GLAECONOMICS

London's Economy Today

Issue 251 | July 2023

Inflation eases, but households still under pressure

By **Gordon Douglass**, Supervisory Economist, **James Watson**, Economist, and **Jasmine Farquharson**, Project Management apprentice

For the first time in almost two years, June's Consumer Price Index (CPI) inflation release offered some good news in that the actual figure was below what forecasters expected. The cost of living crisis is far from over though, and price increases are still extremely rapid, but the data showed clear signs of improvement.

Official UK inflation data from the Office for National Statistics (ONS) showed the CPI up 7.9% year on year in June. This was down from a pace of 8.7% in May, and came below a consensus that inflation would hit 8.2%. According to Trading Economics, inflation had come in at least 0.3 percentage points above the consensus for the previous four months straight. And this was the largest downward surprise since August 2022.

Under the headline, there were widespread signs of slower price momentum. Core inflation (excluding food and fuel) offered the clearest sign of a broad cooldown in prices, dipping to 6.9% in June from 7.1% in May. But the main driver of the deceleration came from falling fuel prices. Drivers are now seeing prices at the pump down nearly 23% from last year's highs. This sharp drop pulled the wider transport category into deflation for the first time since August 2020, when the pandemic was depressing global fuel costs. Food price inflation also slowed by a full percentage point, but at 17.3% year on year, the pace remains rapid.

Also in this issue

Datastore

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

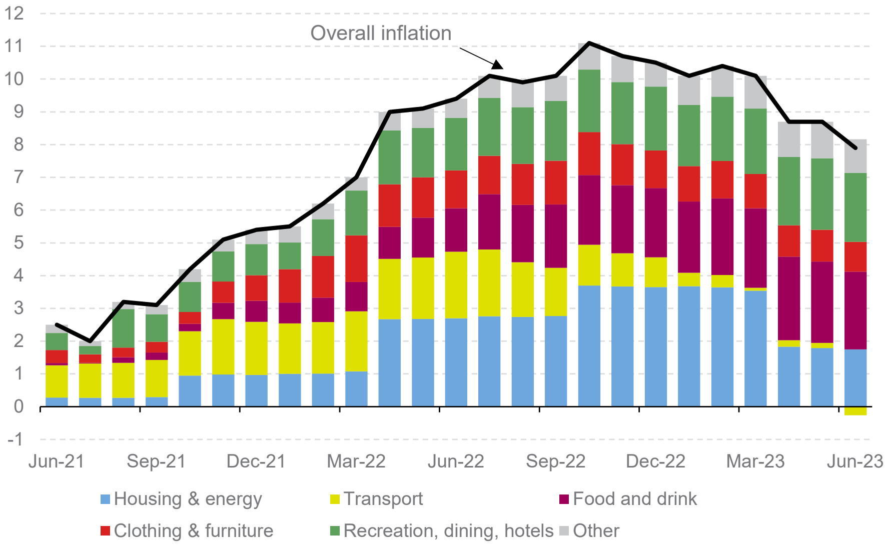


Figure 1: Contributions to CPI inflation

Source: ONS, GLA Economics

Imported costs offer good reasons to expect further deceleration in inflation. Input costs for food producers are falling, which should soon pass into consumer prices. And the Ofgem price cap for energy bills is set to fall 17% in July – the first time bills have fallen since the winter of 2020. Even the collapse of the Black Sea grain deal should not decisively raise food prices in the UK given that energy has likely been the most important factor raising costs.

But some factors will likely keep inflation from falling back to target quickly. Regular pay increased 7.3% in the three months to May, the joint highest pace on record. While this still implies real wages are falling, it will keep business costs growing, probably creating some pass-through to consumer prices. And housing costs are a key concern amid rising mortgage interest rates, which landlords are likely to pass on as higher rents (see below).

A slower-than-expected inflation reading might offer some relief to the Bank of England, and offer a chance to moderate their path of interest rate hikes. The Bank raised rates by a larger-than-expected 0.5% at the end of June, setting the policy interest rate at 5%. Markets had since expected another 0.5% rate raise in the Bank's August meeting. But since the latest inflation figures, that expectation has moderated to a more normal 0.25% rise. The Bank could also opt to keep rates on hold, but the focus on rapid wage growth in recent communications makes this less likely.

However, one former member of the Bank's Monetary Policy Committee, which sets interest rates, sounded a cautionary note against more rate increases. Andy Haldane, the Bank's former Chief Economist, warned vividly that over-tightening to create a wage squeeze could turn into a self-defeating form of monetary austerity. "Past tightening of the monetary elastic is about to propel a brick towards the financially vulnerable. For the UK, that would spell recession… Imagine a doctor, uncertain about the nature and severity of a disease, who has administered a large medicinal dose which has yet to take effect. Prudence would cause them to pause to see how the patient responded before doubling the dosage."

Mortgage costs continue to rise

Concerns continued to mount in July on the impact of rising interest rates on the housing market. This was seen with the average cost of new two year fixed rate mortgages overtaking the level seen in the wake of last year's mini Budget according to data from Moneyfacts. Rising mortgage costs has seen some lenders reporting that house prices are falling as was covered in depth in the June edition of LET. With further evidence coming this month from for example Halifax who reported that UK house prices were down by 2.6% in June compared with the same month a year earlier. This was the largest house price drop they have seen since June 2011, although official ONS statistics do still show price rises. And Bank of England analysis has shown that just under 7 million UK households are expected to see a rise in their mortgage costs between the end of 2023 and the end of 2026. With, around a million households expected to see a rise of over £500 a month.

Renters are also experiencing rising costs with data from the ONS showing private rental payments rose 5.1% in the 12 months to June 2023 in the UK. For London this figure stood at 5.3%, which was the highest rate of increase since September 2012. Survey evidence has indicated that rental demand has been rising recently and other surveys of rents have shown higher rises, this is likely in part due to the high cost of getting a mortgage.

Still the latest bank stress test from the Bank of England which was published in their Financial Stability Report in July found that UK banks are resilient to some businesses and households not being able to cover their debts due to rising interest rates. Thus, in a "stress scenario [which] included the unemployment rate increasing to 8.5%, inflation rising to 17%, and house prices falling by 31%" the Bank found that "the UK banking system would continue to be resilient, and be able to support households and businesses".

UK economy stuck in a rut

GDP contracted in the month of May, as UK economic activity continued to flatline at around its pre-pandemic level.

Production was the main factor behind the drop, falling 0.6%, but Construction also fell (-0.2%) and Services showed no growth. The extra bank holiday for the Coronation likely had an impact by cutting out a working day, but momentum is weak across the board. Despite the hospitality and shopping opportunity of a major public event, Accommodation and Food services fell 0.9% and Wholesale and retail dropped 0.5%.

But more broadly, UK growth momentum is stagnant. For the last year, monthly GDP has fluctuated at the same level as in December 2019 – indeed, never pushing above more than 0.1% (Figure 2).

And the indications are weak for the near-term outlook. Consumer confidence fell back in July, reversing its progress over the previous three months and hitting -30. Looking at the list of concerns, households appear increasingly worried about both inflation and a recession. Strikes from teachers, doctors and rail workers also continued this month, which is likely to weigh on activity. Perhaps reflecting the industrial action, as well as the cost of living crisis hitting the poorest hardest, the share of consumers worried about economic inequality also rose in July.

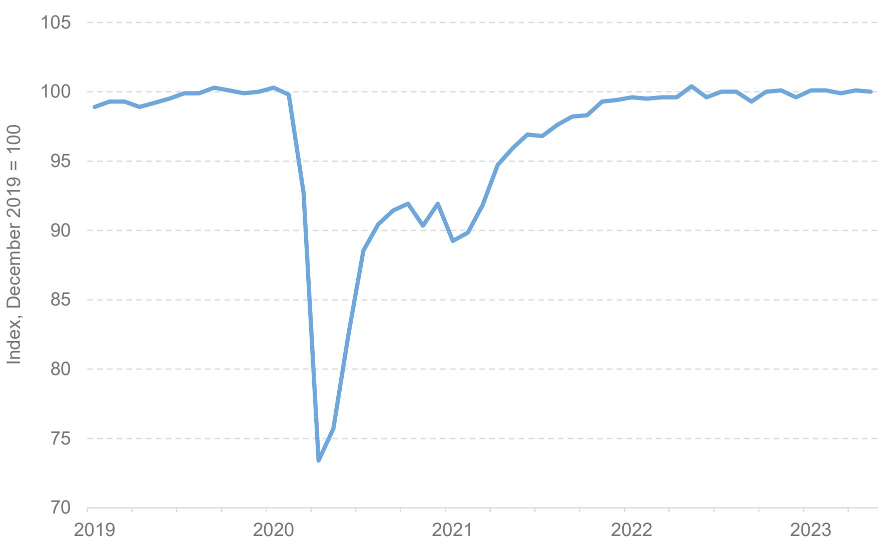


Figure 2: UK monthly economic activity index

Source: ONS

The cost of living crisis, monetary tightening and a stalled pandemic recovery are the backdrop to the UK's weak growth. But these factors are not unique to the UK, and other major economy peers are growing stronger. In the first three months of this year, the UK's pandemic recovery was some 3.6% behind the G7 average, 4.8% behind the wider OECD average, and 5.5% behind the USA. The current stagnation in the UK is a reminder of the chronic long-term challenges faced by its economy, amid more than a decade of flatlining productivity. Improving the output we get from every hour of work would expand our long-term economic potential and support real wages without stoking inflation, helping ease the economic malaise on almost every front.

UK to spend highest share of revenue on debt interest

Fitch, a credit ratings agency, published analysis this month that showed the UK government is on course to spend the highest proportion of its revenue on debt interest payments of any high-income country. They forecast that the UK government will pay 10.4% of its revenue on interest in 2023, the highest ratio of any high-income country and the first time the UK has topped the data set which goes back to 1995. This is being driven by the high proportion of UK debt, around a quarter of all debt, which is indexed linked to inflation, while most other countries have less than 10% of their bonds linked to inflation. The UK debt interest costs to revenue ratio has been rising in recent years according to Fitch and has increased from an average of 6.2% between 2017 and 2021 while the Western European average has been generally stable or declining. However, Fitch expects this ratio to fall in the UK in 2024 as inflation drops and for the US and Italy to overtake the UK on this measure.

IMF upgrades its 2023 forecast but says global recovery is slowing

In July the IMF increased its global growth forecast for 2023, with it now expecting growth of 3.0% this year, an upgrade of 0.2 percentage points (pp) on their April forecast but still slower than the growth of 3.5% seen in 2022. Growth of 3.0% is also forecast for 2024 (unchanged on April).

Most countries also had their forecast for 2023 slightly upgraded but with limited changes made to most forecasts for 2024. Thus the UK is now forecast to grow by 0.4% (an upgrade of 0.7pp on April) and 1.0% in 2024 (no change on the previous forecast). The US is expected to grow by 1.8% this year (a 0.2pp upgrade) and 1.0% next year (a -0.1pp downgrade). For the Eurozone growth of 0.9% is forecast in 2023 (a 0.1pp upgrade) and 1.5% in 2024 (a 0.1pp upgrade).

Commentating on their forecast the IMF said that the global economic outlook "remains weak by historical standards" with "the rise in central bank policy rates to fight inflation [continuing] to weigh on economic activity". They argue that the priority for most countries "remains achieving sustained disinflation while ensuring financial stability. Therefore, central banks should remain focused on restoring price stability and strengthen financial supervision and risk monitoring".

Top London earners get highest post-Covid pay growth

The Institute for Fiscal Studies (IFS) published analysis in July looking at UK pay growth since the start of the pandemic. They found that between February 2020 and May 2023 "mean earnings growth among employees living in and around London has outstripped growth in the rest of the country", with mean earnings for employees living in London increasing by 5.0% in real terms over this time period.

They however observed that "despite high growth in mean earnings, real median earnings have risen by only 1.7% since the pandemic began, to £2,700 a month before tax. That is, top earners in London have pulled away whilst middle earners have seen little real pay growth, leading to an increase in earnings inequality within London". This higher growth in mean than median earnings in London was not however generally replicated in other regions who likely saw a fall in inequality at the local level. They observed that this was caused by pay growth over this period "being concentrated in business services sectors, which tend to be highly paid and located in and around London".

GLA Economics will publish a detailed examination of regional wages in the coming months.

London's economy showing the strain

The risks for London look increasingly skewed to the downside. With mortgage rates increasing, and the likelihood this passes on to rents, London's housing cost situation is troubling. Asking rents in London are already rising 12.5% year on year according to HomeLet. This will test households' financial resilience, and already GLA-commissioned polling by YouGov showed a high of 23% of Londoners saying they are "financially struggling"[1]. London's consumer confidence fell faster than the national average in July, but was still less pessimistic at -14.

And while this month saw London receive some positive indications on future investment, many question marks remain about its long-term potential. A proposed expansion of capacity at Gatwick and the Chancellor's Mansion House speech ambition to make the City a 'capital for capital' offered hope for the future.

But London's labour market inactivity rose in the latest data, and on the business side, office vacancies continue to rise across the UK. The office market also shows how future challenges will not be spread evenly across the capital. HSBC's move from Canary Wharf to the City may point to how different business areas will face different levels of stress. And the same data showing shorter office tenancies and rising vacancy rates across the UK also show resilient demand for quality space – the market appears to be segmenting.

While the capital has recovered its pre-pandemic output level ahead of the rest of the country, how it recovers from the current stresses is still unclear.

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

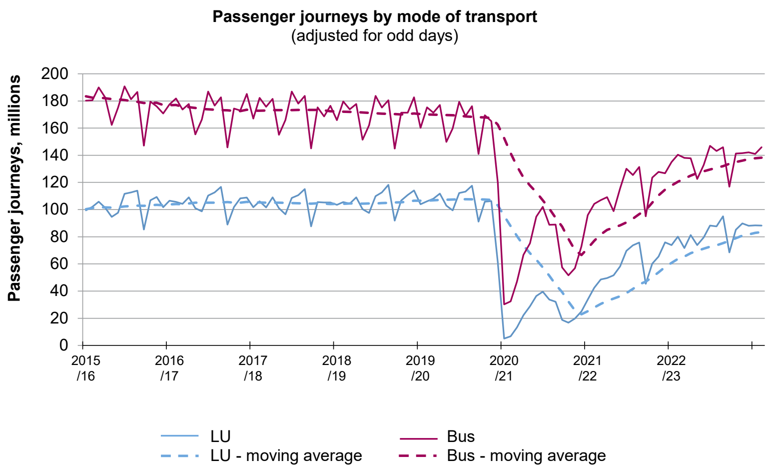
1 All figures, unless otherwise stated, are from YouGov Plc. Total sample size was 1227 adults. Fieldwork was undertaken between 23rd to 29th June 2023. The survey was carried out online. The figures have been weighted and are representative of all London adults (aged 18+). Financially struggling is the combined responses for "I am having to go without my basic needs and/or rely on debt to pay for my basic needs" and "I'm struggling to make ends meet"

Economic indicators

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

- 234.2 million passenger journeys were registered between 30 April and 27 May 2023, 4.9 million more than in the previous period. 229.3 million passenger journeys were registered between 1 April and 29 April.
- In the latest period, 88.2 million of all journeys were underground journeys and 146.0 million were bus journeys.
- The 13-period-moving average in the total number of passenger journeys rose from 220.6 in the previous period to 221.7 in the latest period.

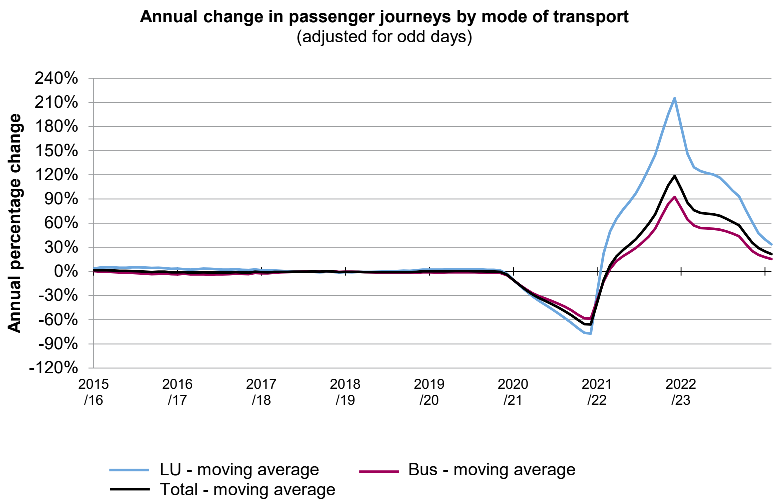
Source: Transport for London
Latest release: June 2023, Next release: August 2023



Annual growth in passenger journeys remained strongly positive, if slowing

- The 13-period moving average annual growth rate in the total number of passenger journeys was 21.6% between 30 April and 27 May 2023, down from 25.0% between 1 April and 29 April 2023.
- The moving average annual growth rate of bus journeys decreased from 17.8% to 15.5% between the above-mentioned periods.
- Likewise, the moving annual average of underground passenger journeys decreased from 39.7% to 33.7% between those periods.

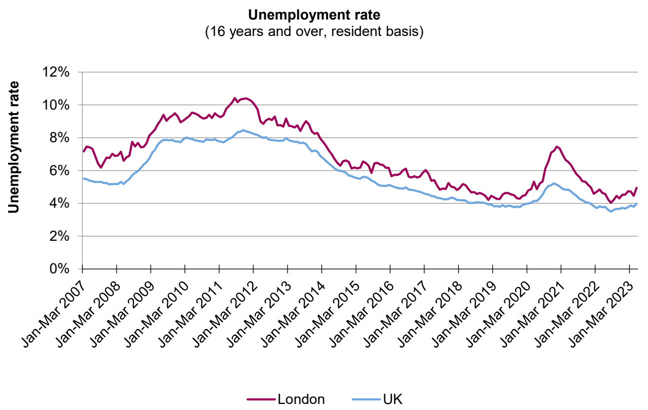
Source: Transport for London
Latest release: June 2023, Next release: August 2023



London's unemployment rate remains low

- Around 250,000 residents 16 years and over were unemployed in London in March – May 2023.
- The unemployment rate in London was 4.9% in that period, slightly higher than in the previous quarter December – February 2023, of 4.7%.
- The UK's unemployment rate increased slightly from 3.8% in December – February 2023 to 4.0% in March – May 2023.

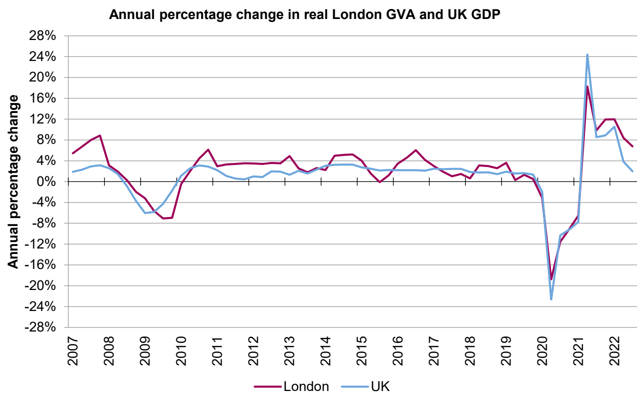
Source: ONS Labour Force Survey
Latest release: July 2023, Next release: August 2023



London's economy had surpassed pre-pandemic levels of output by Q4 2021, and continued to grow in Q3 2022

- By Q3 2022 London's GVA was 4.4% above its pre-pandemic level (Q4 2019), and UK GDP was 0.7% below.
- London's real GVA increased by 0.9% in Q3 2022 - compared with Q2 2022 - after increasing by 1.4% in the previous quarter.
- The UK's real GDP growth rate fell by 0.1% in Q3 2022 – compared with Q2 2022- after increasing by 0.1% in the previous quarter.
- While GDP and GVA are different measures in output their trends have been comparable. UK GDP estimates incorporate a broader range of data than GVA estimates, and so is more robust.
- London's real GVA quarterly estimates for the period Q1 1999 to Q4 2012 have been produced by GLA Economics. Estimates for the intervening period are outturn data from the ONS, which does not publish quarterly estimates for London's real GVA prior to 2013.

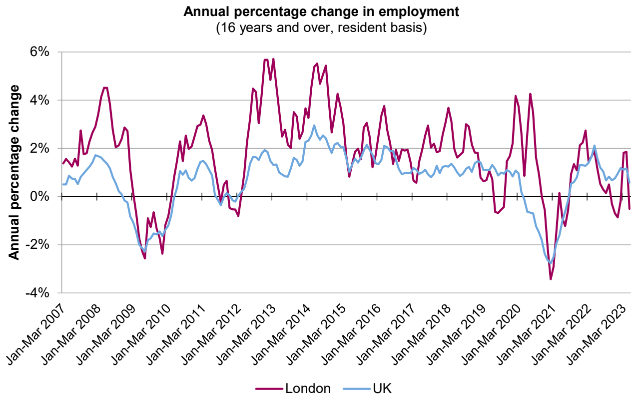
Source: ONS and GLA Economics calculations
Latest release: May 2023, Next release: Suspended until further notice



London's annual employment growth was negative in the quarter to May 2023

- Around 4.8 million London residents over 16 years old were in employment during the three-month period of March – May 2023.
- The rate of employment growth was -0.5% in the year to this quarter, lower than in the previous quarter to February of -0.2%.
- The change in the UK's employment annual growth rate was 0.6% in the most recent quarter, slower than the rate of 1.2% in the previous quarter.
- London's labour market remains a conundrum. Evidence from a range of sources is that labour demand is weakening, although the estimated pace and degree of the weakening varies across data sources. The data reported here shows an earlier and stronger weakening than other sources, perhaps partly reflecting the underlying volatility due to comparatively small sample sizes in this data

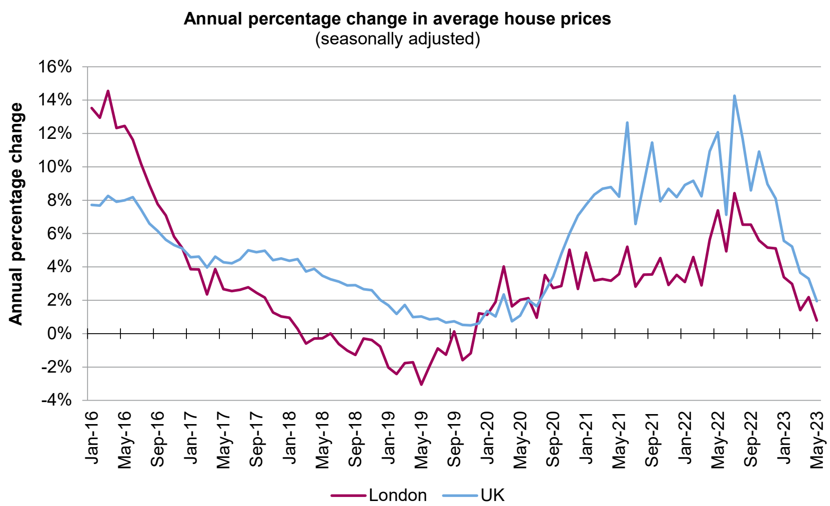
Source: ONS Labour Force Survey
Latest release: July 2023, Next release: August 2023



Annual house price growth in London remained positive, but continued to slow in May

- In May 2023, the average house price in London was £529,000 while in the UK it was £285,000.
- Average house prices in London rose by 0.8% year-on-year in May, lower than the rate of 2.2% in April.
- Average house prices in the UK rose by 2.0% in May on an annual basis, lower than the rate of 3.3% in April.

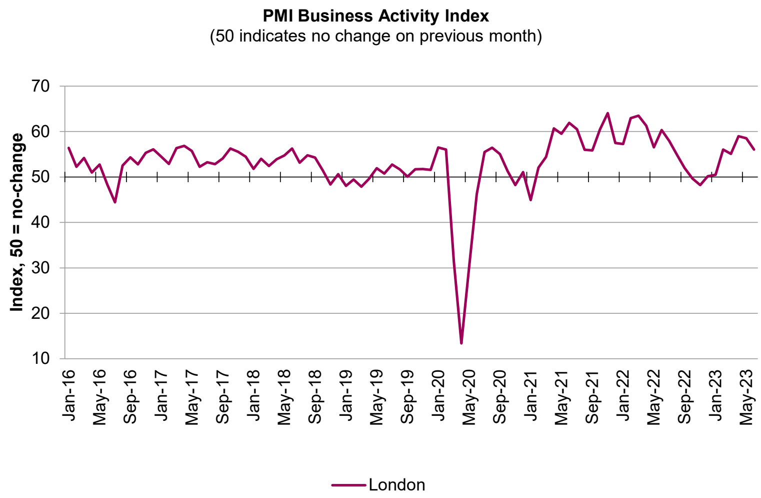
Source: Land Registry and ONS
Latest release: July 2023, Next release: August 2023



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

- The business activity PMI index for London private firms decreased from 58.5 in May to 56.0 in June.
- The Purchasing Managers' Index (PMI) survey shows the monthly business trends at private sector firms. Index readings above 50 suggest a month-on-month increase in activity on average across firms, while readings below 50 indicate a decrease.

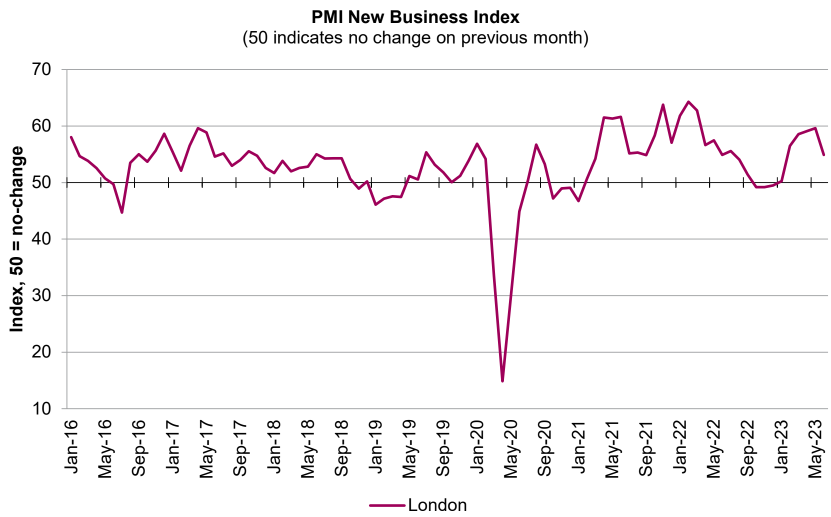
Source: IHS Markit for NatWest
Latest release: July 2023, Next release: August 2023



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

- The PMI new business index in London decreased from 59.6 in May to 54.9 in June.
- An index reading above 50.0 indicates an increase in new orders on average across firms from the previous month.

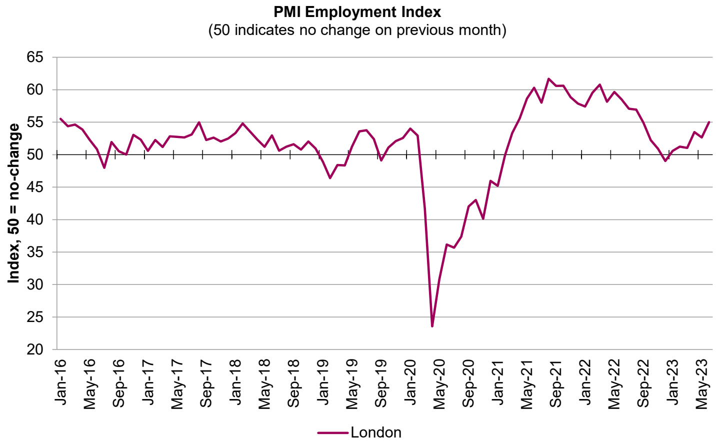
Source: IHS Markit for NatWest
Latest release: July 2023, Next release: August 2023



In June, the sentiment of the PMI employment index in London remained positive and increased

- The Employment Index for London increased slightly from 52.7 in May to 55.0 in June.
- The PMI Employment Index shows the net balance of private sector firms of the monthly change in employment prospects. Readings above 50.0 suggests an increase, whereas a reading below 50.0 indicates a decrease in employment prospects from the previous month.

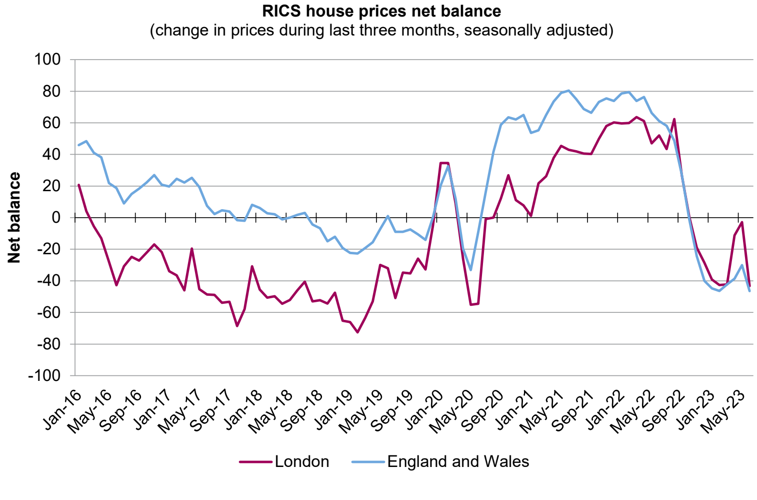
Source: IHS Markit for NatWest
Latest release: July 2023, Next release: August 2023



The number of property surveyors in London reporting house price falls in June increased

- In June 2023, more property surveyors in London reported falling prices than rising prices. The net balance index was -43 and in May 2023 it was -3
- For England and Wales, the RICS house prices net balance index worsened from -30 in May to -46 in June.
- The net balance index measures the proportion of property surveyors reporting a rise in prices minus those reporting a decline.

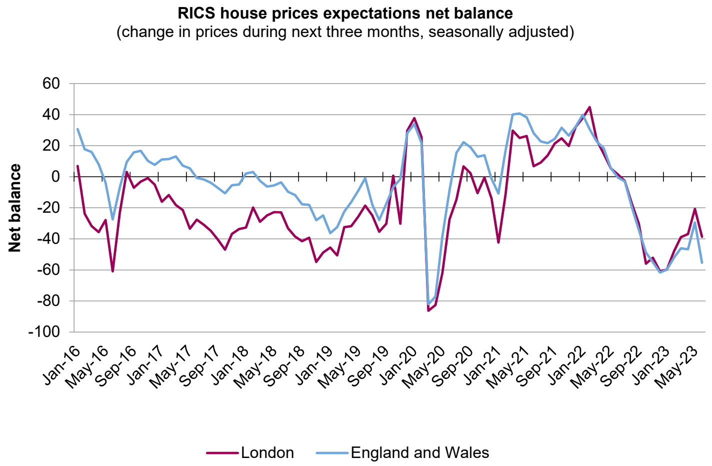
Source: Royal Institution of Chartered Surveyors
Latest release: July 2023, Next release: August 2023



In June, net expectations for house prices in London for the next three months decreased and remained highly negative, according to surveyors

- The net balance of house prices expectations in London was -39 in June, down from -21 in May 2023.
- The index for England and Wales was -29 in May and -55 in June.
- The net balance index measures the proportion of property surveyors reporting a rise in prices minus those reporting a decline.

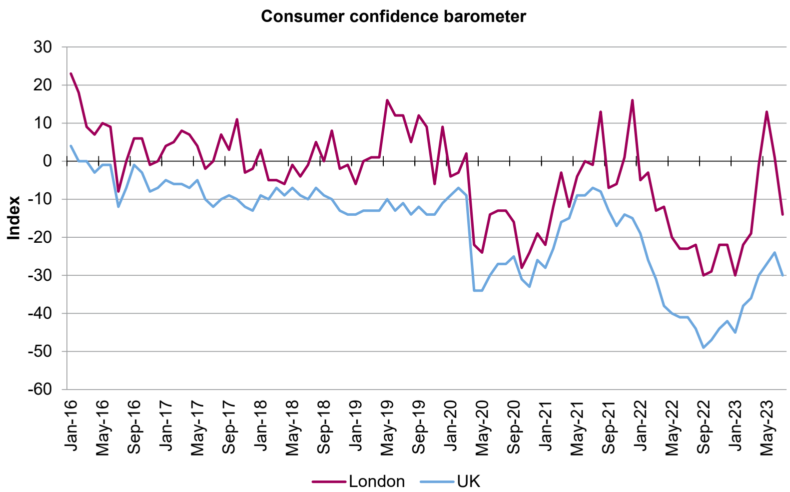
Source: Royal Institution of Chartered Surveyors
Latest release: July 2023, Next release: August 2023



Consumer confidence in London decreased noticeably in July

- The consumer confidence index in London declined from 1 in June to -14 in July.
- The sentiment for the UK worsened from -24 in June to -30 in July. The UK has not seen a positive index score since January 2016.
- The GfK index of consumer confidence reflects people's views on their financial position and the general economy over the past year and in the next 12 months. A score above zero suggests positive opinions; a score below zero indicates negative sentiment.

Source: GfK
Latest release: July 2023, Next release: August 2023

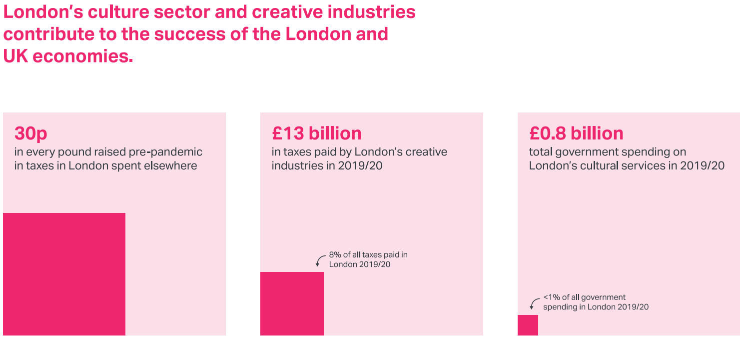


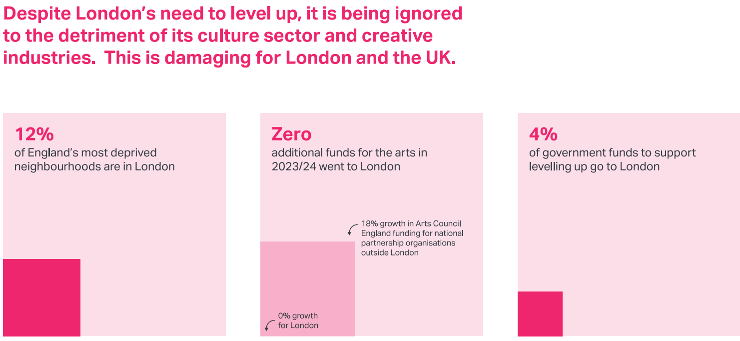
A summary of two of our recent publications

The culture sector and creative industries in London and beyond

by **Mike Hope**, Economist

In June, GLA Economics published a report[1] on the culture sector with a focus on levelling up, provision, engagement and funding. There was an assessment of the effects of Brexit, the pandemic, restraint in government spending, and the cost of living crisis. The main conclusion is that London's culture sector and creative industries contribute to the success of the London and UK economies.





London's creative industries paid £13 billion in taxes in 2019/20, around 8% of taxes paid in London, a significant component of London's net fiscal contribution to the Exchequer. It is the capital's third largest sector, after finance and real estate. The sector supports regions outside of London through trade and supply chains. There is 24p of production generated elsewhere in the UK for every pound consumed or invested in London.

Despite London's need to level up, it is being ignored. Four per cent of the government's £23 billion of levelling up funding went to London, despite 12% of England's most deprived neighbourhoods being in the capital. In 2023/24 there has been an 18% uplift in funding for the arts through Arts Council England National Partnership Organisations – yet there were no additional funds for London. Despite their own cutbacks local authorities, especially in London, have been topping up arts funding withdrawn by central government – this is suggestive of insufficient central government funding. The lack of provision of funds for London is damaging for London and the UK.

1 Hope M (2023), The culture sector and creative industries in London and beyond: a focus on levelling up, provision, engagement and funding, GLA Economics

The creative industries are growing faster in London than elsewhere, both in terms of jobs and output. Jobs in the creative industries in London grew by 3.3% a year between 2015 and 2019, and in Britain by 2.5%. The creative industries in London grew at 5.2% a year over the period 2010-19, and across Britain by 4.1%. The sector is also growing faster than the London economy. All jobs in London grew by 1.8% a year between 2015 and 2019, and in Britain by 1.2%. London's economy grew by 3.0% a year over the period 2010-19, and Britain by 2.1%.

London does not get a disproportionate share of the insufficient central government funding for culture. Total public spending on cultural services, weighted by population, is relatively high in London, but not for the wider South East. Indeed, the provision of culture in London also supports the wider South East. Further, much of London's funding goes to a very small group of nationally-serving organisations – exclude this funding, and London's funding is in line with the rest of the country. In relation to the number of performing arts businesses and attendances at performance, funding for London again is not generous.

London Learner Survey

By **Ruth Moxon**, Economist

The London Learner Survey (LLS)[2] is a new survey of learners who participated in a GLA-funded Adult Education Budget (AEB) course. The survey gives new and unique insight into the outcomes of learners measuring seven outcomes, which can be divided into economic and social outcomes, as approved by the Mayor of London in the Skills Roadmap. The economic outcomes are progression into employment, progression within work and progression into further learning. Meanwhile, the social outcomes are improved health and wellbeing, improved social integration, improved self-efficacy and participation in volunteering.

These outcomes are measured using a baseline survey conducted when a learner starts a course and a follow-up survey 5-7 months after a learner completes their learning aim.

In June the Skills and Employment team published four outputs for the LLS for academic year 2021/22:

Headline findings report
Covering the social and economic outcomes of Londoners participating in the AEB. The report includes results for all learners funded by the AEB and subsections which divide learners based on the fundings model (Adult Skills and Community Learning).

Dashboard
Outlining the key statistics from the research report and allowing users to view and interact with the results by funding model.

Slide-pack overview
An overview of the headline findings report in an accessible slide-pack, providing a more comprehensive commentary on the data than the dashboard.

IFF technical report
Provided by IFF Research (the commissioned partner that conducted the survey), outlining how the survey was conducted, the statistical approach taken to weighting and the full questionnaire.

The main findings for academic year 2021/22 are positive overall and highlight the broad range of outcomes delivered through the Adult Education Budget. The survey is currently underway for academic year 2022/23.

2 https://data.london.gov.uk/dataset/london-learner-survey

Our latest publications

We publish regularly on the state of London's economy, providing the latest economic data for London and interpret how this may affect policy. This includes analysis of recent developments in London's economy and forecasts for the next couple of years.

We provide analysis on sectors of the economy including tourism, retail, housing, health, science, technology and more.

We analyse recent developments in London's labour market, by sector and borough.

View all the GLA Economics publications on our website.

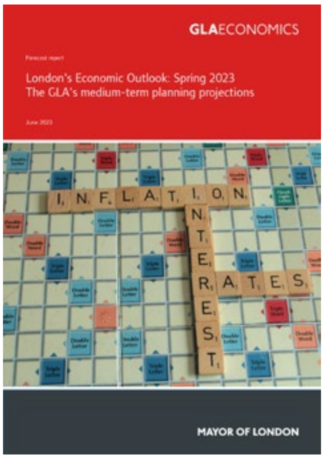
The State of London - June 2023 update
The third edition of the State of London report by City Intelligence brings together a wide range of outcome data relevant to the work of the Mayor, the London Assembly and other stakeholders, and measures how London is performing based on the most recent available data.

Download the full publication.

The culture sector and creative industries in London and beyond: a focus on levelling up, provision, engagement and funding - June 2023
The creative industries in London contributed £13 billion in taxes in 2019/20, which could grow with further investment. Government support has been directed away from London, to the detriment of the UK and London, both culturally and economically.

This report from GLA Economics looks at the provision of cultural services in London and nationally, who engages with those services, and the role of public funding.

Download the full publication.



London's Economic Outlook: Spring 2023
GLA Economics' 42nd London forecast 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.

Download the full publication.

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London's Economy Today is published towards the end of every month. It provides an overview of the current state of the London economy, and a selection of the most up-to-date data available. It tracks cyclical economic conditions to ensure they are not moving outside the parameters of the underlying assumptions of the GLA group.

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