London's Economy Today

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In this issue

GLAECONOMICS

Getting the balance right

by Bridget Rosewell, Consultant Chief Economist

Gordon Brown has just unveiled his eighth Budget, and some of the implications are summarised in the first of this month's features. The second feature this month looks at London's housing market, which is becoming an increasingly critical issue for the capital and was also addressed in the Barker review released earlier this week.

Although the Chancellor presented himself as cautious yesterday, this is not the interpretation that others are likely to use. In particular, there are implications of his optimistic stance on the scope for the economy to grow and for public spending to increase for how the Bank may view interest rates.

We may get more rises in rates than we have so far bargained for. This could be good for financial markets, but not so hot for consumers and investors.

This is because the Treasury appears to think that the economy can grow much faster than the Bank does.

This debate refers to the size of the output gap – the difference between the level of output the economy produces and that which it can produce. When this is small, in theory, upward pressure on prices will increase, especially if demand is increasing. When it is large, there is little pressure on prices and demand can be allowed to rise.

Latest news...

● **The Case for London**: The Mayor released his submission to the Government's Spending Review 2004 last week. The submission argues that increased investment in London will benefit the UK economy. A summary and the full submission are available on www.london.gov.uk, or phone 020 7983 4000 to order printed copies. ● **Working Paper 6: Calculating London's Tax Export** was published today. It estimates that London contributes £9-£15 billion more than it receives in public spending to the UK economy. ● **Environment–Economy Seminar**: Register now to find out about a new model that assesses the economic impact of environmental policies. The seminar will take place on Tuesday 27 April 2004, from 4pm to 5pm, at City Hall. To attend, email glaeconomics@london.gov.uk or phone 020 7983 4922.

The Chancellor has produced a view which says that the long-term growth rate of the economy is 2 ¾ per cent – and he expects the economy to grow faster than this in 2004 and 2005, before falling back in 2006 to trend. At the same time, prices (on the new target measure of CPI) will accelerate slowly because of rising import prices.

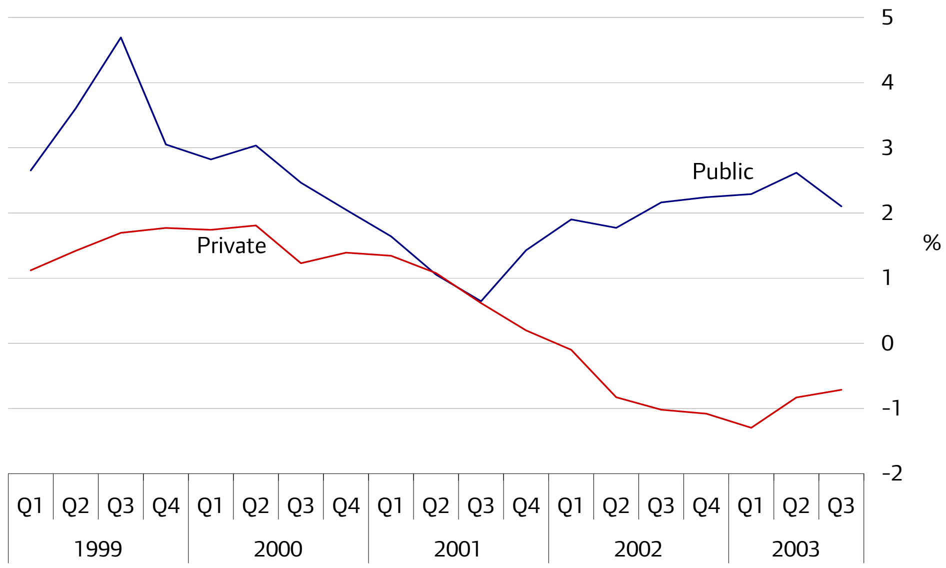
But the Bank, in its latest Inflation Report, is taking a different view. On its projections (with no further interest rate rises), growth is going to peak around the present time at not much more than 3 per cent, and will trend down quickly thereafter. CPI, as in the Treasury view, accelerates slowly both because of import prices but also domestic price pressures. These domestic price pressures arise because, in the Bank's view, the labour market is already tight and there is little sign of faster productivity growth to rescue growth potential. It therefore looks as if the Bank is much more concerned about the ability of the economy to continue growing than the Treasury is.

Within this difference there are two issues which produce real uncertainty. One is the differing fortunes of the private and public sectors. The other is the role of investment and productivity.

Chart 1 illustrates the first issue in terms of employment.

Chart 1. Private and public employment growth

Source: ONS



In each of the past five years, public sector employment has grown. And it has grown consistently faster than employment in the private sector. Indeed, during 2002 and 2003 there has been a net job loss in the private sector, although there is at present some signs of a stabilisation.

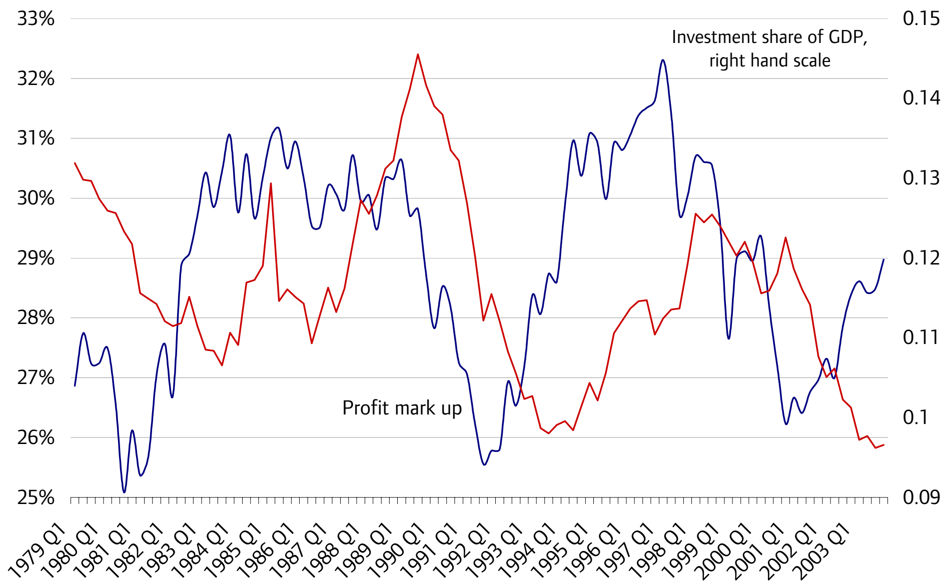
Which brings us to the other major uncertainty – investment and productivity. It is always possible to add growth without needing more people, by raising productivity in total or by adding capital or other factors of production. There is much doubt about productivity in the public sector. Without a market, there is no way of knowing how much output there really is. It maybe that output is 'really' growing faster than the statistics say – and the output gap is already closing. If this is the case, then interest rates will need to continue rising, or so the Bank will think. Reading their reports, this is the flavour that emerges.

It would be interesting to ask them their views on capacity utilisation and the ability of the supply side of the economy to grow.

On the other hand, it might be the case that the private sector could take off again with new investment. A revival in the share of profits and in investment would give support to these hopes. The profit share has indeed recovered somewhat, after falling back from 1995. Investment, especially business investment, however remains subdued. Without investment and with labour markets dominated by the public sector, the private sector may find it hard to recover. Potential output growth is likely to suffer and consumer demand will push up prices, rather than being able to deliver the faster growth that the Chancellor predicts.

Chart 2. Investment and profits

Source: ONS



The long-term growth path which was recently upgraded was based on a 20-year period in which effort was put into slimming the public sector. This has now been reversed and trend growth, on current measurement practices, has been reduced. Whatever happens to consumer spending, this means that the output gap will be smaller and this means that interest rates are more likely to rise.

The latest Budget increases this risk and the pressure may well be felt most in London.

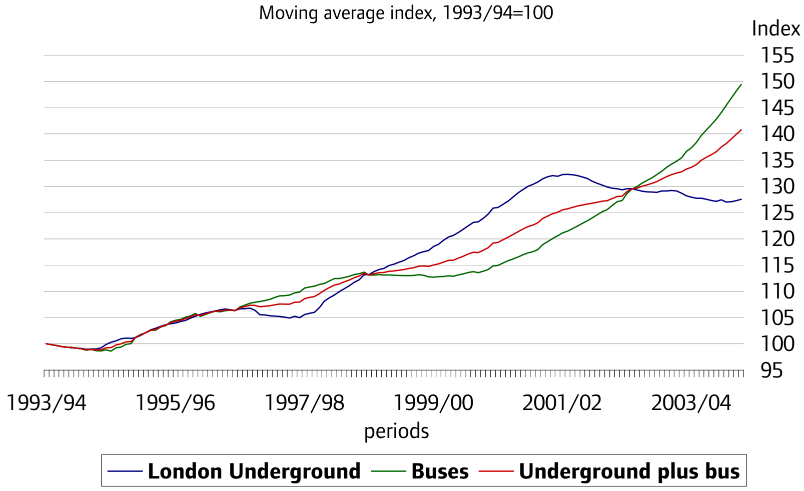
Economic indicators

Tube numbers recover, bus numbers still grow strongly

- The number of tube passengers rose by 0.2% in period 7 (4-31January 2004), the strongest growth since period 7.
- Bus use remained strong, but slowed slightly. The number of passengers increased 0.8% from period 10.
- There were signs of a continued recovery in total tube and bus passengers, which increased 0.6% in period 11.

Latest release: 26/02/04
Next release: March 2004

Tube and bus passenger numbers: monthly change
Moving average index, 1993/94=100



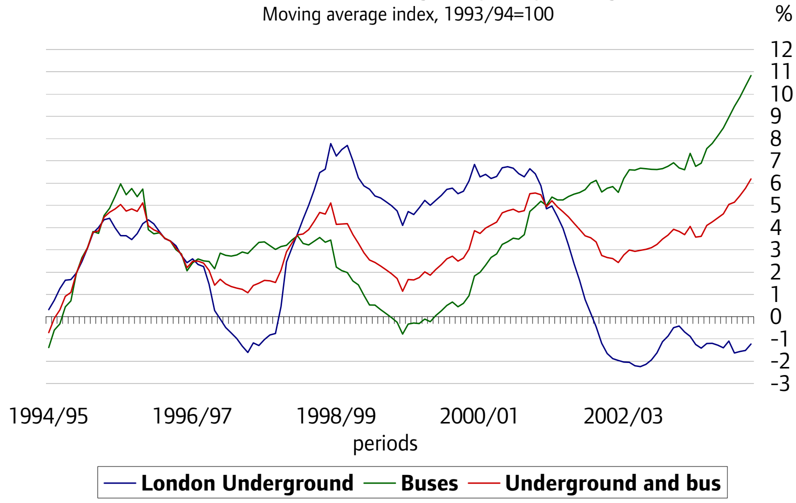
Source: Transport for London

Annual passenger number growth increased sharply

- The annual growth in the number of passengers on buses and the tube combined was 6.2% in period 11.
- Tube ridership remained lower than the previous year, but the numbers continued to recover.
- Annual growth in bus usage rose strongly to almost 11% in period 11 compared to 10.4% in the previous period.

Latest release: 26/02/04
Next release: March 2004

Tube and bus passengers: yearly change
Moving average index, 1993/94=100



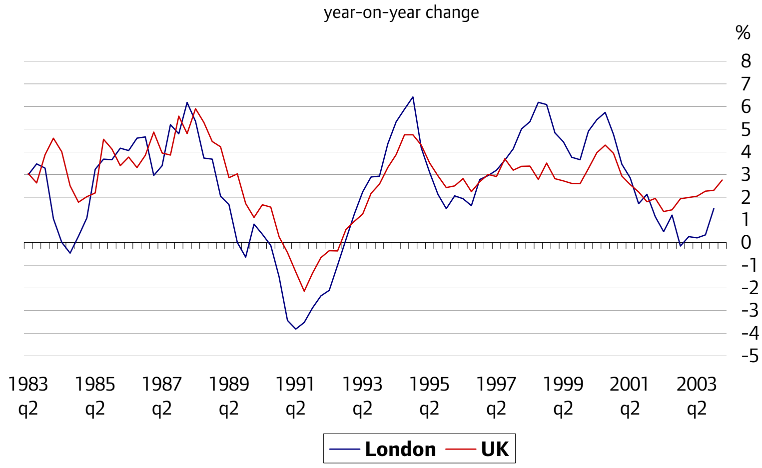
Source: Transport for London

Economic recovery in London

- London's economy grew more strongly than the UK economy in Q4. London GVA rose by 1.0% from Q3 compared to UK GVA growth of 0.8%. Despite this rebound, estimates show London's annual GVA growth at 1.5% still lags behind UK annual GVA growth of 2.1%.
- Latest GDP figures show a firm recovery in the UK economy. UK GDP rose by 0.9% in Q4 in real terms. UK GDP was 2.8% higher in Q4 2003 than Q4 2002, indicating the UK economy is growing above trend.

Latest release: 25/02/04
Next release: 26/03/04

Real London GVA Growth and UK GDP Growth
year-on-year change



Note: Most recent EBS estimates for London GVA include changes due to the adoption of chain linking and rebasing UK figures to 2000 prices.
Source: ONS and EBS

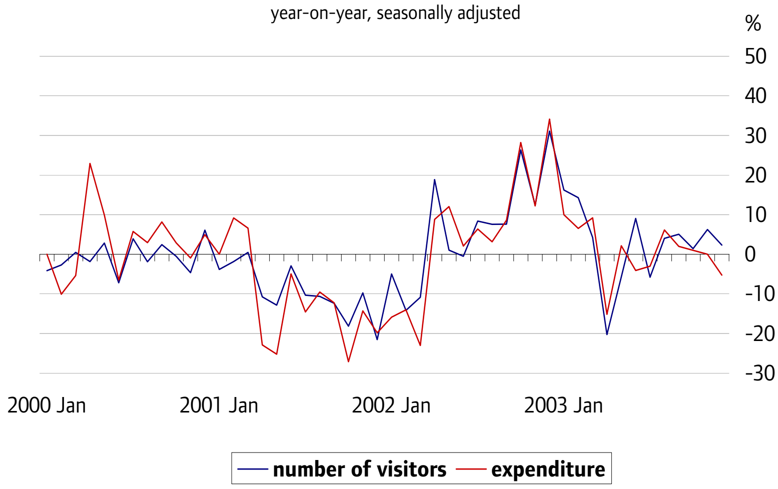
UK tourism activity

Figures for January 2004 will be released by the ONS on 7 April 2004. Last month's figures are shown here.

- The number of overseas visitors to the UK fell by 0.5% from November but stayed above the 2003 average.
- Overseas visitor spending recovered strongly, increasing almost 7% in December.
- Nevertheless, overseas visitor expenditure was down compared to December 2002.

Latest release: 06/02/04
Next release: 07/04/04

Growth in overseas visitors to the UK
year-on-year, seasonally adjusted



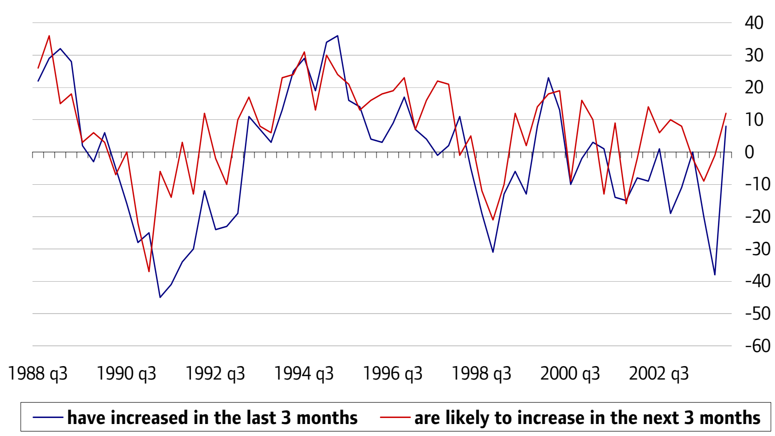
Source: ONS

London manufacturers expand output

- London manufacturers have started to benefit from the recovery in the London economy and strengthening global demand. More London manufacturers reported increases rather than decreases in output during the last three months.
- For the first time for 12 months, more London manufacturers expect output to rise than decrease over the next three months.

Latest release: February 2004
Next release: May 2004

London manufacturers who say the volume of output has increased/will increase



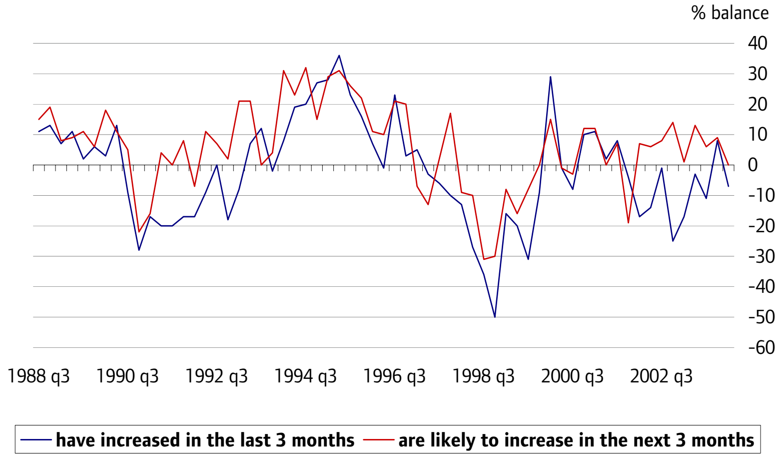
Source: CBI/RTS

Export outlook slows

- Export optimism has fallen among London manufacturers. More London manufacturers reported declines rather than increases in their exports.
- Future prospects of export orders have fallen to a net balance of zero. This is the first time for nine surveys that future prospects for export orders has not been positive.

Latest release: February 2004
Next release: May 2004

London manufacturers whose volume of exports has increased/will increase

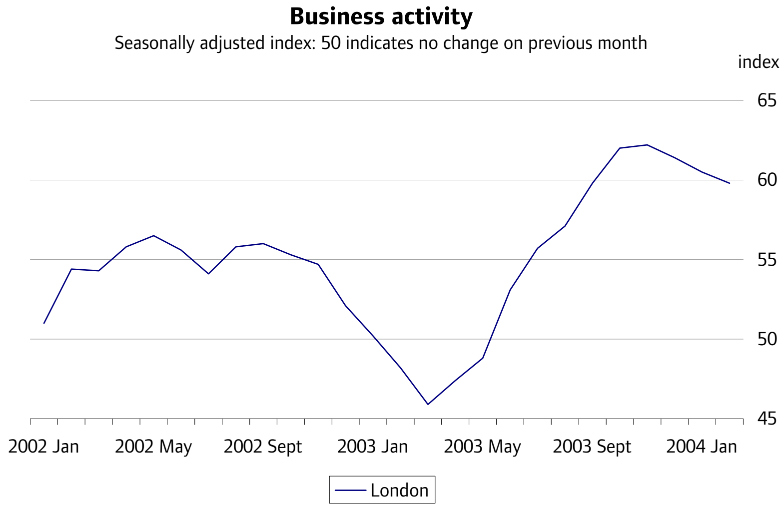


Source: CBI/RTS

Business activity in London keeps expanding

- London firms continued to expand output in goods and services in February, but the rate of expansion has slowed slightly since October 2003. The PMI recorded 59.8 in February compared to 60.5 in January.
- For the eighth consecutive month, London firms recorded stronger growth than the whole of the UK . Strong business optimism and market confidence within the capital have helped this sustained expansion.

Latest release: 08/03/04
Next release: April 2004

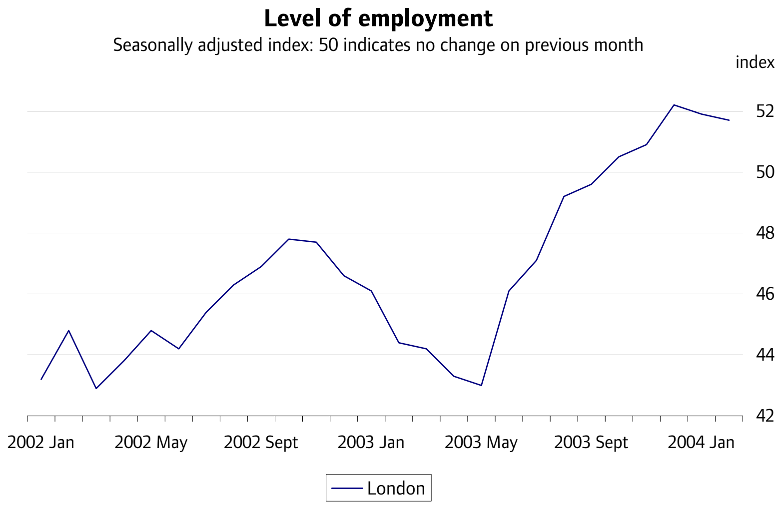


Source: Source: PMI/Royal Bank of Scotland

Employment in London

- London firms expanded their workforce in February for the fifth month in a row.
- Strong growth in output and new orders among firms in the capital led to the recruitment of more staff during the month.
- London firms expanded their labour force at a pace in line with the UK as a whole in February.

Latest release: 08/03/04
Next release: April 2004

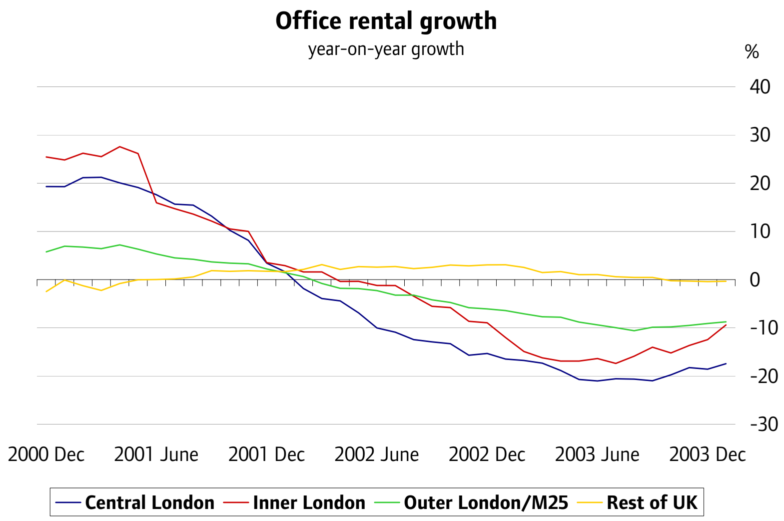


Source: PMI/Royal Bank of Scotland

Signs of improvement in the London office rental market

- Annual rental office growth in London and outside the capital remained in negative territory, but London's annual rental values are declining by less now than in summer 2003.
- The Inner London office market shows the best signs of improvement within the capital. Between the July 2003 trough and January 2004, the rate of the decline in annual rental values in Inner London has almost halved.
- Annualised office rental growth was slightly negative outside London.

Latest release: March 2004
Next release: April 2004

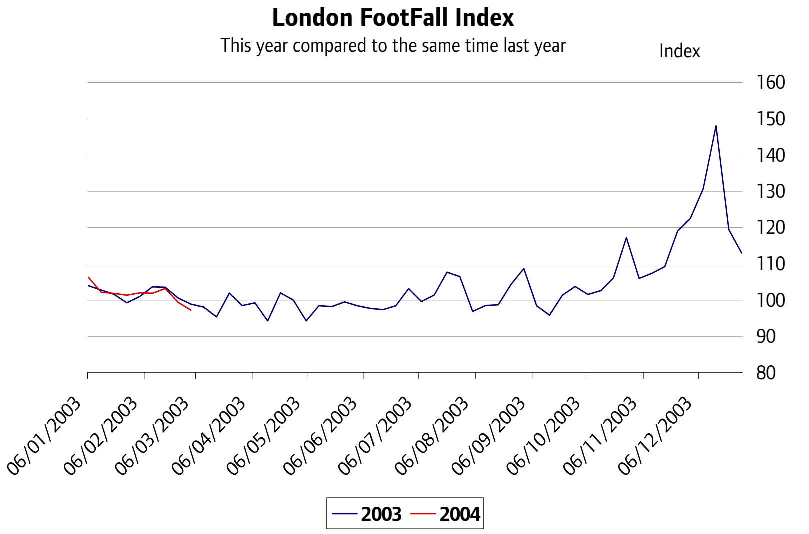


Source: CB Richard Ellis

Number of shoppers in London slightly below trend

- February was a relatively subdued month for retailers in London, as the number of visitors to shopping centres was slightly below trend.
- Consumer sentiment in the whole UK (measured by the GfK consumer index) also fell in February, with households less optimistic about making a major purchase.
- FootFall figures can be erratic, but weaker consumer confidence could have affected this index.

Latest release: 01/03/2004
Next release: every week

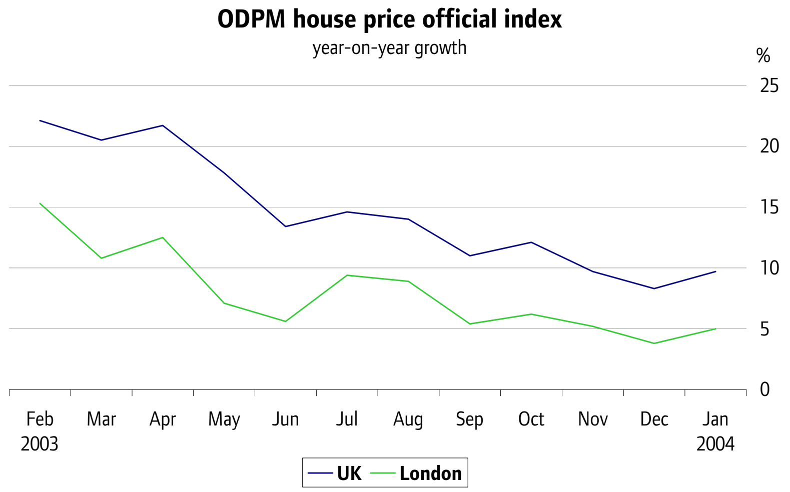


Source: FootFall Ltd

Housing market strengthens

- The UK housing market strengthened in February. The latest index from the Office of the Deputy Prime Minister (ODPM) showed an annual rise of 9.7% in January 2004, up from 8.3% in December 2003.
- London's housing market also recovered. Annual growth was 5% in January 2004, up from 3.8% in December 2003.
- The Nationwide and Halifax indices rose by 3.1% and 1.6% from January, to annual rates of 17.1 % and 17.8% (not shown).

Latest release: 8/03/04
Next release: 13/04/04

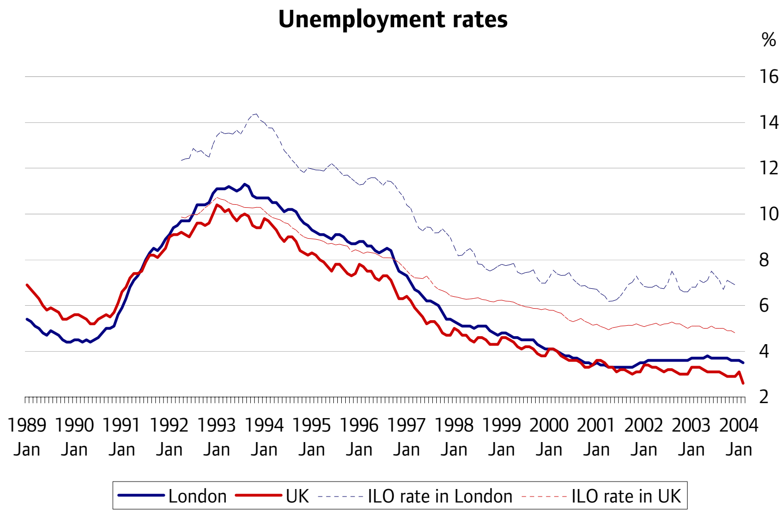


Source: ODPM

Unemployment rates stay low

- London's ILO unemployment rate has remained significantly above the UK rate. UK unemployment fell by 0.1 percentage point to 4.8% in the November-January period from the three months to October 2003. ILO unemployment in the capital was 6.9% in the three months to January.
- Claimant count unemployment rates in London and the UK remained low in February. The London rate was 3.6% in February (down 0.1 percentage point from February 2003). The UK claimant count rate was 2.9%.

Latest release: 17/03/04
Next release: 16/04/04



Note: Civilian workforce jobs include employees, self-employed and government-supported trainees jobs.
Source: ONS

Budget 2004: An initial analysis

by Duncan Melville,
Senior Economist

Yesterday Gordon Brown gave his eighth budget speech. This feature provides a quick initial analysis of some of the main features of the Budget.

Economic and fiscal forecasts

The Chancellor continues to forecast strong economic growth over the next few years. Table 1 shows the forecasts for economic growth and public borrowing comparing the forecasts from the Budget with the latest available consensus amongst economic forecasters. The Chancellor's forecasts for growth are more optimistic than the consensus. However, this does not mean he will be wrong. In last year's Budget he forecast growth of 2 to 2½ per cent for 2003 which was widely believed to be over-optimistic at the time, but growth for last year came in at 2.3 per cent. On public borrowing the Chancellor projects that this will fall over the next two years. In contrast, the consensus among forecasters is for some further increase in public borrowing.

Table 1. Economic and fiscal forecasts

Note: Public Borrowing here refers to Public Sector Net Borrowing (PSNB)

Source: Budget 2004, HM Treasury, March 2004 and A Comparison of Independent Forecasts, HM Treasury, March 2004

	2004	2005	2006
Budget: GDP growth (%)	3 to 3½	3 to 3½	2½ to 3
Consensus: GDP growth (%)	3.0	2.6	–
	2004/05	**2005/06**	**2006/07**
Budget: Public borrowing (£bn)	33	31	27
Consensus: Public borrowing (£bn)	34.5	35.1	–

The Golden Rule

The Chancellor has set himself the Golden Rule that over the economic cycle, the Government will borrow only to invest and not to fund current spending. Many commentators have started to question whether the Chancellor will meet this rule without either reductions in public spending or increases in taxation. The Treasury believes that the current economic cycle began in 1999/2000 and they project it to end in 2005/06. Thus it measures performance against the Golden Rule over that period. The measure it uses to assess the Golden Rule is the average surplus on the current budget (current receipts minus current expenditure) as a percentage of GDP. Treasury projections give this figure as 0.1 per cent per year over the current economic cycle, so it believes the Golden Rule will be met.

GLA Economics has previously assessed the likelihood of the Chancellor meeting his Golden Rule using the Treasury's forecasts for public spending but the more pessimistic projections for public borrowing as given by the consensus amongst independent forecasters. Updating these calculations gives an average surplus on the current budget for the current economic cycle of 0.02 per cent of GDP suggesting that on current policy the Chancellor would just meet his Golden Rule.

Given the average error in forecasting government borrowing only a year ahead is around £11 billon, both are consistent with the view taken by many outside commentators that there is probably a 50:50 chance that on current policy that the Chancellor will not meet his Golden Rule. This does not imply that there is any crisis in the public finances. The level of net government debt remains modest by international and historical standards. Furthermore, the Treasury has often stressed that the Golden Rule would not be broken so the likelihood must be that the Chancellor would if necessary make fiscal policy adjustments to meet his Golden Rule.

Implications for Spending Review 2004 (SR2004)

SR2004, the outcome of which is due to be announced in July, will determine part of the allocation of public spending over a three year period 2005/06 to 2007/08. Total public spending is made up of both Departmental Expenditure Limits (DEL) and Annually Managed Expenditure (AME). DEL is set for three years in the Government's spending reviews while AME is, as its name suggests, set annually and includes essentially demand driven expenditure such as spending on welfare benefits.

The Chancellor did not set out the overall level of DEL for the SR2004 period in this Budget as many had anticipated. Instead he set out a limit for total public spending that is DEL and AME combined. However using these figures for total public spending plus some assumptions GLA Economics has produced some estimates of the possible outcome of SR2004: on average per year over the period 2005/06 to 2007/08, DEL could increase by around 4.1 per cent per year in real terms.

In the last spending review, SR2002, the Government committed to very considerable increases in spending on the NHS through to 2007/08. This commitment, which the Chancellor confirmed in the Budget, must be subtracted from total DEL in order to see how much is left to meet other public spending needs such as transport and policing. Once this is done, GLA Economics estimates suggest that DEL outside of the NHS could increase on average in real terms by 2.7 per cent per year over the period 2005/06 to 2007/08. This compares with an average real increase of 4.5 per cent in SR2002.

This lower future growth in public spending will mean sharper competition for available public resources and greater emphasis on prioritisation. It was in anticipation of this that the Mayor and the GLA submitted *The Case for London* to the Chancellor, setting out the priorities for future investment and spending on public services in London for SR2004.

The Chancellor also announced challenging plans for reductions in the Government's administration costs in order to channel a greater proportion of public spending into public services. By 2008, the Government aims to cut 40,000 jobs from the Department for Work and Pensions and the newly merged Inland Revenue and Customs and Excise, and to reduce headquarters staff at the Department for Education and Skills by nearly a third. All government departments will be expected to cut their administration budgets by at least 5 per cent in real terms by 2008, and achieve annual efficiency savings of 2.5 per cent over the SR2004 period which the Chancellor estimates will release £20 billion a year by 2008 for public services.

The Barker Review

Alongside the Budget, the Barker review of housing supply was published. The main message of the report – the need for increased housing supply – is to be welcomed. In London, the rapid increase in house prices and the level of house prices relative to earnings clearly demonstrates the need for increased housing supply.

Other Budget announcements

Other significant budget announcements included:

- Implementation of the Lyons Review of relocation of civil service jobs. A total of 20,000 jobs will be relocated out of London and the South East.
- A commitment to increase public spending on transport and policing in real terms in SR2004, though the consequences of these commitments will clearly depend on the actual level of real increase provided.
- A precise commitment to increase education spending in England by an annual average of 4.4 per cent in real terms over the SR2004 period.
- An average annual real increase of 17 per cent in spending on Sure Start, early education and childcare between 2004/05 and 2007/08.
- A one-off payment this year of £100 to pensioners over the age of 70 to help with council tax bills.

Where do you live?
London's five housing sub-markets

by Adarsh Varma,
Economist

Londoners would most like to see significant improvements in transport and affordable housing. In relation to housing, the 2003 Annual London Survey[1] shows that:

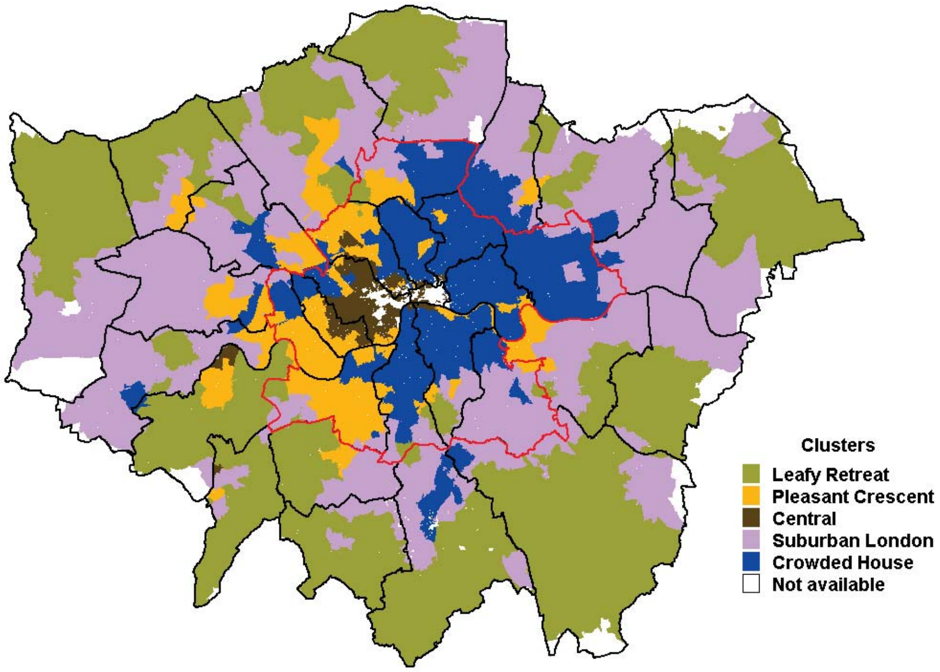
- 68 per cent of respondents strongly agree that housing and accommodation in London is too expensive.
- 48 per cent consider the lack of affordable housing a major problem.
- 38 per cent said the cost of housing was one of the two or three worst things about living in London.

A range of different dwelling and tenure options is required to accommodate London's growing population, household structure, labour mobility and international and domestic migration.

Housing sub-markets in London can thus be defined on the basis of each sub-market's structural, geographic and household characteristics. Looking at London's housing market as a set of sub-markets is useful since the market is very polarised and has significant differences in housing attributes. This is clearly reflected in house prices. In the last quarter of 2003, house prices rose by 18 per cent in Newham and Kensington and Chelsea compared to the last quarter in 2002. However, in the same period, house prices fell by 3 per cent in Camden and Islington.[2]

This feature summarises a new report into London's housing market by GLA Economics.[3] The study divides London into five sub-markets on the basis of postcode sector data on house prices, property types, tenure types, household characteristics and transport and social infrastructure.

London's five housing sub-markets



Central sub-market

Key stats

Population:	245,705
Households:	123,932
Area:	30km^2
Population density:	8,190 per km^2
Household density:	4,131 per km^2
Average house price[4]:	£460,000

The Central sub-market is the smallest of all sub-markets. It is defined as housing located in a region mainly comprising of office and commercial buildings. The average house price is the highest of all sub-markets. A high proportion of households live in flats/maisonettes (90 per cent) and in private rented accommodation (46 per cent). Around 50 per cent of all households comprise of just one person. It has the highest proportion of self employed (13 per cent) and the lowest proportion of part time (5 per cent) workers. The Central sub-market has well performing secondary schools with the highest average key stage 3 scores of all sub-markets.

Crowded House sub-market

Key stats

Population:	1,355,983
Households:	583,929
Area:	142 km^2
Population density:	9,549 per km^2
Household density:	4,112 per km^2
Average house price:	£220,000

This sub-market is situated in the inner east part of London. It adjoins or is closely located to many parts of the more attractive (in terms of housing for this study) clusters such as the Central sub-market and Pleasant Crescent. Some highly localised parts of this cluster, for example in the borough of Islington, would have some postcode sectors with similar neighbourhood characteristics as Pleasant Crescent. However, on average this sub-market is predominantly associated with a high proportion of income support claimants (13 per cent), households living in socially rented accommodation (50 per cent) and overcrowded households (28 per cent). It is also the most densely populated sub-market. Nearly half of all people belong to ethnic groups other than white. This cluster on average has the least number of open green spaces compared to other clusters. The education performance of schools in the crowded house sub-market is the lowest of all the clusters.

Pleasant Crescent sub-market

Key stats

Population:	1,547,344
Households:	676,124
Area:	205 km^2
Population density:	7,548 per km^2
Household density:	3,298 per km^2
Average house price:	£260,000

Most of this sub-market is situated in the inner western part of London, mainly in Wandsworth, parts of Camden, and Hammersmith and Fulham. However, due to the extremes in neighbourhood characteristics within the area, this sub-market also has postcode sectors with similar neighbourhood characteristics as Crowded House. On average, Pleasant Crescent is primarily characterised by the highest proportion of people who are economically active (70 per cent) and employed full time (45 per cent). Nearly 60 per cent of households live in flats/maisonettes and around 4 per cent live in detached properties. House prices are considerably higher in the western part of this cluster, where many parts of some postcode sectors are highly sought-after, such as Wimbledon Village.

Suburban London sub-market

Key stats

Population:	2,436,363
Households:	990,239
Area:	556 km^2
Population density:	4,382 per km^2
Household density:	1,781 per km^2
Average house price:	£190,000

This sub-market has the lowest house prices on average even though there are a higher proportion of large properties (in terms of average rooms per household). Most households live in terraced properties, with 66 per cent of households owning their homes. Suburban London can be defined as an intermediate sub-market for London, where house prices start falling and then rise again towards the outer fringe. This sub-market has the highest proportion of children and teenagers (25 per cent) but the secondary schools do not perform as well as the other clusters on average. It also has a low rate of households living in socially rented accommodation compared to Crowded House and Pleasant Crescent.

Leafy retreat sub-market

Key stats

Population:	1,573,060
Households:	639,945
Area:	751 km^2
Population density:	2,095 per km^2
Household density:	852 per km^2
Average house price:	£275,000

This sub-market is in stark contrast to the rest of the clusters. House prices are defined by a different set of indicators due to the geographic location and type of properties. As the name suggests, this sub-market has the highest number of green spaces close to houses in each postcode sector. Nearly 81 per cent of households own their houses and a high proportion of households live in detached properties (26 per cent). Nearly 87 per cent of people belong to white ethnic groups. The average number of rooms per household is 6, which is the highest of all clusters.[5] The Leafy Retreat sub-market has the lowest proportion of income support claimants, coupled with the fact that 64 per cent of people are employed. It has the second highest proportion of self-employed (12 per cent) after the Central cluster. In Leafy Retreat, nearly 11 per cent of people work part time compared to 5 per cent for the central sub-market, which shows the rate of part time workers increases further away from Central London.

Conclusion

The five sub-markets can be used to compare the differences (or similarities) in housing attributes for each postcode sector. It provides insights into the importance of improving London's urban fabric as well as the need to build more homes or bigger homes. The study has found that private rented accommodation is strongly correlated with proximity to over ground and underground train stations. There is a high premium attached to house prices in catchment areas of good schools.

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[1] http://www.london.gov.uk/mayor/annual_survey/2004/topline04.pdf

[2] Land Registry: http://www.landreg.gov.uk/

[3] GLA Economics will be publishing a report and working paper called *London's Housing Market and Sub-Markets* in the near future. See **www.london.gov.uk** or telephone **020 7983 4922** to order in advance.

[4] Average overall house price over six quarters from Q1 2002 to Q2 2003.

[5] This includes all rooms except bathrooms, toilets, halls or landings, or rooms that can only be used for storage.

Additional information

Data sources

Tube and bus ridership	Transport for London on 020 7941 4500
GDP/GVA growth	Experian Business Strategies on 020 7630 5959
Tourism – overseas visitors	www.statistics.gov.uk
Tourism – domestic visitors	www.visitlondon.com
London airports	www.caa.co.uk
Business activity	www.rbs.co.uk/pmireports
Employment	www.rbs.co.uk/pmireports
London FootFall	www.footfall.com
Office space demand	www.cbhillierparker.com
House prices	www.nationwide.co.uk/hpi/
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.

Claimant count rate

Unemployment rate based on the number of people claiming unemployment benefits.

Employee jobs

Civilian jobs, including employees paid by employers running a PAYE scheme. Government employees and people on training schemes are included if they have a contract of employment. Armed forces are excluded.

FootFall Index

Measures the average number of people passing through London shopping centres on a weekly basis. This index is positively correlated with UK retail spending so it can provide an indication of consumer spending in London.

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.

ILO unemployment rate

The International Labour Organisation's calculation of the number of people out of work.

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 – twelve 28-day periods and one 29-day period. Period 1 starts at the beginning of the financial year rather than the calendar year.

Acronyms

ABI	Annual Business Inquiry
BAA	British Airports Authority
BCC	British Chamber of Commerce
BITOA	British Incoming Tour Operators Association
CAA	Civil Aviation Authority
CBI	Confederation of British Industry
EBS	Experian Business Strategies
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, Bank of England
ODPM	Office of the Deputy Prime Minister
ONS	Office of National Statistics
PMI	Purchasing Managers' Index
PWC	PricewaterhouseCoopers
RICS	Royal Institute of Chartered Surveyors

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