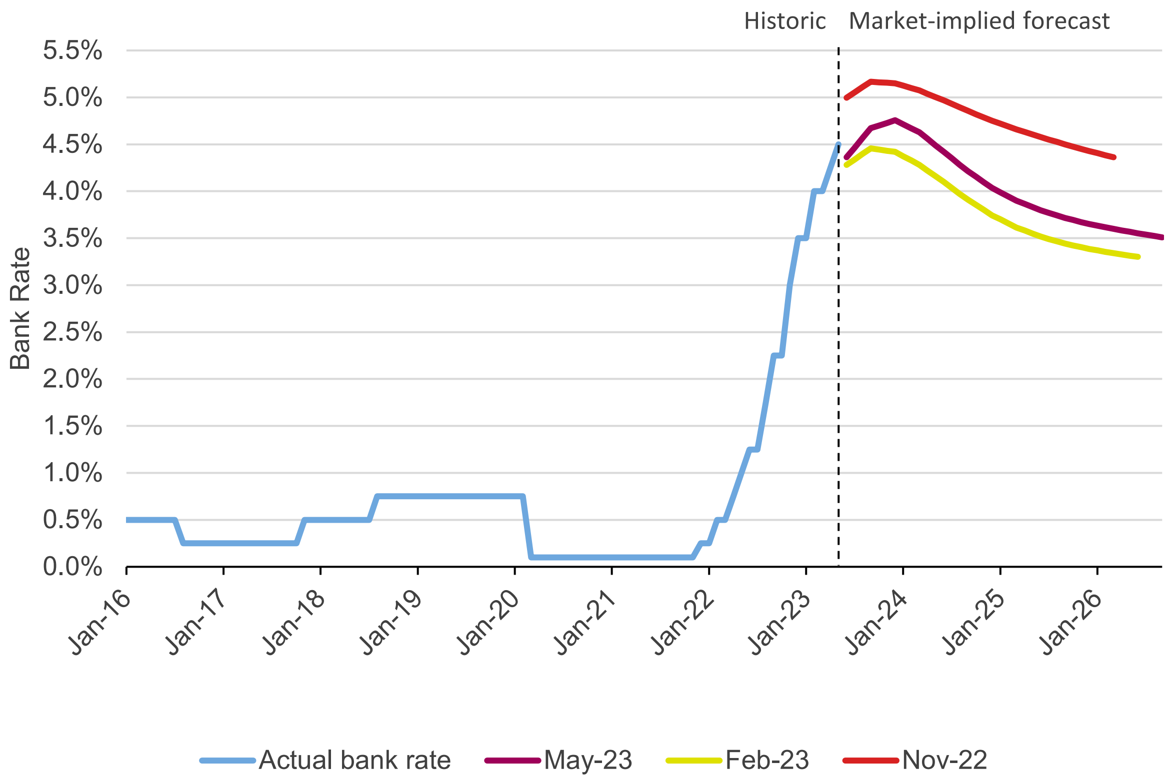
Beyond GDP, another important economic indicator is inflation, as measured by the Consumer Price Index (CPI). The large depreciation of sterling following the EU referendum pushed inflation above the Bank of England's central target of 2% for much of 2017 and 2018, but this shock largely dissipated by 2019. CPI inflation stood at 1.5% year-on-year in March 2020[70]. The weakness of demand in the economy during the pandemic further subdued inflationary pressures. When consumers are making fewer purchases, sellers are less likely to raise prices for fear of driving away the remaining buyers.

However, the easing of lockdowns then rapidly released pent-up demand. Global supply and distribution networks were not ready for the surge in orders, so supply chain bottlenecks began to create shortages that drove up prices. In the UK, the end of the Brexit transition exacerbated this effect. Inflation pushed back above the Bank's target by the end of 2021. Russia's invasion of Ukraine in February 2022 turned the situation into a crisis, with energy and food prices soaring. CPI inflation stood at 11.1% year on year in October 2022 – the highest point since 1981[71]. It had fallen to 8.7% in April 2023[72] when the sharp rise in energy prices the previous year dropped out of the measure. The Bank expects the inflation rate to fall quickly across 2023 and meet the 2% target in late 2024. It appears that inflation is more persistent in the UK than the US or the Eurozone, perhaps because along with Europe the UK has suffered a substantial rise in energy prices, and like the US it has a tight labour market.

With fiscal policy on a relatively restrictive footing since 2010 and few signs of inflation rising on a sustained basis, the Bank of England had kept interest rates near zero for much of the decade to 2020. While the Bank had raised rates in response to the 2017 inflation overshoot, rates were steady at 0.75% from late 2018 to spring 2020. Yet as the scale of the pandemic's impact became apparent in March 2020, the Bank lowered interest rates to 0.25% and then to a record low of 0.1%. However, the rapid acceleration of inflation that has unfolded from autumn 2021 has seen the Bank of England respond sharply. December 2021 saw the first rate rise since 2018, and by May 2023, the Bank had reached a policy interest rate of 4.5%. This is already the fastest hiking cycle since the late 1980s, and market expectations for the path of interest rates anticipate further rises, but not to the heights of 2008 (Figure 3.15).

[70] ONS (2020). 'Consumer price inflation, UK: March 2020', April 2020.
[71] ONS (2022). 'Consumer price inflation, UK: October 2022', November 2022.
[72] ONS 2023). 'Consumer price inflation, UK: April 2023', May 2023.

Figure 3.15: Market-implied interest rate path for the UK



Source: Bank of England (2023), 'Monetary Policy Report – May 2023'.

Interest rate changes can influence the economy in a range of ways[73]. The most important effects are on aggregate demand. Higher interest on savings raises the 'opportunity cost' of spending – i.e. it is relatively more attractive to forgo consumption today by saving more and investing. Consumers also often borrow for major purchases, meaning higher interest rates on consumer loans make those purchases less affordable. Higher mortgage interest rates raise housing costs for owner-occupiers, which may cut their willingness to spend. Reduced homebuying due to more expensive mortgages may lower house prices, reducing households' wealth and making them less inclined to spend money. Business investment may see a similar impact. Here, higher interest rates raise the cost of borrowing to invest, and may lower the valuation of firms due to a higher discounting rate in net present value calculations. As with consumers, costlier borrowing and a dent to wealth should slow business spending.

By slowing aggregate demand, raising interest rates should slow the pace of inflation. Lowering interest rates would have the reverse of these effects. However, the magnitude of these effects depends on several factors, including the speed and scale of the interest rate changes, the time it takes for interest rates to transmit through the economy, and the current state of the wider economy. These "long and variable"[74] lags mean further uncertainty in economic forecasts. With interest rates set to return to levels unseen since before the financial crisis, the Bank of England projects a long, if relatively shallow, recession in the UK economy, with output still below mid-2022 levels by the end of 2025. The OBR also projects a recession, though with a shorter and shallower decline than the Bank of England's forecast.

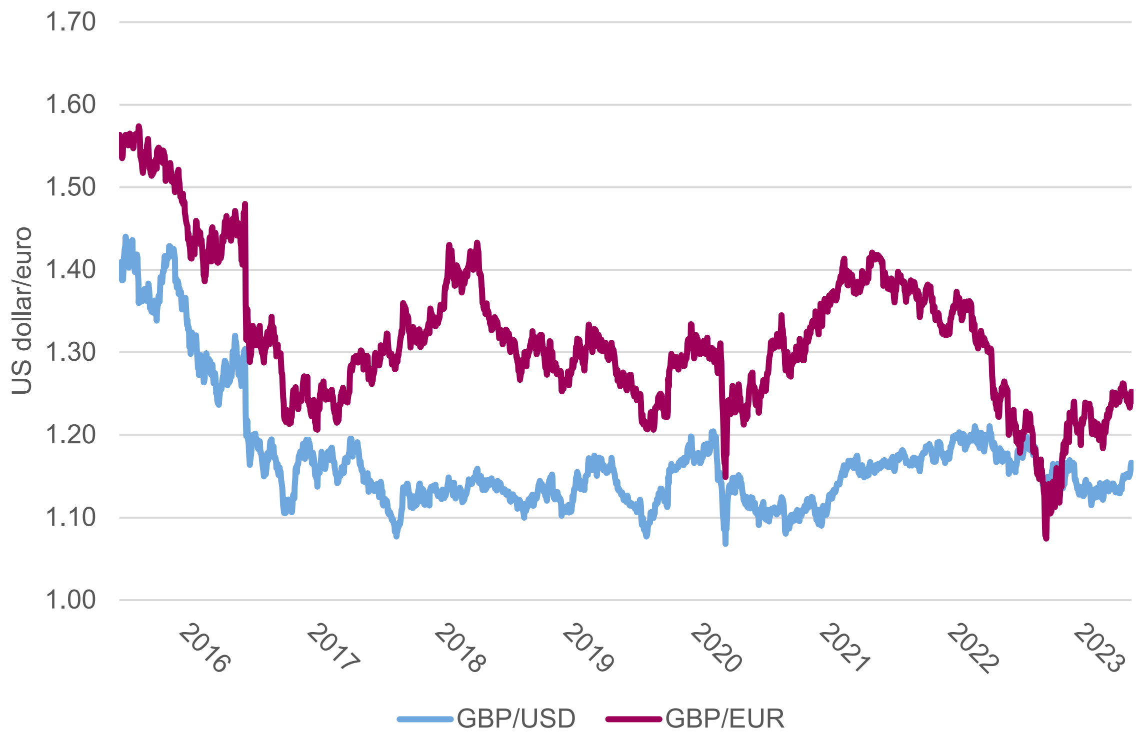
[73] See Bank of England (1999). 'The transmission mechanism of monetary policy', Bank of England Quarterly Bulletin, May 1999.
[74] This concept is often associated with the works of Milton Friedman in the late 1950s and early 1960s, c.f. Friedman (1959), "A Program for Monetary Stability", Fordham University Press, 1959

A separate impact may be seen on the currency. Excluding other influences, interest rate rises can bolster the pound as returns (interest) on sterling assets would be relatively higher than on other countries' assets, leading to an increase in demand for sterling-based assets by foreigners. As the currency appreciates, imports are relatively less costly for UK buyers to purchase. As a result, this exchange rate effect should enhance the inflation-dampening effects of rate rises.

The value of sterling fell following the result of the EU referendum in June 2016, as seen in Figure 3.16. Sterling had been relatively steady against the euro since mid-2017, although there have been marked down and then upward movements in the second half of 2019. This came as first a no-deal Brexit became more likely, and then a deal became increasingly likely. At the same time, sterling appreciated against the US dollar through 2017 and into the early part of 2018 but had since dropped back largely due to the continuing impact of Brexit.

In early March 2020, it became apparent that the UK economy would be significantly affected by COVID-19, and the pound depreciated against both the US dollar and the euro. In part, this reflects a flight to strong currencies, but it may also reflect the comparative weakness of the UK economy after the vote to leave the EU. Fluctuations in the US outlook saw the pound recover against the dollar, then weaken again after the election of Joe Biden as US President. Since 2021, the pound has recovered against the euro, reflecting first the strength of the UK vaccination programme and then expectations of interest rate rises. More recently, the pound has fallen against the euro and the dollar, likely reflecting diminished expectations for the UK economy during the cost of living crisis. Following the mini-budget in late September 2022, the pound depreciated sharply to its lowest level against the dollar since 1984. The unfunded tax cuts in the mini-budget put pressure on UK government bond markets, and along with a generalised loss of investor confidence in the UK economy, this impacted on sterling. The pound has made up its losses since as policy has stabilised (Figure 3.16).

Figure 3.16: Sterling to US dollar and euro exchange rates



Source: Bank of England
Note: First data point is 1 July 2015, and last data point is 1 June 2023

Box 3.2: An update on Brexit

The thirteen previous editions of LEO[75] from Autumn 2016 to Autumn 2022 have provided updates on the process of the UK leaving the EU and estimates of the impact on the London economy. This update does the same and has sections on: legislative background; impact of Brexit; Brexit and migration; Brexit and students; and Brexit and trade. A complex and nuanced picture is emerging of the effects of Brexit on the economy, legislation and wider society.

1 Legislative background

1.1 Windsor Framework

In the last few months there has been a calming of the relationship between the UK and the EU. Notable has been the announcement of the Windsor Framework to change the way the Northern Ireland protocol works[76]. Amongst other changes there is a new system of checks on goods moving from Great Britain to Northern Ireland, so that there are far fewer checks and controls on goods destined to stay in Northern Ireland. As a result, the UK Government is letting lapse the Northern Ireland Protocol Bill[77], which would have unilaterally disapplied constitutive elements of the protocol. The EU had threatened to respond with all measures at its disposal had this Bill been passed[78]. The risk of a trade war detrimental to the London and UK economies has now largely subsided.

A consequence is that the Government is likely to water down the Brexit Freedoms Bill. The intention was that all EU legislation would be amended, repealed, or replaced by the end of 2023. It would have enabled the Government to create regulations that they say would have been tailor-made to the UK's own needs[79]. 3,800 (or more) pieces of legislation would have been affected. It would not have been possible to replace all this legislation in 2023, and so there would have been areas of activity where there was no longer regulatory certainty. As the likely effects of the bill were not yet well understood there would have been uncertainty for business. This may well have adversely affected decision making[80]. The current plan is to remove 800 statutes and regulations[81], which would appear more predictable in its effects. One area where there will now be unpredictability is that all courts, and not just the Supreme Court as at present, will be able to depart from established EU case law. It risks opening a licence to litigate for anyone who did not like a decision under EU law[82], and wishes it to be interpreted in a different way. Airlines, for example, could renege on the current guarantee of compensation for delayed or cancelled flights[83].

The signing of the Windsor Framework has unlocked other talks between the UK and the EU[84]. Talks are ongoing on deeper cooperation on security and defence, and for closer ties in the energy sector. More fraught are talks for the UK to re-join the Horizon programme to support science research collaboration, where there is disagreement on the financial terms.

---

75 GLA Economics (2016, 2017a, 2017b, 2018a, 2018b, 2019a, 2019b, 2020a, 2020b, 2021a, 2021b, 2022a, 2022b). 'London's Economic Outlook: Autumn 2016 The GLA's medium-term planning projections': editions from Autumn 2016, Spring 2017, Autumn 2017, Spring 2018, Autumn 2018, Spring 2019, Autumn 2019, Spring 2020, Autumn 2020, Spring 2021, Autumn 2021, Spring 2022, Autumn 2022.
76 House of Commons Library (2023), Northern Ireland Protocol: the Windsor Framework
77 Casalicchio E (2023), UK shelves controversial Northern Ireland Protocol Bill as EU deal reached, Politico
78 GLA Economics (2022), 'London's Economic Outlook: Spring 2022 The GLA's medium-term planning projections', June 2022
79 Department for Business, Energy and Industrial Strategy (2022), UK government to set its own laws for its own people as Brexit Freedoms Bill introduced
80 GLA Economics (2022), 'London's Economic Outlook: Autumn 2022 The GLA's medium-term planning projections', December 2022
81 O'Carroll L (2023), Bonfire of EU laws watered down to just 800 after meeting of Brexiter MPs, The Guardian, 28 April
82 Rutter J (2023), Government sees some sense at last on the Retained EU Law Bill, Institute for Government, 11 May
83 O'Carroll L (2023), Tories' revised plans to scrap EU laws are still reckless, say lawyers, The Guardian, 12 May
84 Hancock A (2023), UK participation in EU Horizon programme at risk due to price, Financial Times, 11 May

As a sign of improved relations, the EU will sign up to a deal with the UK to boost cooperation on the regulation of financial services. This would include the establishment of a joint UK-EU Financial Regulatory Forum. Once signed off by EU member states it would improve coordination between the UK and the EU and replicate arrangements the EU already has with other major jurisdictions including the US[85].

1.2 Other regulatory developments

Alongside the implementation of the Northern Ireland Protocol a more nuanced picture is emerging of regulatory divergence with the EU[86]. The government has postponed divergence where it sees a threat to business interests. There have been delays to: the mandatory use of the UKCA mark on goods; the introduction of new veterinary certification requirements for meat exports; and the registration of chemicals on a new UK database. The government is also taking longer to regulate on safety and cyber resilience, and single-use plastics. In contrast, the new UK subsidy regime could become a point of tension with the EU, as it is more permissive than the EU system.

There have also been developments on financial and insurance services. The Chancellor of the Exchequer, Jeremy Hunt, announced the Edinburgh financial services reforms in December 2022. The intention is to support growth, and deliver a framework for financial services that is both agile and proportionate. This will, in part, take advantage of freedoms from leaving the EU[87]. There will be legislative progress over 2023, building on the Financial Services and Markets Bill, to: enable consumers to access the benefits of new products and technologies; support innovation and technology; and, be a world leader in sustainable finance. The proposals for reform are not set, as a series of consultations and calls for evidence have been launched[88].

For its part the EU is continuing with its strategy to build up clearing of euro-denominated financial transactions within the EU. It is the only area where the EU has granted London "equivalence" since Brexit, allowing the City to handle swaps trades worth more than €130 trillion. The EU remains set on the date of June 30 2025 to end "equivalence" despite the threat to financial stability according to industry players[89].

One other area of likely regulatory divergence is in the EU's Solvency II rules for the insurance sector to loosen capital requirements. Although, the EU is itself already reviewing these rules[90], and the recent banking failures described in Box 3.1 might diminish appetite for substantial change. Indeed, the Bank of England has already introduced a tighter version of global banking capital rules than that being pursued by the EU[91].

An area of development where Brexit may further adversely affect British industry is in the promotion of green technologies. Both the US, through its Inflation Reduction Act, and the EU, through its draft Net-Zero Industry Act, are adopting protectionist measures to promote their industries[92]. This will limit the access of UK companies to these markets.

[85] Bounds A and Fleming S (2023), Brussels agrees to sign regulatory co-operation deal with the UK, Financial Times, 17 May
[86] UK in a Changing Europe (2023), UK-EU Regulatory Divergence Tracker, 6th edition, January
[87] HM Treasury (2022), Edinburgh Reforms hail next chapter for UK Financial Services
[88] Deloitte (2022), The Edinburgh Reforms: what they are and what they mean for financial services
[89] Fleming S and Pickard J (2023), EU sticks with post-Brexit clearing trade deadline despite objections, Financial Times, 24 May
[90] European Commission (2021), Reviewing EU insurance rules: encouraging insurers to invest in Europe's future, Press release, 22 September
[91] Parker G et al (2022), City set for boost as Hunt loosens financial services rule book, Financial Times, 8 December
[92] Rankin J (2023), EU targets 40% of clean tech to be made within the bloc by 2030, The Guardian, 7 March

1.3 Trade agreements

Both the UK and the EU have been reaching trade agreements with third parties. Divergences in partners for trade agreements are starting to emerge.

On 31 March the UK Government reached an agreement to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) as its 12th member[93, 94]. This is an important milestone in establishing new trade partnerships after leaving the EU, and raises the UK's global profile, but is unlikely to be significant in economic terms. The UK already has trade agreements with nine of the partnership members – the EU is not a member. The Government has estimated the long run increase in GDP from joining at 0.08%. This compares with a fall in output of 4% from leaving the European Union, see below, and makes clear the importance of Europe to UK trade. Curiously, the economies of the CPTPP and the EU are of a similar size at $13.5 trillion.

Of the 71 other trade deals the UK has signed since leaving the EU[95], 68 are rollover deals identical to the deals the UK had with those countries when it was in the Single Market. They have allowed the UK to continue relations as they were with key trade partners across the globe.

One new agreement was the UK-Japan Comprehensive Economic Partnership Agreement (CEPA), which came into effect in December 2020. (Japan is also a member of the CPTPP.) The deal is nearly identical with that the UK had with Japan while part of the EU, with the exception of a chapter on digital trade.

The two other new deals with Australia and New Zealand came into force on 31 May[96, 97]. The deal with Australia is estimated to increase UK GDP by 0.08% by 2035[98], and that with New Zealand might increase UK GDP by 0.03% by 2025[99].

The EU is also active in trade negotiations[100]:

- It has signed Economic Partnership Agreements with West Africa[101] and the East African Community[102]. They have yet to come into force, and would be one of the first major trade divergences between the EU and the UK from the EU side
- It is in negotiations with Australia, Indonesia, and India
- Negotiations have been paused with China and the Philippines

2 Impact of Brexit

Since the Autumn 2022 LEO there have been no new studies on the impact of Brexit. The Office for Budget Responsibility (OBR) has, though, provided an assessment of economic developments, and how

93 Arasasingham A et al (2023), The UK is joining the CPTPP. What comes next?, the Center for Strategic and International Studies
94 Schneider-Petsinger M (2023), Real value for the UK in joining CPTPP is strategic, Chatham House
95 Hunsaker S and Howe T (2023), Trade tracker: UK trade deals, UK in a Changing Europe
96 House of Commons Library (2023), UK – Australia Free Trade Agreement
97 House of Commons Library (2023), UK – New Zealand Free Trade Agreement
98 Department for Business and Trade and Department for International Trade (2021), UK-Australia FTA: impact assessment
99 Department for Business and Trade and Department for International Trade (2021), UK-New Zealand FTA: impact assessment
100 Hunsaker S and Howe T (2023), Trade tracker: EU trade deals, UK in a Changing Europe
101 This involves 16 West African states. All 16 states must sign the deal and adopt it in their respective legislatures for the deal to be ratified fully
102 This involves six countries: Burundi, Kenya, Rwanda, Tanzania, South Sudan, and Uganda. Only Kenya has ratified to date

they compared to modelling assumptions for the UK made prior to Brexit[103]. There are three areas to consider.

On trade and productivity, the OBR assumed that the volume of UK imports and exports will both be 15% lower in the long run than if the UK had remained in the EU. The OBR further assumed that this leads to a 4% reduction in the potential productivity of the UK economy. The reduction builds over time with the full effect felt after 15 years. The OBR concludes that the current picture is clouded by data measurement issues, but two years into implementation of the Trade and Cooperation Agreement, the trends in UK trade volumes remain consistent with the Brexit assumptions made.

On investment, the OBR assumed that greater uncertainty after the EU referendum would see investment projects postponed or cancelled. The lower capital stock would reduce productivity by 1.5%. This shortfall would fade as uncertainty over the future trading relationship receded and investment recovered. The OBR reports that business investment stalled in the years after the EU referendum, as expected. This is partly due to increased uncertainty, as well as the diversion of resources away from more productive uses towards Brexit preparations. Contrary to assumptions, business investment has remained stagnated. The pandemic and the increase in global energy prices provide some of the explanation, but UK non-dwellings investment has continued to underperform relative to other G7 countries.

On migration, the initial assumption was that migration would be less than otherwise. Once details of the UK's post-Brexit migration regime became available the assumption was that there would be reduced net migration from the EU, but that non-EU flows would be higher. This is what has happened, and is discussed further in the next section.

The London School of Economics Centre for Economic Performance has also updated its analysis of the impact of Brexit on food prices using data to March 2023[104]. Higher non-tariff barriers (NTBs) due to Brexit, such as increased paperwork and the application of phytosanitary standards, are affecting food price inflation and costing UK households:

- 30% or 8 percentage points of the 25 percentage point increase in food prices between December 2019 and March 2023 might be attributed to the effects of Brexit
- Between January 2022 and March 2023, the price of food products that were more exposed to Brexit (due to their reliance on imports from the EU before the referendum) increased by approximately 3.5 percentage points more than those that were not
- These changes were entirely driven by products with high NTBs. Food products which fall into this category, such as meat and cheese imported from the EU, have seen price increases in the region of 10 percentage points more since January 2021 relative to similar products not exposed to Brexit
- The household cost of Brexit from food products stands at £250 per household since December 2019, and in 2019 prices. Across UK households this comes to £6.95 billion[105]
- The observed price increases of products more exposed to Brexit are not associated with inflationary events such as COVID-19 lockdowns, or the Russian invasion of Ukraine. The fact that the results are entirely driven by products imported from the EU with high NTBs offers strong evidence that Brexit is the driving force behind these effects

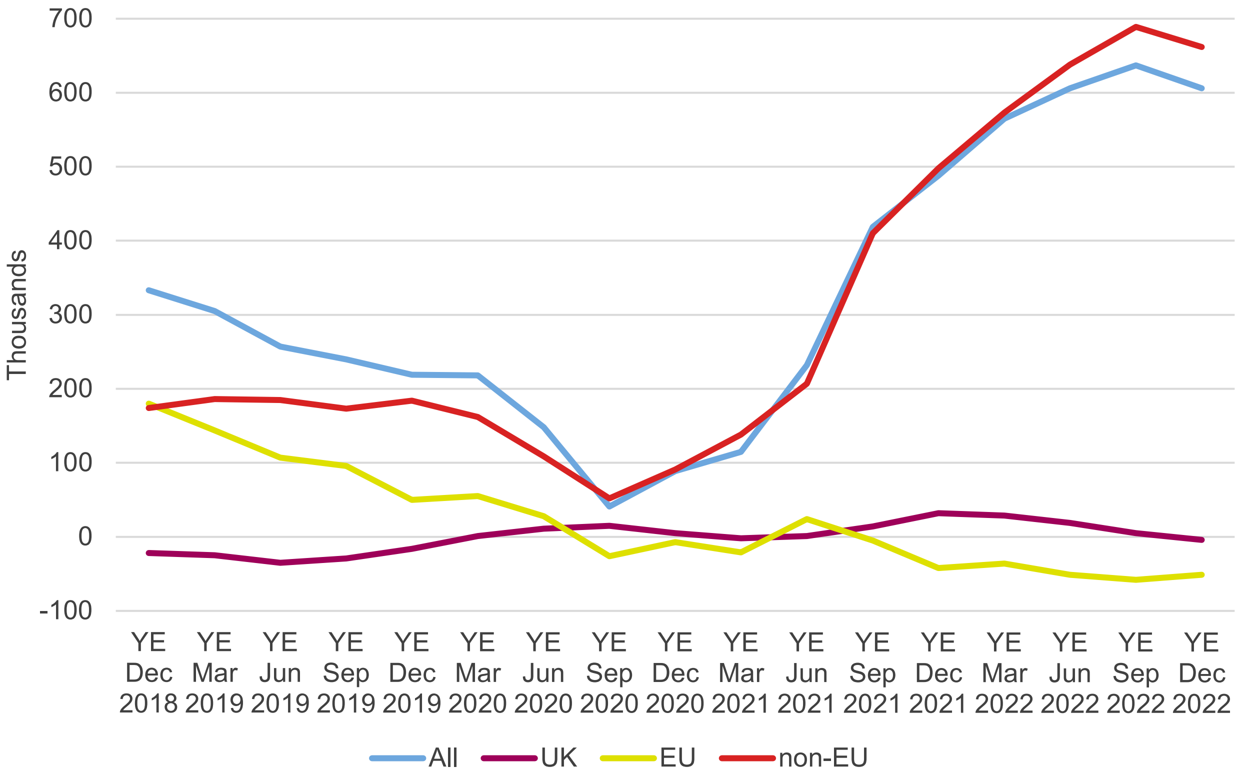
[103] OBR (2023), Economic and Fiscal Outlook – March2023
[104] Bakker J et al (2023), Brexit and consumer food prices: May 2023 update, London School of Economics Centre for Economic Performance
[105] These numbers come from a welfare calculation in a steady state model. The baseline number is from 2019, so in this sense the figures are in 2019 prices

3 Brexit and migration

The evidence continues to add that there has been a marked shift in the levels, composition, and location of migrants over the last few years. Changes due to Brexit have impacted on the flows of non-EU citizens as well as EU citizens.

Net migration has risen sharply over the last five years, rising from 333,000 in 2018 to 606,000 in 2022. In the case of the EU, though, net migration has fallen from 180,000 in 2018 to a decline of 51,000 in 2022 – that is, more EU citizens are leaving the UK than coming (Figure 3.17).

Figure 3.17: UK net long term migration 2018-2022



Source: ONS long-term international migration statistics

There has been an increase of 488,000 in net long-term non-EU migration between 2018 and 2022:

- work-related net migration has increased by 132,000 – this is attributable to the post-Brexit immigration regime, which has made it easier for non-EU citizens to work in the UK
- study-related net migration has increased by 174,000 – the reasons are not well understood[106]. It is likely that the re-introduction of a post-study work visa post-Brexit has made the UK more attractive to international students. The government also had an explicit strategy of increasing international student recruitment. India and Nigeria, the two countries that have seen the largest increases in the number of student visa grants, were named among the immediate 'priority countries'. There may also have been a bounce back from the pandemic when students returned to study in person, requiring a visa, after studying remotely without one

[106] Sumption M (2022), Why has non-EU migration to the UK risen?, The Migration Observatory

- net migration for humanitarian reasons has increased by 166,000 – this is primarily to permit entry by Hong Kong and Ukrainian nationals
- net migration by asylum seekers has increased by 45,000
- net migration by family members has fallen by 39,000 and for other reasons has risen by 7,000

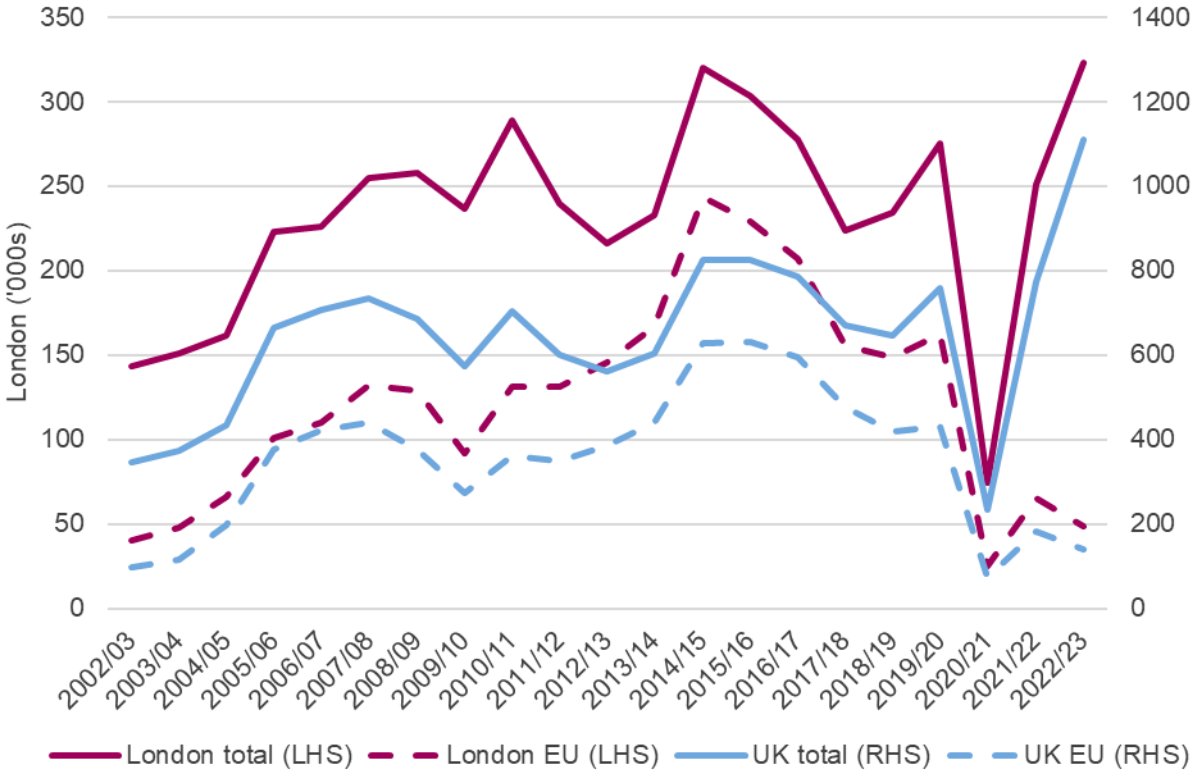
Net EU migration for work reasons has fallen, as the remainder of this section discusses – again this can be attributed to the new migration regime, and its bar on lower skilled individuals from the EU finding work in this country. Net EU migration for study reasons has also fallen, as is discussed in the next section. Again, this is Brexit-related, as fees for EU students have risen to the levels charged for non-EU students.

Research[107] concludes, as the analysis above suggests, that the new immigration system is working broadly as expected in encouraging more immigration by non-EU citizens, and less by EU citizens. The conditions of the new system, though, while liberal, are too onerous to compensate for the loss of free movement in low-skilled sectors of the economy, which is contributing to labour shortages. Using a counterfactual of what would have happened otherwise, the research authors estimate that by September 2022 there was a significant shortfall of around 460,000 EU-origin workers, partly but not wholly compensated for by an increase of about 130,000 non-EU workers. The net loss of workers – around 330,000 – is 1% of the labour force. There was no evidence (by mid-2022) of widespread wage increases in low-wage industries that previously relied on EU workers[108]. More positively[109], the new immigration system has alleviated workforce pressures through the introduction of entry visas, including for low paid work, on the NHS and social care sectors, and seasonal agricultural workers. The rise in skilled worker inflows, alongside the rise in international students, is likely to have increased not just GDP, but GDP per capita as well, benefiting the UK economy and public finances.

The emerging evidence is that London has gained less from the inflows of non-EU workers. In the case of National Insurance number (NINO) registrations, which records both new immigrants and existing residents newly entering the labour market, numbers in London in 2022/23 were broadly similar to (3,000, or 1% higher than) those at the previous peak in 2014/15. For the UK as a whole numbers of NINO registrations in 2022/23 were 286,000, or 35% higher, than in 2014/15. Consequently, the proportion of London-based NINO registrations has fallen from 39% to 29%. Over the same time period again the number of NINO registrations by EU citizens has fallen by around 80% for both London and the UK (Figure 3.18).

[107] Springford J and Portes J (2023), The impact of Brexit on the UK labour market: an early assessment, UK in a Changing Europe
[108] Sumption M et al (2022), How is the End of Free Movement Affecting the Low-wage Labour Force in the UK?, The Migration Observatory
[109] Portes J (2023), Why the panic over rising immigration? The post-Brexit system is working, The Guardian, 23 May

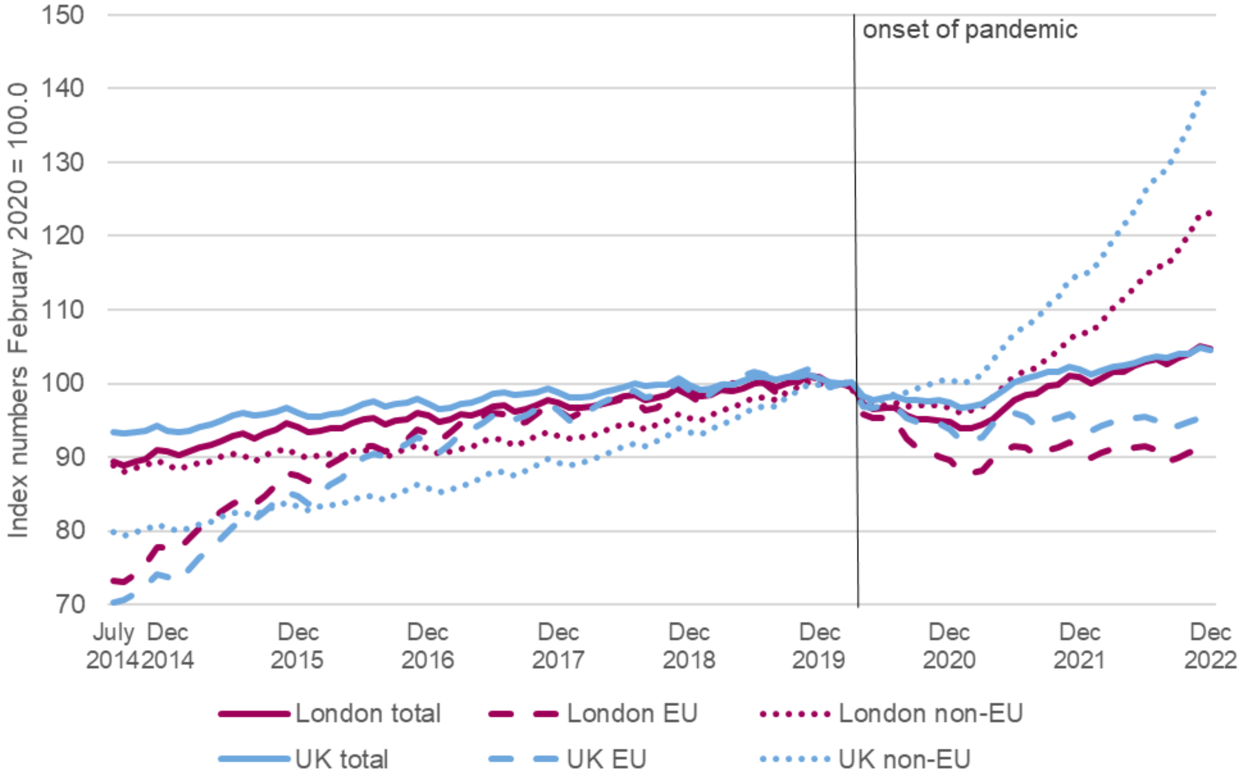
Figure 3.18: London and UK NINO registrations, total and EU citizens, 2014/15 to 2022/23



Source: DWP NINO registrations to adult overseas nationals entering the UK

Payrolled employments provides a broader measure of jobs, and includes employees and working business owners, but not the self-employed. Again, by this measure the UK benefits more from the liberalisation of employment for non-EU citizens, total jobs for these people rising by 41%, over the period February 2020 to December 2022, compared with a 23% increase for London. In contrast, there has been a more pronounced loss of jobs held by EU citizens in London, falling by 10% over this period compared with 5% for the UK – it appears that London has been disproportionately impacted by emigration, if immigration patterns are similar as the previous figure indicated (Figure 3.19). Over the period of analysis, London's share of EU employment has fallen marginally from 32% to 31%, while its share of non-EU employment has fallen from 41% to 36%.

Figure 3.19: Payrolled employments by country of origin, London and the UK, July 2014 to December 2022



Source: HMRC Payrolled employments in the UK by region, industry and nationality, from July 2014 to June 2021

4 Brexit and students

There has been a marked decline in students from the EU visiting or studying in the UK.

4.1 Children

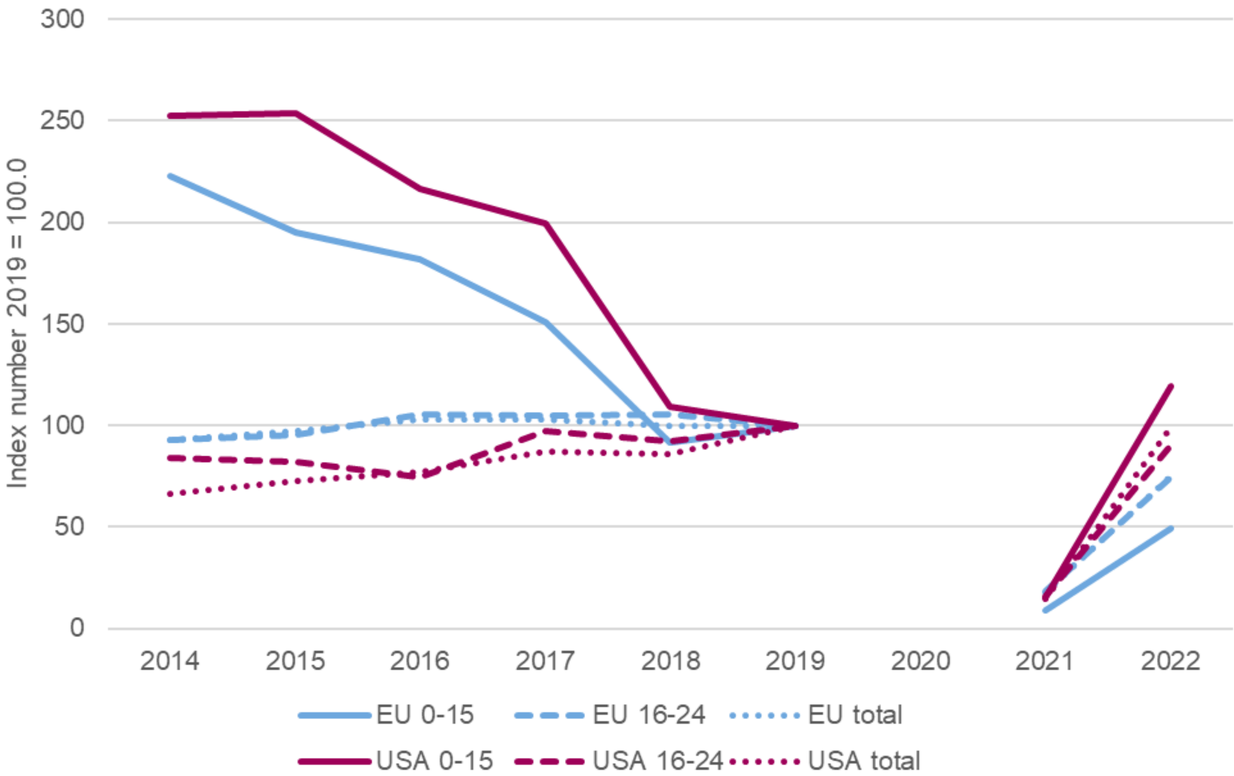
Prior to the UK leaving the EU, students who were EU nationals, or had the right to reside in the EU, could travel to the UK as part of an organised school group. That is, provided they were accompanied by a teacher from the school, who gave the Border Force a list of children and their national ID card numbers. After the UK left the EU it became a requirement that all visitors from the EU used a passport rather than a national ID card to gain entry into the UK. This raises two problems:

- A large percentage of EU school students do not have passports. Figures vary by country but, for example, it is estimated that only 35% of Italian school children have a passport
- Many schools have children who are foreign nationals with the right to live in the EU but who do not have an EU passport. In addition to the passport requirement, many of these children would also need to apply for a visa to enter the UK[110]

The scale of the impact of these changes has been estimated by a survey for the Tourism Alliance. It was completed by 82 operators based in Europe that specialise in sending groups of students aged up to 18 to the UK for the purposes of attending an English language school, or undertaking an educational, cultural or sport-related trip to the UK. These operators sent a total of 37,000 students to the UK up to the end of August 2022. This was 83% down on the number of students (220,000) that they sent to the UK during the same period in 2019. In comparison, the number of students going to Ireland fell by 29%. 56% of the businesses surveyed ranked the requirement for all students to have a passport as highly important, compared with 24% ranking the increased cost of travelling to the UK as highly important, and 9% ranking COVID-19 as highly important[111].

There has also been a marked drop in the numbers of children visiting the UK, whether with a school or otherwise, between 2019 and 2022. The number of visits by EU-domiciled 0-15 year olds fell from 774,000 in 2019 to 382,000 in 2022, or by 51%. A fall would be expected as the overall number of visitors to the UK remains down after the pandemic. But, the fall has been greater than for all EU nationals, and those aged 16-24. Indeed, child visitors from the US in 2022 were above the level in 2019, and rose more strongly than for all visitors, and the 16-24 year olds (Figure 3.20).

Figure 3.20: UK visitors by area of residence and age band, 2014-22



Source: ONS Travel Trends

Note: ONS has adopted the same survey methodology throughout the period of analysis

4.2 Adult students

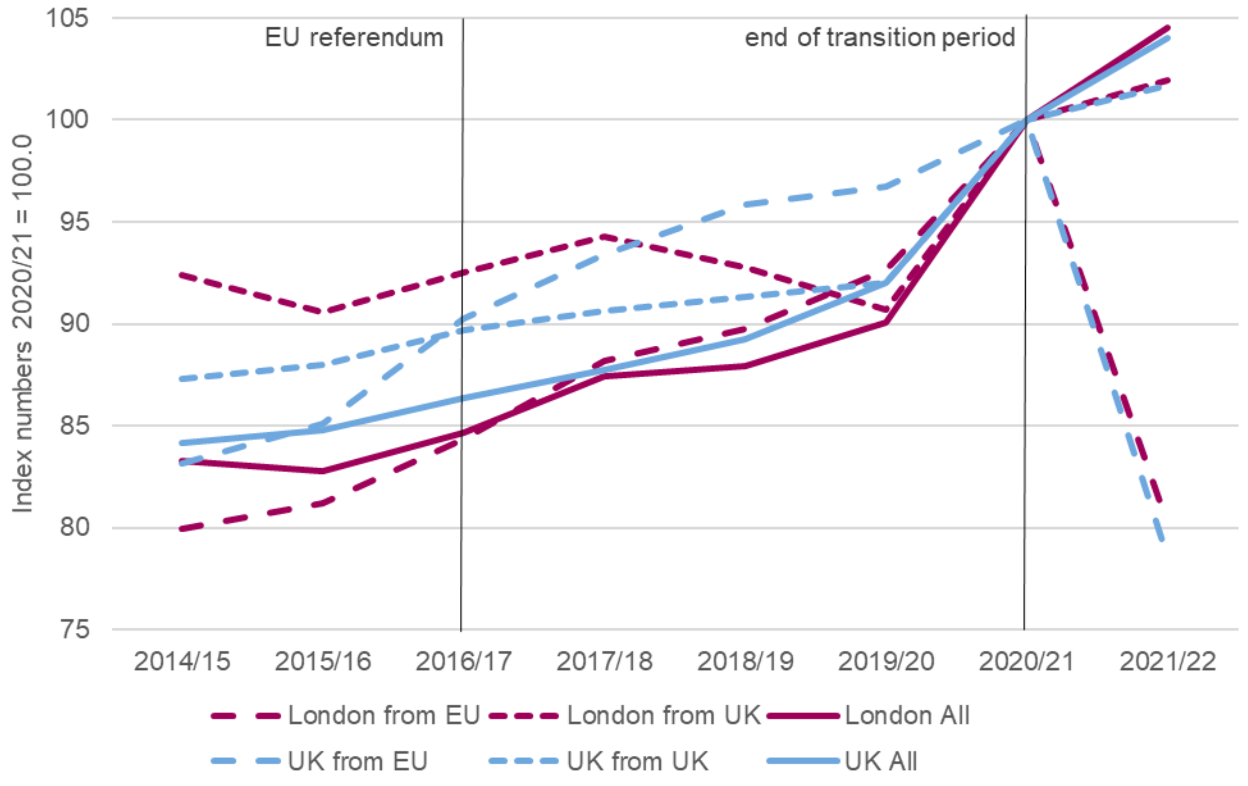
Adult students from the EU at UK universities have fallen markedly in 2021/22, the first year after the transition period before leaving the Single Market. In the prior period after the EU Referendum the numbers of students rose in terms of total numbers, as well as those from each of the UK and EU – there was a similar pattern for students at London and UK universities, although over the period 2014/15 to 2020/21 numbers at London universities rose slightly stronger. In the year to 2021/22, the total

[110] Tourism Alliance (2022), The Economic impact of the requirement for EU students on school trips to have passports to enter the UK, November

[111] Tourism Alliance (2022), The Economic impact of the requirement for EU students on school trips to have passports to enter the UK, November

number of students at London and UK universities continued to rise as did the number of students from the UK, and overseas students from outside the EU. However, the number of EU students at London universities fell from 44,000 to 35,000, or by 20%. The corresponding fall for EU students at UK universities was from 153,000 to 120,000, or by 21% (Figure 3.21). The proportion of EU students at UK universities is expected to continue to fall as the current cohort graduates, and is not fully replaced.

Figure 3.21: Students at London and UK universities by area of origin, 2014/15 to 2021/22



Source: Higher Education Statistics Agency

First year EU domiciled enrolments across UK universities dropped by 53% from 2020/21 to 2021/22. This is likely to be because of Brexit. Accompanying the UK's exit from the EU there was a change in international fee policy from 1 August 2021[112]. Before Brexit EU students paid home fees of just over £9,000 and had student finance available. Now charges are the same as for other overseas students. Fees have risen from £11,400 to £38,000 depending on the learning institution[113].

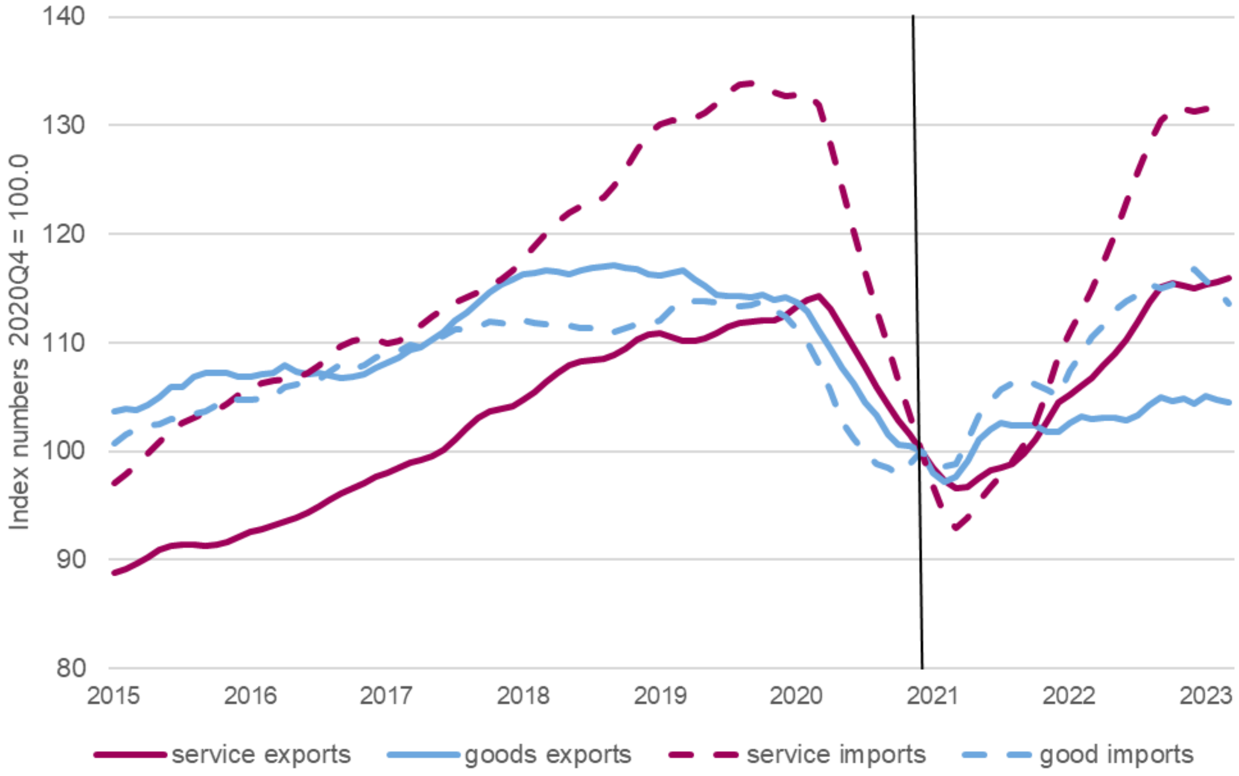
5 Brexit and trade

After the EU Referendum in June 2016 UK goods and services exports and imports increased. The exchange rate depreciation made exports more competitive, while the UK's involvement in international supply chains may have increased demand for imports. After the onset of the pandemic trade collapsed to below 2016 levels. This continued after the Trade and Cooperation Agreement (TCA) came into effect in the first quarter of 2021.

[112] Higher Education Statistics Agency (2023), Higher Education Student Statistics: UK, 2021/22 – Where students come from and go to study
[113] O'Carroll L and Adams R (2023), Number of EU students enrolling in UK universities halves post-Brexit, The Guardian, 27 January

There have been differing experiences of the recovery for goods and services. Notably, goods exports have not returned to former levels. Exports of both goods and services dipped once the TCA came into effect. Initially goods exports picked up first, but service exports have had a stronger, and more sustained recovery. The volume of service exports has now passed its pre-pandemic peak, while goods exports remain 10% below their previous peak. Service imports continued to fall after the introduction of the TCA, and are now near their pre-pandemic peak. Good imports have broadly risen steadily since the TCA, and have returned to their pre-pandemic peak (Figure 3.22). The UK having not yet introduced post-Brexit border checks for imports from the EU may have helped.

Figure 3.22: UK goods and services trade after inflation, annual moving average, January 2015 – March 2023, index numbers 2020 Q4 = 100.0

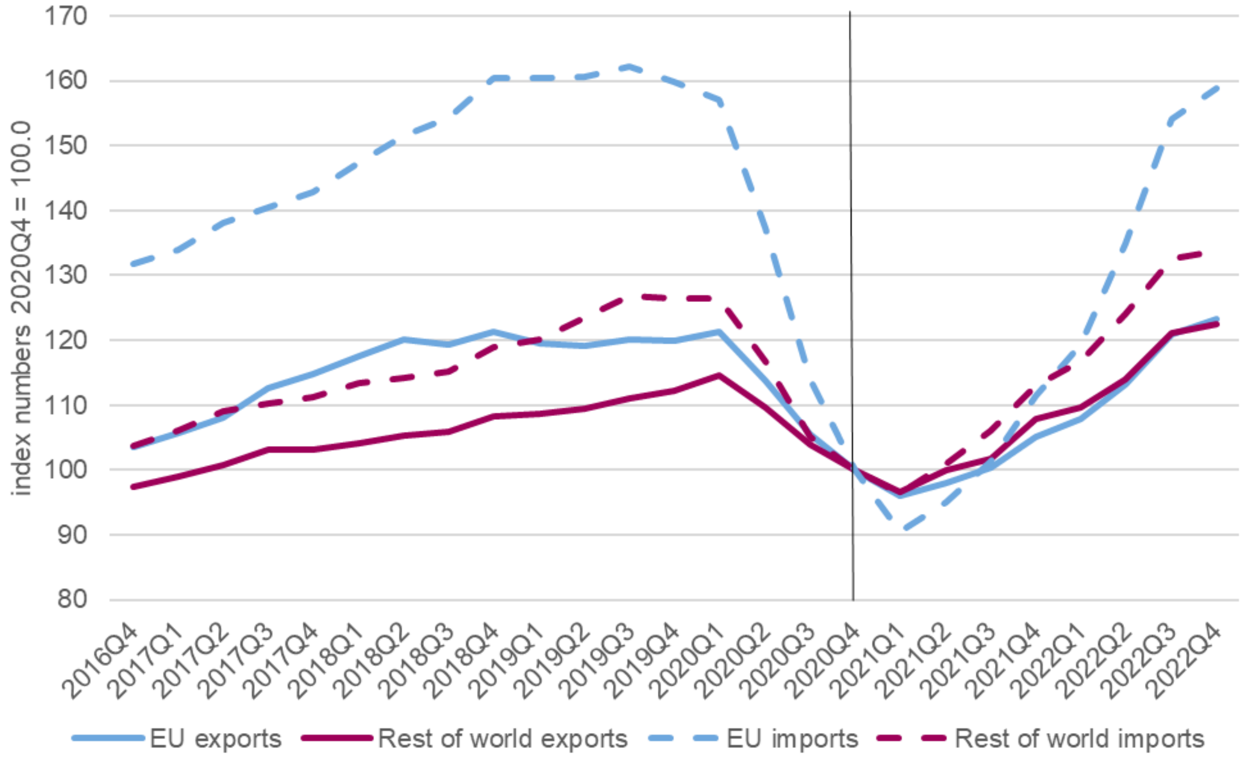


Source: ONS monthly trade statistics

Note: Inflation has been estimated for individual series by the ONS, and goods figures exclude precious metals

The expansion in services trade has happened with the rest of the world rather than the EU. The expansion of UK trade in services with the EU after the EU Referendum continued into 2018 before flattening out, perhaps reflecting the uncertainty at the time about the UK's future relationship with the EU. Trade with the rest of the world continued to grow. UK services trade, both with the EU and beyond, fell dramatically during the pandemic. Exports have since reached pre-pandemic levels: EU export volumes are 3% higher, and exports to the rest of the world 9% higher. After a further fall in the first part of 2021 following the introduction of the TCA, there has been a subsequent recovery. The speed of the recovery has been greater for imports, and for trade outside the EU. This is consistent with the introduction of trade barriers on exports to the EU (Figure 3.23).

Figure 3.23: Trend in UK services trade, after inflation, to the EU and the rest of the world, annual moving average, 2016 Q4 to 2022 Q4, index numbers 2020 Q4 = 100.0



Source: ONS UK trade in services: service type by partner country; Note: Inflation measure used is the GDP deflator.

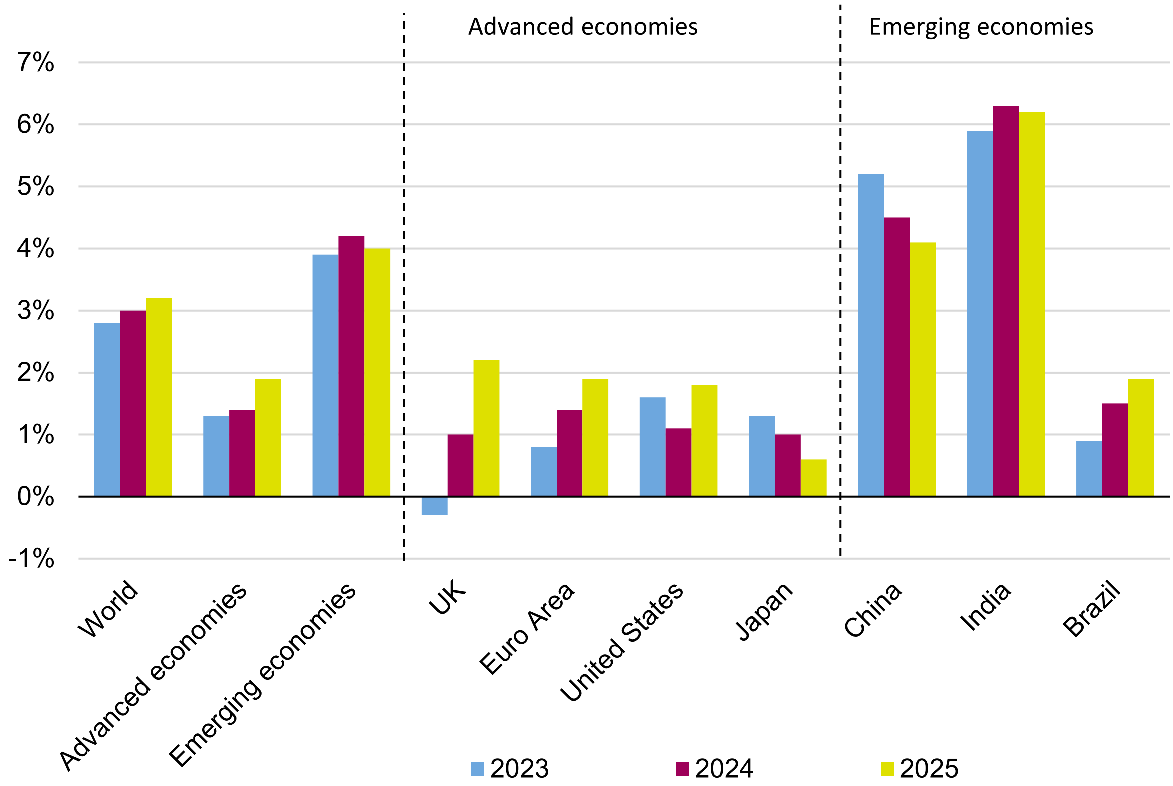
3.3 The global economy

Global economies grew in 2021 and into 2022 with the easing of the pandemic due to the vaccination programmes in the more developed countries, and the associated ending of lockdowns in most countries. However, global inflationary pressures rose due to the impact of the war in Ukraine on commodity prices as well as ongoing supply chain issues. Central banks are responding and global growth is expected to ease off at the end of 2022 and 2023. This has exposed weaknesses in the banking sector, notably the systemically important UBS Credit Suisse. The IMF notes that, "The recent events are powerful reminders of the challenges posed by the interaction between tighter monetary conditions and the vulnerabilities built up since the global financial crisis"[114]. The IMF further observes that, "We are therefore entering a perilous phase during which economic growth remains low by historical standards and financial risks have risen, yet inflation has not yet decisively turned the corner" [115].

The latest IMF World Economic Outlook[116] forecasts global growth of 2.8% this year (0.1 percentage points down from its January forecast) but improving slightly to 3.0% next year (also 0.1 percentage points down). Advanced economies are projected to expand – on average – by 1.3% this year while emerging economies will grow – on average as well – by 3.9%. This implies that the global economy is recovering from the 2020 global recession but now faces fresh global headwinds (Figure 3.24).

[114] IMF (2023). 'Global Financial Stability Report: Safeguarding financial stability amid high inflation and geopolitical risks', April 2023.
[115] IMF (2023). 'World Economic Outlook: A rocky recovery', April 2023.
[116] IMF (2023). 'World Economic Outlook: A rocky recovery', April 2023.

Figure 3.24: IMF forecasts of real GDP growth for selected economies



Source: IMF – World Economic Outlook, April 2023.

The advanced economies grew by 2.7% on an annual basis in 2022. The IMF expects growth in 2023 of 1.3% (up 0.1 percentage points on the January 2023 forecast), and then an almost identical 1.4% growth in 2024 (unchanged on their last forecast). The output of most advanced economies recovered to pre-COVID levels in 2022 (although the UK did not).

Looking at the advanced economies in more detail, the **US** economy grew by 1.3% year on year in Q1 2023. This follows a year-on-year expansion of 2.6% in Q4 2022[117]. An acceleration in consumer spending drove the increase in GDP in the first quarter, and was accompanied by an upturn in exports and imports. Compared with the fourth quarter, the deceleration in GDP after inflation reflected a downturn in inventory investment, a slowdown in business investment, and a decrease in housing investment. Jobs growth also continues to be firm in a tight labour market. Inflation remains elevated at 4.9% in April, down from the 40-year high of 9.1% last June. In response in May, the Federal Reserve raised its benchmark lending rate to stand at 5.0-5.25%, the tenth increase in rates, and the highest level since September 2007. On a positive note the US legislature ended the debt ceiling stand off for public spending that risked a default in the world's largest economy.

The **Eurozone's** economy has entered recession. In Q1 2023, GDP decreased by 0.1% on a quarter-by-quarter basis, but increased by 1.0% on an annual basis[118]. This followed a 0.1% quarter-by-quarter decline in Q4 2022. The IMF forecasts that the Eurozone will grow by 0.8% in 2023 (a rise of 0.1 percentage points

[117] Bureau of Economic Affairs (2023). '[Gross Domestic Product (Second Estimate) and Corporate Profits (Preliminary), First Quarter 2023](#)', 25 May 2023.
[118] Eurostat (2023). '[GDP main aggregates and employment estimates for the first quarter of 2023](#)', 8 June 2023.

on their January forecast) and by 1.4% in 2024[119] (unchanged from January). Meanwhile, the European Commission forecasts EU growth of 1.0% in 2023 and 1.7% in 2024[120]. The EU is the part of the world most dependent on Russian energy imports, and so one of the most exposed to the adverse economic effects of the war in Ukraine. The European Central Bank (ECB) has been tightening monetary policy to tackle inflation with rates increasing since July from -0.5%, with the main benchmark rate now standing at 3.25%, a level not seen since the 2008 sovereign debt crisis. Further rate increases are expected.

The **Japanese** economy grew year-on-year by 1.6% in the first quarter of 2023 after growing by 4.5% in the fourth quarter of 2022[121]. Still, the IMF expects that Japan's economy will expand by 1.3% in 2023 (0.5 percentage points down on their January forecast), and by 1.0% in 2024 (0.1 percentage points higher than previously forecast).

Emerging market economies
The IMF expects growth of 3.9% in the emerging market economies in 2023 (a downgrade of 0.1 percentage points on their January forecast) and growth of 4.2% in 2024[122] (unchanged from January). In relation to volatility in the financial sector, the IMF has noted that, "contagion to the banking systems of major emerging markets remains contained, continuing the theme of resilience of these economies during this period of global monetary tightening. Emerging markets tend to have less exposure to interest rate risk and a substantially higher share of stickier retail deposits"[123].

Of the major emerging markets, **China's** economy grew by 4.5% between Q1 2022 and Q1 in 2023[124]. The IMF expects growth to be 5.2% in 2023 before slowing to 4.5% in 2024[125] (unchanged in both years on their January forecast). The Asian Development Bank (ADB) also expects China's economy to grow, even if the pace is more moderate than in recent years. The ADB anticipates growth of 3.6% in 2023 and 3.7% in 2024[126]. Looking at China's economy in detail, the IMF comments that, "As the country's COVID restrictions were ultimately lifted, multiple large outbreaks led to declines in mobility and economic activity in the fourth quarter of 2022 [...] The surge in infections compounded the headwinds from property market stresses. Declining property sales and real estate investment posed a drag on economic activity last year [...] As COVID-19 waves subsided in January of this year, mobility normalized, and high-frequency economic indicators – such as retail sales and travel bookings – started picking up"[127].

Meanwhile, **India's** economy is estimated to have grown by 7.2% in 2022/23[128]. Looking at the year as a whole, the IMF expects growth of 5.9% in 2023, and 6.3% in 2024 (a downgrade of 0.2 percentage points for 2023 and 0.5 percentage points for 2024[129] on their January forecast). The ADB also expects healthy growth this year and next, at 6.4% in 2023 and 6.7% in 2024[130].

In **Russia**, the economy grew by 5.6% in 2021, and contracted by 2.1% in 2022 according to the IMF. The IMF expects the economy to grow by 0.7% in 2023 and a further 1.3% in 2024 (upgrades of 0.4 percentage points for 2023 and a downgrade of 0.8 percentage points for 2024[131] compared with their previous

---

119 IMF (2023). 'World Economic Outlook: A rocky recovery', April 2023.
120 European Commission (2023). 'Spring 2023 Economic Forecast: An improved outlook amid persistent challenges', 15 May 2023.
121 Source: OECD Economic Outlook, March 2023
122 IMF (2023). 'World Economic Outlook: A rocky recovery', April 2023.
123 IMF (2023). 'Global Financial Stability Report: Safeguarding financial stability amid high inflation and geopolitical risks', April 2023.
124 National Bureau of Statistics of China (2023). 'Preliminary Accounting Results of GDP for the First Quarter of 2023', 20 April 2023
125 IMF (2023). 'World Economic Outlook: A rocky recovery', April 2023.
126 Asian Development Bank (2023). 'Asian Development Outlook (ADO) April 2023'.
127 IMF (2023). 'World Economic Outlook: A rocky recovery', April 2023.
128 Press Information Bureau Government of India, Press note on provisional estimates of national income 2022-23 and quarterly estimates of gross domestic product for the fourth quarter (January – March) of 2022-23, 31 May
129 IMF (2023). 'World Economic Outlook: A rocky recovery', April 2023.
130 Asian Development Bank (2023). 'Asian Development Outlook (ADO) April 2023'.
131 IMF (2023). 'World Economic Outlook: A rocky recovery', April 2023.

forecast). It notes that, "the contraction in Russia's economy is less severe than earlier projected, reflecting resilience in crude oil exports and in domestic demand with greater fiscal and monetary policy support and a restoration of confidence in the financial system".

3.4 Risks to London's economy

The outlook for both the London and UK economies has improved as energy prices have been lower than expected. That said, there remain significant headwinds which are clearly restraining activity in the UK economy, and to a lesser degree London. There remains considerable uncertainty around the size and lasting impact of these factors. Here, we outline some of the key risks on both the upside and downside. While there remain some potential triggers for an improvement in the outlook, overall, risks are skewed to the downside.

Starting with the positive possibilities, the key near-term upside risk is around household resilience to high inflation. While the poorest Londoners may be among the most exposed in the UK to the cost of living crisis, the average London household may see relief from a number of sources. First, Londoners have higher average incomes than in other regions. Second, Londoners on average devote less of their spending to energy and have more energy efficient housing. Evidence of this London-specific resilience may be visible in the capital's less pessimistic consumer and business confidence readings.

On top of these region-specific sources of resilience, recent national accounts revisions also show that at the UK level, there may be an even larger than previously estimated pool of pandemic excess savings on hand. The savings rate is now estimated to have been even higher during the pandemic than previously thought, and a higher share of this increase has been estimated as due to 'forced' savings due to activity restrictions[132]. Taken together, these changes mean that forced pandemic savings have been revised up from a cumulative £145 billion across the UK to £194 billion – 13% of annual household disposable income. Combining this larger-than-expected pool of excess savings during the pandemic with Londoners' higher-than-average incomes, households may have more financial capacity to deal with the rising cost of living than we currently expect. As a result, consumer spending could ultimately see less of a decline in London than we envision in our baseline.

London's resilience may be boosted by recent growth in the London economy while the UK stagnates. The reasons for this are not fully clear, and it is based on early statistical estimates which will be subject to revision. However, there is evidence that some of the export-oriented sectors in which London specialises are doing well, and that UK services exports other than to the EU are growing strongly. These gains may be flowing through to the average incomes of Londoners, whose expenditure as a result on consumer-facing sectors such as arts and hospitality may be higher than otherwise. Forced savings may also be contributing to higher expenditure.

In the longer term, one positive possibility hinges on demographics in London. As discussed in Box 3.2, overseas worker and student migrant numbers have risen, and are well ahead of pre-pandemic levels. London receives a major share of skilled migrants, so increases in visa numbers and students could boost the capital's labour supply and human capital.

Turning to downside risks, a cluster of risks focus on triggers for even higher household costs, including around energy, food and housing. The war in Ukraine and Russia's moves to cut gas supply to Europe in response to sanctions continue to threaten higher energy costs. So do repeated moves from OPEC+ to shore up the price of oil with supply cuts. In partial mitigation, the Government has continued to provide some

[132] ONS (2022), "Blue Book 2022 – revised impacts of the coronavirus (COVID-19) pandemic on the UK economy", 31 October 2022

relief for business energy bills until April 2024[133], which will alleviate any price rises from firms to offset higher costs.

Russia's war in Ukraine also carries a risk for food price inflation. As Russia is a major fertilizer producer and both Russia and Ukraine major grain exporters, food costs could potentially overtake energy costs as an external driver of inflation. A further depreciation of the pound would also increase import costs, boosting energy and food prices.

Housing costs also look likely to rise in the near term. Record increases in asking rents in London will soon begin to feed through into the overall stock of rents. And rising short- and long-term interest rates will increase mortgage costs. It is even possible that the rising costs of servicing a mortgage will see more private landlords sell off their property, while households on the margin between renting and buying cannot finance buying up that spare supply.

Any of these triggers raising household costs in the near term would tighten the squeeze on consumers' budgets, likely deepening pressures on consumer spending.

There is also downside risk that could come from medium-term inflation drivers like higher inflation expectations or a wage-price spiral. While long-term inflation expectations are at comparable levels to pre-pandemic surveys, the distribution of responses to the Bank of England's inflation surveys have become increasingly dispersed. For example, while overall inflation is falling, food price inflation, which affects low incomes households disproportionately, remains stubbornly high at over 19%[134]. This means that the risk of de-anchoring inflation expectations could be higher than the average suggests as households are less certain about their expectations. As a result, households may be more prone to changing their minds about the inflation outlook – so de-anchoring could happen quite quickly.

The risk of a wage-price spiral remains. Although the labour market is starting to cool and real wages are falling sharply, core inflation, that is inflation less the more volatile elements of energy, food, alcohol and tobacco, is continuing to rise. Indeed, the longer inflation remains high, the more compelling demands for higher wages will become, and industrial action could become more widespread. If firms respond to increased labour costs by hiking prices to preserve profit margins, this will entrench higher inflation for longer. In turn, the longer inflation remains high, the longer households are likely to depress spending further restraining economic activity.

There are also long-term downside risks. Firstly, while migration numbers have been up in recent national figures, London's inactivity rate has also been increasing, especially among older workers. The data has been somewhat volatile, making a clear trend difficult to pick out. Yet if recent increases were sustained and more Londoners did drop out of the pool of workers and job-seekers, this would reduce London's labour supply and its potential output.

Secondly, the arrival of a fresh downturn immediately on the heels of the pandemic shock makes long-term economic scarring increasingly likely. Business closures have overtaken business births for more than a year in London[135], raising the risk of lasting job losses. London already has a higher share of long-term unemployed than the wider UK[136]. Further increases could damage the capital's skills profile and make it harder for those out of work to quickly find new employment in a recovery. This could be a key trigger for

---

[133] Department for Energy Security and Net Zero and Department for Business, Energy and Industrial Strategy (2023), Energy Bill Relief Scheme: help for businesses and other non-domestic customers
[134] ONS 2023). 'Consumer price inflation, UK: April 2023', May 2023.
[135] ONS (2023), "Business demography, quarterly experimental statistics, UK: January to March 2023", 5 May
[136] GLA Economics (2022), "Out-of-work trends in London", November 2022. Accessible on the Labour Market Analysis web page.

long-term damage to London's output potential. A drop in business investment due to lower growth expectations, higher interest rates and elevated uncertainty would also damage London's long-term prospects by reducing growth in the capital stock. Lower investment is also likely to damage productivity growth in the long term. Combining these possible triggers, if London declines as an international centre for work and investment in the medium term and loses core business agglomerations, this would degrade output below our baseline in the long term.

A range of risks also arise from policy – both on the upside as well as the downside. The Bank of England's interest rate hiking cycle is already the most aggressive since the late 1980s, and rates may rise still further. But if inflation remains stubbornly high for longer than the Bank currently projects, yet more increases could do serious damage to aggregate demand. Conversely, if inflation falls faster than expected, the reduced need for interest rate hikes could provide some relief for the outlook. Meanwhile, the future path for fiscal policy faces several sources of uncertainty. If interest rates on government debt continue to increase, this will likely result in more fiscal tightening, dragging on overall economic activity. Conversely, if tax revenues surprise on the upside or falling inflation lowers long-term interest rate expectations, this could offer scope for less fiscal tightening, helping support demand.

3.5 Conclusion

The unprecedented fall in London's economic activity over 2020 reflected a decline in both demand and supply because of the COVID-19 pandemic. The successful vaccine rollout and major fiscal support built a foundation for the recovery across 2021, but the UK economy has only just returned to pre-pandemic levels. While London was hit harder by the pandemic in 2020, its rapid recovery in 2021 has allowed it to fare better than the UK average, recovering to pre-pandemic output levels by late 2021. However, global supply shocks and Russia's invasion of Ukraine now mean that London and the wider UK face a fresh headwind from high inflation. The cost of living crisis, and higher taxes to repay spending during the pandemic, will depress consumer spending and restrain output growth. Irrespective of this, London, unlike the UK, appears to be growing, possibly benefiting from growing service exports outside the EU.

All sectors of London's economy were affected by the shock, despite the unprecedented UK economic policy response during the pandemic. More recently, some of the sectors in which traditionally London has specialised have come to the fore. This may have boosted household incomes, and so spending on some consumer-facing sectors, which suffered disproportionately during the pandemic.

Stepping back from central projections, the outlook for London's economy remains unusually uncertain. The risks to the economic recovery are varied and continue to skew to the downside. The evolution of the global economy, supply risks from the war in Ukraine, policy responses, the depth of savings cushions, the ongoing effects of Brexit are all salient risks. The response of households and firms to all these developments will determine the evolution of the capital's economy over the coming year.

Considering all these elements, GLA Economics provides its medium-term scenario-based forecasts for London's economy in Chapter 5 of this document.

4 Review of independent forecasts

GLA Economics forecasts four economic indicators: workforce jobs, real GVA, private consumption (household expenditure) and household income in London. This chapter summarises the consensus view as of 19 June 2023 on these indicators[137], drawing on forecasts from outside (independent) organisations[138]. Chapter 5 then provides a summary of GLA Economics' own projections.

All the external forecasts were produced after the March 2023 Office for Budget Responsibility Economic and Fiscal Outlook, and over the period March to May. While some were produced after the ONS 2021 annual regional GDP release, none incorporate the quarterly data release in May.

Both annual growth rates and 'standardised' absolute levels are reported. All money-valued data is in real terms (constant 2019 prices). The source for the historic data on GVA and workforce jobs presented in the following tables and charts is GLA Economics modelling using ONS data[139]. The source of historical data for Household Income and Expenditure is a mixture of Experian Economics (EE) for growth rates and GLA Economics modelling using EE data for the absolute levels.

Beyond the headline, both the external consensus and GLA Economics deliver forecasts for employment and output growth in six broad sectors[140]:

- Manufacturing
- Construction
- Transport and storage
- Distribution[141], accommodation and food services
- Finance and business services[142]
- Other (public & private) services[143].

[137] The consensus forecast for GVA and employment is based on the latest available forecast from the Centre for Economics and Business Research, Experian Economics, Oxford Economics and S&P Global.
[138] S&P Global do not provide household expenditure forecasts.
[139] The main underlying ONS source for output is the Quarterly country and regional GDP series and the main underlying ONS source for employment is Workforce jobs by region and industry.
[140] Since our spring 2012 forecast, GLA Economics has been using the 2007 Standard Industrial Classification (SIC 2007). For more information see Appendix A of 'London's Economic Outlook: Spring 2012', GLA Economics, June 2012.
[141] Distribution is made from the summation of Wholesale and Retail.
[142] Business services is made from the summation of Information and Communication, Professional, scientific and technical services, Real estate, and Administrative and support service activities.
[143] This is the sum of Public admin and defence, Education, Health, Arts, entertainment and recreation and Other services. While this set of sectors neglects primary industry and utilities, these made up less than 1.5% of London's 2021 output.

Output

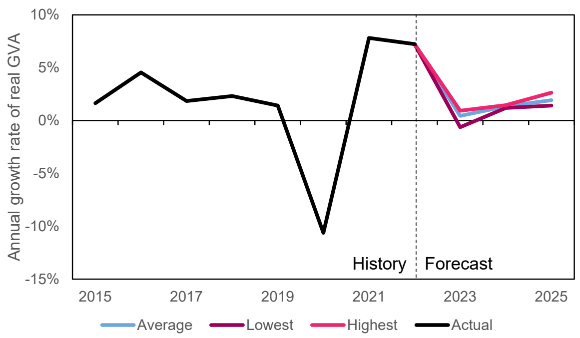
(London GVA, constant prices (base year 2019), £ billion)

The consensus (mean average) forecast puts real output growth at 0.4% in 2023, followed by a moderate recovery to 1.3% in 2024 and 1.9% in 2025.

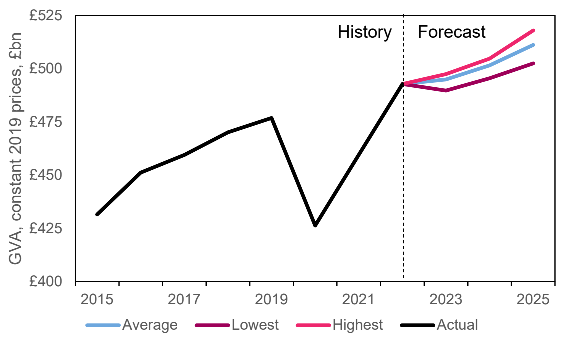
The consensus forecast has improved significantly since December 2022. The mean estimates in the last LEO were for a contraction of 0.4% in 2023 and 1.8% growth in 2024. This implies the consensus projection for the total size of London's economy by 2024 is now more than 3% higher than in December, though revisions also increase the start point.

The range of estimates has narrowed since December. The widest range of estimates for growth comes in 2023, when there is a difference of 1.6 percentage points (ppts) between the highest and lowest output growth estimates. The highest-growth profile would see London's economy 1.3% larger than the consensus path by 2025. This profile sees output largely shrug off the cost of living crisis and grow faster in the medium term. The lowest-growth profile would see London's economy 1.7% smaller than the consensus path by 2025. The levels of output in 2025 under the highest- and lowest-growth profiles differ by around 3%, compared to a range in three-years-ahead output levels of around 4% in December.

Annual growth



Level (constant year 2019, £ billion)



Annual growth (%)			
	2023	2024	2025
Average	0.4	1.3	1.9
Lowest	-0.6	1.2	1.4
Highest	0.9	1.5	2.6

Level (constant 2019 prices, £ billion)			
	2023	2024	2025
Average	494.9	501.6	511.2
Lowest	489.7	495.5	502.5
Highest	497.4	504.7	517.9

History: Annual growth (%)

2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
2.9	4.4	1.6	4.6	1.8	2.3	1.4	-10.6	7.8	7.2

History: Level (constant 2019 prices, £ billion)

2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
406.6	424.5	431.5	451.1	459.5	470.1	476.8	426.2	459.6	492.8

Employment

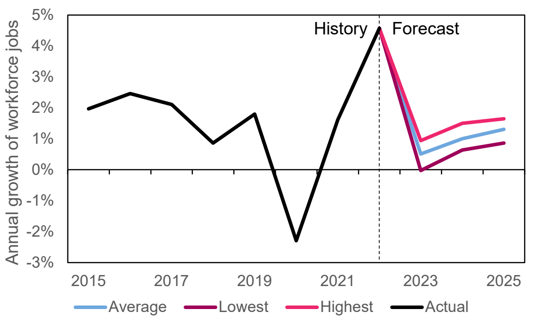
(London workforce jobs)

The consensus forecast for workforce jobs anticipates growth of 0.5% in 2023, before recovering to 1.0% in 2024 and 1.3% in 2025.

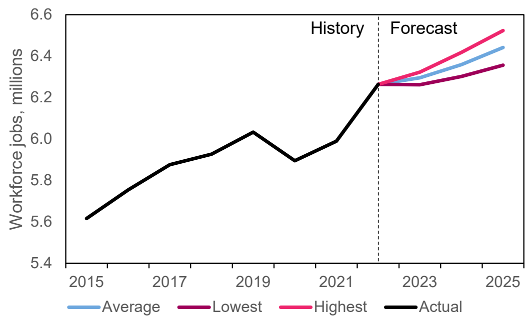
As with output, this represents an improvement on December forecasts – particularly in the near term. Last autumn, the consensus saw a contraction of 0.3% in 2023 and growth of 1.2% in 2024. With major upward revisions to workforce jobs data in 2022, the consensus forecast for the size of the job market in London by 2024 has risen over 4% since December.

The range of estimates for the size of London's job market has narrowed somewhat since December, suggesting somewhat less uncertainty about the path ahead for London's labour market. The widest range of growth projections is in 2023, with a 1.0ppt difference between the highest and lowest forecasts. The lowest-growth profile would see employment 1.3% below the consensus level by 2025, while the highest-growth profile would leave employment 1.3% above the consensus. There are 2.6% more jobs in the highest-growth profile than in the lowest-growth profile by 2025, compared to a three-year-ahead range of 3% in December.

Annual growth



Level (millions of workforce jobs)



Annual growth (%)			
	2023	2024	2025
Average	0.5	1.0	1.3
Lowest	0.0	0.6	0.9
Highest	0.9	1.5	1.6

Level (millions of persons)			
	2023	2024	2025
Average	6.30	6.36	6.44
Lowest	6.26	6.30	6.36
Highest	6.32	6.42	6.52

History: Annual growth (%)

2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
2.9	4.3	2.0	2.5	2.1	0.9	1.8	-2.3	1.6	4.7

History: Level (millions of persons)

2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
5.3	5.5	5.6	5.8	5.9	5.9	6.0	5.9	6.0	6.3

Household expenditure

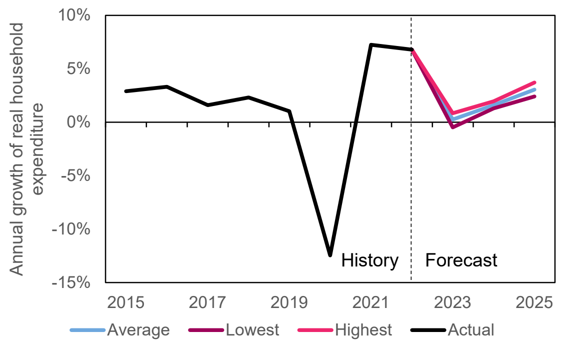
(Constant prices (base year 2019), £ billion)

The consensus forecast for consumer spending is for growth of 0.3% in 2023, rising to a moderate 1.6% in 2024 and recovering to 3.1% in 2025. The consensus implies that spending will remain above pre-pandemic levels throughout the forecast.

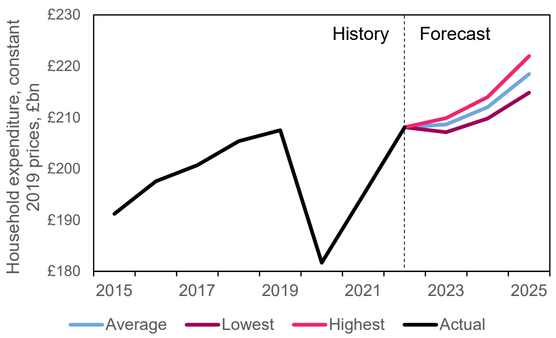
This is stronger in the near term than the December 2022 consensus, which involved a drop of 0.1% in 2023, followed by growth of 2.2% in 2024. However, downward data revisions mean the consensus forecast for spending in London by 2024 is below its level last autumn.

The range of uncertainty around spending is similar to last December's forecasts. The widest range of growth projections is for 2023, with a 1.3ppt gap between the highest and lowest. The lowest-growth profile sees spending around 1.7% lower than the consensus by 2025. This path envisages a contraction in 2023, with a softer medium-term recovery. Meanwhile, the highest-growth profile implies spending 1.6% higher than the consensus. Overall, by 2025 expenditure is over 3% higher in the highest-growth profile than in the lowest-growth profile, which is wider than the three-year-ahead range of just under 3% in December 2022.

Annual growth



Level (constant 2019 prices, £ billion)



Annual growth (%)			
	2023	2024	2025
Average	0.3	1.6	3.1
Lowest	-0.5	1.3	2.4
Highest	0.9	2.0	3.7

Level (constant year 2019, £ billion)			
	2023	2024	2025
Average	208.6	212.0	218.5
Lowest	207.1	209.8	214.8
Highest	209.9	214.0	222.0

History: Annual growth (%)

2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
2.6	3.2	2.9	3.3	1.6	2.3	1.0	-12.4	7.2	6.8

History: Level (constant 2019 prices, £ billion)

2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
180.0	185.8	191.2	197.5	200.7	205.4	207.5	181.7	194.8	208.1

Household income

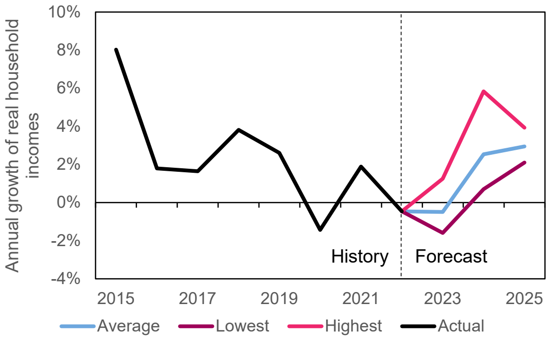
(London real disposable household income, constant prices (base year 2019), £ billion)

The consensus forecast for household income is for a 0.5% contraction in 2023, rebounding to 2.5% in 2024 and 2.9% in 2025. The consensus implies that real incomes will fall below pre-pandemic levels this year, but recover by 2024.

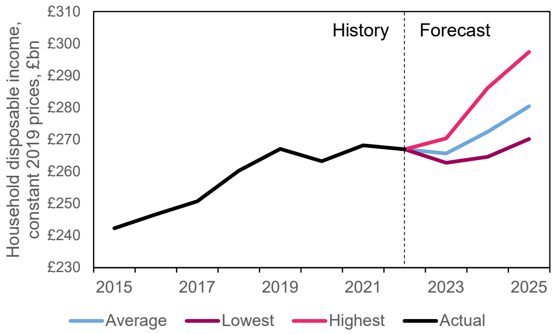
This is similar to the December 2022 consensus, which envisaged a drop of 0.4% in 2023, followed by growth of 2.7% in 2024. The consensus forecast for total disposable income in London by 2024 is largely the same as its level last autumn.

Uncertainty around income projections is very high. The widest range of growth projections is for 2024, with a striking 5.1ppt gap between the highest and lowest. The lowest-growth profile sees incomes just under 3% lower than the consensus by 2025. This path envisages a substantial contraction in 2023, with a slow medium-term recovery. Meanwhile, the highest-growth profile implies average incomes 5% higher than the consensus. Overall, by 2025 income in the highest-growth profile is over 10% above the lowest-growth profile.

Annual growth



Level (constant 2019 prices, £ billion)



Annual growth (%)			
	2023	2024	2025
Average	-0.5	2.5	2.9
Lowest	-1.6	0.7	2.1
Highest	1.3	5.8	3.9

Level (constant year 2019, £ billion)			
	2023	2024	2025
Average	265.7	272.4	280.4
Lowest	262.7	264.6	270.2
Highest	270.3	286.1	297.4

History: Annual growth (%)

2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
4.3	4.6	8.0	1.8	1.7	3.8	2.6	-1.4	1.9	-0.5

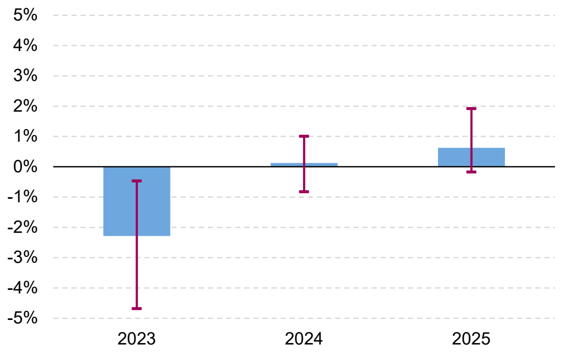
History: Level (constant 2019 prices, £ billion)

2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
214.4	224.3	242.3	246.6	250.7	260.3	267.1	263.2	268.2	267.0

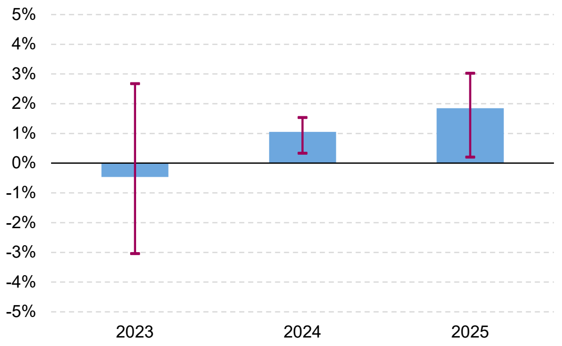
Output growth by sector

The consensus forecast most of London's services sectors maintaining growth across the next three years. However, goods sectors tend to see a contraction in 2023. The fastest growth is expected in the Transport and storage sector in 2024 (2.5%). This sector also has the highest cumulative average growth of 1.5% a year, 2022 to 2025.

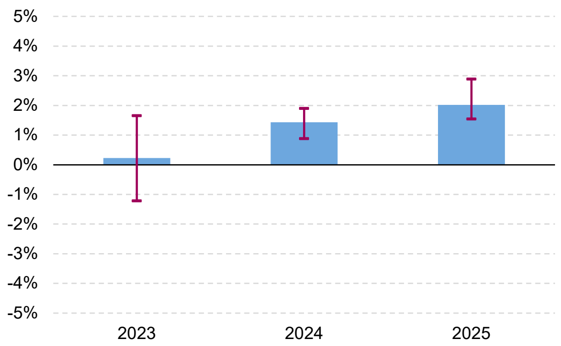
Manufacturing



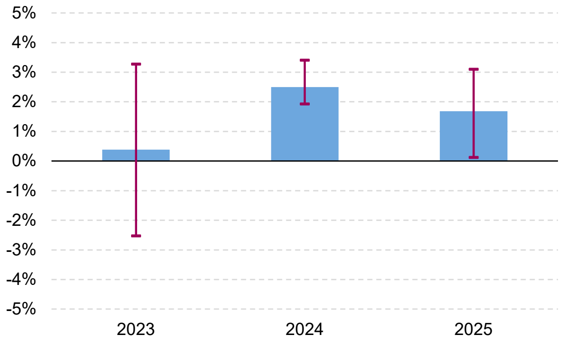
Construction



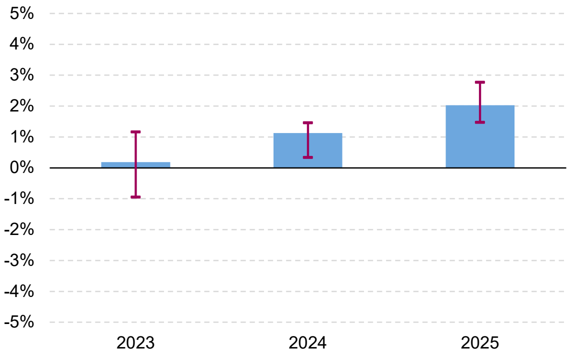
Distribution, accommodation and food services



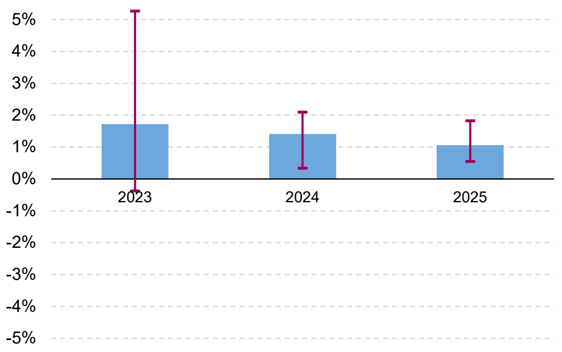
Transport and storage



Finance and business



Other services (public and private)

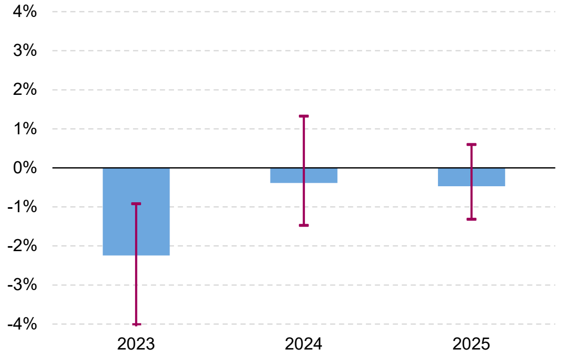


		2023	2024	2025			2023	2024	2025
Manufacturing	Average	-2.3	0.1	0.6	**Construction**	Average	-0.5	1.1	1.8
	Lowest	-4.7	-0.8	-0.2		Lowest	-3.0	0.3	0.2
	Highest	-0.5	1.0	1.9		Highest	2.7	1.5	3.0
Distribution, accommodation and food	Average	0.2	1.4	2.0	**Transport and storage**	Average	0.4	2.5	1.7
	Lowest	-1.2	0.9	1.5		Lowest	-2.5	1.9	0.1
	Highest	1.7	1.9	2.9		Highest	3.3	3.4	3.1
Finance and business	Average	0.2	1.1	2.0	**Other services (public and private)**	Average	1.7	1.4	1.1
	Lowest	-0.9	0.3	1.5		Lowest	-0.4	0.3	0.5
	Highest	1.2	1.5	2.8		Highest	5.3	2.1	1.8

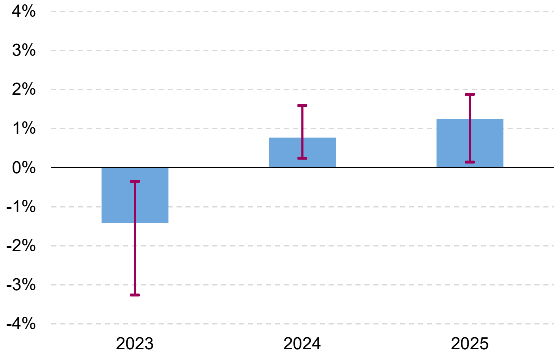
Employment growth by sector

The profile of sectoral job growth is more mixed. Again, services outperform goods sectors, but consumer-facing sectors may be more at risk of lost jobs than lost output in 2023. The fastest growth is expected in the Finance and business sector in 2025 (2.1%). This sector also has the highest cumulative average job growth of 1.3% a year from 2023 to 2025.

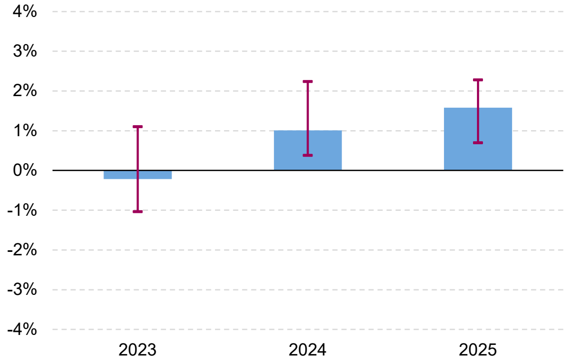
Manufacturing



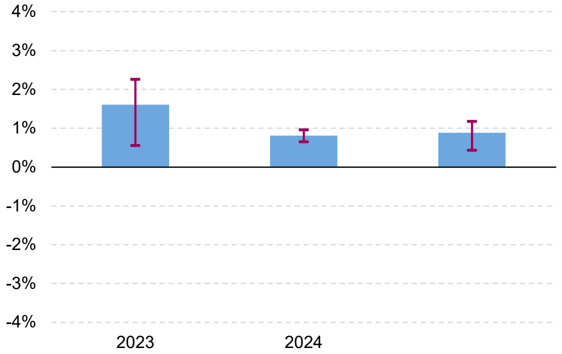
Construction



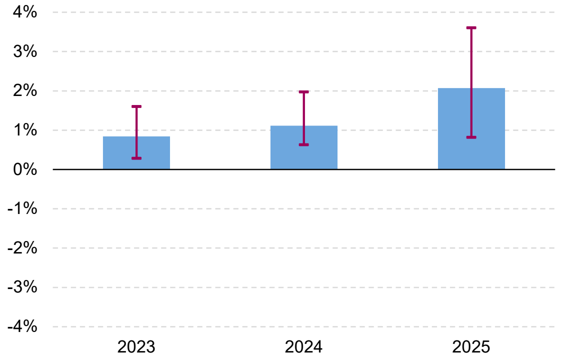
Distribution, accommodation and food services



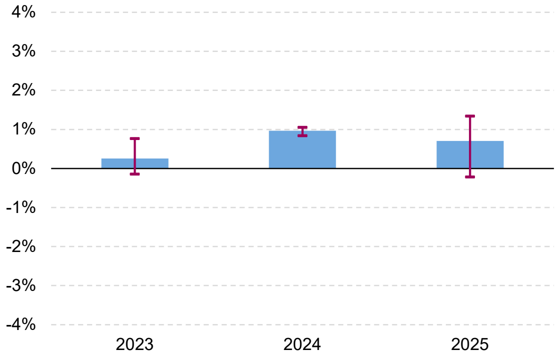
Transportation and storage



Finance and business



Other services (public and private)



		2023	2024	2025			2023	2024	2025
Manufacturing	Average	-2.2	-0.4	-0.5	**Construction**	Average	-1.4	0.8	1.2
	Lowest	-4.0	-1.5	-1.3		Lowest	-3.3	0.2	0.1
	Highest	-0.9	1.3	0.6		Highest	-0.3	1.6	1.9
Distribution, accommodation and food	Average	-0.2	1.0	1.6	**Transport and storage**	Average	1.6	0.8	0.9
	Lowest	-1.0	0.4	0.7		Lowest	0.6	0.7	0.4
	Highest	1.1	2.2	2.3		Highest	2.3	1.0	1.2
Finance and business	Average	0.8	1.1	2.1	**Other services (public and private)**	Average	0.3	1.0	0.7
	Lowest	0.3	0.6	0.8		Lowest	-0.1	0.8	-0.2
	Highest	1.6	2.0	3.6		Highest	0.8	1.1	1.3

5. The GLA Economics reference forecast

For business planning purposes (for example, the likely course of revenue), GLA Economics produces estimates of job numbers and output at a range of points in time. The medium-term planning projections (this forecast) provide those estimates.

This forecast differs from the GLA's long-term employment projections[144], which are trend-based. Trend projections, by definition, do not incorporate cyclical variations and the actual course of output and employment will vary around this trend. These long-term projections are essential for planning to provide capacity (such as office space, housing and transport). They also allow planners to accommodate the needs of the economy throughout the cycle, including at its peak. However, business planning also requires estimates of actual economic aggregates in the medium term, including cyclical paths.

As time progresses and more data is available, it becomes possible to identify turning points in the data; whether underlying trends are continuing, or new trends are being established.

The source for historic data in the following tables and charts is GLA Economics modelling using ONS data.

This analysis includes a measure of uncertainty around the central scenario using alternative scenarios developed by GLA Economics. The upside scenario sees a stronger recovery as London's relatively higher-income consumers are cushioned by a buffer of savings built up over the pandemic and inflation fades swiftly. Our downside scenario sees a downturn and a slow recovery, as inflation remains higher for longer, dragging on incomes and driving up interest rates, also prompting businesses defer investment. The prolonged spell of low growth also means deeper pandemic-related scarring on medium-term output and jobs.

5.1 Results

London's economic output had been growing every year from 2010 to 2019 before the pandemic drove an unprecedented contraction in 2020. The latest annual regional output data from the ONS trimmed the size of the pandemic drop to -10.6%, from -12.3% in previous estimates. The latest estimates continue to show London growing much faster than the UK average in 2021. London's output regained its pandemic losses by the end of 2021. Figures up to Q3 2022 show London continuing to grow firmly, well above the UK average.

However, the pace of the recovery is likely to slow substantially in the coming quarters. Inflation at a 40-year high is weighing on real incomes, and a sharp increase in interest rates will drag on investment and consumption. So far, the economy has shown enough resilience that successive updates of official forecasts have seen upgrades to the UK outlook. A strong labour market and the release of excess savings built up during the pandemic are helping to cushion the impact of the cost of living crisis. Most commentators now expect the UK to avoid recession. Yet the economy has largely stagnated in output terms in recent data.

Consistent with these shifts, we are upgrading our outlook for London's growth, but with a bumpy path for growth in much of 2023. The medium-term outlook is steady, without much of a growth rebound to make up for lost progress after 2023. While the capital should again recover faster than the national average, two downturns in succession will do long-term damage. We see a medium-term gap of around 4% opening by 2025 between the central scenario for London's output and our pre-pandemic forecasts.

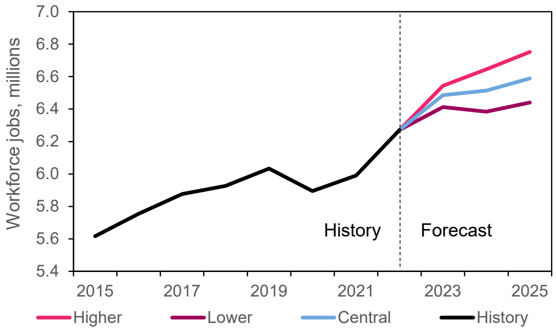
[144] GLA Economics (2022). 'London labour market projections 2022'.

On the employment side, our forecast has sharply improved since December 2022. Full-year revisions to workforce jobs data show London's labour market reaching its pre-pandemic size by early 2022. And recent data showed jobs growth at its fastest pace on record in Q1 2023. But a worse activity outlook in the medium term will drag on jobs. Momentum from a strong 2022 means London should avoid a jobs recession, but the pace of employment growth in the rest of this year is limited. Jobs growth eases to long-term averages by 2025.

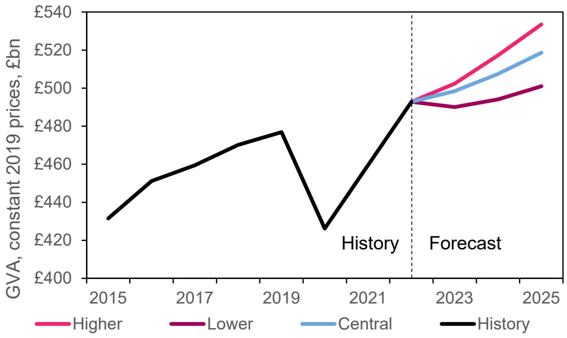
Our forecasts for household income and spending have also been upgraded. While we still see income contracting for two successive years in 2022 and 2023, the total losses are much smaller, with a recovery complete in 2024. We expect consumer spending to avoid a contraction in 2023, holding above pre-pandemic levels of consumption. Spending runs above income because we expect further release of the savings built up over the pandemic.

Figure 5.1: GLA Economics' forecasts and scenarios for employment and output

Workforce jobs



Output



Source: GLA Economics estimates for historic data and GLA Economics calculations for forecast

Table 5.1: Central scenario-based forecast and historical growth rates

(Annual % change)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
GVA	4.6	1.8	2.3	1.4	-10.6	7.8	7.2	1.1	1.8	2.2
Workforce jobs	2.5	2.1	0.9	1.8	-2.3	1.6	4.7	3.4	0.4	1.2
Household spending	3.3	1.6	2.3	1.0	-12.4	7.2	6.8	0.3	1.6	3.1
Household income	1.8	1.7	3.8	2.6	-1.4	1.9	-0.5	-0.5	2.5	2.9

Table 5.2: Scenario-based forecast and historical levels

(constant 2019 prices, £ billion except jobs)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
GVA	451.1	459.5	470.1	476.8	426.2	459.6	492.8	498.5	507.5	518.7
Workforce jobs (million)	5.8	5.9	5.9	6.0	5.9	6.0	6.3	6.5	6.5	6.6
Household spending	197.5	200.7	205.4	207.5	181.7	194.8	208.1	208.6	212.0	218.5
Household income	246.6	250.7	260.3	267.1	263.2	268.2	267.0	265.7	272.4	280.4

Output
(London GVA, constant prices (base year 2019), £ billion)

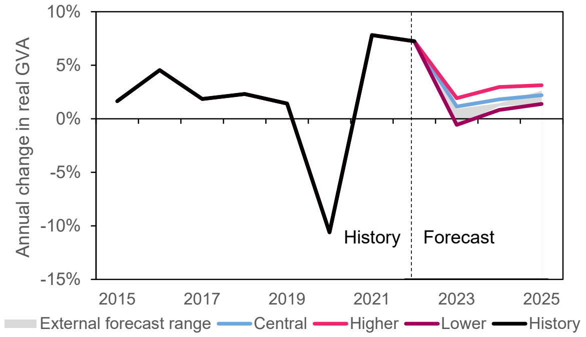
The latest data show London's real GVA grew 7.8% in 2021, and GLA Economics estimates growth of 7.2% in 2022. Our forecast then expects moderate growth of 1.1% in 2023 rising to 1.8% in 2024 and 2.2% in 2025. This profile is consistent with an economy fluctuating between contraction and growth in the second half of 2022 and the first half of 2023, then modest growth in H2 2023. While London should therefore avoid a recession, its output may never return to the expected trend from pre-pandemic forecasts.

The slowdown in 2023 has received an upgrade compared to our Autumn LEO forecast, as national and regional data show surprising resilience to the cost of living crisis. And the medium-term profile is stronger as the capital avoids a damaging recession. Our forecast in December 2022 was for a contraction of -0.8% in 2023 and growth of 1.5% in 2024. We now expect the level of London's output by 2024 to be 2.8% larger than projected in December.

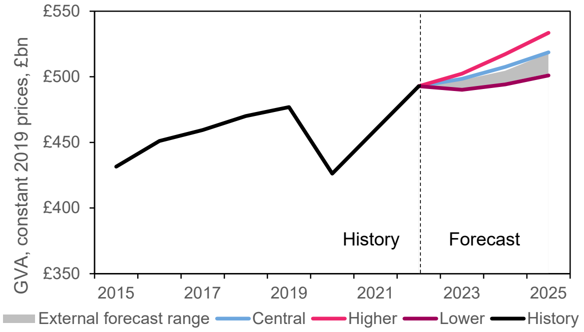
Our scenarios envision different levels of resilience, both in 2023 and structurally in the medium term. Our upside scenario sees high-income consumers spend more of their savings, pushing growth close to 2% in 2023. Growth then converges close to 2010 to 2019 averages. Meanwhile, our downside scenario sees continued high inflation and monetary tightening dragging output into a downturn in H2 2023, before growing just 0.8% in 2024. Projected output by 2025 in the upside scenario is over 6% above the downside.

Due to recent upward data revisions, our baseline scenario for output tends toward the upper end of the range of external forecasters. Our downside scenario, meanwhile, is quite close to the lower range of external forecasts in each year of the projections. The range between upside and downside scenarios in 2024 is similar to the Autumn 2022 LEO. We see risks for output as somewhat skewed to the downside.

Annual growth (%)



Level (constant 2019 prices, £ billion)



Growth (annual %)				
	2022	2023	2024	2025
Gradual economic recovery	7.2	1.1	1.8	2.2
Fast recovery		1.9	3.0	3.1
Recession, slow recovery		-0.6	0.8	1.4

Level (constant 2019 prices, £ billion)				
	2022	2023	2024	2025
Gradual economic recovery	492.8	498.5	507.5	518.7
Fast recovery		502.4	517.2	533.5
Recession, slow recovery		490.1	494.1	501.0

(See Chapter 4 for tables of historical data)

Employment
(London workforce jobs)

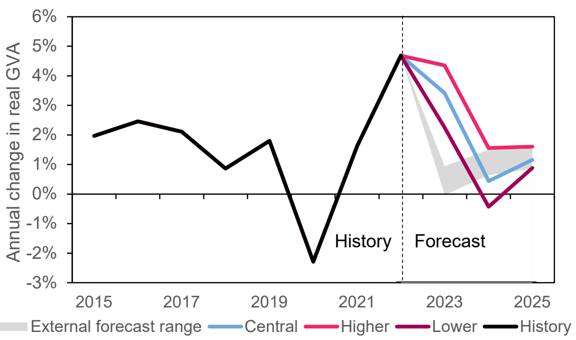
London's workforce jobs grew 4.7% in 2022 – their fastest pace since comparable records began in 1998. The first quarter of 2023 also saw public sector employment drive jobs growth to a fresh record. GLA Economics projects that this rapid momentum will keep jobs growing 3.4% in 2023. Job growth should then decelerate sharply to 0.4% in 2024, before converging closer to long-term averages, up 1.2% in 2025. This is consistent with a pull-back in mid-2023, and then modest jobs momentum for much of the rest of the forecast.

This outlook is a clear upgrade on our forecast in the Autumn 2022 LEO, which anticipated jobs contracting 0.2% in 2023, before growing 0.7% in 2024. We now expect workforce jobs to avoid a recession. Combined with recent upward data revisions, this means the new forecast anticipates 6% more jobs in London by 2024 than we expected in autumn.

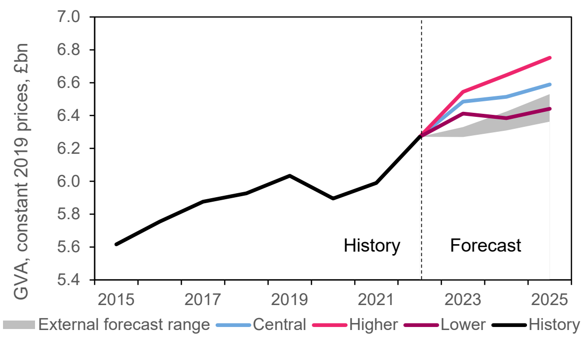
Our upside scenario sees continued firm momentum in the labour market as the economy largely shrugs off the cost of living crisis and monetary tightening. Job levels are around 2.5% higher in this scenario than the baseline. Meanwhile, the downside scenario sees a job recession in late 2023 generate an annual-terms contraction across 2024. Uncertainty around how the job market will progress after recent data surprises means the fast recovery scenario sees nearly 5% more jobs by 2024 than the slow recovery scenario. This gap is up from less than 2% in our Autumn 2022 LEO.

Even our downside scenario is currently above the range of external forecasts in 2023. And by the end of the forecast, our baseline is still above the top end of the external forecast range. However, this is due to external forecasts not incorporating the latest strong growth figures for late 2022 and early 2023. Given that a strong labour market likely underpins the recent resilience in wider economic data, we see risks for jobs as reasonably balanced.

Annual growth (%)



Level (millions of workforce jobs)



Growth (annual %)				
	2022	2023	2024	2025
Gradual economic recovery	4.7	3.4	0.4	1.2
Fast recovery		4.4	1.6	1.6
Recession, slow recovery		2.3	-0.4	0.9

Level (millions of workforce jobs)				
	2022	2023	2024	2025
Gradual economic recovery	6.3	6.5	6.5	6.6
Fast recovery		6.5	6.6	6.8
Recession, slow recovery		6.4	6.4	6.4

(See Chapter 4 for tables of historical data)

Household expenditure

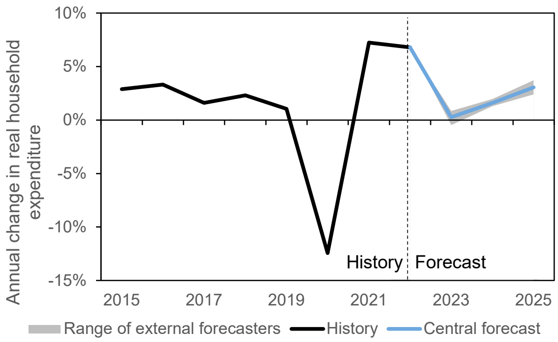
(London household spending, constant prices (base year 2019), £ billion)

GLA Economics forecasts consumer spending to grow by 0.3% in 2023, before recovering steadily to growth of 1.6% in 2024 and 3.1% in 2025. This profile is in line with the external consensus.

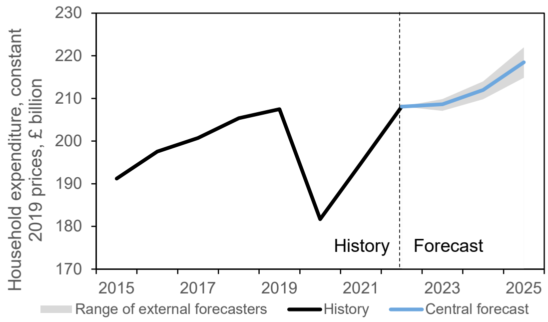
This stands in contrast to our Autumn 2022 LEO forecast, which envisaged a 0.4% contraction in 2023, followed by 2.2% growth in 2024. So while we see less downside for the current year, the spending recovery from the cost of living crisis is set to be more gradual.

In the near term, household spending is set to lag overall output growth. With consumers tightening their purse strings amid a cost of living crisis, this will affect which sectors of output are most affected. Consumer-facing sectors like Wholesale and retail are likely to take a harder hit, along with sectors depending on a strong property market like Real estate.

Annual growth (%)



Level (constant year 2019, £ billion)



(See Chapter 4 for tables of historical data)

Household income

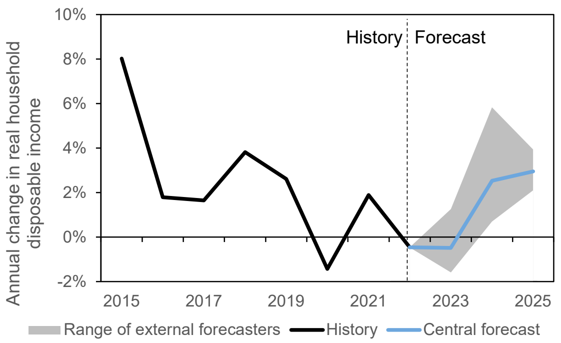
(London real disposable household income, constant prices (base year 2019), £ billion)

GLA Economics forecasts overall real disposable income in London to grow by 0.3% in 2023, before recovering steadily to growth of 1.6% in 2024 and 3.1% in 2025. This profile is in line with the external consensus.

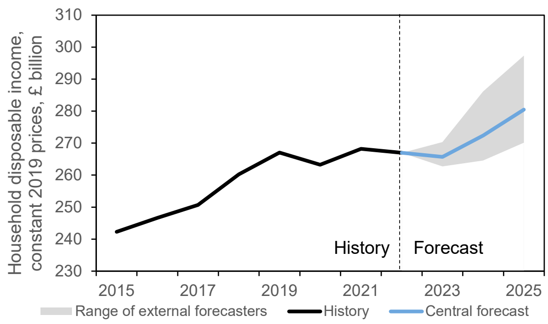
This stands in contrast to our Autumn 2022 LEO forecast, which envisaged a 0.4% contraction in 2023, followed by 2.2% growth in 2024. So while we see less downside for this year, we think the incomes recovery from the cost of living crisis will be more gradual.

Incomes are set to lag both output and spending growth, which may not be sustainable if real incomes stagnate for longer. There is significant uncertainty around the baseline, since inflation has run higher than expected for several months. If this continues, it would further erode real incomes, likely putting the rest of the forecast at risk. The cost of living crisis is already likely to create a debt overhang for struggling households, and richer households will not run down their savings indefinitely. Real incomes therefore represent a key downside risk for the forecast.

Annual growth (%)



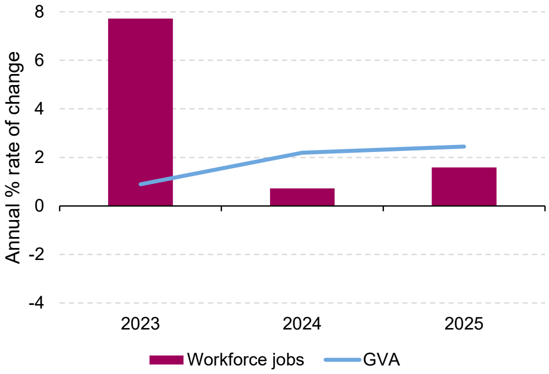
Level (constant year 2019, £ billion)



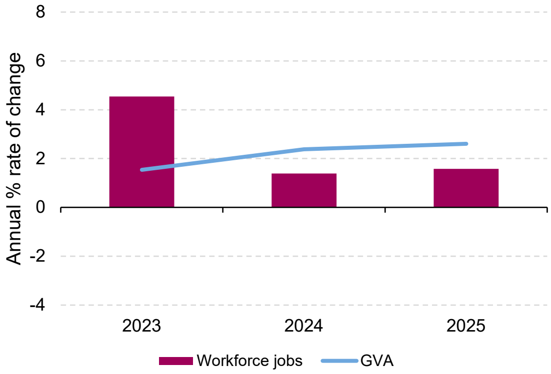
(See Chapter 4 for tables of historical data)

Output and employment growth by sector (% annual change)

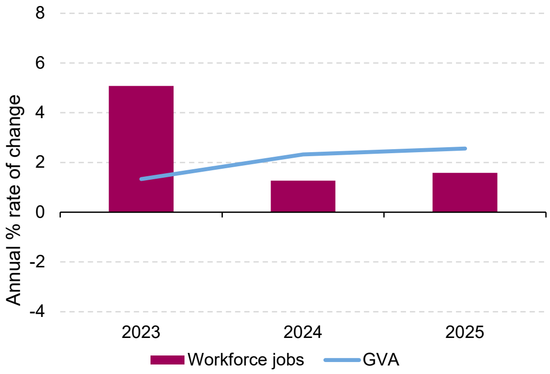
Financial services



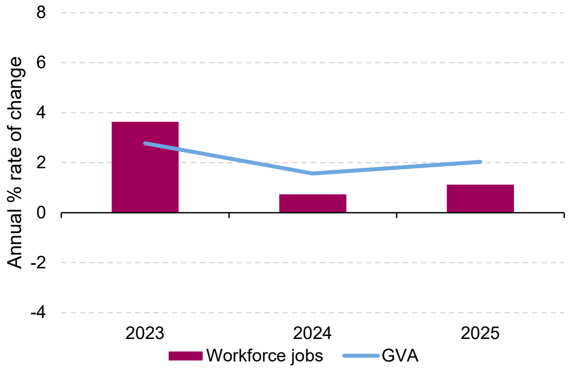
Business services



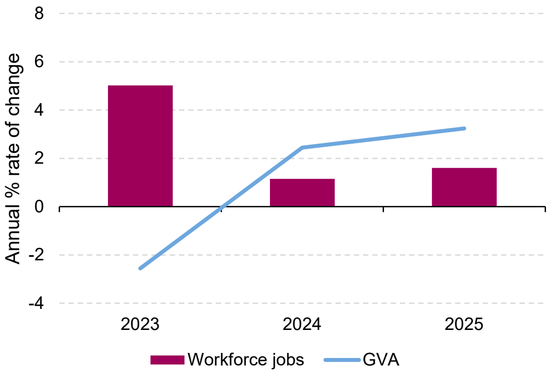
Finance and business (combined)



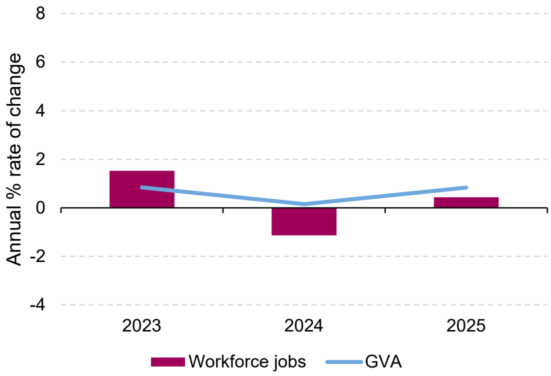
Distribution, accommodation and food services



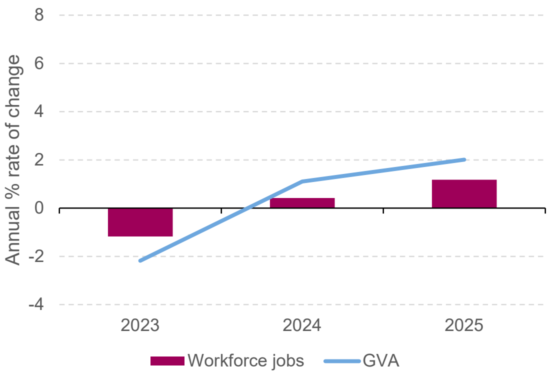
Transport and storage



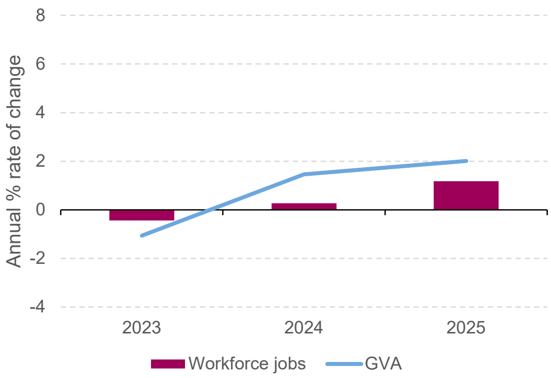
Other (public & private) services



Manufacturing



Construction



Output and employment growth by sector (% annual change)

Main sector	**2023**	**2024**	**2025**
Financial services			
Output	0.9	2.2	2.4
Jobs	7.7	0.7	1.6
Business services			
Output	1.5	2.4	2.6
Jobs	4.5	1.4	1.6
Financial and business services			
Output	1.3	2.3	2.6
Jobs	5.1	1.3	1.6
Distribution, accommodation and food services			
Output	2.8	1.6	2.0
Jobs	3.6	0.7	1.1
Transportation and storage			
Output	-2.6	2.4	3.2
Jobs	5.0	1.2	1.6
Other (public & private) services			
Output	0.8	0.2	0.8
Jobs	1.5	-1.1	0.4
Manufacturing			
Output	-2.2	1.1	2.0
Jobs	-1.2	0.4	1.2
Construction			
Output	-1.1	1.5	2.0
Jobs	-0.4	0.3	1.2
(Memo: non-manufacturing)			
Output	1.2	1.8	2.2
Jobs	3.5	0.4	1.2

5.2 Comparison with previous forecasts

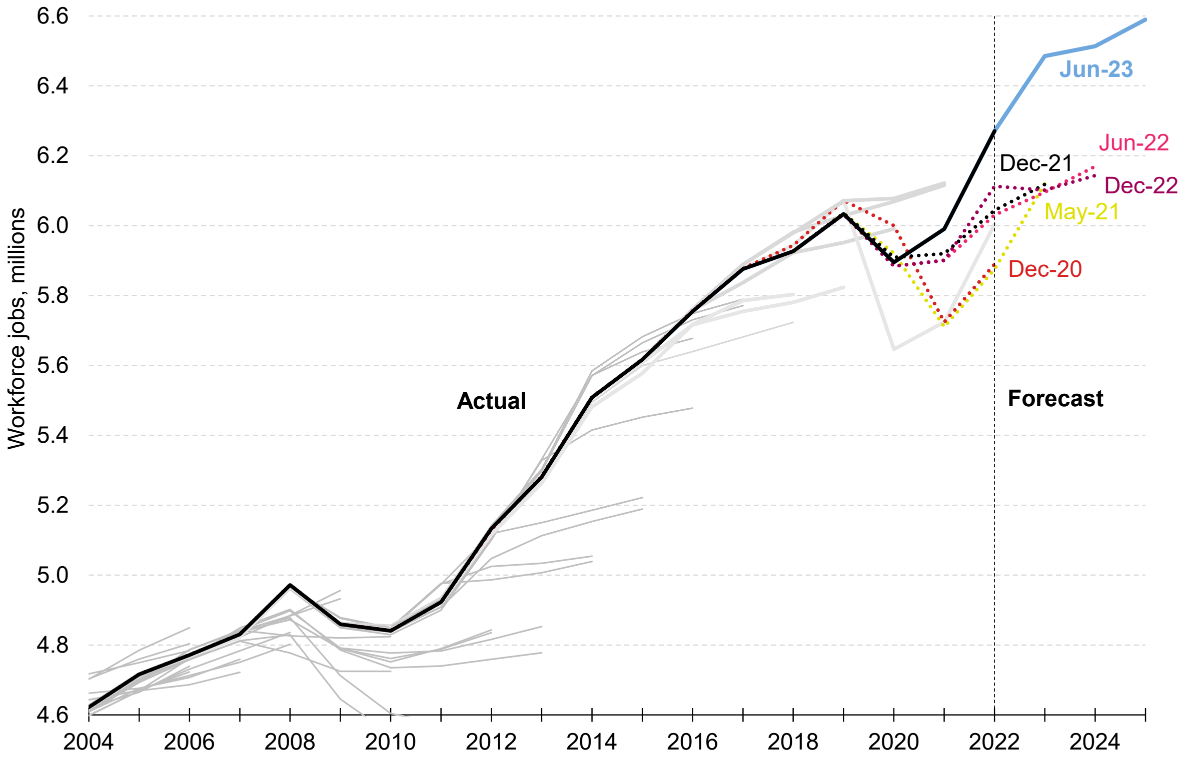
This section compares the current forecast with previous forecasts in this series. Since the base years for the forecasts change and the base data is continuously revised, the forecasts have been rebased into a common base year for the comparisons in Figures 5.2 and 5.3.

The large variation seen in projections produced in the last three years reflects the environment of unprecedented uncertainty. Some variation is also due to the evolving public health and economic policy responses to the pandemic and cost of living crisis.

Workforce jobs

The level of London's workforce jobs reached its 2019 level in early 2022 and is not set to decline again in the next three years. The medium-term profile of the forecast involves a major upgrade on the December 2022 forecast, along with significant upward revisions to the historical data. The profile is also a major upgrade on the forecast profiles constructed in 2020 and 2021. This reflects the strong recovery in labour demand after the pandemic, limited disruption from the end of furlough, and higher-than-expected immigration.

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



Source: ONS, GLA Economics; Note: grey lines show job levels under historic GLA Economics forecasts of employment growth. The last six GLA Economics forecasts are also shown (and labelled) in colour.

Table 5.3: Comparisons with previous published forecasts[145]

(London workforce jobs, % annual growth)

Forecast	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Jun-23	**1.7%**	**4.3%**	**2.9%**	**4.3%**	**2.0%**	**2.5%**	**2.1%**	**0.9%**	**1.8%**	**-2.3%**	**1.6%**	**4.7%**	**3.4%**	**0.4%**	**1.2%**
Dec-22												3.6%	-0.2%	0.7%	
Jun-22												2.2%	1.1%	1.2%	
Dec-21											0.2%	2.1%	1.2%		
May-21											-3.6%	2.9%	4.2%		
Dec-20										-1.1%	-4.6%	3.0%			
Jun-20										-7.0%	1.4%	4.9%			
Dec-19									1.5%	0.1%	0.7%				
Jun-19									0.8%	0.7%	0.8%				
Nov-18								1.5%	0.5%	0.7%					
May-18								0.6%	0.3%	0.7%					
Nov-17							1.4%	0.3%	0.5%						
Jun-17							0.7%	0.5%	0.7%						
Nov-16						2.5%	1.2%	0.3%							
May-16						0.7%	0.7%	0.7%							
Nov-15					1.7%	1.2%	0.7%								
May-15					1.7%	1.2%	0.7%								
Nov-14				4.5%	1.2%	0.7%									
May-14				1.6%	0.7%	0.5%									
Nov-13			1.3%	0.8%	0.7%										
Jul-13			0.6%	0.7%	0.7%										
Nov-12		1.0%	0.2%	0.4%											
Jun-12		0.2%	0.4%	0.6%											
Nov-11	0.1%	0.4%	0.4%												
May-11	0.1%	0.7%	0.8%												
Oct-10	0.6%	1.0%													
Jun-10	0.8%	1.1%													
Oct-09	-0.6%														
Apr-09	-0.4%														

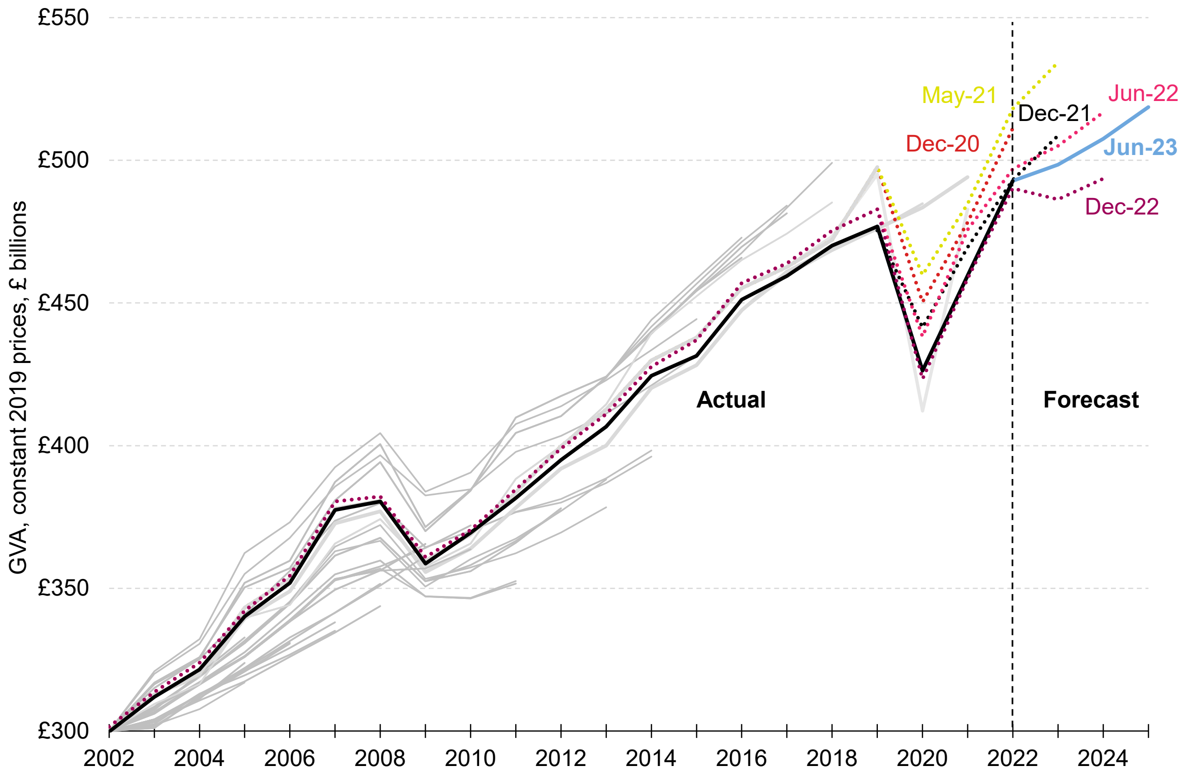
Source: ONS, GLA Economics

[145] This table only reports forecasts for 2011 onwards unlike Figure 5.2. For earlier GLA Economics forecasts please see previous editions of London's Economic Outlook.

Output

The most recent medium-term scenario-based forecast for London's GVA level has output comfortably above the December 2022 projections. However, it represents a downgrade on most other forecasts since 2020. The historic level of London's GVA has been revised downwards once again in 2021, making the comparison less clear-cut. A stronger growth profile in 2021 than in most previous editions reflects London's resilience to ongoing activity restrictions. The lower medium-term growth forecasts are consistent with a series of downward revisions to national-level forecasts.

Figure 5.3: Output – latest forecast compared with previous forecasts
(constant prices (base year 2019), £ billion)



Source: ONS, ESCoE, GLA Economics; Note: the grey lines show levels of GVA given historic GLA Economics forecasts of GVA growth. The last five GLA Economics forecasts are also shown (and labelled) in colour.

Table 5.4: Comparisons with previous published forecasts[146]

(London GVA, % annual growth)

Forecast	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Jun-23	**3.3%**	**3.5%**	**2.9%**	**4.4%**	**1.6%**	**4.6%**	**1.8%**	**2.3%**	**1.4%**	**-10.6%**	**7.8%**	**7.2%**	**1.1%**	**1.8%**	**2.2%**
Dec-22												6.9%	-0.8%	1.5%	
Jun-22												4.5%	1.6%	2.3%	
Dec-21											6.4%	5.0%	3.1%		
May-21											5.4%	6.9%	3.1%		
Dec-20										-9.5%	6.2%	6.9%			
Jun-20										-16.8%	17.2%	4.5%			
Dec-19									1.8%	1.1%	1.8%				
Jun-19									1.5%	1.6%	2.2%				
Nov-18								1.9%	1.6%	1.9%					
May-18								1.6%	1.9%	2.2%					
Nov-17							2.1%	1.8%	2.6%						
Jun-17							2.3%	2.4%	2.9%						
Nov-16						2.8%	2.0%	2.3%							
May-16						2.9%	3.4%	3.3%							
Nov-15					3.4%	3.2%	2.7%								
May-15					3.6%	3.2%	2.5%								
Nov-14				4.8%	3.3%	3.1%									
May-14				3.8%	3.2%	2.6%									
Nov-13			2.2%	2.5%	2.5%										
Jul-13			1.9%	2.4%	2.5%										
Nov-12		0.9%	1.8%	2.4%											
Jun-12		1.2%	1.9%	2.5%											
Nov-11	1.4%	2.0%	2.4%												
May-11	2.0%	2.6%	2.9%												
Oct-10	2.4%	2.9%													
Jun-10	2.8%	3.3%													
Oct-09	1.5%														
Apr-09	1.7%														

Source: ONS, ESCoE, GLA Economics

[146] This table only reports forecasts for 2010 onwards, unlike Figure 5.3. For earlier GLA Economics forecasts please see previous editions of London's Economic Outlook.

Appendix A: Explanation of terms and some sources

Definitions, differences, and revisions

Forecasting organisations use varying definitions of the regional indicators they supply. It is therefore not always possible to assign a completely consistent meaning to the terms used.

Throughout this report 'employment' refers to 'workforce jobs' and uses the ONS historical series as a base for the forecast.

Forecasters' definitions are broadly compatible with this but in some cases differences arise from the treatment of small items such as participants in government training schemes or the armed forces. The GLA uses civilian workforce employment throughout.

Output refers to GVA, a term introduced by the 1995 revision of the European System of Accounts (ESA95). GLA Economics' *London's Economic Outlook: December 2003* provides a more detailed explanation of this term.

At the time of writing national statistics estimates of real regional GVA are available up to 2018 from the ONS[147]. The historic real London GVA figures used in this GLA Economics' forecast are estimates produced by GLA Economics using ONS data.

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

[147] ONS Regional GVA (balanced approach).

Appendix B: Glossary of acronyms

ADB	Asian Development Bank
BIS	The Bank for International Settlements
BoE	Bank of England
bn	Billion
CE	Cambridge Econometrics
CEBR	The Centre for Economic and Business Research
CPI	Consumer Price Index
DCLG	Department for Communities and Local Government
ECB	European Central Bank
EE	Experian Economics
EERI	Effective Exchange Rate Index
EU	European Union
Fed	Federal Reserve
FT	Financial Times
GDP	Gross Domestic Product
GLA	Greater London Authority
GVA	Gross Value Added
HM Treasury	Her Majesty's Treasury
IFS	Institute for Fiscal Studies
ILO	International Labour Organisation
IMF	International Monetary Fund
LEO	London's Economic Outlook
LFS	Labour Force Survey
LHS	Left Hand Scale
m	Million
MPC	Monetary Policy Committee
OBR	Office for Budget Responsibility
OE	Oxford Economics
OECD	Organisation for Economic Co-operation and Development
ONS	Office for National Statistics
PMI	Purchasing Managers' Index
Q2	Second Quarter
QE	Quantitative Easing
RHS	Right Hand Scale
RICS	Royal Institution of Chartered Surveyors
RPI	Retail Price Index
TfL	Transport for London

Appendix C: Bibliography

Asian Development Bank (2023). 'Asian Development Outlook (ADO) April 2023'.

Arasasingham A et al (2023), The UK is joining the CPTPP. What comes next?, the Center for Strategic and International Studies.

Alexandra Scaggs (2023), "Silicon Valley Tank(s)", FT Alphaville, March 2023.

Bureau of Economic Affairs (2023). 'Gross Domestic Product (Second Estimate) and Corporate Profits (Preliminary), First Quarter 2023', 25 May 2023.

Bakker J et al (2023), Brexit and consumer food prices: May 2023 update, London School of Economics Centre for Economic Performance.

Bank of England (1999). 'The transmission mechanism of monetary policy', Bank of England Quarterly Bulletin, May 1999.

Bank of England, "Banking sector resilience", Financial Policy Summary and Record, March 2023.

Bank of England, "Banking sector resilience", Financial Policy Summary and Record, March 2023.

Bank of England (2022), "Bank of England announces gilt market operation", November 2022.

Bank of England (2023), 'Monetary Policy Report', 11 May 2023.

Bank of England database, 3 month growth rate (annualised) of bank loans to business, indicator RPMZO8F

Bank of England database, Monthly growth rate of lending to individuals, indicator LPMBZ2E

Bank of England database, Official Bank Rate series, indicators IUQABEDR and IUQLBEDR

Bank of England database, 10 year nominal par yield on British Government securities, indicator IUDMNPY.

Bank of England database, 2 year fixed rate 60% LTV household mortgage interest rate, indicator IUMZICQ.

Bank of England database, Interest rate on personal loan of £5k to households, indicator IUMBX67.

Bank of England database, Interest on non-variable loans to non-financial corporations, indicator CFMHSDC.

Breeden (2022), "Risks from leverage: how did a small corner of the pensions industry threaten financial stability?", Speech at ISDA & AIMA, November 2022.

Bounds A and Fleming S (2023), Brussels agrees to sign regulatory co-operation deal with the UK, Financial Times, 17 May.

Casalicchio E (2023), UK shelves controversial Northern Ireland Protocol Bill as EU deal reached, Politico.

Caitlin Gilbert, Alyssa Fowers, Jacob Bogage and Daniel Wolfe (2023), "These companies had billions of dollars at risk in Silicon Valley Bank", Washington Post, March 2023.

Centre for Economic and Business Research (2023), UK regional forecasts, May 2023

Choi, Willems & Yoo (2023), "Revisiting the monetary transmission mechanism through an industry-level differential approach", Bank of England Staff Working Paper No. 1,024, May 2023.

Daniel Cunningham (2023), "Strong lending volumes, more defaults: Bayes' key 2022 UK market findings", Real Estate Capital Europe, April 2023.

Deloitte (2022), The Edinburgh Reforms: what they are and what they mean for financial services.

Department for Business and Trade and Department for International Trade (2021), UK-Australia FTA: impact assessment.

Department for Business and Trade and Department for International Trade (2021), UK-New Zealand FTA: impact assessment.

Department for Business, Energy and Industrial Strategy (2022), UK government to set its own laws for its own people as Brexit Freedoms Bill introduced.

Department for Energy Security and Net Zero and Department for Business, Energy and Industrial Strategy (2023), Energy Bill Relief Scheme: help for businesses and other non-domestic customers.

Durante, Ferrando & Vermeulen (2022), "Monetary policy, investment and firm heterogeneity", European Economic Review Vol. 148, September 2022.

European Commission (2021), Reviewing EU insurance rules: encouraging insurers to invest in Europe's future, Press release, 22 September.

European Commission (2023). 'Spring 2023 Economic Forecast: An improved outlook amid persistent challenges', 15 May 2023.

Eurostat (2023). 'GDP main aggregates and employment estimates for the first quarter of 2023', 8 June 2023.

Evgueni Ivantsov (2023), "Strategic risk failure is what unites Credit Suisse and SVB", FT, May 2023.

Experian Economics (2023), UK regional forecasts, March 2023

Fleming S and Pickard J (2023), EU sticks with post-Brexit clearing trade deadline despite objections, Financial Times, 24 May.

Financial Stability Board (2022), "2022 List of Global Systemically Important Banks", November 2022.

Federal Reserve (2023), Press release, March 2023.
Federal Open Market Committee (2023), Staff Economic Outlook, FOMC Minutes, May 2023.

Federal Reserve (2023), "Near-Term Risks to the Financial System", Financial Stability Report, May 2023.

Financial Stability Board (2022), "Enhancing the Resilience of Non-Bank Financial Intermediation: Progress Report", November 2022.

GLA (2023), "GLA cost of living polling", May 2023

GLA Economics (2016). 'London's Economic Outlook: Autumn 2016 The GLA's medium-term planning projections', November 2016.

GLA Economics (2017a). 'London's Economic Outlook: Spring 2017 The GLA's medium-term planning projections', June 2017.

GLA Economics (2017b). 'London's Economic Outlook: Autumn 2017 The GLA's medium-term planning projections', November 2017.

GLA Economics (2018a). 'London's Economic Outlook: Spring 2018 The GLA's medium-term planning projections', May 2018.

GLA Economics (2018b). 'London's Economic Outlook: Autumn 2018 The GLA's medium-term planning projections', November 2018.

GLA Economics (2019a). 'London's Economic Outlook: Spring 2019 The GLA's medium-term planning projections', June 2019.

GLA Economics (2019b). 'London's Economic Outlook: Autumn 2019 The GLA's medium-term planning projections', December 2019

GLA Economics (2020a). 'London's Economic Outlook: Spring 2020 The GLA's medium-term planning projections', June 2020.

GLA Economics (2020b), 'London's Economic Outlook: Autumn 2020 The GLA's medium-term planning projections', December 2020.

GLA Economics (2021a). 'London's Economic Outlook: Spring 2021 The GLA's medium-term planning projections', May 2021.

GLA Economics (2021b), 'London's Economic Outlook: Autumn 2021. The GLA's medium-term planning projections', December 2021.

GLA Economics (2022a), 'London's Economic Outlook: Spring 2022 The GLA's medium-term planning projections', June 2022.

GLA Economics (2022b), 'London's Economic Outlook: Autumn 2022 The GLA's medium-term planning projections', December 2022.

GLA Economics (2022), labour market analysis page, "Out-of-work trends in London", November 2022.

GLA Economics (2022). 'London labour market projections 2022'.

Higher Education Statistics Agency (2023), Higher Education Student Statistics: UK, 2021/22 – Where students come from and go to study.

HM Treasury (2022), Edinburgh Reforms hail next chapter for UK Financial Services

HM Treasury (2023), 'Forecasts for the UK economy: a comparison of independent forecasts', May 2023

Hancock A (2023), UK participation in EU Horizon programme at risk due to price, Financial Times, 11 May.

Hunsaker S and Howe T (2023), Trade tracker: UK trade deals, UK in a Changing Europe.

House of Commons Library (2023), UK – Australia Free Trade Agreement.

House of Commons Library (2023), UK – New Zealand Free Trade Agreement.

House of Commons Library (2023), Northern Ireland Protocol: the Windsor Framework.

Hunsaker S and Howe T (2023), Trade tracker: EU trade deals, UK in a Changing Europe
OBR (2023), Economic and Fiscal Outlook – March2023.

Hauser (2023), "Looking through a glass onion: lessons from the 2022 LDI intervention", Speech at University of Chicago Booth School of Business, March 2023.

IMF (2023), "A Financial System Tested by Higher Inflation and Interest Rates", GFSR, April 2023.

IMF (2023). 'Global Financial Stability Report: Safeguarding financial stability amid high inflation and geopolitical risks', April 2023.

IMF (2023). 'World Economic Outlook: A rocky recovery', April 2023.

IMF (2023). 'Global Financial Stability Report: Safeguarding financial stability amid high inflation and geopolitical risks', April 2023.

Kalyeena Makortoff and David Pegg (2022), "Crooks, kleptocrats and crises: a timeline of Credit Suisse scandals", The Guardian, February 2022.

Kashyap (2020), "The Dash for Cash and the Liquidity Multiplier: Lessons from March 2020", Speech at London Business School, November 2022.

MarketWatch, KBW Regional Banking Index data, Ticker KRX

MarketWatch, S&P 500 Index data, Ticker SPX

MarketWatch, S&P 500 Banks Industry Group Index data, Ticker SP625

MarketWatch, FTSE 350 Banks Index GBP, Ticker 189731

Marc Jones (2023), "Europe's banks in 'better place' than U.S. in terms of commercial property risk – JPMorgan", Reuters, March 2023.

Matthew Pointon, Capital Economics, via Julia Kollewe (2023), "Could office blocks be the next big casualty of the banking crisis?", The Guardian, March 2023.

National Bureau of Statistics of China (2023). 'Preliminary Accounting Results of GDP for the First Quarter of 2023', 20 April 2023.

OBR (2023). 'Economic and fiscal outlook – March 2023', 15 March 2023.

O'Carroll L (2023), Bonfire of EU laws watered down to just 800 after meeting of Brexiter MPs, The Guardian, 28 April.

O'Carroll L and Adams R (2023), Number of EU students enrolling in UK universities halves post-Brexit, The Guardian, 27 January.

O'Carroll L (2023), Tories' revised plans to scrap EU laws are still reckless, say lawyers, The Guardian, 12 May.

ONS (2023), "Regional economic activity by gross domestic product, UK: 1998 to 2021", April 2023.

ONS (2022), "Personal financial & property debt by age and region: April 2018 to March 2020", January 2022.

ONS (2022), "Regional gross disposable household income: all ITL level regions", October 2022.

ONS (2022), "UK business; activity, size and location: 2022", September 2022.

ONS (2022), "Business demography, UK", November 2022.

ONS (2023), "Quarterly country and regional GDP", May 2023

ONS (2022), "Business investment by industry and asset", August 2022.

ONS (2023), "JOBS05: Workforce jobs by region and industry", March 2023.

ONS (2020), 'Consumer price inflation, UK: March 2020', April 2020.

ONS (2022), 'Consumer price inflation, UK: October 2022', November 2022.

ONS (2023), 'Consumer price inflation, UK: April 2023', May 2023.

ONS (2023), "UK House Price Index: March 2023", May 2023

ONS (2023), "Index of Private Housing Rental Prices, UK: April 2023", May 2023.

ONS (2023), "Business demography, quarterly experimental statistics, UK: January to March 2023", 5 May.

ONS (2022), "Blue Book 2022 – revised impacts of the coronavirus (COVID-19) pandemic on the UK economy", 31 October 2022.

Orellana, E. (2020) 'The new GLA Economics forecast models for London's economy', GLA Economics Working Paper 98.

Oxford Economics (2023), UK regional forecasts, April 2023

Parker G et al (2022), City set for boost as Hunt loosens financial services rule book, Financial Times, 8 December.

Press Information Bureau Government of India, Press note on provisional estimates of national income 2022-23 and quarterly estimates of gross domestic product for the fourth quarter (January – March) of 2022-23, 31 May.

Portes J (2023), Why the panic over rising immigration? The post-Brexit system is working, The Guardian, 23 May.

Robert Armstrong (2023), "SVB is not a canary in the banking coal mine", Financial Times, March 2023.

Reuters (2023), "Factbox: Top five U.S. regional banks with most uninsured deposits", March 2023.

Rankin J (2023), EU targets 40% of clean tech to be made within the bloc by 2030, The Guardian, 7 March.

Rutter J (2023), Government sees some sense at last on the Retained EU Law Bill, Institute for Government, 11 May.

S&P Global (2023), UK regional forecasts, April 2023

Schneider-Petsinger M (2023), Real value for the UK in joining CPTPP is strategic, Chatham House.

Sumption M (2022), Why has non-EU migration to the UK risen?, The Migration Observatory.

Springford J and Portes J (2023), The impact of Brexit on the UK labour market: an early assessment, UK in a Changing Europe.

Sumption M et al (2022), How is the End of Free Movement Affecting the Low-wage Labour Force in the UK?, The Migration Observatory.

The foundational paper on this channel is Bernanke and Gertler (1989). "Agency costs, net worth, and business fluctuations." American Economic Review 79, no.1, March 1989: 14-31.

Tourism Alliance (2022), The Economic impact of the requirement for EU students on school trips to have passports to enter the UK, November.

UK in a Changing Europe (2023), UK-EU Regulatory Divergence Tracker, 6th edition, January.

Walker O, "Credit Suisse finds 'material weaknesses' in financial reporting controls", March 2023.

GLAECONOMICS

Greater London Authority
City Hall
Kamal Chunchie Way
London E16 1ZE

Tel 020 7983 4000
Minicom 020 7983 4000
Email glaeconomics@london.gov.uk