London's Economy Today



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GLAECONOMICS

Global growth to slow in 2005

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With Christmas almost upon us, the Chancellor of the Exchequer's usual festive season 'present', the Pre-Budget Report (PBR), contains few surprises. This month's feature (p. 8) provides a quick guide to its points of interest. The Chancellor has stuck to his forecasts for UK economic growth of three to 3½ per cent in 2005 and 2½ to three per cent in 2006. These forecasts are considered to be optimistic when compared with the consensus of independent forecasters.

As anticipated, the Chancellor also predicted that his *Golden Rule* would be met. The Golden Rule means that over the economic cycle the Government should only borrow to invest and not to fund current spending. The Treasury believes that the current economic cycle began in 1999/00 and they project it to end in 2005/06. However, there is little margin of error to meet the Golden Rule and many economists expect it to be just broken rather than just met.

London performing well

London's economy continues to expand and currently seems to be outpacing the UK economy as a whole. The recovery in tube passenger numbers has been sustained. The positive average annual rate of growth in tube passenger numbers is increasing and the average rate of growth in bus passenger numbers remains strong. The City rental market is also expected to pick up over the next few years, though the timing

Latest news...

- The new GLA Economics publication **Enter the Dragon: An analysis of Chinese Foreign Direct Investment into London** is now available: www.london.gov.uk/mayor/economic_unit.

The GLA Economics team wishes you a happy Christmas and a prosperous New Year

is still open to debate. British Land has forecast that office rents in the City of London will return to growth next year, but other property groups, Great Portland Estates and Land Securities, predict a pick up in 2006.

UK housing market continues to cool

The slow down in the UK housing market has continued with the number of new mortgages approved in October falling to their lowest level since January 2000. Bank of England figures showed that new mortgages fell for the fifth successive month in October to 83,000 (seasonally adjusted) compared with 88,000 in September. However, the housing market has certainly not collapsed. House prices as measured by Nationwide rose by one per cent in November reversing a fall of 0.4 per cent in October with the annual rate of house price inflation easing to 15 per cent from 15.3 per cent. The Halifax house price index fell by 0.4 per cent in November, compared with a 1.2 per cent fall in October. With the Halifax measure house prices were still 16.8 per cent higher in the three months to November compared with a year ago (they were up an annual 18.5 per cent in the three months to October). The slowing trend in house prices is expected to continue in 2005 with Nationwide predicting UK and London house prices to grow by two per cent and three per cent respectively and Halifax predicting small falls of two per cent in the UK and four per cent in London.

The implications of the housing market slowdown for the UK economy depend to a large degree on its impact on household spending. Historically, house price inflation and household spending growth have moved together, but in the current UK economic climate of relatively low levels of unemployment, inflation and interest rates, the Bank of England does not expect that a less buoyant housing market will cause a substantial weakening of household spending. However, this is certainly a major downside risk to the UK - and the London - economy.

US dollar readjustment continues

This month, international economic commentary has continued to focus on the potential risks to the world economy associated with the decline in the US dollar. This is a necessary adjustment given the large size of the US current account deficit and will only become a problem if the decline is too rapid and disorderly. During the month the dollar fell to a level against the Sterling last seen in 1992 (see Chart 1), before the UK withdrew from the Exchange Rate Mechanism. A low for the dollar of around £1 = $1.95 has been reached.

London's economy is more concentrated in exporting services than the rest of the UK. London is the UK centre of services in business and finance. International trade in these sectors is much more exposed to international markets, particularly the US's market, than other sectors. Many of these services are high in value and their competitive advantage depends on specialist skills so despite being made more expensive to US customers by the weak dollar, they are likely to be continued to be sold to the US. There are also opportunities for London exporters and with the US economy continuing to grow stronger than the Eurozone, there could even be increasing demand from the US for London's business and financial services[1].

Chart 1. The UK Sterling - US Dollar exchange rate (£=$)

Source: Ecowin

Oil prices have fallen to below $40, well beneath the October highs of above $50 per barrel. In early December the Energy Information Administration figures showed that US crude stocks were now 3.5 per cent higher than a year ago, which has calmed down worries about a potential winter fuel shortage in the US. The Organization of the Petroleum Exporting Countries (OPEC) has also increased oil production to 25-year highs to meet global demand, which has helped stabilise the oil market. Currently OPEC is estimated to be producing as much as 1.7 million barrels per day (mbpd) more than their 27mbpd quota. However, at a meeting on 10 December, OPEC members agreed to cut back on their quota-breaking. This cut is scheduled to start in mid-January and could reduce overproduction by about a million barrels per day.

Growth to ease in 2005

In its latest bi-annual report, the Organisation of Economic Co-Operation and Development (OECD) reduced its growth predictions for the world's main industrialised regions. It expects US growth to be 4.4 per cent in 2004 before falling back to 3.3 per cent in 2005 from a previous forecast of 3.7 per cent. The forecasts for Japanese growth have been reduced to 4.0 per cent in 2004 (previous forecast 4.4 per cent) and 2.1 per cent in 2005 (previous forecast 2.8 per cent). Below trend Eurozone growth is expected to continue. The forecasts for Eurozone growth have been reduced to 1.8 per cent in 2004 (previous forecast 2.0 per cent) and 1.9 per cent in 2005 (previous forecast 2.4 per cent). The UK economy is forecast to expand by 2.6 per cent in 2005 (previous forecast 2.7 per cent, compared with a prediction of 3.2 per cent for 2004). Against this world background we would also expect to see a measured slowdown in London's economy in 2005 compared with 2004.

Footnote

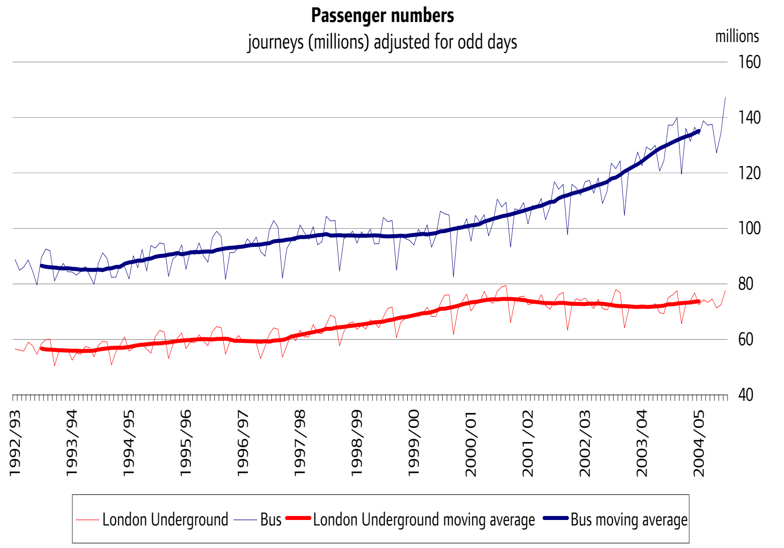
[1] For a more in-depth analysis of London's international trade position please read: GLA Economics, 2004, London's Economic Outlook: Spring 2004, chapter 4 'London's International Trade'

Economic indicators

Moving average for passenger numbers rises further

- In the most recent 28-day period, London's public transport had 224.8 million passenger journeys; 147.2 million by bus and 77.6 million by Underground.
- The moving average increased to 208.9 million passengers every period, the highest recorded in this publication. The average for buses increased to 135.2 million passenger journeys each period and the average for the Underground edged up to 73.8 million.

Latest release: November 2004
Next release: December 2004

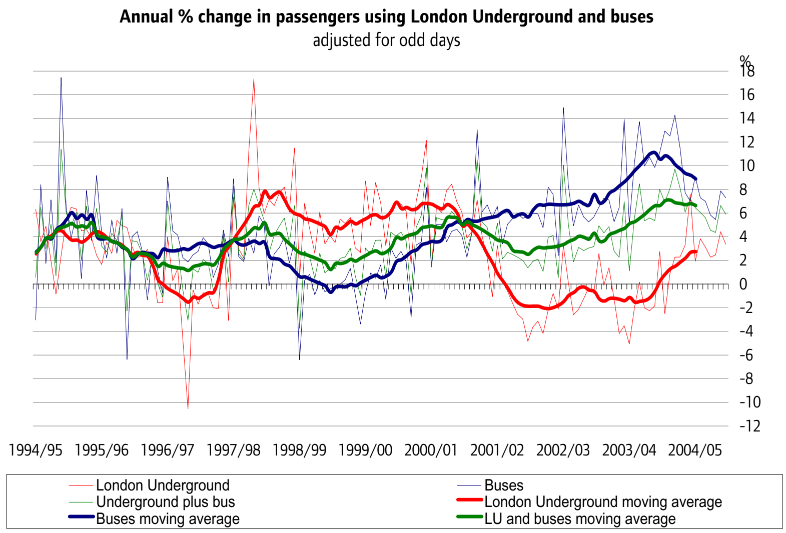


Source: Transport for London

Sustained growth on buses and the tube

- The average annual rate of growth in passenger journeys is 6.6%.
- The average annual rate of growth in the number of bus journeys at 8.8% is similar to last period's figures.
- The recovery in Underground passenger numbers has been sustained. The average annual rate of growth increased to 2.7%.

Latest release: November 2004
Next release: December 2004

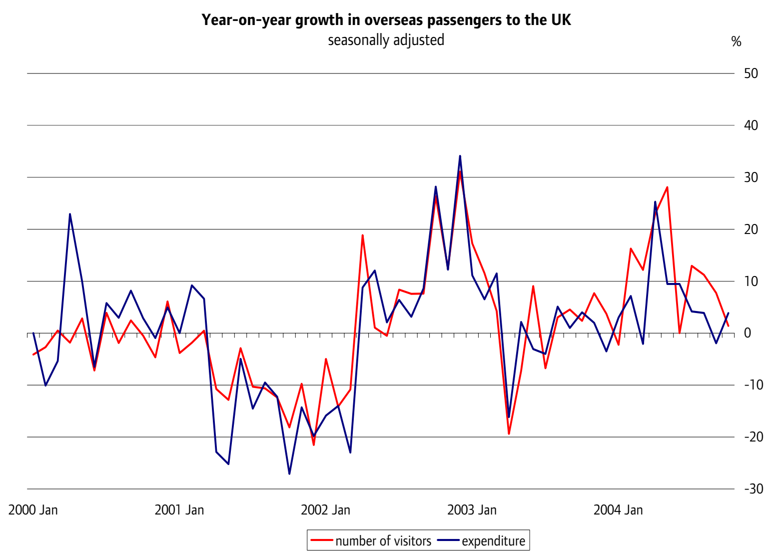


Source: Transport for London

Slowdown in the growth of overseas visitor numbers

- The autumn of 2004 showed slow annual growth in overseas visitors to the UK and their spending. Up to half of overseas visitors spend time in London.
- The number of overseas visitors to the UK was 1.4% higher in October 2004 than October 2003.
- The year-on-year growth in expenditure by overseas visitors in the UK was 3.8% in October 2004.

Latest release: December 2004
Next release: January 2005

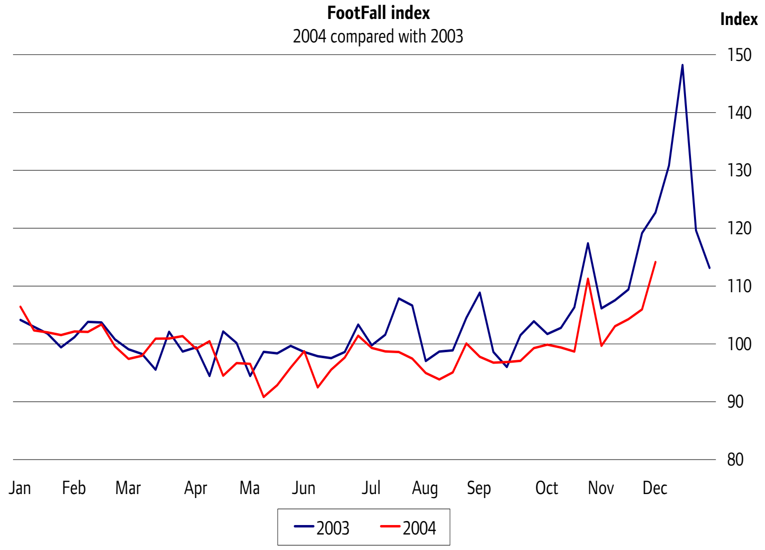


Source: Office of National Statistics

Christmas shopping begins

- The FootFall index had a sharp increase in the final week of November, echoing a similar increase at the same time last year.
- However, the current level of the index remains below last year's level, suggesting fewer numbers of shoppers in this year's build up to Christmas.
- The FootFall index measures the number of shoppers and does not necessarily reflect the level of spending.

Latest release: 29/11/04
Next release: every week

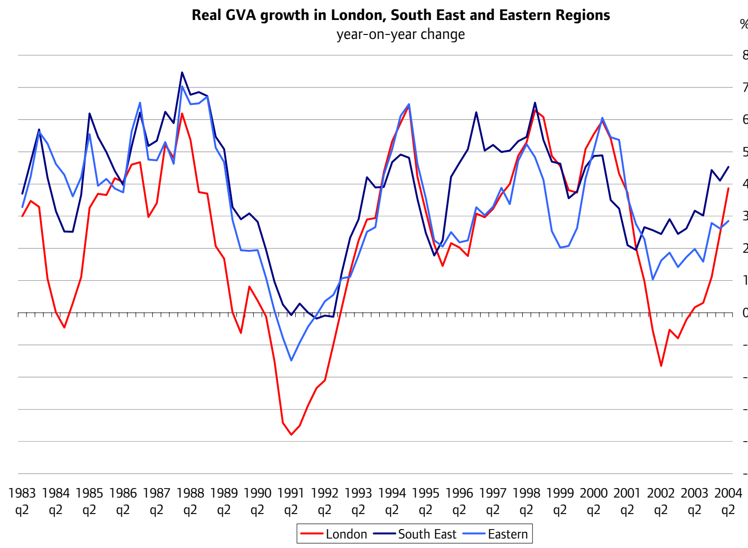


Source: FootFall Limited

Strong recovery in economic growth

- London's output grew strongly at an annual rate of 3.9% in Q2 2004, up from annual growth of 2.5% in Q1.
- The South East region's annual output growth increased to 4.5% in Q2 from 4.1% in Q1.
- The Eastern region's output rose by an annual rate of 2.8% in Q2 from 2.6% in Q1.

Latest release: September 2004
Next release: January 2005

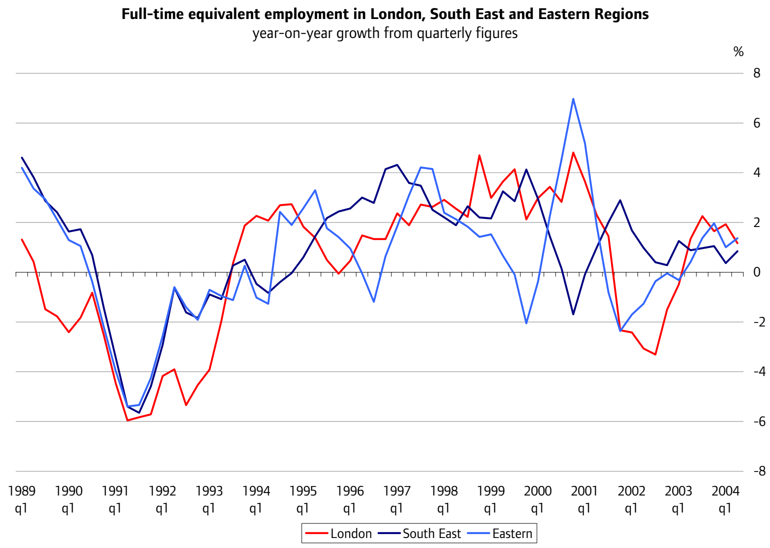


Source: Experian Business Strategies

Sustained employment growth in London

- London's year-on-year employment growth was 1.7% in Q1 2004 but slightly reduced to 1.2% in Q2 2004.
- The South East year-on-year employment growth was 0.8% in Q2 2004, an increase from 0.4% in Q1.
- The Eastern region's year-on year employment growth was 1.4% in Q2 compared to 1% in Q1.

Latest release: September 2004
Next release: January 2005

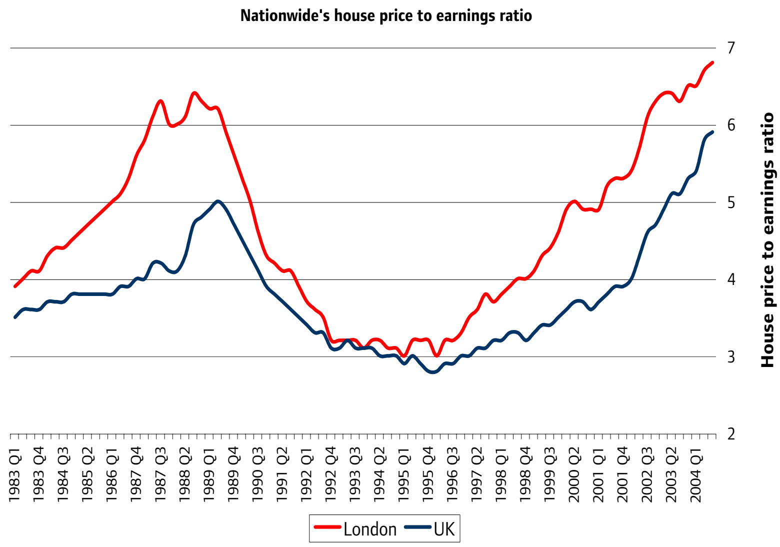


Source: Experian Business Strategies

House price to earnings ratio on the rise

- Nationwide calculates a house price to gross earnings ratio which shows that under this measure houses are less affordable in London than the UK as a whole.
- The house price to earnings ratio in London increased to 6.8 in Q3 2004 from 6.3 in Q3 2003.
- The house price to earnings ratio for the UK increased to 5.9 in Q3 2004 from 5.1 in Q3 2003.

Latest release: December 2004
Next release: January 2005

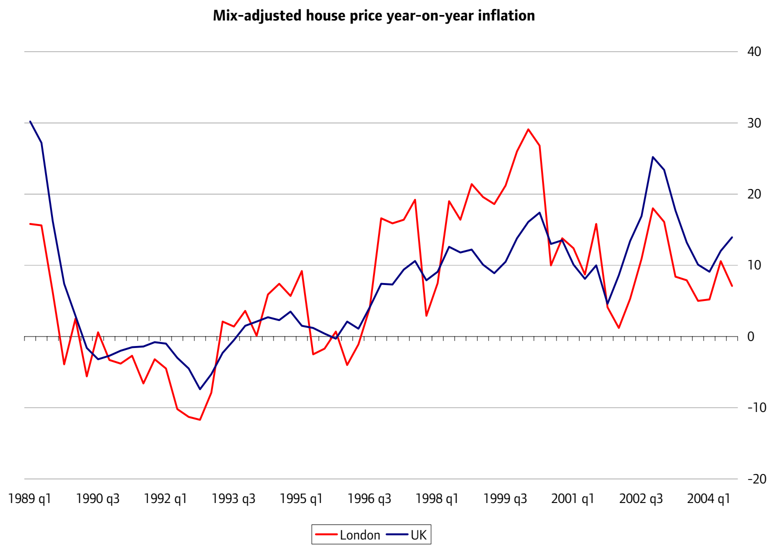


Source: Nationwide

London's house price inflation fell in Q3

- House prices as measured by the ODPM showed a slowdown in house price inflation in London but an increase across the UK in Q3 2004.
- Annual house price growth in London decreased to 7% in Q3 2004 from almost 11% in Q2.
- Annual house price growth for the UK increased to 13.9% in Q3 2004, up from 12% in Q2.

Latest release: December 2004
Next release: January 2005

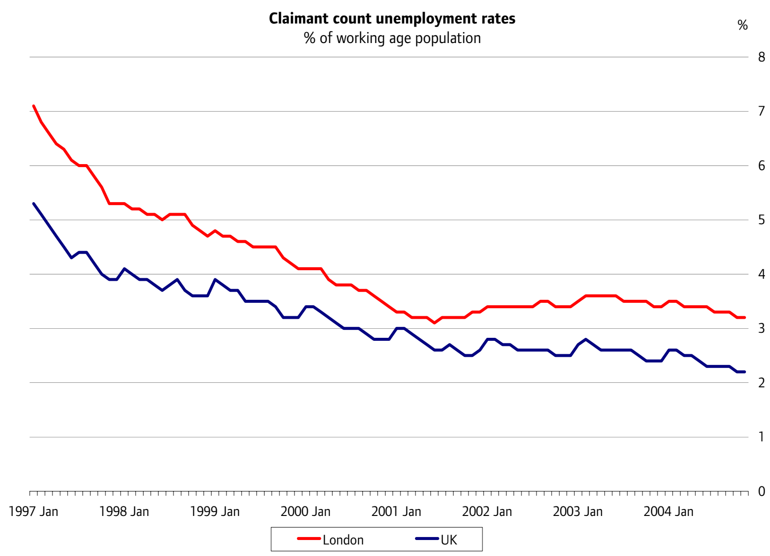


Source: ODPM

Claimant count unemployment remains low

- The rate of claimant count unemployment, people unemployed and claiming Jobseekers Allowance, in London remained at 3.2% in November.
- There were 157,700 unemployment claimants in London in November 2004, compared with 167,800 in November 2003.
- The UK's claimant count unemployment rate remains below that of London's.

Latest release: December 2004
Next release: January 2005



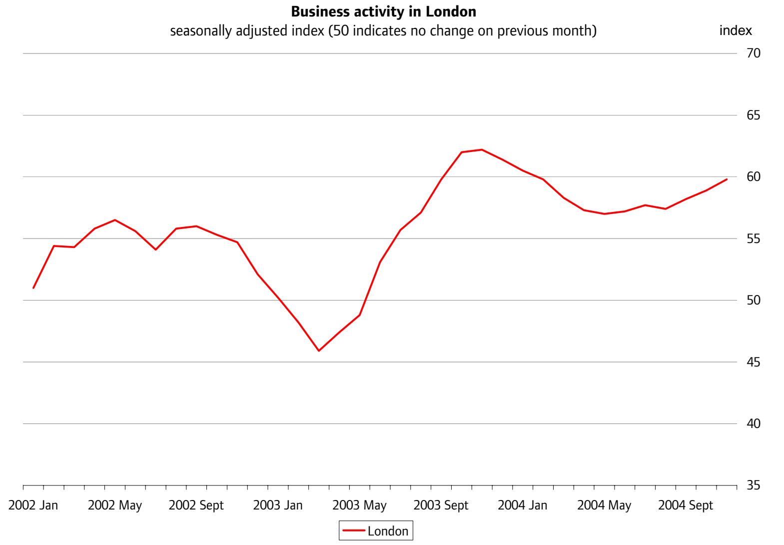
Source: Claimant count, Nomis

Business activity in London expands

- London firms continued to expand their output of goods and services in November with the rate of growth increasing slightly.
- The Purchasing Managers' Index (PMI) of business activity recorded 59.8 in November 2004, up from 58.9 in October 2004.
- A rate above 50 on the index indicates an increase in business activity from the previous month.

Latest release: December 2004

Next release: January 2005



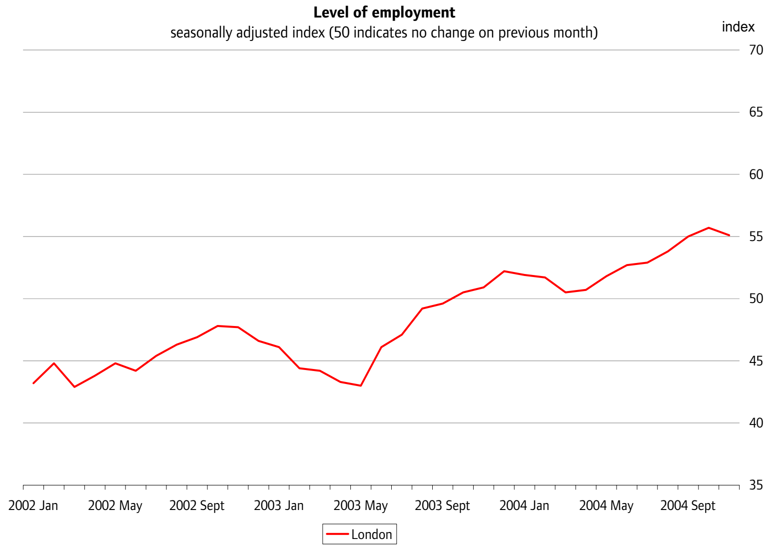
Source: PMI/The Royal Bank of Scotland

Employment growth continues

- London firms increased their level of employment in October. The PMI for the level of employment recorded 55.1 in November 2004, which compares with 55.7 in October 2004.
- This compares favourably with a level of 50.9 in November 2003.
- A rate above 50 on the index indicates an increase in the level of employment from the previous month.

Latest release: December 2004

Next release: January 2005



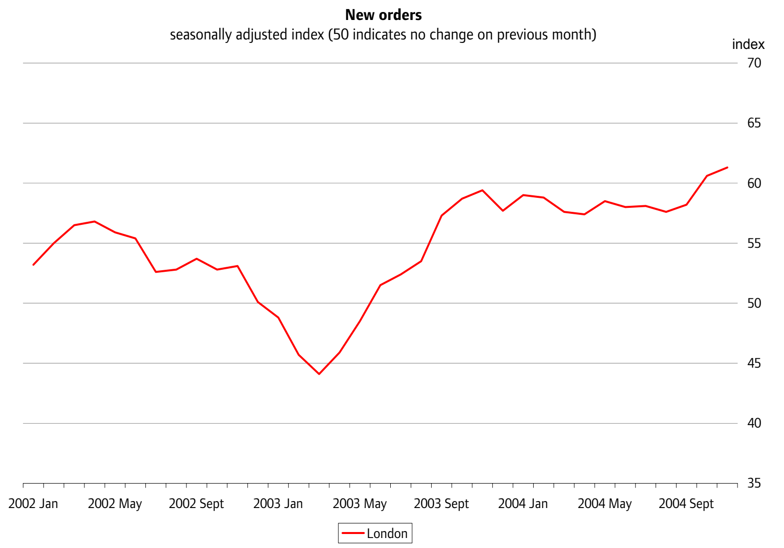
Source: PMI/The Royal Bank of Scotland

New orders still increasing

- New orders for London firms continued to rise, setting a yearly high in November. The PMI for new orders was 61.3 in November 2004, which compares with 60.6 in October 2004.
- This compares with 59.4 in November 2003.
- A rate above 50 on the index indicates an increase in new orders from the previous month.

Latest release: December 2004

Next release: January 2005



Source: PMI/The Royal Bank of Scotland

The 2004 Pre-Budget Report reviewed

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The Chancellor's Pre-Budget Report (PBR), released in early December, contains few surprises – he remains optimistic about the economy, is still committed to his Golden Rule on public borrowing and wants to keep the UK internationally competitive, stimulate employment and improve childcare provision.

Misplaced optimism?

Sticking to his Budget 2004 economic forecasts, the Chancellor continues to predict strong economic growth. As Table 1 shows, the Chancellor's forecasts are more optimistic than independent forecasters and the Organisation for Economic Cooperation and Development (OECD)'s forecasts. Against a background of an expected slowing in world growth in 2005, recent increases in interest rates, high oil prices, and a slowing UK housing market and so lower consumption growth, it is difficult not to feel that the Chancellor's forecasts are optimistic. However, his past forecasts for 2003 and 2004 were generally felt to be overoptimistic by most independent analysts but the Chancellor turned out to be right.

Table 1: Output annual growth forecasts (%)

Source: HM Treasury, OECD

	2004	2005	2006
PBR 2004	3¼	3–3½	2½–3
Consensus	3.2	2.6	2.5
OECD	3.2	2.6	2.4

Similarly his forecasts for public sector borrowing are generally more optimistic than either the consensus amongst independent forecasters or an extrapolation for 2004/05 based on data from the first seven months of this financial year (see Table 2). While the Chancellor projects declining levels of public borrowing, the consensus is for public borrowing to stay around £36 billion through to 2006/07.

Table 2: Public sector net borrowing forecasts (£ billion)

Source: HM Treasury, GLA Economics calculations

	2004/05	2005/06	2006/07
PBR 2004	34.2	33	29
Consensus	36	35.4	36.9
Extrapolation	37.6	-	-

All that glitters isn't gold

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. With the consensus projections for public borrowing being more pessimistic than the Chancellor's, many commentators are questioning whether the Chancellor will meet this rule without either reductions in public spending or increases in taxation. However, even on the Chancellor's figures there is a substantial risk that the Golden Rule will not be met. The Treasury measures performance against the Golden Rule over the current economy cycle (which they classify as 1999/00 - 2005/06). Their measure for assessing the Golden Rule is the average surplus on the current budget (current receipts minus current expenditure) as a percentage of GDP. As the PBR projects this figure to be 'around 0.1 per cent of GDP', the Treasury believes the Golden Rule will be met. However the margin against failing the Golden Rule is on the Chancellor's figures at just £8 billion – less than the average one-year ahead forecasting error for public borrowing of around £11 billion.

In addition, the Chancellor's projections may be overoptimistic. A simple extrapolation of data for the first seven months of this financial year suggest the current budget is heading for a deficit of £21.3 billion this year while the Chancellor's projections are for a deficit of just £12.5 billion. The difference between these two projections exceeds the Chancellor's own £8 billion margin.

GLA Economics has updated its assessment of the likelihood of the Chancellor meeting his Golden Rule, adjusting the Treasury's forecasts for public spending and taxation to allow for the lower growth projections given by the consensus of independent forecasters and the consensus's more pessimistic projections for public borrowing. These calculations give an average surplus on the current budget for the current economic cycle of –0.03 per cent of GDP suggesting that on current policy the Chancellor would just fail to meet his Golden Rule.

Even if the Chancellor marginally fails to meet his Golden Rule, fiscal policy is not 'in crisis'. Public borrowing looks set to be around three per cent of GDP. Between 1992/93 and 1996/97 public borrowing averaged around six per cent of GDP. In addition, public sector net debt is just 33 per cent of GDP, well below the 40 per cent level that the Chancellor has set for his Sustainable Investment Rule, and low by both historic and international standards. Public borrowing exceeded 40 per cent of GDP in every financial year between 1974/75 and 1986/87. Comparing the UK internationally, Germany's public debt is around 65 per cent of their GDP while Italy's public debt is more than 100 per cent of their GDP.

GLA Economics says:

There is little risk that by borrowing more the Chancellor is building an unsustainable debt-servicing burden for future years. In truth a marginal breach of the Golden Rule would be no big deal in economic terms. However it would be a big political deal for the Chancellor given the amount of political capital he has invested in his determination to meet his fiscal rules.

Competing on the global scale

The Chancellor stressed the need for the UK to stay internationally competitive and 'meet long-term global economic challenges', particularly the increasing importance of China and India. To help achieve this he announced measures on business creation, innovation and skills.

Innovation

To promote innovation, the Chancellor said he will re-examine the research and development (R&D) tax credit for mid-sized science based firms, remove tax barriers when university spin-off companies form, and establish an industry-led science forum to assess progress in raising business R&D.

GLA Economics says:

These measures are unlikely to have a dramatic effect although judgement on the science forum should presumably be delayed until it releases its findings.

Improved regulation

The *Hampton Report* on business regulations, published with the PBR, concluded that further regulatory enforcement improvements were needed as regulations have been applied inconsistently, paperwork has been a heavy burden for small business, and the penalty regime has been cumbersome with few incentives for compliance. The report proposes consultation to address these concerns. In addition, the Chancellor announced that Inland Revenue is setting up a new small business unit and will consult on creating a single tax return for small business, with the long-term goal of creating a single account for payments.

GLA Economics says:

These reforms are welcome as they appear designed to reduce administrative burdens on business, especially small ones, and so reduce the costs of doing business.

Skills

The existing Employer Training Pilots will be rolled out on a national basis from 2006/07 and will cover the whole country by 2007/08 creating a national Employer Training Programme. The programme aims to increase the number of British workers with NVQ2 level qualifications. In the pilot scheme, employers provided time off for workers to receive training while the amount of government compensation they received for this loss of labour ranged from zero to 100 per cent. The expanded programme's level of compensation is still to be decided.

GLA Economics says:

Of all the measures designed to improve international competitiveness, this appears the most substantial. The UK has a much higher percentage of adults with low-level skills and a smaller proportion with medium-level skills than countries such as the US or Germany. However given that employer participation is voluntary, the Government will need to provide employers with sufficient compensation for allowing employees to take time-off for training, if the programme is to be a success.

Got to get that job

The Chancellor announced a number of measures to help people move into work.

Lone parents

The In-Work Credit for lone parents (providing £40 per week for the first year of returning to work) will be extended from four to ten areas in the South East from October 2005 (around 84,000 more lone parents). However last year's PBR announced that the credit would be available to all parents in London (outside the North East London Jobcentre Plus district where similar incentives are already available) from April 2005 so the benefit to London's lone parents may be limited.

GLA Economics says: *As evaluation evidence suggests that such payments are effective at helping lone parents return to work, this announcement is welcome.*

Incapacity related benefit claimants

The Pathways to Work pilots for claimants of incapacity related benefits are being extended to cover around a third of the country from October 2005. The pilot provides new claimants with mandatory work-related interviews, rehabilitation services, links with New Deal for Disabled People job brokers, and improved financial incentives (£40 per week Return to Work credit).

GLA Economics says: *Early evidence from the pilots suggest Pathways to Work has been successful at helping individuals move back into work so this is a welcome announcement. However, disappointingly, London will not be included in the expansion.*

Ethnic minorities

The National Employment Panel working with the Ethnic Minority Business Forum will report to the Chancellor by Budget 2005 on measures to encourage employment, self-employment and small business growth for ethnic minority groups. Ethnic minority communities suffer high rates of worklessness and this is particularly relevant as nearly a third of London's population are of minority ethnic origins.

GLA Economics says: *The fact that the Government has asked for such a report suggests they are still unsure of what measures are most effective at tackling this problem.*

Learning allowances

From April 2006, the Government will pilot a £10 per week learning allowance to help benefit claimants take up full-time training towards a first Level 2 qualification.

GLA Economics says: *This announcement is less welcome as UK and overseas evaluation evidence suggests that training programmes for the unemployed are not effective at helping them return to work.*

Ten Year Childcare Strategy

As part of the Government's Ten Year Childcare Strategy, announced alongside the PBR, the Greater London Authority (GLA) and London Development Agency will be working with the Department for Education and Skills to improve the accessibility and affordability of good quality childcare for lower income families in London. This initiative should benefit more than 10,000 London families.

Other highlights of the Ten Year Childcare Strategy include:

- raising the Childcare Tax Credit ceiling from April 2005 (from £135 to £175 for one child; £200 to £300 for more than one child) and increasing the proportion of childcare costs that can be claimed
- legislating to secure sufficient supply of affordable, flexible, high quality childcare places
- creating a yearly £125 million transformation fund from April 2006 to support local authority investment in high quality affordable childcare
- extending free high quality care for three and four year olds to 15 hours a week for 38 weeks by 2010
- ensuring, by 2010, that out-of-school childcare places are available until 6pm
- increasing Sure Start Children's Centres from 600 to 2,500 by 2008 and 3,500 by 2010
- extending paid maternity leave to nine months from April 2007 and to 12 months in the life of the next parliament and legislating to allow mothers to transfer a proportion of this paid leave to the child's father.

GLA Economics says: *The Ten Year Childcare Strategy is a welcome announcement as it contains measures to address the expense and availability of childcare which are important factors preventing many London mothers from entering or remaining in work; the employment rate of mothers in London is well below the national average. In addition, the announcement on maternity leave is also welcome as evidence suggests that consistent one-to-one care in the first year of a child's life appears to enhance subsequent child outcomes.*

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
ODPM	Office of the Deputy Prime Minister
ONS	Office of National Statistics
PMI	Purchasing Managers' Index
PWC	PricewaterhouseCoopers
RICS	Royal Institute of Chartered Surveyors

Past features

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	Nappies and 'power suits': Childcare issues for London employers

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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.

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