GLAECONOMICS

London's Economy Today

Issue 206 | October 2019

The Government negotiates a new Brexit deal

By **Mike Hope**, Economist,
and **Eduardo Orellana**, Economist

The Government reached a new Brexit deal with the EU in October. Despite this deal the UK's relationship with the EU after Brexit and its economic implications still remains uncertain. The EU has agreed to extend the UK's membership up to 31 January 2020 at the latest, and Parliament has voted to hold a General Election, which will take place on 12 December.

There have been a number of studies of the economic impact on the UK economy of alternative Brexit outcomes. A significant economic difference between the current EU-UK Government deal and the previous deal is that Great Britain will have no customs union for the free movement of goods with the EU. Recent research indicates that this may have a different economic impact compared with the previous deal between the EU and UK Government, (Table 1). Further, the deal allows for regulatory standards to diverge between the two economies and will give the UK Government more freedom to strike its own trade agreements. It is not, though, expected that the benefits of any such deal will be comparable to a customs union with the EU, or indeed membership of the EU Single Market, because of the importance of the EU to UK trade.

Also in this issue

Datastore

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

	lower bound	upper bound
previous deal	-1.9%	-5.5%
current deal	-2.3%	-7.0%
no-deal Brexit	-3.5%	-8.7%

Table 1: Impact on UK GDP per capita ten years after Brexit of EU-UK Government deals and no-deal compared with remaining in the EU, range of estimates

Source: UK in a Changing Europe - The economic impact of Boris Johnson's Brexit proposals

If you wish to know more, earlier this month GLA Economics published an assessment of The economic impact of Brexit on London which discusses the macroeconomic impacts more fully, and considers the impacts on businesses, migrants and visitors, and households.

Growth in advanced economies remains subdued and global growth forecasts have been revised down

The International Monetary Fund (IMF), in its latest World Economic Outlook has downgraded its medium-term global growth forecasts. The global average GDP growth rate is now expected to stand at 3% for the current year 2019, its lowest level since the world financial crisis and 0.2 percentage points lower than the IMF forecast in July. For 2020, the international institution projects an improvement in global growth up to 3.4% (although this is 0.1 percentage points lower than the July forecast). The IMF notes that these recent pessimistic revisions are mainly because "over the past year, global growth has fallen sharply. Among advanced economies, the weakening has been broad based, affecting major economies and smaller Asian advanced economies. The slowdown in activity has been even more pronounced across emerging market and developing economies, including Brazil, China, India, Mexico, and Russia, as well as a few economies suffering macroeconomic and financial stress". The IMF report also warns that a "much more subdued pace of global activity could well materialize in the medium-term due to the remaining uncertainty about prospects for several of these countries, the projected slowdown in China and the United States, and prominent downside risks globally".

In this vein, Kristalina Georgieva, the Managing Director of the IMF, has warned that Brexit in whatever form it takes will be painful, and add to the effects of a global slowdown.

Another risk is trade tensions with Ms Georgieva noting that the trade war between the US and China has brought trade growth to a near standstill, and has hurt manufacturing and business investment. The dispute over state subsidies and technology theft has led the two sides to impose tariffs on billions of dollars' worth of each other's goods.

There has also been a long-running battle between Washington and Brussels over illegal subsidies to the plane manufacturers Airbus and Boeing. This has had a direct bearing on London and the UK, as the US imposed tariffs on EU products including Savile Row suits and Scotch whisky on 18 October.

The UK's rate of productivity growth falls

The synchronised slowing of the global economy provides less opportunity for export-led growth for the UK economy. This is on top of Brexit-related uncertainty, which has led to a slowing down of UK growth.

In line with the trend in output growth, labour productivity growth in the UK has remained weak since the financial crisis. Latest data from the Office for National Statistics (ONS) show that in the second quarter of 2019 labour productivity (as measured by output per hour worked) contracted by 0.5% compared to the same quarter in 2018. In terms of output per worker - which is another measure of labour productivity – it was unchanged. Figure 1 highlights the poor post-financial crisis performance of the UK's labour productivity in terms of output per hour worked and output per worker. This shows, for example, that output per hour worked in the UK is only 2.1% higher at present than it was in Q4 2007 when this indicator would be 26.1% higher today if it had followed its pre-recession trend. A detailed analysis of the recent labour productivity trends in London is presented in the supplement section of this publication.

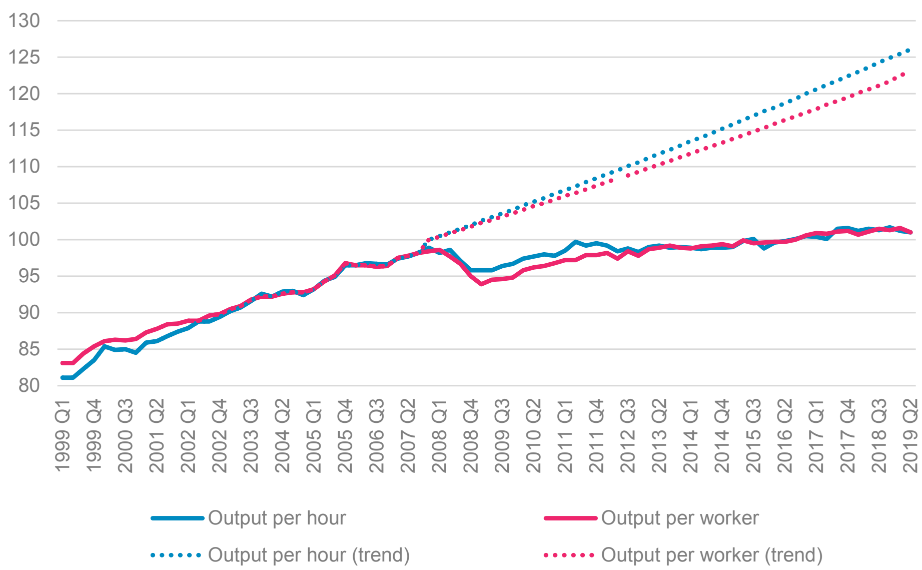
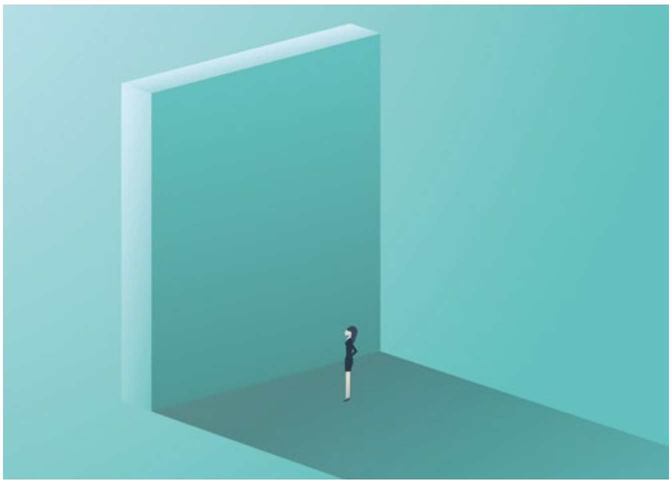


Figure 1: UK output per hour worked and output per worker, seasonally adjusted, Q1 1999 to Q2 2019

Source: GLA Economics elaboration based on ONS data

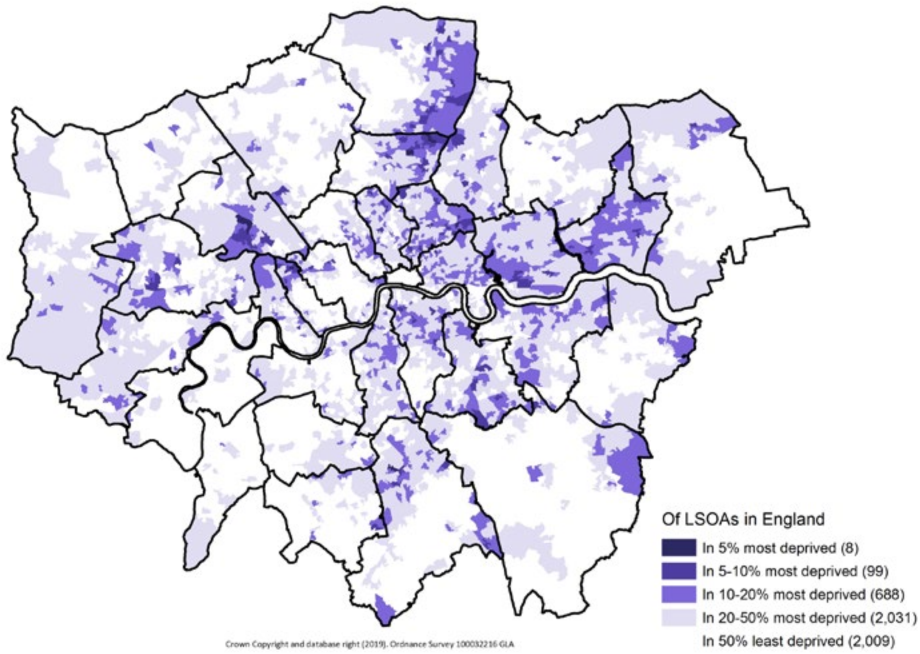
The latest UK Quarterly Economic Survey for Q3 2019 from the British Chamber of Commerce showed UK economic conditions weakened in the last quarter amid a significant deterioration in manufacturing sector activity. The survey - which covered 6,600 firms in the country -concluded that "the balance of firms in the manufacturing sector that increased investment in training dipped to its lowest level since Q1 2010 while indicators for cash flow, business confidence in turnover, and profitability among manufacturers dropped to an eight-year low". Summarising the findings, Suren Thiru - Head of Economics at the British Chamber of Commerce - said "our findings point to a worrying drop-off in UK economic activity, with unrelenting uncertainty over Brexit and a notable slowing in global growth prospects dragging down almost all the key indicators in the quarter. The manufacturing sector continues to toil under the weight of diminishing cashflow, weakening global demand and disrupted supply chains. Although the slowdown in a number of the key service sector indicators was relatively modest, slowing activity in the sector is a concern given its dominant share of overall UK economic output. Looking forward, weakening orders, confidence and investment intentions suggest that unless action is taken the UK's current weak growth trajectory could drift markedly lower over the near term".

The Index of Multiple Deprivation 2019 provided an updated picture of relative deprivation in London



The Government has recently published the Indices of Deprivation 2019 (ID2019), which replace and update the Indices of Deprivation 2015 (ID2015). The Index of Multiple Deprivation (IMD) is the main measure in these indexes. It is important to note that the ID 2019, though published in 2019 are based largely on administrative data from 2015 and 2016, while the ID2015 used data mainly from 2012.

Overall, London is less deprived compared with other parts of England in IMD2019 than was the case with IMD2015. There are eight London neighbourhoods (as measured by Lower Super Output Areas (LSOAs)) among the 5% most deprived in England, out of 4,835 in London. This is 0.2% of London's LSOAs. A further 99 LSOAs are amongst England's 10% most deprived, (Map 1).



Map 1: Index of Multiple Deprivation 2019, LSOAs in London
Last data point is July 2019

Source: Indices of Deprivation 2019, MHCLG

The areas with higher levels of deprivation overall across London show the familiar pattern of a crescent from the eastern side of Enfield down through Haringey and Hackney and across into Newham and Barking and Dagenham. There are additional patches of higher relative deprivation around Brent/Kensington/Westminster and further pockets, most notably in Ealing, across the inner south London boroughs and into Croydon. 11 of the 33 local authorities in London are in the top 50 by average LSOA rank. This is down from ID2015 when the number was 13.

However, there have also been some quite dramatic changes. Tower Hamlets, for example, has fallen from 24th between ID2015 and ID2019 in terms of proportion of LSOAs in the worst 10% nationally to 175th. Westminster has fallen from 43rd to 134th. There are now no London local authorities in the top 50 most deprived by this measure.

It is not clear what the reasons for these changes are. One explanation is the gentrification of areas as London's population expands. That is, the absolute number of poor households may not have changed, even if there are relatively fewer poor. Some displacement of households to other areas may have also occurred.

London's economy seems robust with some caveats

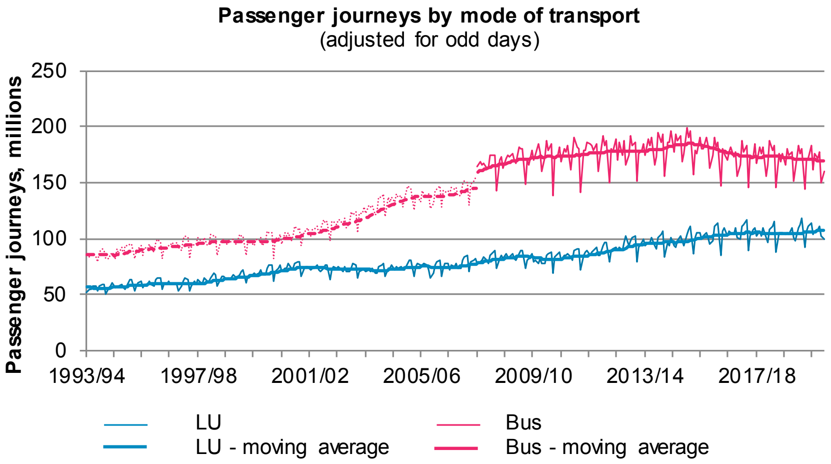
Looking more broadly London's economy appears to remain resilient in the face of a large degree of uncertainty. Thus, the latest Quarterly Economic Survey by the London Chamber of Commerce and Industry reported mixed but generally "better than expected results" for the capital's economy in the third quarter of the year. For example, the report says that "export orders are now at their highest since Q2 2017, while the business investment indicator had its largest increase since Q1 2016". Besides, below 17% of the 505 surveyed London businesses expected their workforce size to increase over the next three months but this is 4 percentage points higher than the previous quarter. On the negative side of this survey, business costs, business confidence, and the expected economic outlook worsened in Q3 2019 with respect to the previous quarter according to London firms.

Economic indicators

TfL passenger journeys increased by 6.4 million in the last period

- A total of 259.5 million passenger journeys were registered between 18 August and 14 September 2019; 6.4 million more than the previous period. 99.4 million of these journeys were Underground journeys and 160.1 million were bus journeys.
- The 12-month-moving average in the total number of passenger journeys remained at 277.1 million.
- 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).

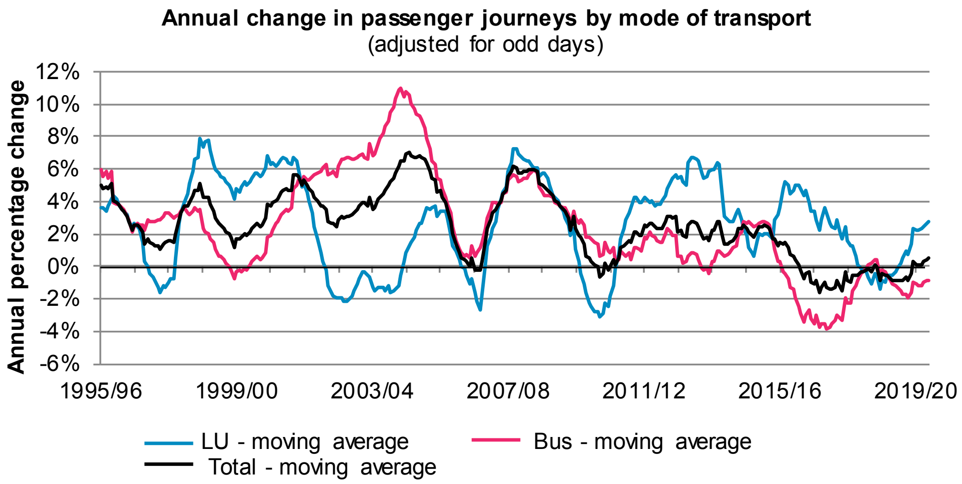
Source: Transport for London
Latest release: October 2019, Next release: November 2019



In the last period, the moving average annual growth rate in passenger journeys was the highest in four years

- The moving average annual growth rate in the total number of passenger journeys was 0.5% between 18 August and 14 September 2019. This rate has remained positive for seven consecutive months after fourteen periods of negative growth.
- The moving average annual growth rate of Underground journeys increased from 2.7% to 2.8%.
- The moving average rate of Bus passenger journeys also went up from -0.9% to -0.8%.

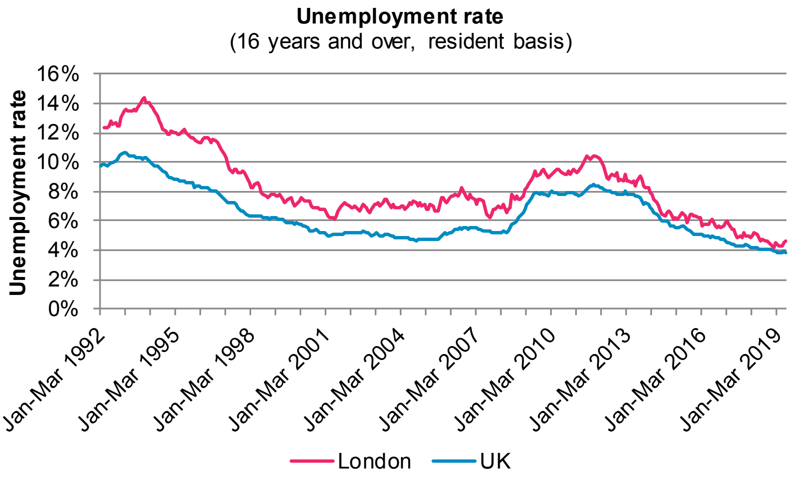
Source: Transport for London
Latest release: October 2019, Next release: November 2019



London's unemployment rate remained subdued in the period June-August 2019

- Over 225,000 London residents over 16-year were unemployed in the three-month period June-August 2019, 17,000 more than between March and May.
- The unemployment rate in London went up from 4.3% that period to 4.6% between June and August this year.
- The UK's unemployment rate also went marginally up from the historic low of 3.8% in the mentioned period May-July 2019 to 3.9% between June and August.

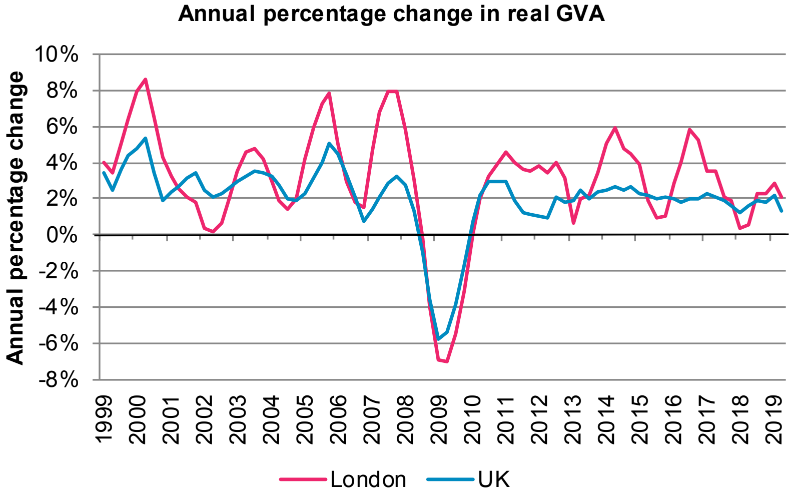
Source: Transport for London
Latest release: October 2019, Next release: November 2019



London's economy grew by 2.1% in real annual terms in the second quarter of the year

- London's annual real GVA growth fell from 2.9% in Q1 2019 to 2.1% in the second quarter of the year based on GLA Economics estimates. This was the lowest rate in one year but still compares strongly with the growth rate registered for the whole year 2018 which was recently published by the ONS (1.4%).
- In the UK, annual output growth was 1.4% in Q2 2019, 0.8 percentage points down from the previous quarter (-0.2% in quarter on quarter terms).
- From LET Issue 165 (May 2016), GLA Economics reports its own GVA estimates for London and ONS data for the UK. This LET publication also incorporates the new London's real GDP historic quarterly data released by the ONS in September 2019 to the GLA Economics forecasts.

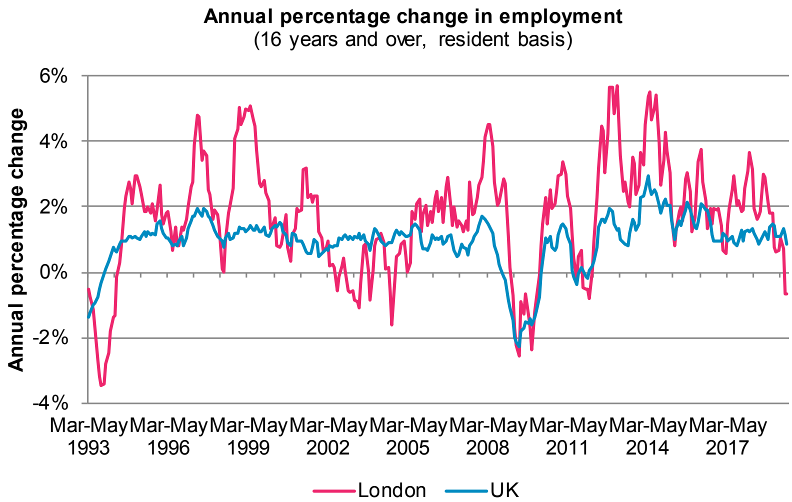
Source: Transport for London
Latest release: October 2019, Next release: January 2020



Employment fell in London in the year to June-August 2019

- Over 4.64 million residents over 16 years old were employed in London in the three-month period June-August 2019, this is 44,000 persons less than the period March-May 2019, and 32,000 less than a year earlier.
- Between June and August 2019, the rate of annual employment growth for the capital was slightly more negative (-0.7%) than the previous period of March-May (-0.6%) and represented the second consecutive negative rate since Q1 2012.
- The annual growth in UK employment fell by 0.2 percentage points, from 1.1% for the period March-May to 0.9% in June-August 2019.

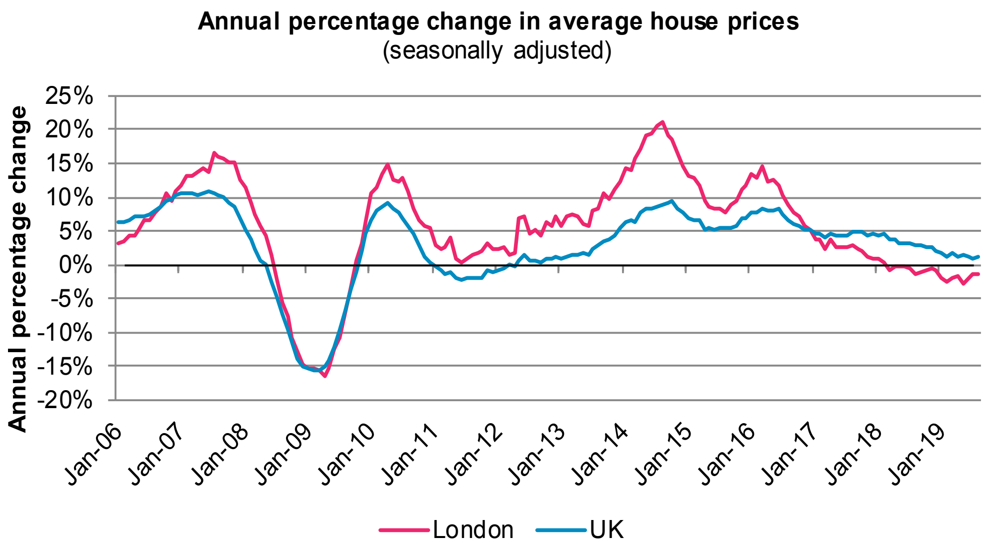
Source: Transport for London
Latest release: October 2019, Next release: November 2019



The year-on-year fall in London house prices from March 2018 continues

- In August, the average seasonally adjusted house price in London was £467,018, while for the UK, the average was £230,314.
- The annual growth rate in house prices in London was -1.4% in August, same as July. London prices have been falling in year-on-year terms for 18 consecutive months, registering a cumulative fall of 2.7% over this period.
- For the UK, the annual growth rate in house prices was 1.3% in August, 0.4 percentage points more than the previous month.

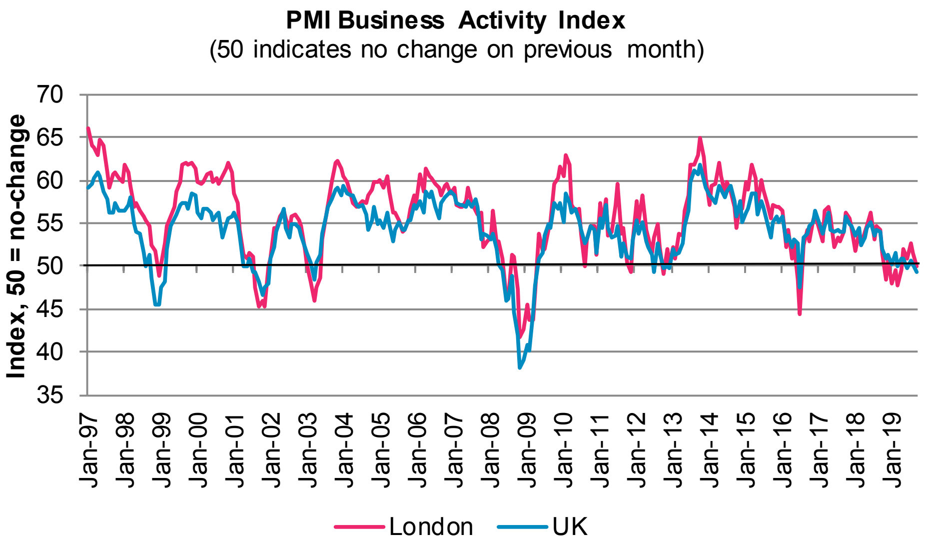
Source: Transport for London
Latest release: October 2019, Next release: November 2019



Business activity in London broadly stagnant in September

- 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 with the majority of firms reporting increased activity, while readings below indicate a decrease.
- Business activity at London private firms was broadly neutral in September (50.1), weaker than in August (51.7).
- The UK index decreased in September (49.3) from 50.2 in August.

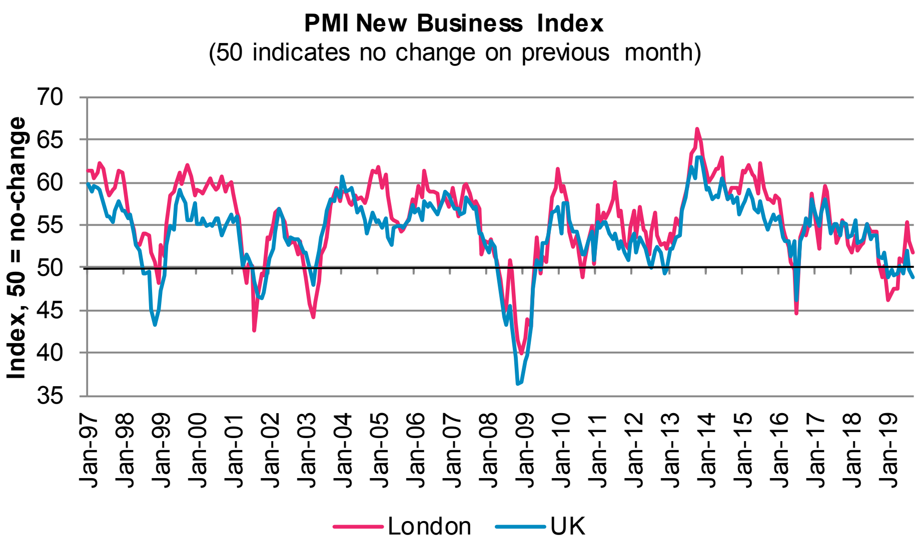
Source: Transport for London
Latest release: October 2019, Next release: November 2019



New business in London was weak by historic standards in September

- The PMI New Business Index was 51.8 in London in September, down from 53.2 in August.
- UK firms reported an index of 48.8 in September, lower than in August (49.8).
- An index reading above 50.0 indicates an increase in new orders from the previous month for most firms surveyed.

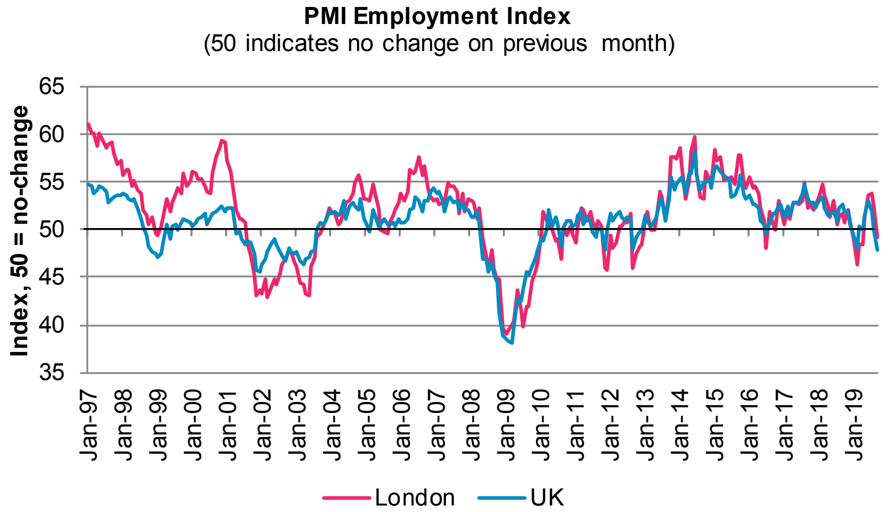
Source: Transport for London
Latest release: October 2019, Next release: November 2019



PMI Employment prospects became negative in London in September

- The PMI Employment Index shows the monthly change in employment at private sector firms. Readings above 50.0 indicates over half of surveyed firms have increased employment, whereas a reading below 50.0 indicates a decrease in employment on average across firms from the previous month.
- The PMI Employment Index for London fell in September to 49.1 from 52.4 in August after four months with a reading over 50.0.
- The PMI Employment Index for the UK also decreased from 50.0 in August to 47.8 in September.

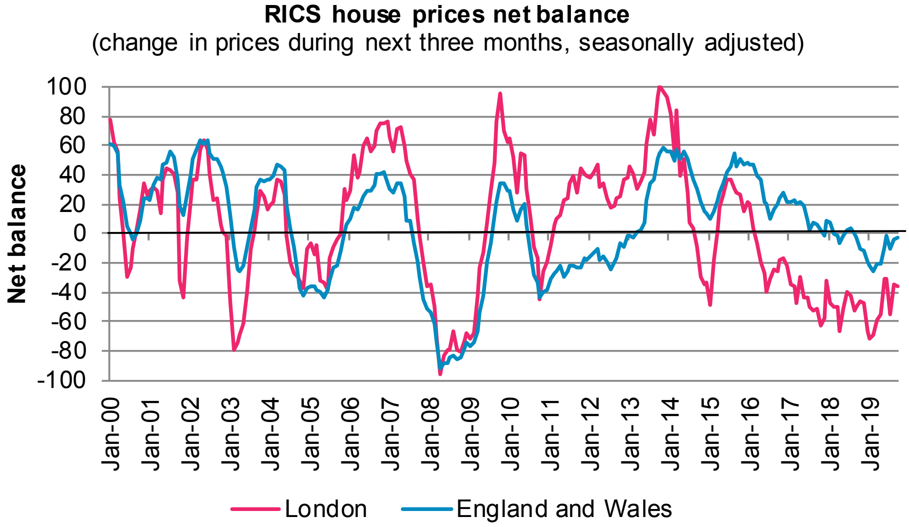
Source: Transport for London
Latest release: October 2019, Next release: November 2019



Net balance in London's house prices remains negative in September according to property surveyors

- Most surveyors reported a further fall in London house prices in the three months to September (a net balance of -36 compared to -35 in the previous period). This index has remained negative since February 2016.
- The RICS house prices net balance index for England and Wales increased from -4 in August to -2 in September.
- The net balance index measures the proportion of respondents reporting a rise in prices minus those reporting a decline.

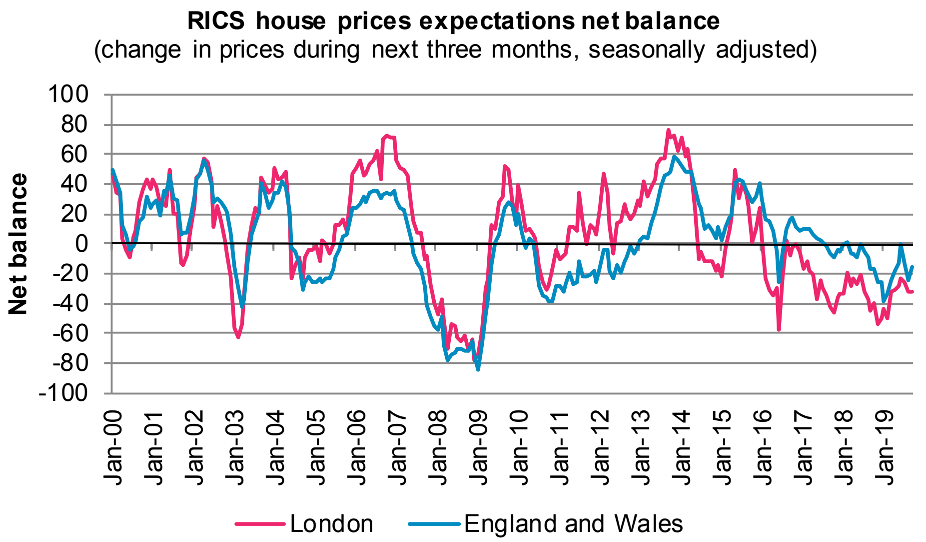
Source: Transport for London
Latest release: October 2019, Next release: November 2019



House prices expectations in London stay negative

- Most surveyors continued to have negative expectations for the next three months for house prices in London. The RICS index was -32 in September, the same figure as in August.
- London remains as the region with the most negative expectations for house prices.
- Sentiment in England and Wales was less negative (-16) in September compared to August (-24).

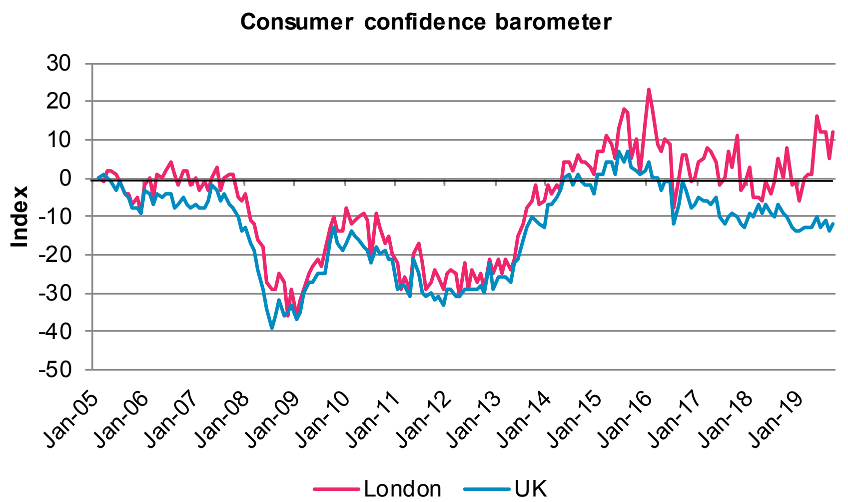
Source: Transport for London
Latest release: October 2019, Next release: November 2019



Consumer confidence in London increases

- 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.
- The consumer confidence index in London was 12 in September, up from 5 in August.
- Sentiment in the UK also increased from -14 in August to -12 in September but has remained negative since April 2016.

Source: Transport for London
Latest release: September 2019, Next release: October 2019



As productivity performance in the UK and London continues to disappoint, this article reviews the main reasons behind the recent productivity slowdown

By **Christopher Rocks**, Economist

Despite its high aggregate level of productivity, labour productivity growth in London has been strikingly weak in the aftermath of the 2007/08 financial crisis. While the capital recorded the highest rate of growth in economic output per hour worked of any UK region from 1998 to 2007, it had a far lower rate of growth in the period from 2010 to 2017 (Table A1). Median employee earnings have also declined since 2010, with this productivity slowdown cited as a major factor.[1]

		London	UK
Productivity	CAGR 1998-2007	2.9%	2.1%
	CAGR 2010-2017	0.3%	0.3%
	Change in growth (pps)	-2.6	-1.8
Output (GVA)	CAGR 1998-2007	4.1%	2.8%
	CAGR 2010-2017	3.4%	2.0%
	Change in growth (pps)	-0.6	-0.8
Hours worked	CAGR 1998-2007	1.2%	0.7%
	CAGR 2010-2017	3.1%	1.7%
	Change in growth (pps)	1.9	1.0

Table A1: Average productivity growth has fallen by 2.6 percentage points in London, with an increase in employment (hours worked) playing a large role in the slowdown
Compound annual growth rate in productivity, real GVA, and hours worked (%)

Source: ONS Region by industry labour productivity

As with the UK as a whole, London's productivity slowdown is broad-based. Out of 16 industry groups in the capital, fully three-quarters recorded a lower rate of productivity growth in 2010-2017 than in 1998-2007. According to our analysis, sectoral shifts – that is, an increasing share of employment in less productive sectors such as Accommodation & food services – have only made a small contribution to London's worsening productivity performance during this time.

What then explains this dramatic stalling in productivity? The rest of this article draws attention to some of the factors most relevant for London based on our recent research into London's productivity performance.

1 For example, the ONS estimates that market sector wages would now be £5,000 higher for the average UK worker if productivity had grown in-line with its long-term trend since 2008 (assuming wages as a share of income had remained constant). Source: ONS (2019) Productivity economic commentary: January to March 2019.

1. A general slowdown in trade and finance

The openness of the London economy and the size of its financial sector mean that macro developments, such as slower world trade growth and financial sector deleveraging, are likely to have a particular impact in the capital. Indeed, while economic activity in London has picked-up since the financial crisis, the annual rate of output growth remains lower than before the recession in 2008/09, down (on average) by 0.6 percentage points a year compared with 1998-2007.

This is partly linked to a general slowdown in world trade. Overall, international trade has been on a downward trend relative to global GDP since 2011. Focusing on the UK alone indicates that services exports have been especially affected: from 2010 to 2017 the annual average rate of growth in UK service exports was far below that recorded from 1998 to 2007 (Figure A1).

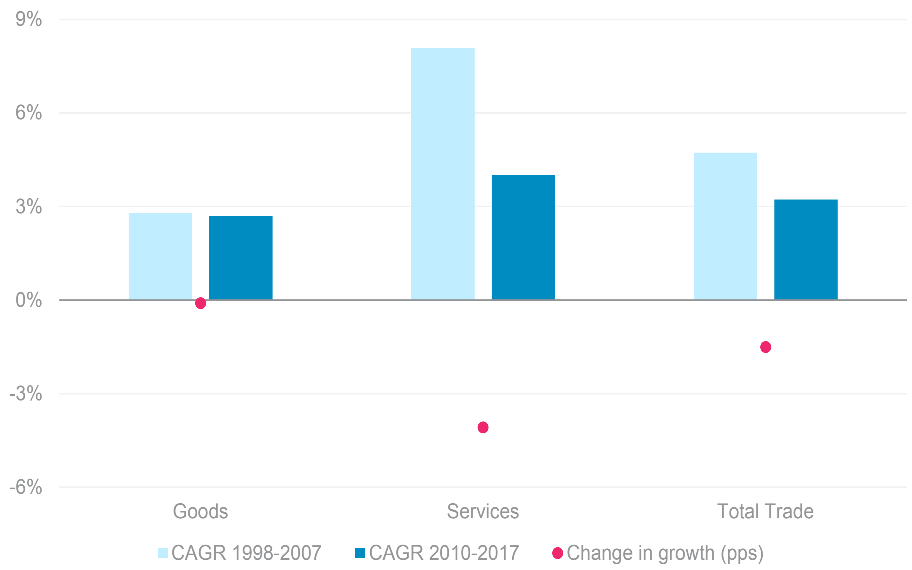


Figure A1: UK export growth has slowed in the post-crisis period, with a particularly sharp slowdown in services trade
Compound annual growth rate in UK exports, 1998-2007 versus 2010-2017

Source: ONS UK trade time series

Although data on international trade is more limited at a regional level, ONS estimates indicate that London had a lower rate of growth in service exports than most UK regions in the five years to 2016 – largely down to sluggish growth in financial services exports.[2] Consistent with this finding, the industries in London with the most pronounced falls in productivity growth post-crisis are those which are more dependent on global demand. As well as Finance & insurance, this includes sectors like Information & communication and Manufacturing.

2. Falling real wages and a ready supply of workers

Yet, as suggested earlier, productivity growth has slowed in most sectors in recent years, suggesting that wider factors must be at play. What is generally noteworthy is that since 2010 London firms have hired labour nearly as fast as economic output has increased (as shown in Table A1). In fact, most industry groups in London have seen growth in hours worked accelerate in the post-crisis period, despite more subdued growth in economic output.

This has been partly attributed to a flexible labour market facilitating a fall in real wages. Pessoa & Van Reenen (2014), for example, point towards an unusually 'dramatic' fall in real wages in the post-crisis period as an explanation for low labour productivity growth (linked to weaker union power and welfare reforms). The sharp decline in median earnings in London has also been associated with changes in the composition of the employed labour force, including an increase in migrant workers and non-standard forms of employment.

2 Based on our estimates 'Finance & insurance' alone accounts for a quarter of the slowdown in the capital's aggregate productivity growth compared to pre-crisis trends.

In this context, it's possible that a combination of low wage growth and high labour supply may have reduced the incentive for firms to invest in measures to improve labour productivity, i.e. if employers have been able to hire labour at a relatively low cost recently. Of course low productivity is itself cited as a key factor in low wage growth. However, there is a growing body of evidence that the relationship could go both ways: rising labour costs could, for example, spur managers into productivity-boosting improvements.

3. Low business investment and persistent economic uncertainty

The other side of an employment-rich recovery is that, as firms have expanded through increased hiring, capital investment has been unusually subdued.

As Figure A2 shows, the volume of UK business investment recovered to pre-crisis levels by 2013. But investment levels have stalled again recently, falling in each of the four quarters of 2018. The resulting weakness in the growth of capital relative to labour – known as 'capital deepening' – has been widespread across sectors. Investment in the ICT equipment sub-component has remained especially weak, despite the substantial productivity gains associated with the adoption of digital technologies.

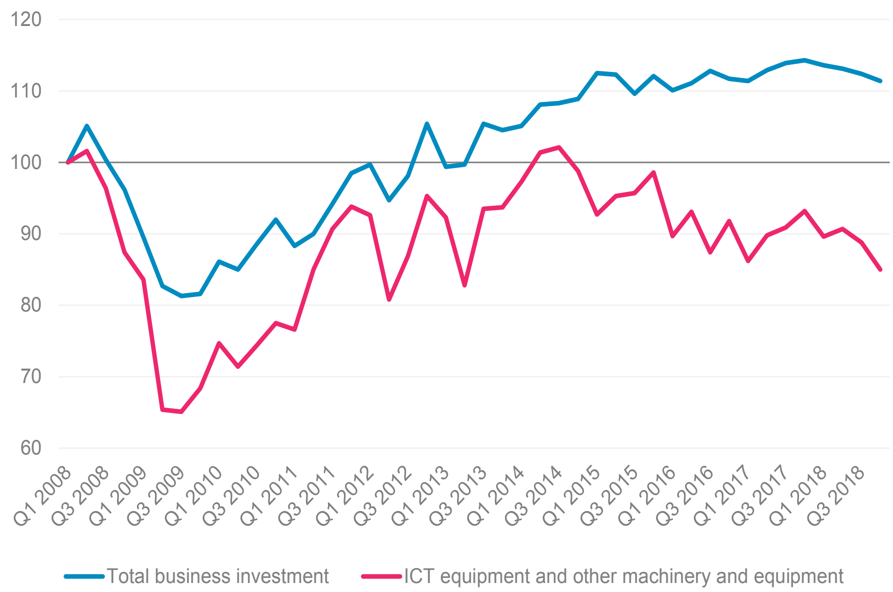


Figure A2: The level of business investment has stalled again recently, while investment in ICT equipment has been declining since 2014
UK business investment and sub-component, chained volume measure, SA (Index, 2008=100)

Source: Office for National Statistics

Detailed estimates of business investment are again not available below the national level. However, analysis of regional gross-fixed capital formation data suggests that headline trends in London have not been out-of-step with most other parts of the country since 2010.

So what explains the overall downturn in business investment? There is a growing body of evidence linking macroeconomic uncertainty to reduced investment in physical capital and R&D. Following the financial and Eurozone crises, there are signs that the UK's decision to leave the European Union has become a particularly important source of uncertainty in the UK since 2016. According to Bloom et al. (2019) the Brexit process has gradually reduced UK investment levels by approximately 11% over the three years since the referendum. Internationally orientated firms – which are relatively prominent in London as a whole – are thought to be especially (adversely) affected by this source of uncertainty.

4. The outlook for productivity growth remains unclear

Given the complex mix of factors weighing on London's productivity performance, there continues to be considerable uncertainty around the outlook for future productivity growth.

Some of the issues highlighted here are likely to ease in the medium term, particularly as deleveraging in the financial sector runs its course or as workers become more confident in a tightening labour market. Yet national estimates suggest that the stagnation of productivity has persisted in recent quarters. The Brexit process – in particular – will continue to have significant implications for business investment and productivity growth. A lot will depend on the nature of any future agreement with the EU, including its impacts on international migration and trade.

Further information on London's productivity trends can be found in the full publication. This is published alongside a report on the effectiveness of policy levers to enhance productivity at a regional level, with a particular focus on levers which can be influenced by the public sector. Together these reports support and complement the London Local Industrial Strategy evidence base.

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 economic impact of Brexit on London
This report summarises the evidence on the economic impacts of Brexit on the London and UK economies. It looks both at the impacts that have been already observed since the EU Referendum (e.g. impacts on investment and GDP) and at potential future impacts, both in the short and longer term.

Download the full publication.

Productivity trends in London
The ‘Productivity trends in London’ report looks at the reasons for the capital’s high overall level of productivity and the factors behind the sharp slowdown in productivity growth in the post-financial crisis period.

Download the full publication.

Productivity levers in London
The ‘Productivity levers in London’ report summarises the findings of a rapid literature review on the effectiveness of policy levers to enhance productivity at a regional level, with a particular focus on levers which can be influenced by the public sector and on UK (and where possibly, London) evidence.

Download the full publication.

GLAECONOMICS

City Hall
The Queen's Walk
London SE1 2AA

Email glaeconomics@london.gov.uk
Internet www.london.gov.uk

October 2019

ISSN 1740-9136 (print) ISSN 1740-9195 (online) ISSN 1740-9144 (email)

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.

Images

Subscribe
Subscribe online at https://www.london.gov.uk/what-we-do/research-and-analysis/join-our-mailing-list-research-and-analysis

Disclaimer
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.

GLA Economics, Transport for London and the Greater London Authority 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 publication.

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

MAYOR OF LONDON