GLAECONOMICS

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http://data.london.gov.uk/gla-economics/let/

Bank rate held while inflation reaches four-year high

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

Inflation in May was the highest for nearly four years, according to data published this month by the Office for National Statistics (ONS). At 2.9 per cent, Consumer Price Index (CPI) inflation has not been this high since June 2013, and was above HM Treasury's latest summary of independent forecasters' average for the whole of 2017 of 2.7 per cent.

The ONS observed that this increase was primarily driven by "rising prices for recreational and cultural goods and services (particularly games, toys and hobbies)", though there was also a small "upward contribution from increased electricity and food prices". These latest trends in inflation are likely to put a squeeze on household incomes, as real wages fail to keep up with rising prices. Official estimates suggest that real pay in Great Britain has not yet recovered from the falls following the financial crisis (see Figure 1). That said, UK employment continues to rise; UK employment is at 74.8 per cent, up from 74.6 per cent in the previous quarter. However, employment in London is lower and has fallen a touch recently, at 73.3 per cent this quarter, down from 73.4 per cent the previous quarter.

Latest news...

London's Economic Outlook: Spring 2017

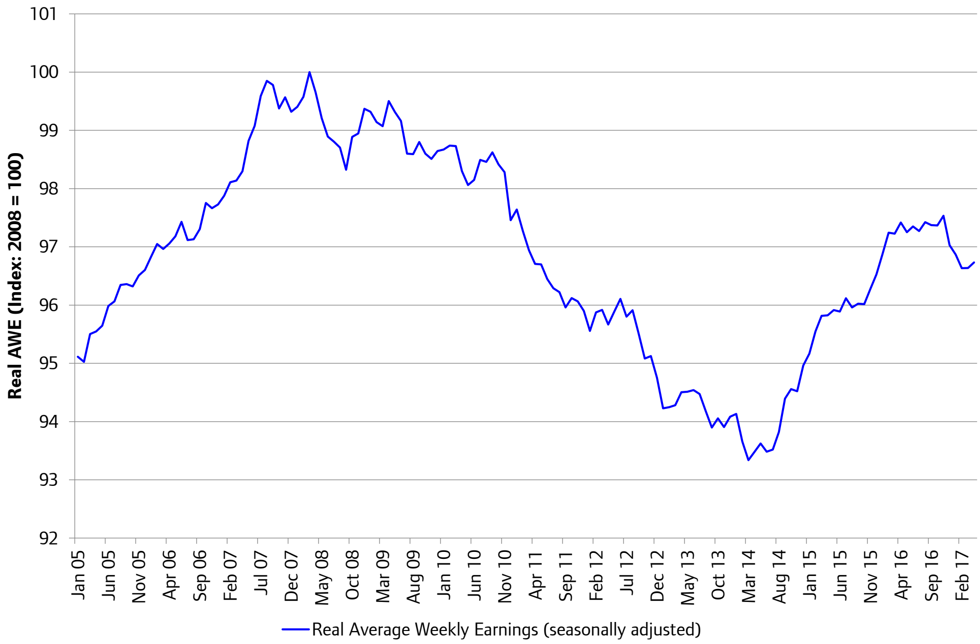
GLA Economics' 30th London forecast suggests that:

- London's Gross Value Added (GVA) growth rate is forecast to be 2.3 per cent in 2017 with the growth rate increasing slightly to 2.4 per cent in 2018 and 2.9 per cent in 2019.
- London is forecast to see rises in employment in 2017, 2018 and 2019.
- London household income and spending are both forecast to increase over the next three years.

Download the full publication.

Figure 1: Real Average Weekly Earnings (Regular Pay, seasonally adjusted), Great Britain, Jan 2005 - Apr 2017, Index: March 2008 = 100

Source: ONS



Further pressures on household incomes are likely to come from the impact on import prices of exchange rate changes and the continued depreciation of the pound against most major trading currencies such as the US dollar and the euro. As of 27 June, the pound was at $1.14, down from around $1.43 prior to last year's referendum. However, this is still slightly higher than the low of around $1.10 seen in October last year, and comes despite continued uncertainty especially around the nature of 'Brexit'.

With these growing pressures in mind, at its June meeting, the Bank of England's Monetary Policy Committee (MPC) voted by a majority of 5-3 to maintain the 0.25 per cent Bank Rate, with the minority voting to raise interest rates. The MPC also unanimously voted to maintain the programme of Quantitative Easing (QE) in the form of bond purchasing. The three members that voted for a rate increase did so on the concern of above-target inflation (with CPI inflation standing above the Bank's central symmetrical target of 2 per cent). Indeed, the MPC's outlook suggests that inflation could rise above 3 per cent by Autumn - above their last published forecast of just below 3 per cent in the Bank's May Inflation Report. This is based on the judgements that: the lower level of sterling will continue to raise consumer prices; regular pay growth will remain modest in the near term but pick up over the forecast period; and subdued household spending growth is largely balanced by a pickup in other components of demand. Despite the split vote, all members agreed that any increases in Bank Rate should occur at a gradual pace and to a limited extent.

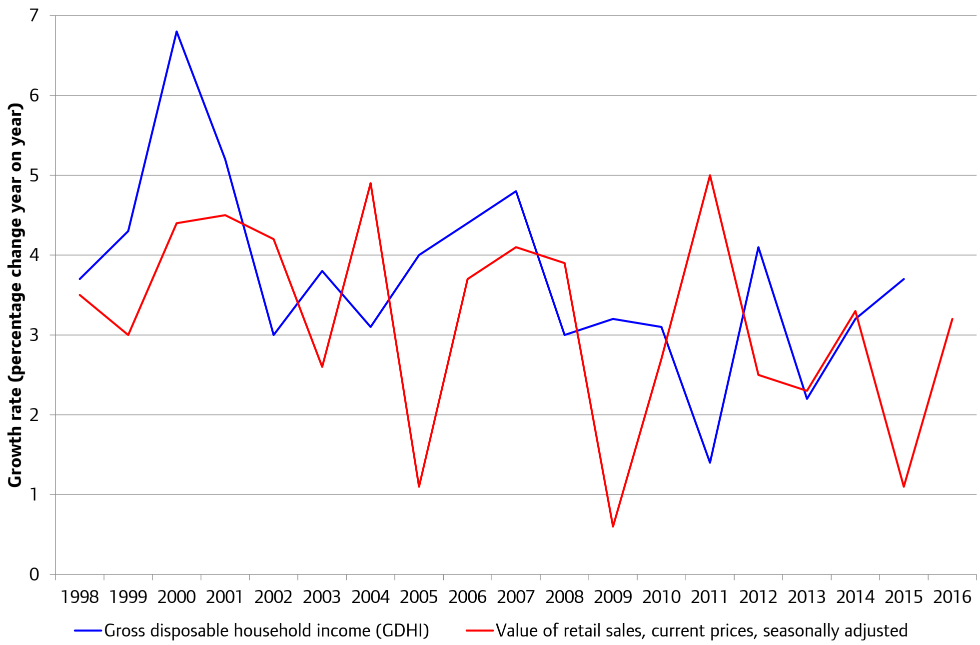
Commenting on the decision, Bank of England Governor, Mark Carney, said that he was of the opinion that "given the mixed signals on consumer spending and business investment, and given the still subdued domestic inflationary pressures, in particular anaemic wage growth, now is not the time to begin that adjustment". However, Andy Haldane, Chief Economist at the Bank, said that he thought that the reasons for keeping rates on hold at 0.25 per cent had lessened. Speaking in Bradford, Haldane said "the risks of tightening 'too early' have shrunk as growth and, to lesser extent, inflation have shown greater resilience than expected. And if policy tightened 'too late', this could result in a much steeper path of rate rises later on, contrary to the MPC's collective expectation that Bank rate would increase 'at a gradual pace and to a limited extent'". Following the Bank's decision, the FTSE 250 index (which includes more UK focused firms than the FTSE 100) fell by 2.1 per cent – making it the worst day so far this year.

Retail sales grow at the slowest rate in four years

Meanwhile, the UK's retail sector performed disappointingly in May, with sales growing at the slowest rate for four years. This could be partly a possible consequence of the squeeze on household incomes, with retail sales making up a third of all household spending in the UK according to research by KPMG. Sales volume fell 1.2 per cent month-on-month, after unusually high growth (2.3 per cent) in April caused by the timing of Easter. According to the ONS, non-food stores were the main contributing factors to this slowdown. Compared to the same month a year ago, retail sales were up 0.9 per cent, but this compares poorly to the growth seen in May 2016 of 5.5 per cent. This May's growth is the lowest growth reported since April 2013. If lower retail sales is evidence of a slowdown in consumer spending, this could be particularly worrying for the UK economy as household spending accounts for 60 per cent of economic activity and has been a significant driver of growth in recent years. Despite lower retail sales, the Confederation of British Industry (CBI) has demonstrated a slight improvement in optimism over the economy having raised its UK growth forecast. It predicted the UK economy will expand 1.6 per cent this year and 1.4 per in 2018, up from annual growth of 1.3 per cent and 1.1 per cent respectively in their November forecast.

Figure 2: GDHI and retail sales, UK, 1998 – 2016

Source: ONS



Fed raises interest rates despite continued low inflation

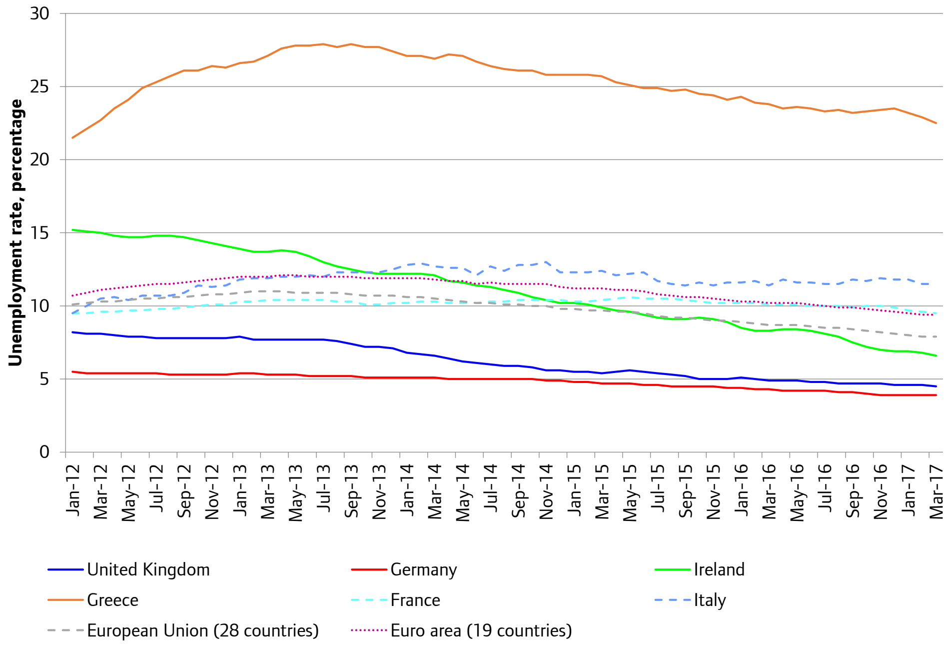
Internationally, in a particularly hawkish move and in contrast to the Bank of England, the United States' Federal Reserve (the Fed) opted to raise rates for the second time so far in 2017 and the fourth time since the financial crisis. The decision raised short-term rates by another quarter point to between 1.0 and 1.25 per cent but rates remain low by historic standards. It is unlikely to be the last such move this year. Fed Chair, Janet Yellen, pointed to the recent progress made by the US economy towards greater employment and price stability, stressing the importance of the rate rise decision in helping to sustain labour market health and the inflation target in the longer run. However, at least recently, US inflation appeared softer; slowing to 1.9 per cent in May. Nonetheless, Yellen said that the recent inflation readings were driven by oneoff price reductions, and that the committee expected inflation to be around 2 per cent over the next couple of years.

Eurozone unemployment falls to 9.3 per cent amidst some evidence of a Greek recovery

Elsewhere internationally, unemployment in the Eurozone reached an eight-year low of 9.3 per cent in April 2017, down from 10.2 per cent a year earlier. Similarly, Eurostat data showed that 155 million people were employed in the euro area in Q1 2017, which was the first-time employment has surpassed pre-crisis levels. The recovery has been attributed to cheap credit, subdued oil prices, a weaker euro, and loosening of government austerity. Although the economic outlook has improved a touch in the Eurozone, the European Central Bank (ECB) has announced that although it does not intend to cut interest rates any further it is concerned about continued relatively weak inflation and low wage growth. It has therefore promised there will have to be an end to both before it considers ending its extremely accommodating monetary policy.

Figure 3: Percentage of active population unemployed, seasonally adjusted, EU countries, Jan 2012 – Mar 2017

Source: Eurostat



In other news, Eurozone finance ministers have announced a deal to unblock Greece's bailout programme. The deal, worth €8.5 billion, represents the end of disputes with other Eurozone ministers as the IMF has now agreed to join the rescue programme, making an additional €2 billion available. The deal will allow Athens to avoid defaulting on bailout repayments and has provided some clarity for investors on how Greece will manage its debt burden. And in other positive news for Greece, this month saw Greece's GDP growth rate for Q1 2017 revised upwards to a 0.4 per cent expansion, from a previously estimated 0.1 per cent contraction. This is just below the EU average of 0.5 per cent growth.

However, Italy's economy has fared less well this month, with Italy's government forced to rescue two banks at the cost of €5.2 billion. Italian Prime Minister, Paolo Gentiloni, said that the rescue was needed to protect savers and ensure the continued good health of the Italian banking system. The European Commission has approved the move which avoids a bailout by guaranteeing up to €12 billion for potential losses from bad and risky loans. The Italian press has reported that up to 4,000 jobs at the banks could be lost. The Italian banking system has long been of concern, making up approximately a third of the Eurozone's total bad debt – at €350 billion.

Londoners maintain their optimism but concerns arise for the financial sector

Despite ongoing 'Brexit' concerns, London businesses remain optimistic for the future. As shown in the economic indicators section in this publication, the Purchasing Manager's Index (PMI) New Business Index points to a further strong rise in new work in London in May; meanwhile, the PMI Employment Index, although remaining subdued, showed an increase in London employment for the seventh consecutive month.

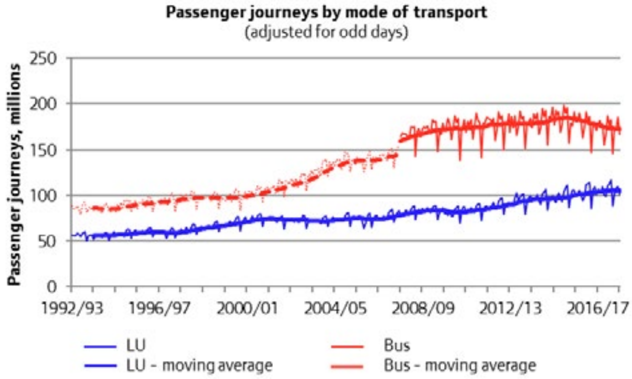
Likewise, the London Small Business Index, from the Federation of Small Business (FSB), also suggested that London business retains confidence in the economy. Their survey reported a score of +25 for Q2 2017, up from +24 in Q1 2017, and -10 a year earlier. However, at a UK level, optimism fell from +20 in Q1 2017 to +15 in Q2 2017. National Chairman, Mike Ferry, said "small businesses were feeling more pessimistic even before the General Election was called. Now alongside increasing inflationary pressure, a business rates revaluation and rising labour costs, they have a whole new wave of political uncertainty to contend with". Still, the Lloyds Bank Business in Britain report, which surveys 1,500 companies in the UK, reported that business confidence was at an 18-month high of 24 per cent in May. They attributed the jump to increased demand from UK consumers.

However, of possible concern to London's financial sector going forward, was the news that the European Commission has revealed a draft law about 'euro-clearing'. It states if the European Securities and Markets Authority decides that a clearing house is handling 'systemically' important volumes of euro-denominated trade, a system of tougher supervision would be introduced. In addition, under this rule, any 'systemically important' business deemed to pose a potential risk to stability, could be required to relocate to within the EU. The ECB has further put forward a proposal that would give it a significantly enhanced role in regulating the market. Under their proposals, the ECB and its national central banks, would monitor risks that could affect monetary policy or the stability of the euro. Clearing refers to the process by which third-party organisations act as the middleman for both buyer and seller of financial contracts tied to the underlying value of a share, index, currency, or bond. London currently processes three-quarters of all trade in this industry, which supports a number of jobs in the capital. The financial industry has already warned that forced relocation of the work would split markets, increase trading costs, weaken the euro, and threaten jobs. Benoit Coeure, a member of the ECB's executive board, said their proposed approach would be justified "in case EU authorities are unable to adequately control risks and fulfil their mandates through other means".

Statistics released this month by HM Land Registry and the ONS show that London house prices rose 4.7 per cent in the year to April 2017, compared to a UK average of 5.7 per cent. This is the first increase in the rate of house price inflation in nearly a year in London, and is part of a marginal revival across the UK more generally. In-spite-of some economic concerns, London's consumers – like London's businesses – retain confidence in London's economy, with London the only UK region to report a positive GfK Consumer Confidence Index score in May. The economic prospects for London, although more subdued than before last year's referendum, remain positive, with the latest forecast for London's economy published by GLA Economics this month predicting continued economic growth to 2019.

Slight fall in the 12-month moving average of total passenger journeys

- In the 29 day period between 1 and 29 April and adjusting for odd days, there were 268.2 million passenger journeys. This consisted of 101.8 million Tube and 166.4 million bus journeys.
- The 12-month moving average fell slightly to 278.0 million total passenger journeys, which was slightly higher than the average for 2016/17. Both the moving average in London Underground (105.2 million) and bus passengers (172.8 million) fell marginally during the latest period.
- The methodology used to calculate the number of bus passenger journeys was changed by TfL on 1 April 2007. For a detailed explanation, please see LET issue 58 (June 2007).

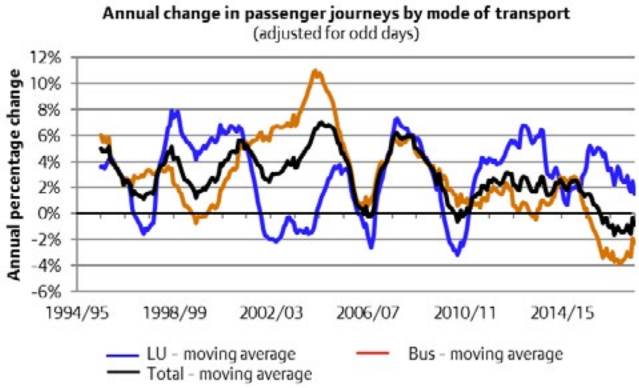


Latest release: June 2017
Next release: July 2017

Source: Transport for London

Moving average annual rate of change in tube passenger journeys at three-year low

- At 1.5 per cent, the moving average annual rate of growth in Tube passenger journeys was the slowest since mid-2014/15.
- The moving average annual rate of change was meanwhile negative for bus journeys, down 2.3 per cent.
- Overall, total passenger journeys fell 0.9 per cent on average, down from a 0.3 per cent decline in the previous period.

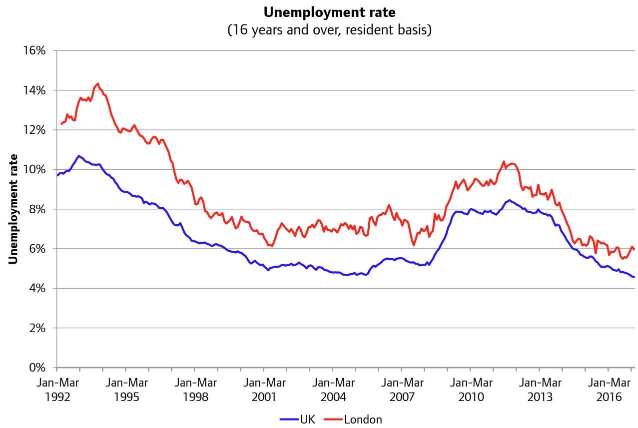


Latest release: June 2017
Next release: July 2017

Source: Transport for London

London's unemployment rate ticks up

- There were 290,400 unemployed people living in London and aged 16 years and over during the three months to April 2017. That was up from 275,600 reported during the three months to January 2017.
- London's unemployment rate consequently rose from 5.7 per cent to 6 per cent during the latest three-month period.
- That was higher than the UK as a whole; where the unemployment rate was down slightly from 4.7 per cent to 4.6 per cent in the three months to April.



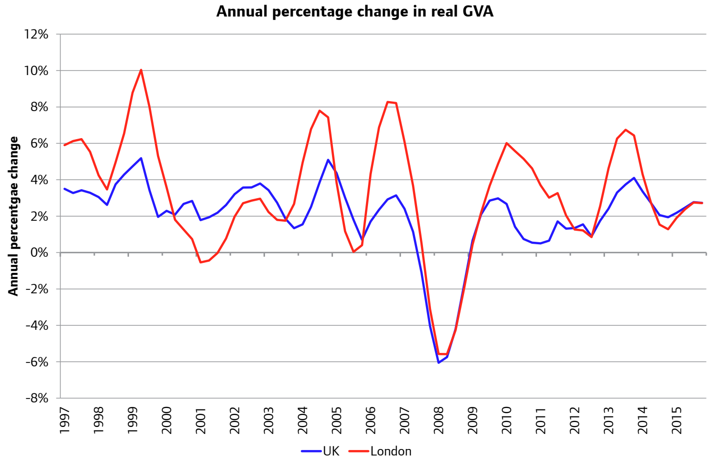
Latest release: June 2017
Next release: July 2017

Source: ONS Labour Force Survey

Annual output growth holds steady in London in Q4 2016

- London's annual growth in output remained at 2.7 per cent in Q4 2016.
- Annual output growth in the UK decreased to 2.7 per cent in Q4 2016 from 2.8 in Q3 2016. In Q4 2016, London's annual output growth was equal to the UK as a whole.
- From LET Issue 165 (May 2016), GLA Economics now reports our own GVA estimates for London and ONS data for the UK.

Latest release: April 2017
Next release: July 2017

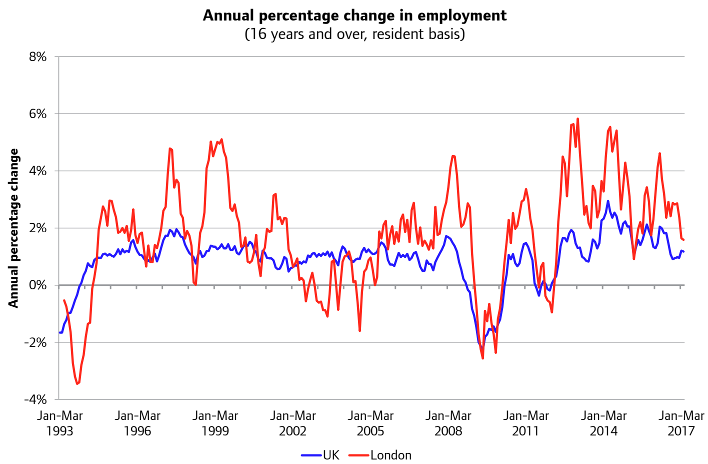


Source: ONS and GLA Economics calculations

Employment growth in London slows

- The number of London residents aged 16 years and over and who were in employment was 4.580 million during the three months to April 2017. That was the highest number since data collection began in 1992.
- However, the annual rate of growth was just 1.6 per cent, down from 2.9 per cent in the three months to January.
- Nonetheless, the rate of employment growth in London was faster than that for the UK as a whole (1.2 per cent).

Latest release: June 2017
Next release: July 2017

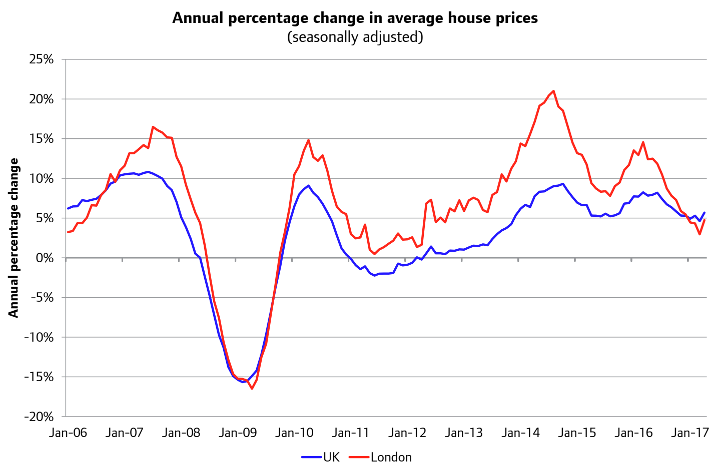


Source: ONS Labour Force Survey

House prices in London grow at a subdued pace

- The average house price in London was £483,300 in April 2017. That was more than double the UK average of £219,200.
- London house prices grew 4.8 per cent year-on-year, though at a much slower rate than those seen in 2016.
- The UK saw a stronger annual increase in house prices, with the rate of growth accelerating to a six-month high of 5.7 per cent.

Latest release: June 2017
Next release: July 2017

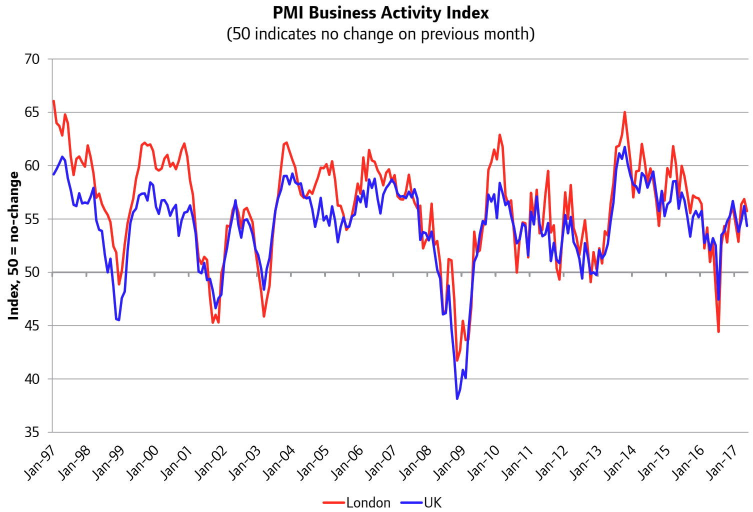


Source: Land Registry and ONS

Further solid rise in business activity levels

- The Purchasing Managers' Index (PMI) survey shows the monthly business trends at private sector firms. Index readings above 50.0 suggest a month-on-month increase in that variable, while readings below indicate a decrease.
- At 55.7, the Business Activity Index suggested that London firms continued to experience a solid rise in output during May.
- While business activity also increased across the UK, London's index reading was higher (55.7 versus 54.4) suggesting a faster rate of growth in the capital.

Latest release: June 2017
Next release: July 2017

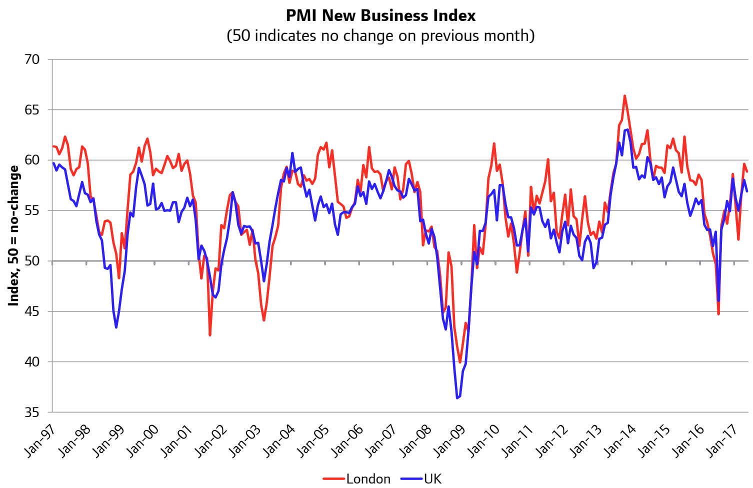


Source: IHS Markit

New business at London firms continues to grow strongly

- Although down from April's near two-year high (59.6), the New Business Index pointed to a further strong rise in new work in London in May (58.9).
- The UK index similarly pointed to an increase in new business (56.9). Overall, London had the third-highest index reading among the 12 UK regions or nations.
- An index reading above 50.0 indicates an increase in new orders from the previous month.

Latest release: June 2017
Next release: July 2017

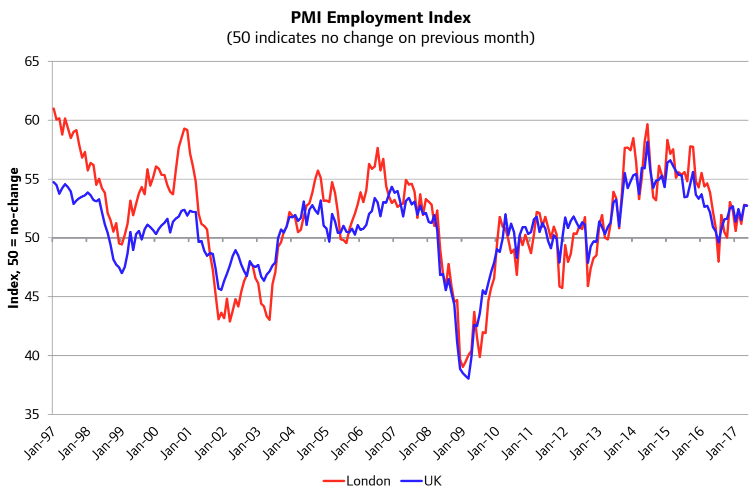


Source: IHS Markit

London businesses report a further rise in employment

- The PMI Employment Index shows the monthly change in employment at private sector firms. Readings above 50.0 suggests and increase, whereas a reading below indicates a decrease in employment from the previous month.
- London firms reported an increase in employment for the seventh consecutive month in May. At 52.7, the rate of job creation was little-changed from April (52.8).
- The Employment Index for London was on par with the UK in May.

Latest release: June 2017
Next release: July 2017

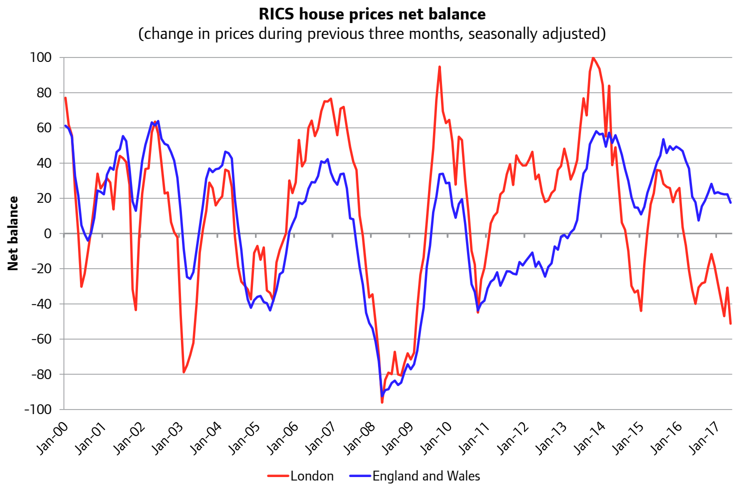


Source: IHS Markit

Most negative net balance in relation to London's house prices since early 2009

- Property surveyors reported that London's house prices continued to fall in the three months to May 2017. The net balance was -51 which was the lowest since February 2009.
- In contrast, house prices across England and Wales increased, though the net balance of +17 was the lowest in nine months.
- London was the only region to see a fall in house prices during the three months to May 2017.

Latest release: June 2017
Next release: July 2017

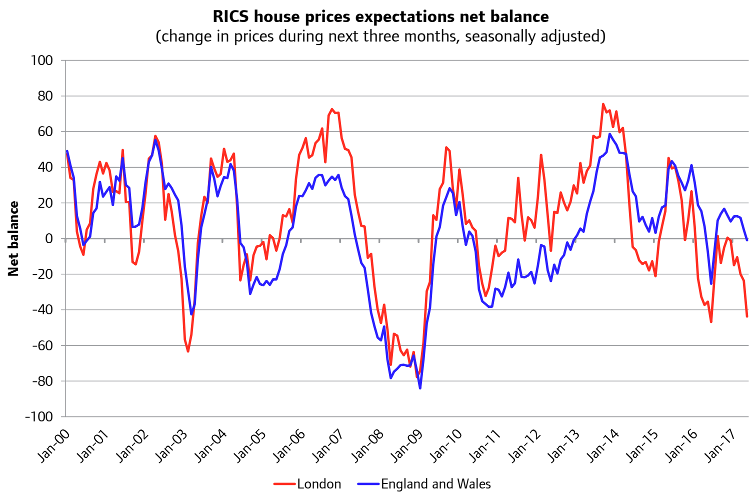


Source: Royal Institution of Chartered Surveyors

Sentiment towards future house prices in London at an 11-month low

- House price expectations for London remained negative in May 2017. The net balance of -44 was the lowest since June 2016.
- Meanwhile, property surveyors on average expect house prices across England and Wales to remain broadly unchanged over the next three months. At -1, the net balance was close to the zero no-change mark.
- House price expectations was only negative in London and the South East.

Latest release: June 2017
Next release: July 2017

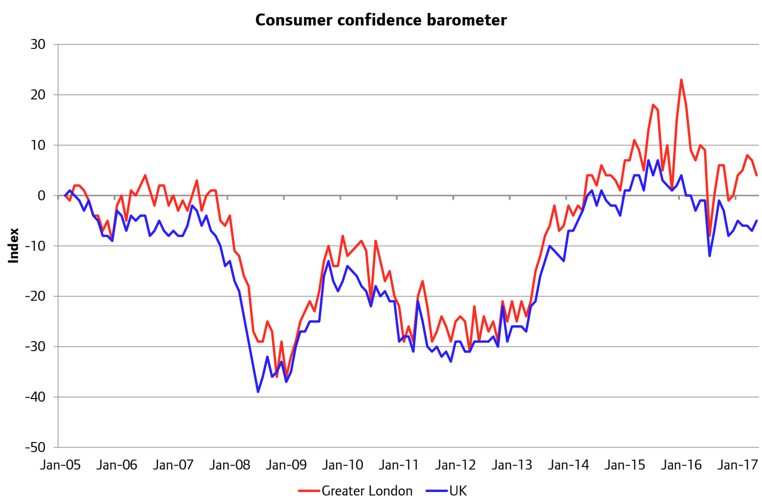


Source: Royal Institution of Chartered Surveyors

Londoners continue to be more optimistic than the rest of the UK

- 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.
- Consumers in London were optimistic about the future. At +4, the index has now signalled optimism for five consecutive months.
- At -5, the index reading for the UK has been negative in every month since April 2016.

Latest release: May 2017
Next release: June 2017



Source: GfK NOP on behalf of the European Commission

Productivity trends in London

By **Mark Wingham**, Economist

Productivity is an important indicator of economic performance by showing the efficiency of converting inputs into outputs. While there are a variety of ways of measuring productivity, one of the most widely used indicators is output per job. This measure of labour productivity – the amount of output generated by a unit of labour – is based on readily available data for output and jobs and, consequently, can be easily compared with other regions and countries as well as by sector.

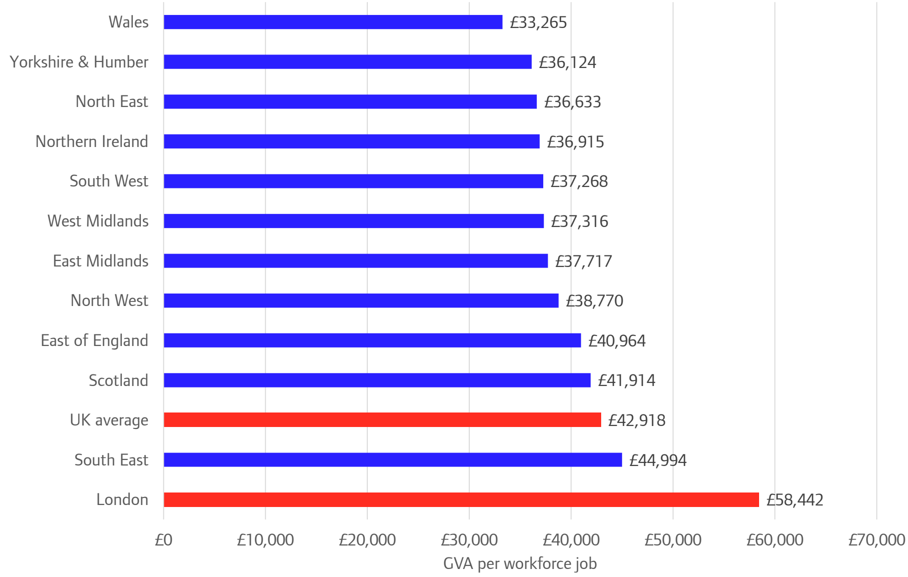
In a recently published report[1] GLA Economics estimated this by UK region and by industry division and section up to 2015 using a gross value added (GVA) per workforce job definition. This can not only contribute to the current debate on productivity, but can also be used for appraisal and evaluation purposes to estimate the economic impact of policies.

The methodology used to calculate GVA per workforce job is an extension of that used in a previous report[2]. This approach first identified the proportion of GVA attributed to the workforce at the section (1-digit SIC) level taking advantage of more comprehensive data from the ONS Regional GVA release. This is then apportioned to the constitute divisions (2-digit SIC) based on the share of both the number of employees and self-employed jobs. This is further adjusted to account for different labour productivities at the division level so that divisions with higher wages will have a larger proportion of the section's GVA. This methodology is discussed in greater detail in Appendix A of the latest report.

The latest data finds that GVA per workforce job in London was £58,442 in 2015. That was the highest among the UK regions, with the UK average being £42,918. To put that in perspective, the next highest was the South East with £44,994.

Figure A1: GVA per workforce job by UK region in 2015

Source: GLA Economics calculations



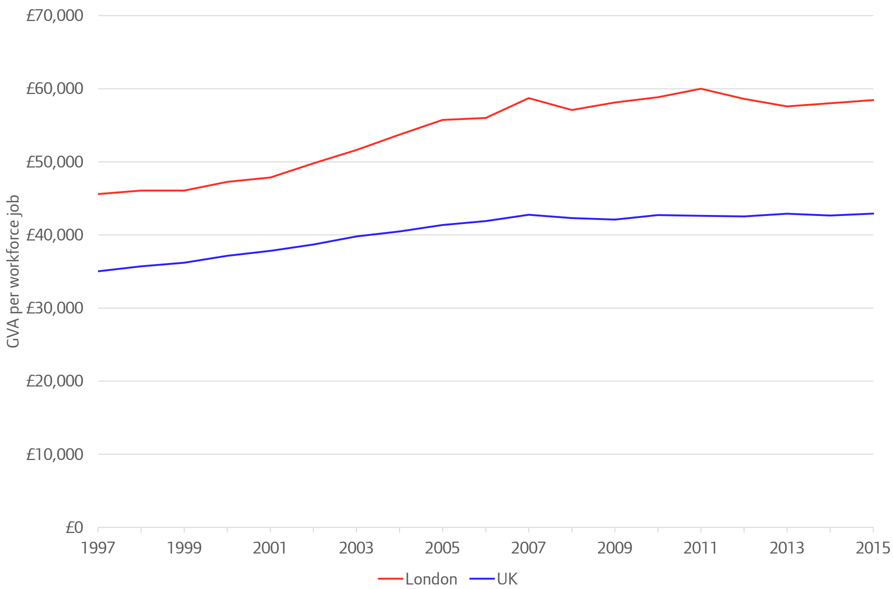
1 Smith, B. & Girardi, A., March 2017, 'Productivity Trends: GVA per workforce job estimates for London and the UK, 1997 – 2015'. Working Paper 87. GLA Economics.

2 Smith, B., February 2015, 'Gross Value Added per Workforce Job in London and the UK'. Working Paper 63. GLA Economics.

London's GVA per workforce job increased 1.3 per cent year-on-year in 2015 (current prices). That was marginally faster than the UK average of 1.2 per cent. However, when looking at growth over time, it is often better to exclude the effects of inflation. That is because some of the increase could be down to higher prices rather than an improvement in productivity itself. On this basis, after accounting for inflation, GVA per workforce job in London fell 0.4 per cent year-on-year in 2015. In fact, there has been little change since 2008, with GVA per workforce job only growing on average by 0.35 per cent per annum in real terms through to 2015. That was broadly in line with that for the UK as a whole (0.32 per cent). This stagnant trend in productivity following the 2008-09 recession is peculiar in that other downturns have usually been followed by a period of growth.

Figure A2: GVA per workforce job in London and the UK between 1997 and 2015, constant 2015 prices

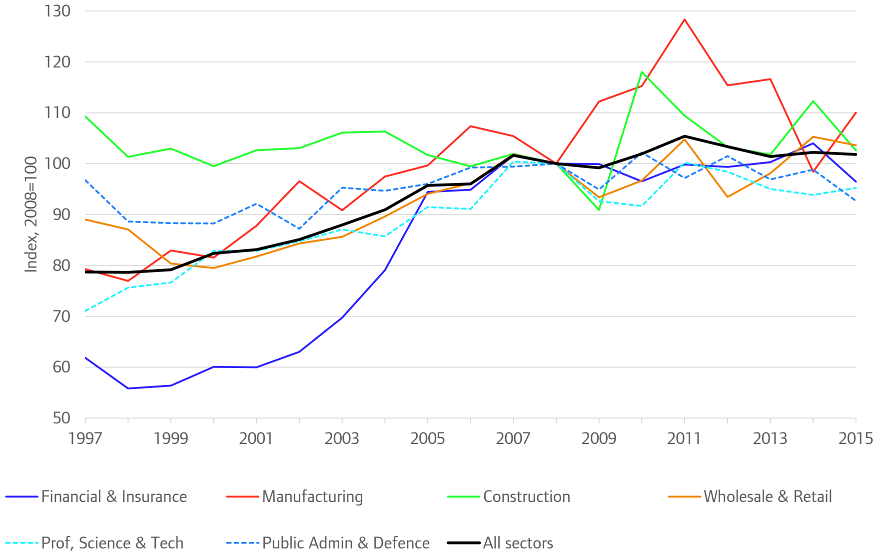
Source: GLA Economics calculations



However, the broadly stagnant trend in GVA per workforce job at the headline level masks quite different individual sector trends. For example, some of the recent poor performance was experienced in the Professional, scientific & technical activities, Public administration & defence, and Financial & insurance activities sectors. In contrast, Manufacturing and Construction have seen periods of higher productivity growth, though the data is more volatile. Looking at the Financial & insurance activities sector specifically, the strong productivity growth experienced during the 2000s was one of the driving forces behind the growth at the London level. However, the rate of growth in GVA per workforce job in that sector has fluctuated more recently and even had a significant fall in 2015.

Figure A3: GVA per workforce job in London for selected industries between 1997 and 2015, index 2008=100, constant prices

Source: GLA Economics calculations



Interestingly, London has a higher GVA per workforce job estimate for all industries than the UK average. Sectors with the largest differences are those where London has a competitive advantage in comparison to other UK regions. For example, GVA per workforce job for the Financial & insurance activities sector was approximately 58 per cent higher in London than the UK as a whole. Other large differences were for Arts, entertainment & recreation (44.2 per cent) and Real estate (40.9 per cent).

In addition, given the way that the GVA per workforce job estimates have been constructed, it is possible to create bespoke industry groupings and provide more economic insight into certain aspects of London's economy. For example, using definitions from the Department for Culture, Media and Sport (DCMS), the GVA per workforce job for London's tourism industry was estimated at £42,399 in 2015. Similarly, using creative industry definitions from DCMS, the GVA per workforce job for that grouping was estimated at £71,435 in 2015.

Overall, on this GVA per workforce job measure, London is more productive than the UK as a whole. This in part is reflective of the capital's competitive advantages relative to other UK regions. However, productivity has been broadly stagnant since the 2008-09 recession, which is peculiar as a downturn is usually followed in a few years by productivity growth.

This research, along with other GLA Economics publications, can be accessed from the GLA Economics' publication page.

Additional information

Data sources

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

Glossary

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

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

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

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

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

Tube ridership
Transport for London's measure of the number of passengers using London Underground in a given period. There are 13 periods in a year. In 2017/18 there are twelve 28-day periods and one 29-day period. Period 1 started on 1 April 2017.

Bus ridership
Transport for London's measure of the number of passengers using buses in London in a given period. There are 13 periods in a year. In 2017/18 there are twelve 28-day periods, and one 29-day period. Period 1 started on 1 April 2017.

Acronyms

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

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