

London's Economy Today



Issue 52 | December 2006

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Outlook for UK public finances worsens slightly

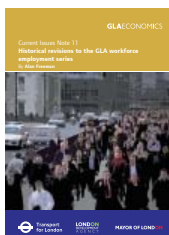
by Christopher Lewis, Senior Economist

London is a successful world city with a global outlook. Globalisation has facilitated increased integration in world capital markets and had a positive impact on London's financial services sector. As the economies of emerging countries grow they will become increasingly important markets for London to tap into allowing the capital to build on its strength and comparative advantage in specialised services. This month's supplement 'London's opportunities in emerging markets', by Stephen King, summarises some recent research that looked at the potential benefits that strong growth in emerging market countries might create for the capital.

Overall, London's economy continues to perform very well compared to the UK as a whole. The capital's labour market remains firm with October's Bank of Scotland London Labour Market Report showing that permanent staff placements and temporary staff billings continued to rise strongly. The rate of improvement of labour market conditions in London remained above the UK average for the twelfth consecutive month.

GLAECONOMICS

Latest news...



- **Current Issues Note 11: Historical revisions to the GLA workforce series**
GLA Economics publishes, each year, a dataset of workforce employment in London. This Current Issues Note explains the revisions that the GLA has made to its own data series and the reasons they were made. Visit www.london.gov.uk/mayor/economic_unit to download this publication.

- **Sectors Seminar:** GLA Economics will be hosting a seminar on the morning of Wednesday 7 February on the subject of Sectors. If you would like further information about this event please email glaeconomics@london.gov.uk

Meanwhile in November, the Purchasing Managers' Index (PMI) measures of seasonally adjusted business activity, private sector workforce and new orders indices for the capital were all above their UK levels. The PMI shows that the rate of London's expansion is still robust but may well have eased slightly since late spring.

The City of London's office market has continued its pick-up with rising take-up, lower vacancy rates and higher rents. Demand from financial services firms has been especially strong. Jones Lang Lasalle believe that office rents in the City will grow by more than 30 per cent in the next three years.

Christmas is the key period for London's retailers. The London Chamber of Commerce and Industry (LCCI) has conducted interviews with the managers of 50 high street stores to assess how the sector is currently performing. Nine out of ten retailers said they were confident about the outlook for their business this Christmas. Comparing this Christmas with last year, 60 per cent of retailers said their volume of sales was higher and 58 per cent said turnover was up. Overall, seven out of ten retailers said this Christmas was 'better' or 'the same' when compared to this time last year.

Tax increases in the Pre-Budget Report

The Chancellor of the Exchequer's Pre-Budget Report (PBR) on 6 December contained few surprises. As anticipated, the Chancellor predicted that his Golden Rule would still be met, though the spare margin was reduced. The Golden Rule means that over the economic cycle the Government should only borrow to invest and not to fund current spending. However, HM Treasury once again revised the length of the current economic cycle over which the Golden Rule should be judged – this time down to ten years ending this financial year (April 2006 – March 2007). HM Treasury also changed its assumptions regarding future trend growth (increased from 2007 onwards from 2½ per cent per annum to 2¾ per cent per annum).

Relative to the Budget 2006 projections the Chancellor has increased his forecast for economic growth this year from 2 to 2½ per cent to 2¾ per cent, but reduced his forecast for 2008 from 2¾ to 3¼ per cent to 2½ to 3 per cent. The forecast for 2007 remained unchanged at 2¾ to 3¼ per cent. The increase in forecast growth for 2006 was widely expected and is in line with the consensus amongst independent economic forecasters (2.6 per cent). In contrast, the Chancellor's forecast for economic growth in 2007 is well above the consensus forecast of 2.4 per cent.

Despite tax increases in the PBR the projections for public borrowing were increased in the years 2006-07 to 2009-10 compared to those contained in this year's Budget. The Chancellor announced tax increases of roughly £2bn a year, approximately a half coming from the doubling in air passenger duty from 1 February 2007.

UK house price inflation has exceeded most analysts expectations during 2006 due in part to the continued steady growth of the economy. In November, seasonally adjusted UK house prices, as measured by the Nationwide and Halifax rose rapidly by 1.4 per cent and 1.7 per cent respectively. Annual house price inflation remains strong increasing to 9.6 per cent on both measures in November. House price inflation is expected to cool down in 2007 as recent rises in interest rates and increasing unaffordability dampen demand. However, mortgage lending and approvals are currently running at their highest levels since 2003 so an abrupt collapse in the housing market is certainly not likely in the near future. The Halifax forecasts that UK house price inflation will ease to 4 per cent in 2007, which would be the lowest rate since 1995, while the Nationwide's forecast is between 5-8 per cent. London is the region expected to have the highest house price inflation in England next year at 8 per cent (the same rate as estimated for 2006) by the Halifax and between 8-11 per cent by the Nationwide.

Weak US housing market dragging down on economy

Economic news regarding the US has been mixed over the last month. The Federal Reserve's Beige Book survey showed that economic growth was solid in October and early November. US growth has also been revised upwards for Q3, though there has still been a slowdown compared with the first half of 2006. US job growth and retail sales in November were better than expected and an improvement compared with October. The Dow Jones has also hit another all-time high during December. However, consumer confidence and durable goods orders have fallen recently. The housing market remains weak and is expected to continue as a drag on growth into 2007. The Organisation for Economic Cooperation and Development (OECD) now predicts that US growth will slow from 3.3 per cent in 2006 to 2.4 per cent next year. Over the last few months the US dollar has depreciated against a wide range of currencies including Sterling, which recently managed to hit a 14 year high against the dollar (see Figure 1). Any disorderly collapse of the dollar could bring about financial market turbulence and would be a significant risk to the world economy.

Figure 1. The Sterling-Dollar exchange rate

Source: Ecwin



Despite the recent economic recovery in the Eurozone the OECD still expects its growth rate to be lower than the slowing US economy this year and next. The OECD's forecast for Eurozone growth has been revised higher to 2.6 per cent in 2006 and 2.2 per cent in 2007. With a firmer economy German unemployment fell again in November to below four million but the unemployment rate remains high at nearly 10 per cent. As expected the European Central Bank (ECB) increased interest rates by 0.25 per cent (to 3.5 per cent) on 7 December as they believe there is no room for complacency over inflation. This was the sixth rise in the last twelve months and further increases are likely in 2007.

Oil prices have risen to just above \$60 per barrel. They rose after OPEC announced on the 14 December that they would make a further cut in output. The extra reduction of 0.5mbpd from 1 February 2007 follows November's cut of 1.2mbpd. However, reports suggest that some of the 11 OPEC members have yet to comply fully with November's reduction hence the delay in introducing this further cut until next year. At above \$60 per barrel oil prices remain high but below their peak of nearly \$80 this summer.

World economic growth expected to slow in 2007

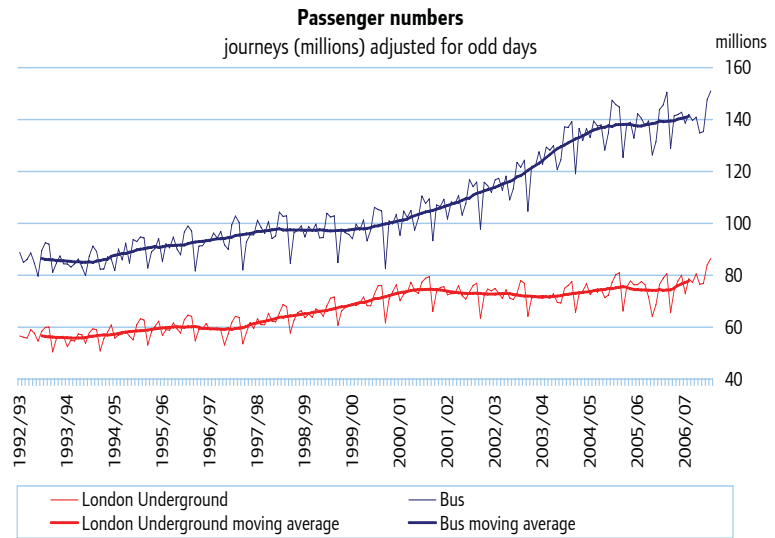
Slower US growth in 2007 is expected to drag down world economic prospects. The OECD forecasts that world growth will slow to 2.5 per cent next year (its weakest for four years) from 3.2 per cent this year. However, growth is expected to remain buoyant in China, India and Russia. China's economy remains especially robust with the annual growth rate in industrial production rising to 14.9 per cent in November from 14.5 per cent in October. The UK economy is growing at around trend and the latest data surprisingly showed unemployment falling. With average earnings growth picking up recently and Consumer Price Index (CPI) inflation jumping further above its 2 per cent target to 2.7 per cent in November another interest rate rise in early 2007 cannot be ruled out. The consensus among independent forecasts is for the UK economy to slow slightly next year along with other industrialised countries. Despite this global and national background the London economy is expected to perform well in 2007 supported by current strong financial markets and buoyant activity in the City. In the run up to Christmas the FTSE100 reached its highest level since February 2001. However, the risks to the capital's economy remain skewed to the downside especially from any colder than expected economic winds blown from across the Atlantic.

Economic indicators

5

Moving average of passenger numbers continues to rise

- The most recent 28-day period is from 15 October to 11 November 2006. London's public transport had 237.5 million passenger journeys; 151 million by bus and 86.5 million by Underground.
- The moving average increased to 219 million from an upwardly revised 218 million passengers every period.
- The moving average for buses was 141.2 million. The moving average for the Underground was 77.8 million.



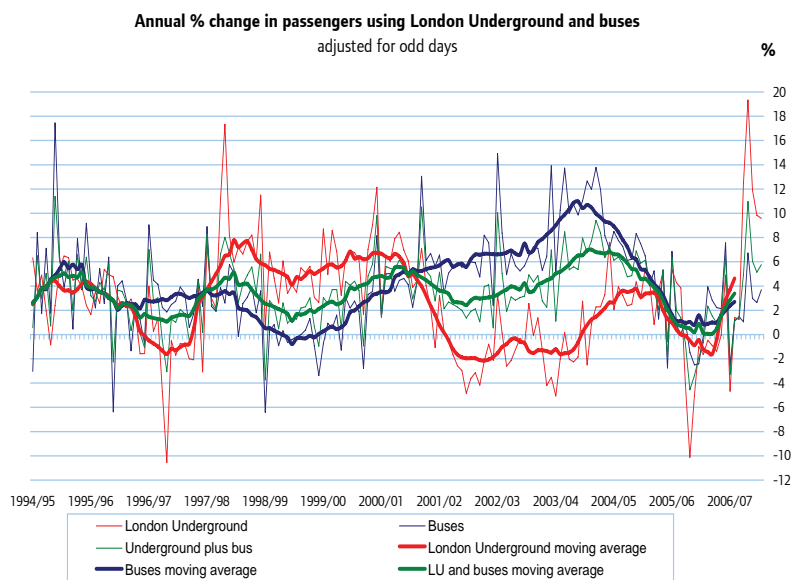
Source: Transport for London

Latest release: December 2006

Next release: January 2007

Annual growth rate of passenger journeys increasing

- The moving average annual rate of growth in passenger journeys increased to 3.4% from 2.9% in the previous period.
- The moving average annual rate of growth in bus journey numbers increased to 2.7% from 2.4% in the previous period.
- The moving average annual rate of growth in Underground passenger journey numbers increased to 4.6% from 3.7% in the previous period.



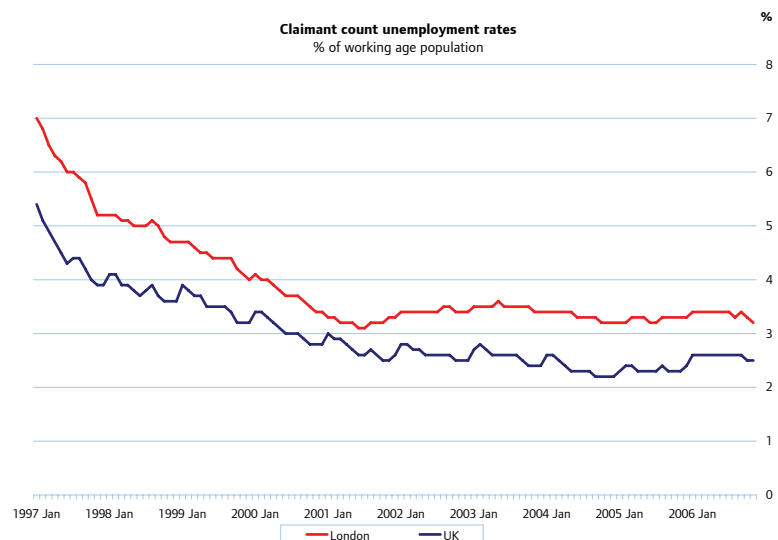
Source: Transport for London

Latest release: December 2006

Next release: January 2007

Claimant count unemployment

- The rate of claimant count unemployment (the percentage of resident working age population who are unemployed and claiming Jobseeker's Allowance) in London was 3.2% in November 2006.
- There were 163,500 unemployment claimants in London in November 2006 compared with 165,300 in November 2005.
- The claimant count unemployment rate in the UK remains below that of London's.



Source: Claimant Count, NOMIS

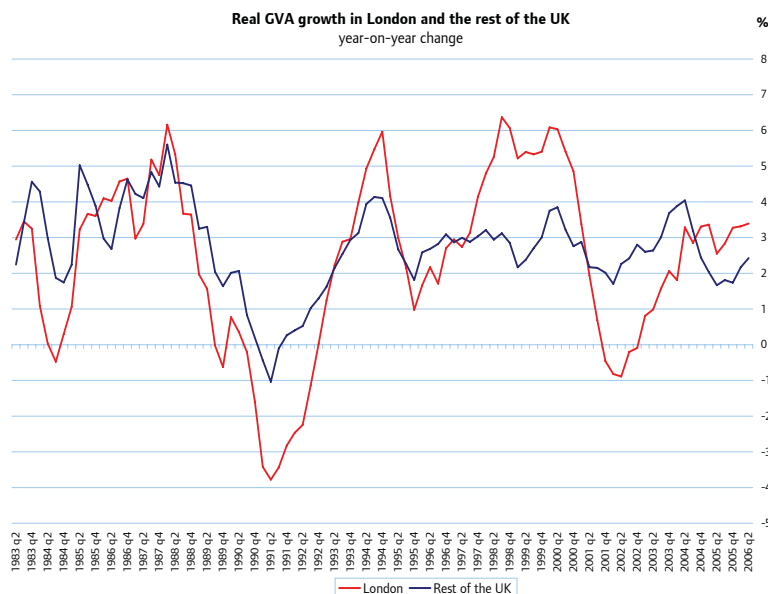
Latest release: December 2006

Next release: January 2007

London continues to grow more quickly than the rest of the UK

- London's annual growth in output increased to 3.4% in Q2 2006 from 3.3% in Q1 2006.
- The rest of the UK's annual growth in output increased to 2.4% in Q2 2006 from an upwardly revised 2.2% in Q1 2006. London has been growing at a faster annual rate than the rest of the UK since Q4 2004.
- There have been revisions to previous growth rates to reflect the availability of new data.

Latest release: November 2006
Next release: February 2007

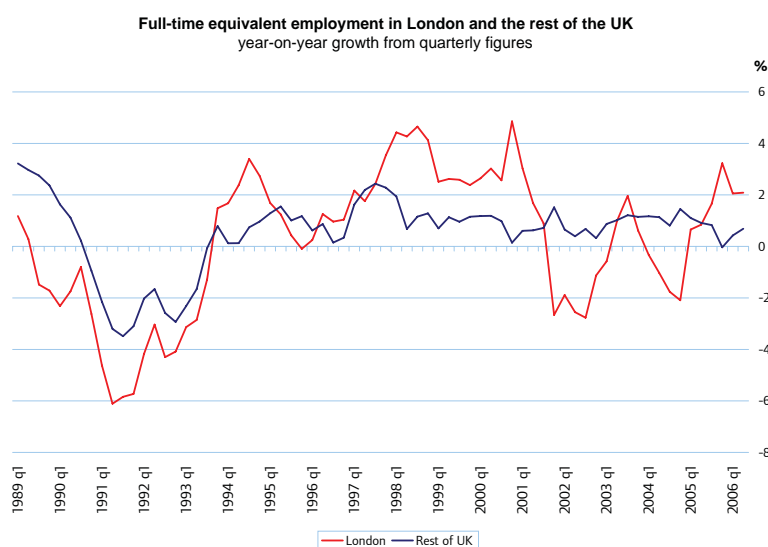


Source: Experian Business Strategies

London's annual employment growth stronger than the rest of the UK

- London's annual employment growth remained at 2.1% in Q2 2006.
- Annual employment growth in the rest of the UK increased to 0.7% in Q2 2006 from 0.4% in Q1 2006. London's annual employment growth continues to be above that of the rest of the UK.
- There have been revisions to previous growth rates to reflect the availability of new data.

Latest release: November 2006
Next release: February 2007

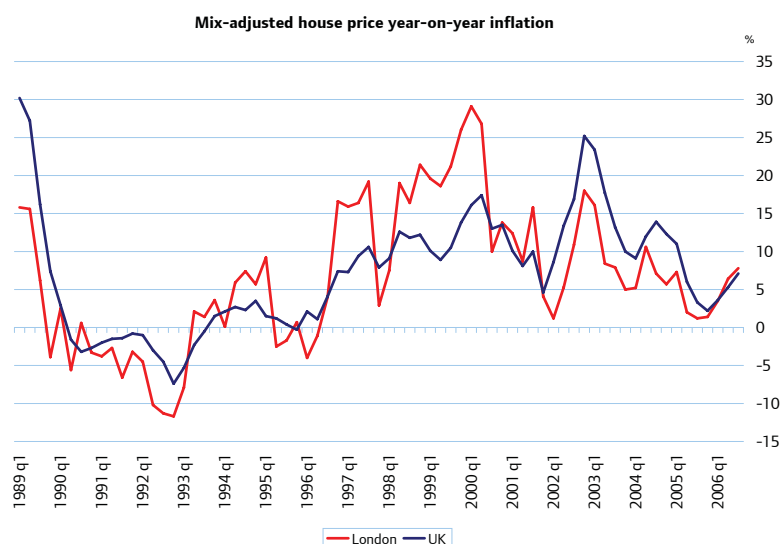


Source: Experian Business Strategies

Rising annual house price inflation

- The Department for Communities and Local Government (DCLG) house price index is an official measure of house prices. It is available up to Q3 2006.
- The DCLG reported an increase in annual house price inflation in London and the UK in Q3 2006.
- Annual house price inflation in London increased to 7.8% in Q3 2006 from a downwardly revised 6.4% in Q2. Annual house price inflation in the UK increased to 7.1% in Q3 2006 from 5.3% in Q2.

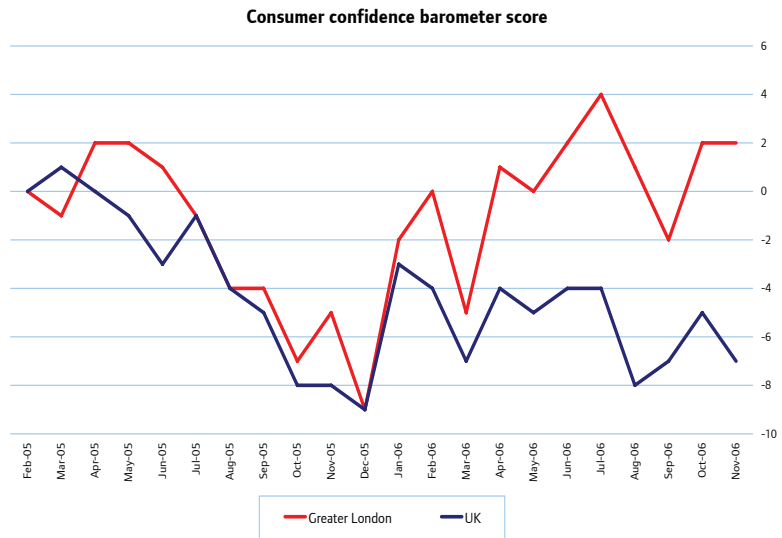
Latest release: November 2006
Next release: February 2007



Source: Department for Communities and Local Government

London's consumer confidence remains higher than the UK's

- GfK produces on behalf of the European Commission an index of consumer confidence. The index reflects peoples views on their financial position and the general economic situation over the past year and their expectations for the next 12 months (including whether now is a good time to make major purchases). A score above zero signifies a positive change in views.
- For Greater London the consumer confidence score remained at 2 in November 2006.
- For the UK the consumer confidence score decreased to -7 in November 2006 from -5 in October.



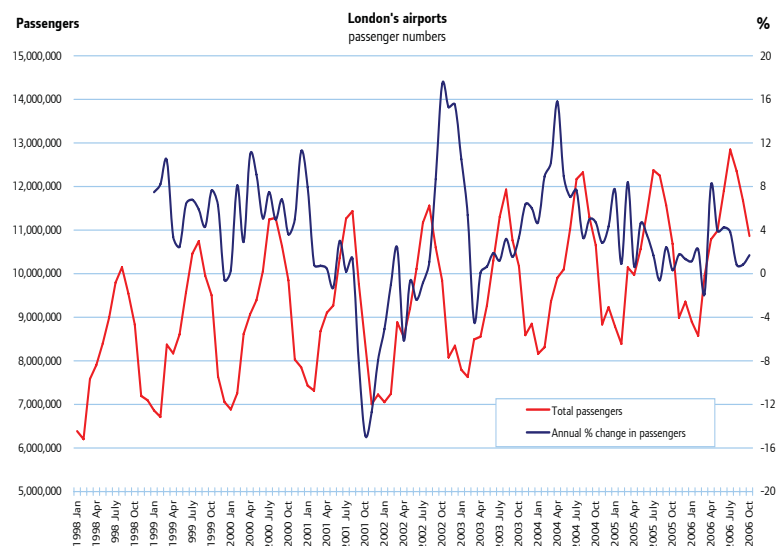
Source: GfK NOP on behalf of the European Commission

Latest release: November 2006

Next release: December 2006

Annual growth in airport passenger numbers

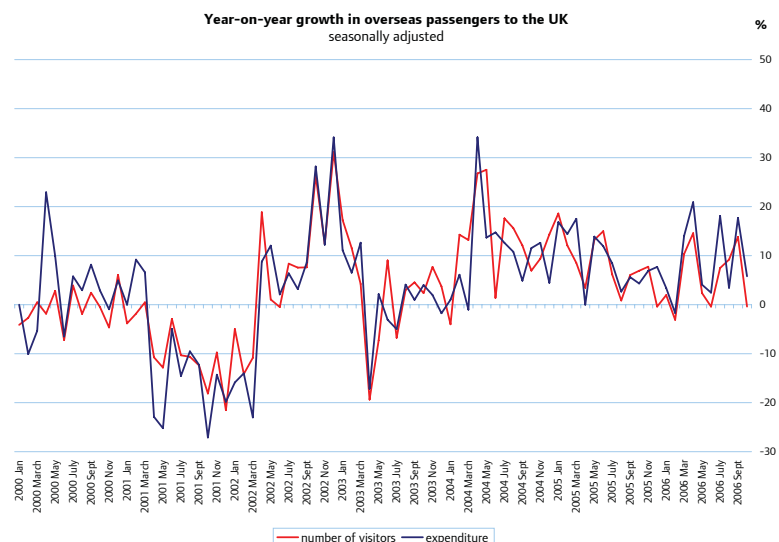
- 10.9 million passengers travelled through London's airports in October 2006.
- The number of passengers using London's airports increased by 1.7% from October 2005 to October 2006.
- The number of passengers at London's airports has seen positive annual growth in the last seven months.



Source: Civil Aviation Authority

Slower annual growth in overseas visitors expenditure

- Annual growth in overseas visitors expenditure in the UK continued in October 2006, whereas overseas visitor numbers to the UK showed no growth. Up to half of overseas visitors to the UK spend time in London.
- The annual growth rate of overseas visitors to the UK was -0.4% in October, down from 13.8% in September.
- The annual growth in expenditure by overseas visitors in the UK was 5.8% in October, down from 17.7% in September.



Source: Office for National Statistics

Latest release: December 2006

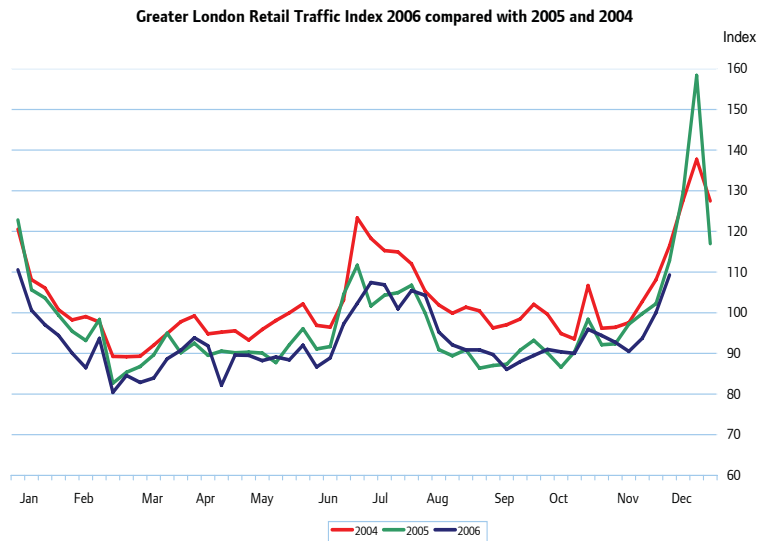
Next release: January 2007

SPSL Retail Traffic Index slightly below 2005 levels

- The SPSL Retail Traffic Index of shoppers in London was 109.3 in the first week of December compared to 100 in the previous week.
- The level of the index at the beginning of December 2006 was lower than for the same period in 2005 and 2004.
- SPSL's Retail Traffic Index measures the number of shoppers and does not necessarily reflect the level of spending.

Latest release: mid-December

Next release: every week



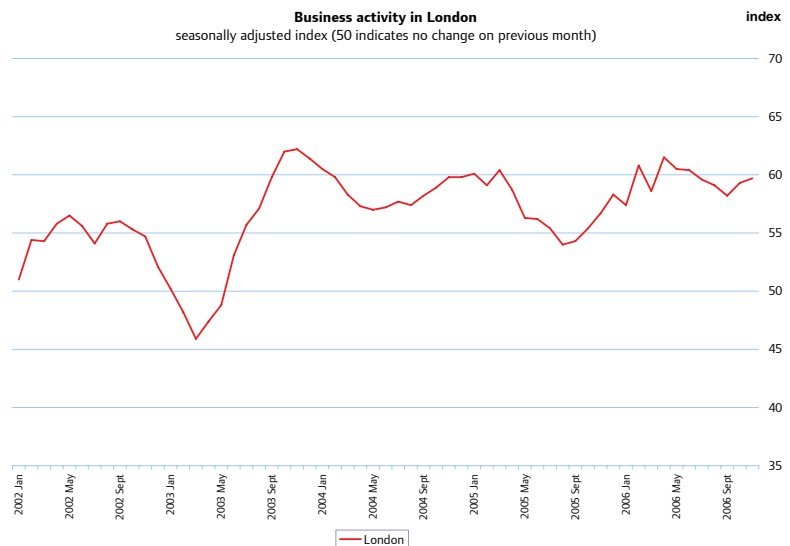
Source: SPSL

London's business activity improving

- London firms continued to expand their output of goods and services in November 2006.
- The Purchasing Managers' Index (PMI) of business activity recorded 59.7 in November compared to 59.3 in October.
- A rate of above 50 on the index indicates an increase in business activity from the previous month. The PMI for business activity has been above 50 since June 2003.

Latest release: December 2006

Next release: January 2007



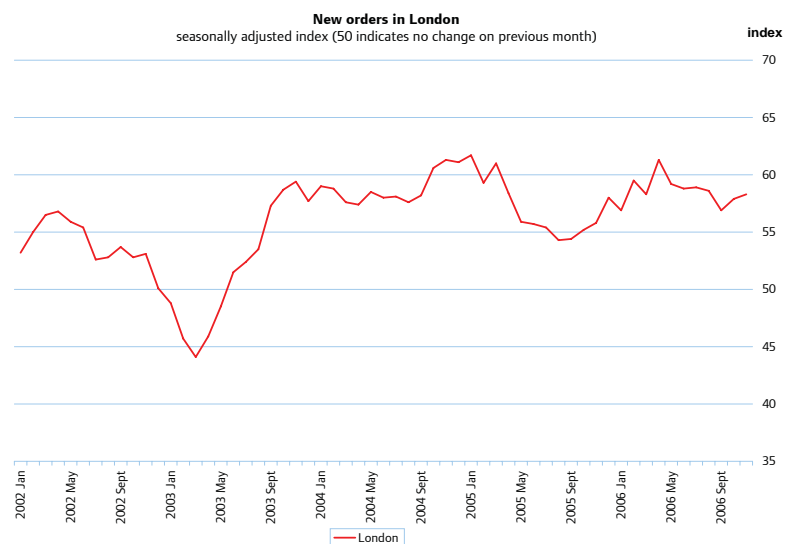
Source: PMI/The Royal Bank of Scotland

New orders in London increasing

- November 2006 saw continued growth in new orders for London firms.
- The PMI for new orders recorded 58.3 in November compared to 57.9 in October.
- A rate above 50 on the index indicates an increase in new orders from the previous month.

Latest release: December 2006

Next release: January 2007



Source: PMI/The Royal Bank of Scotland

London's opportunities in emerging markets

Stephen King
International Economist

This article provides a short summary of some recent research commissioned by the London Development Agency (LDA) and carried out by Oxford Economics (OE). The research looked at the potential benefits that strong growth in emerging markets might create for London in the form of increased trade, tourism, foreign direct investment (FDI) and students into the education sector. The study highlights the role the LDA and Greater London Authority (GLA), in collaboration with other agencies, can play in maximising the benefits of this growth.

Which emerging markets are the most important?

OE analysis confirms that China and India are the most important emerging markets for London. Both China and India have big populations and a commensurately large GDP which, over recent years, has been rising consistently at rates of 7-11 per cent per annum.

Figure 2 illustrates how world income is currently divided between the major developed and developing economies. Figure 3 shows that China, India and other emerging Asian economies are set to drive global growth between 2006 and 2015. The charts are based on purchasing power parity (PPP) exchange rates and constant year 2000 dollars.

Figure 2: Shares of global GDP in 2005

Source: World Bank and Oxford Economics forecast

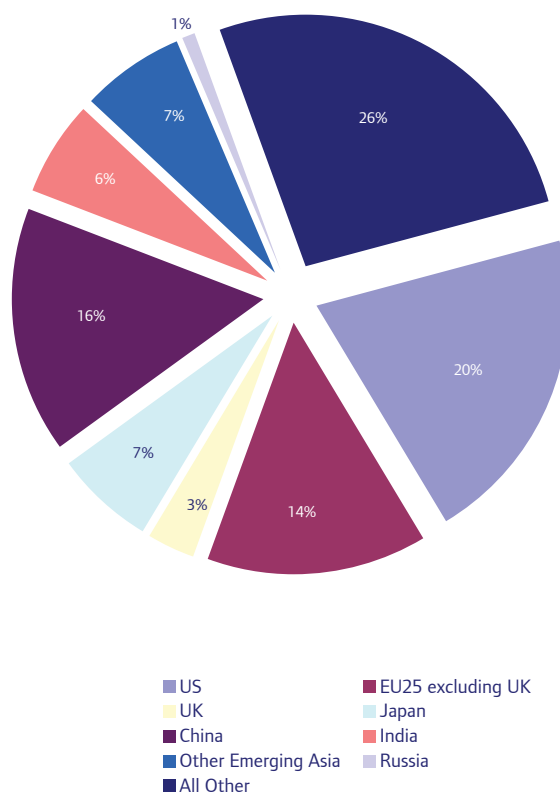
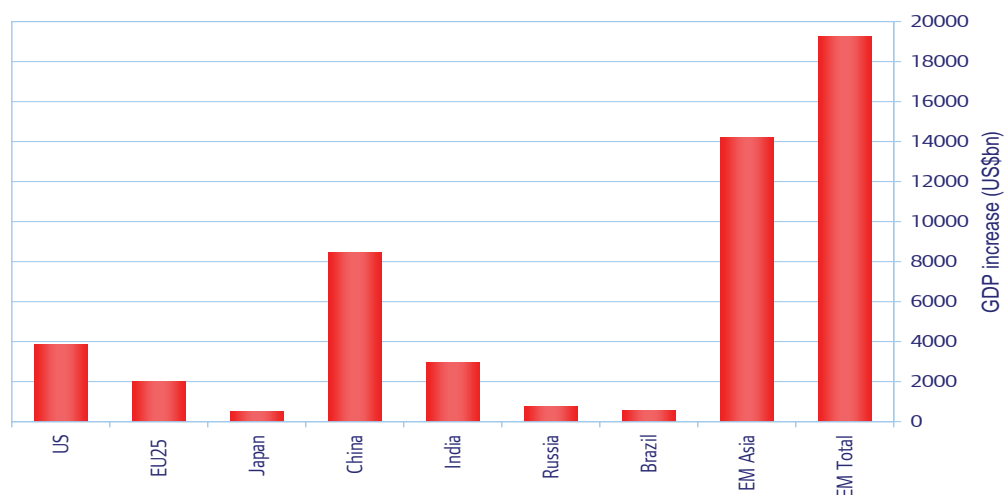


Figure 3: World GDP increase 2006-2015

Source: World Bank and Oxford Economics forecast



Opportunities for London

The London economy already benefits from strong links with emerging markets. The OE report estimates that through trade, tourism, FDI, and the supply of educational services, emerging markets contributed around £11-14 billion to London's Gross Value Added (GVA) in 2005.

As the emerging economies develop and incomes per head rise from their still relatively low levels, discretionary spending will also increase. OE forecast that this will result in more demand for more products and services, some of which London is likely to be particularly good at supplying.

For instance, UK exports of financial and business services have already grown rapidly reflecting increased demand from around the world. London's specialisation in financial and business services puts it in a strong position to benefit from increased demand from emerging economies, and China and India in particular.

In addition, international tourism from emerging markets is likely to pick up over the next decade, and there should also be abundant opportunity for London to benefit from further FDI from emerging markets as their economies grow.

The OE report estimates that the links between London and the emerging markets could have a direct impact on London's GVA of between £29 billion and £42 billion in ten years' time and support between 290,000 and 440,000 jobs in London.

OE's base case is consistent with their forecasts for the world, UK and London economies, and assumes that the existing links with emerging market economies continue to grow in line with recent trends. The higher end, alternative, forecasts explore the potential impact if London's business with emerging markets grows at a faster rate than has been the case in the past, and relative to London's global competitors. The alternative forecasts also assume that emerging markets demand increasingly more imports of services rather than goods (again at a faster rate than has occurred in the past). The GVA and employment totals in Table 1 are adjusted down slightly to reflect some crossovers between the four contributing components. For example, part of the contribution from tourism is included in official trade data, and there may in certain cases be interactions between trade and FDI.

Table 1: Forecasts of GVA and employment impact on London for 2015

Source: Oxford Economics forecast

	GVA (£ billion 2003)		Employment (000s)	
	Base case	Alternative	Base case	Alternative
Trade	16.1	27.4	164	285
Tourism	0.9	1.0	29	31
FDI	13.3	15.3	122	142
Education	0.7	1.0	11	16
Total	29	42	290	440

Helping London maximise its opportunities

When markets are not working efficiently they produce a sub optimal allocation of goods and services – termed market failure. The report finds that there are a number of market failures that inhibit London’s relationship with emerging markets. These include a lack of information about opportunities in emerging markets for London business, various externalities (where the full costs and/or benefits are not reflected in market prices), and co-ordination problems.

A number of organisations have been established to address some of these market failures. The research finds there is a key role for the LDA and GLA in co-ordinating and managing the activity of all organisations involved in promoting London’s engagement with emerging markets. This should ensure that activities are not duplicated and that there is a consistent message about London. As an overarching organisation and funding partner the report suggests that the LDA is ideally placed for such a role.

The LDA will now move to implement the findings of this research. Indeed a dedicated LDA emerging markets team has already been established, complementing the promotional work of an office in Beijing and representation in Shanghai. Offices in Delhi and Mumbai are planned to open in time for the Mayor of London’s trip to India in November 2007.

The full OE report will be published on the LDA website shortly.

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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
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.

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	GVA	Gross value added
BAA	British Airports Authority	ILO	International Labour Organisation
BCC	British Chamber of Commerce	IMF	International Monetary Fund
BITOA	British Incoming Tour Operators Association	LCCI	London Chamber of Commerce and Industry
CAA	Civil Aviation Authority	LET	London's Economy Today
CBI	Confederation of British Industry	MPC	Monetary Policy Committee
DCLG	Department for Communities and Local Government	ONS	Office for National Statistics
EBS	Experian Business Strategies	PMI	Purchasing Managers' Index
GDP	Gross domestic product	PWC	PricewaterhouseCoopers
		RICS	Royal Institute of Chartered Surveyors

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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.

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