London's Economy Today

Issue 63 | November 2007

In this issue

GLAECONOMICS

London's economy set to slow down in 2008

by Richard Davies, Economist

The Bank of England published its quarterly Inflation Report on 14 November. The report implies that the Bank is more worried in the short term about the expected slowdown in growth next year rather than any small increase in inflation. There is downside risk for growth and balanced risk for inflation. The US Fed has reduced US interest rates from 5.25 per cent to 4.5 per cent in recent months and a reduction in UK interest rates seems increasingly likely next year.

The Bank expects inflation to rise slightly over the coming year mainly due to increases in oil and food prices as a result of strong economic growth in emerging economies such as China and India. Consumer Price Index (CPI) inflation rose above the Government's 2 per cent target in October increasing from 1.8 per cent to 2.1 per cent.

The risks on the downside are probably particularly significant for London with its exposure to the US economy and a large financial sector.

Latest news...

- **Central Business District (CBD) seminar** GLA Economics will be hosting a high-level seminar on the morning of Wednesday 23 January 2008, to discuss London's Central Business District. Central Business Districts are increasingly important to the economic vitality of cities. London's CBD, covering the City, a large part of Westminster, parts of several other central boroughs and the Canary Wharf exclave to the east is home to many of the capital's core functions.

If you would like further information about this event please email glaeconomics@london.gov.uk

Retail sales growth expected to slow

On the positive side, recent data from the London Retail Consortium shows that retail sales in central London in October were 11 per cent higher than a year ago. Retail sales were up 9 per cent between August-October this year compared with the same period in 2006. Although retail footfall had slowed in central London it was stronger than in other parts of the UK. There were fewer US visitors than last year, possibly reflecting the weakness of the dollar against sterling.

Office for National Statistics (ONS) data confirms that there is a positive underlying growth in UK retail sales, with particular increased growth in food stores. Despite a seasonally adjusted fall in the volume of retail sales in October of 0.1 per cent, the total sales volume in the three months from August to October increased by 1.4 per cent compared with the previous three months. The total sales volume in the three months to October was 5.1 per cent higher than the same period a year ago. However, the average weekly value of sales in October was only 3.2 per cent higher than in October 2006. Many retailers are cautious about future prospects.

There is evidence that some retailers have been substantially discounting goods in order to increase sales volumes to shift stock. The ONS confirm that the implied deflator was negative in recent months. It was minus 1 per cent for both July and August, minus 1.5 per cent in September and minus 1.1 per cent in October. This means that to maintain sales volumes retailers have been discounting prices to a large degree. It could also reflect a stronger pound against the dollar.

House price inflation starting to moderate but may not cause a slump in consumption

The UK housing market, especially outside London, is starting to cool. Many commentators believe this will cause a slump in consumption. However, the strength of the relationship between real house prices and consumer spending varies over time and has been weakening in recent years. House price movements can cause changes in consumer spending via a number of 'causal channels'. In recent years, these may have been weakening for the following reasons:

- Housing is used as collateral for loans – when house prices rise the value of collateral is higher so lenders will lend more at lower interest rates, in turn causing spending to rise. However, households' dependence on house price gains to facilitate spending is likely to have been weakened with the rise of more flexible forms of unsecured credit, such as credit cards. Also, the amount of collateral at homeowners' disposal was already substantial at the start of this decade, so the boost to spending from further house price rises due to this reason is now likely to be limited; and,

- Housing wealth forms part of households' precautionary savings. As house prices rise, the need to hold other forms of wealth as precautionary savings is reduced, which may encourage spending. However, households' desire for precautionary savings may have declined in recent years as the economic environment has been relatively stable. In addition, given housing equity had reached high levels by the beginning of the decade, it is likely that many households have more than enough equity in their homes to satisfy the need for precautionary savings.

The correlation between house prices and consumer spending seems to occur because common factors such as expectations of future income affect both consumption and house prices, rather than because of strong causality between house prices and consumption. It is likely that in recent times house prices have been influenced by a set of variables that have a lesser impact upon consumption. Factors which have a greater influence on house prices than consumption, such as rates of household formation, investment demand and interest rates, are more likely to have driven house prices in recent years, explaining some of the divergence between house prices and consumer spending.

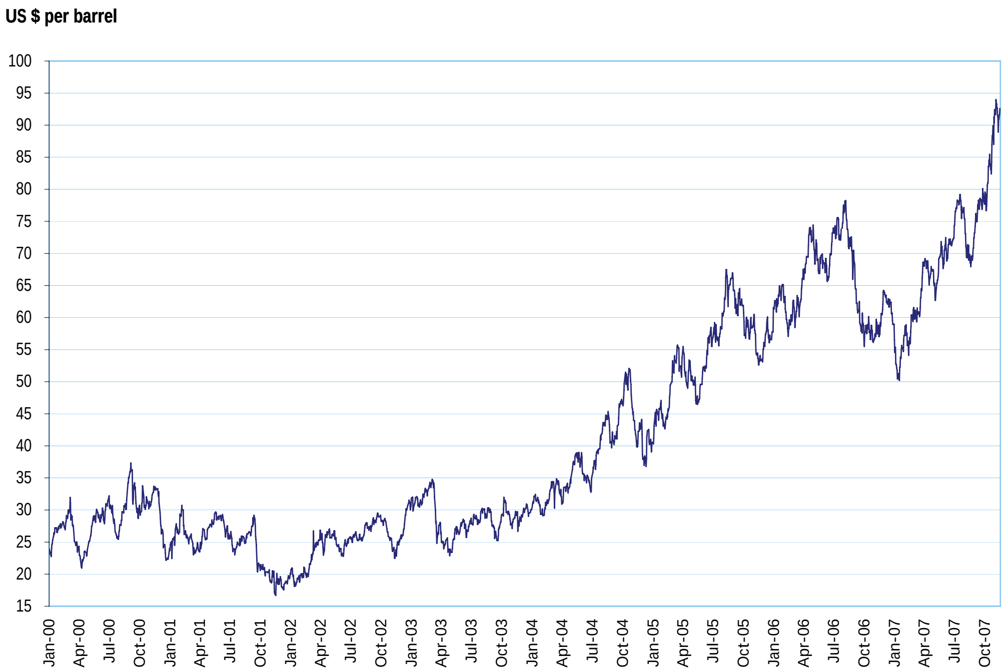
Oil prices moving closer towards $100 per barrel

Brent crude oil has been consistently trading above $90 per barrel over the past few weeks (see Figure 1). There are many reasons for these high oil prices: the weakness of the US dollar; the recent decision by OPEC not to increase oil production; strong growth in China and India has meant an insatiable demand for oil; and the continuing unrest in the Middle East.

Despite record nominal oil prices after adjusting for inflation, oil prices would have to rise to around $105 per barrel to reach record real levels set in 1980. Oil prices at these heights have an inflationary impact on the UK economy. However, the impact would be greater if the US$ was not so weak at the moment. Oil prices are quoted in US dollars and the weakening dollar against sterling means that increases in dollar oil prices are not so large when they are converted into pounds. Since the beginning of 2007 oil prices have risen by around 60 per cent in dollar terms but by a lower 50 per cent in sterling prices.

Figure 1: Brent crude oil price (US $ per barrel)

Source: FT



Credit crunch and volatility in financial markets continuing

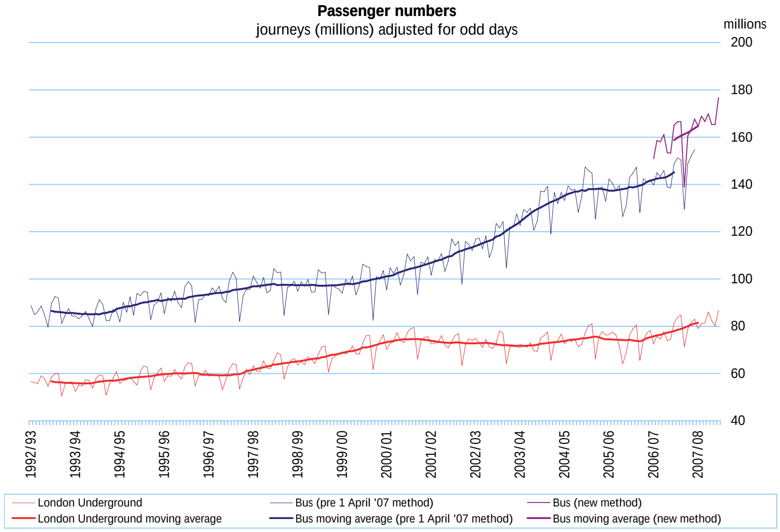
Financial markets remain fragile and volatile, especially in developed economies. Meanwhile stock markets have performed remarkably well since the summer in emerging markets such as China and India. Having eased slightly since September, the credit crunch in the UK seems to have got worse over the last couple of weeks, which is a major concern for economic prospects. The full impact on company investment intentions has yet to be seen and it could be large for small firms. Under these continuing circumstances growth in London is expected to slow in 2008 and the possibility that the slow down will be sharp remains.

Economic indicators

Increase in moving average of passenger numbers

- The most recent 28-day period is from 16 September to 13 October 2007. London's Underground and buses had 263.4 million passenger journeys; 176.7 million by bus and 86.7 million by Underground.
- The moving average increased to 246.2 million from 244.9 million passengers every period. The moving average for buses was 164.6 million. The moving average for the Underground was 81.5 million.
- The methodology used to calculate the number of bus passenger journeys was changed by TfL from 1 April 2007. For a detailed explanation please see LET edition 58 (June 2007).

Latest release: November 2007
Next release: December 2007

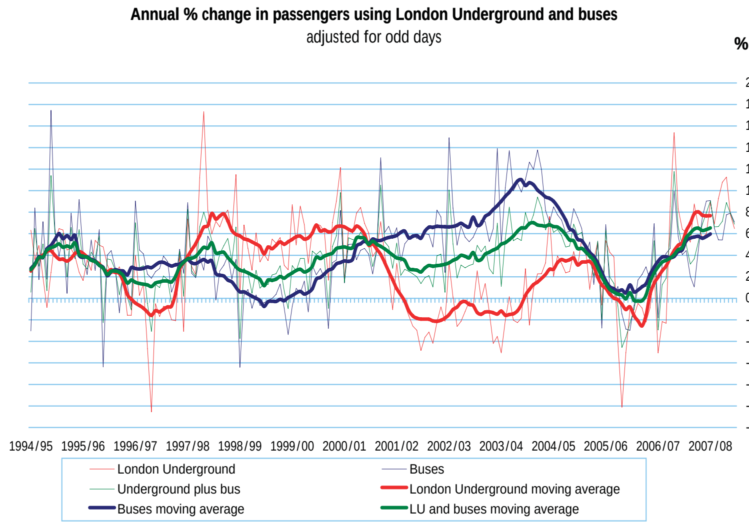


Source: Transport for London

Average annual growth rate of passengers increases

- The moving average annual rate of growth in passenger journeys increased to 6.5% from 6.4% in the previous period.
- The moving average annual rate of growth in bus passenger journey numbers increased to 6.0% from 5.8% in the previous period.
- The moving average annual rate of growth in Underground passenger journey numbers remained at 7.7%.

Latest release: November 2007
Next release: December 2007

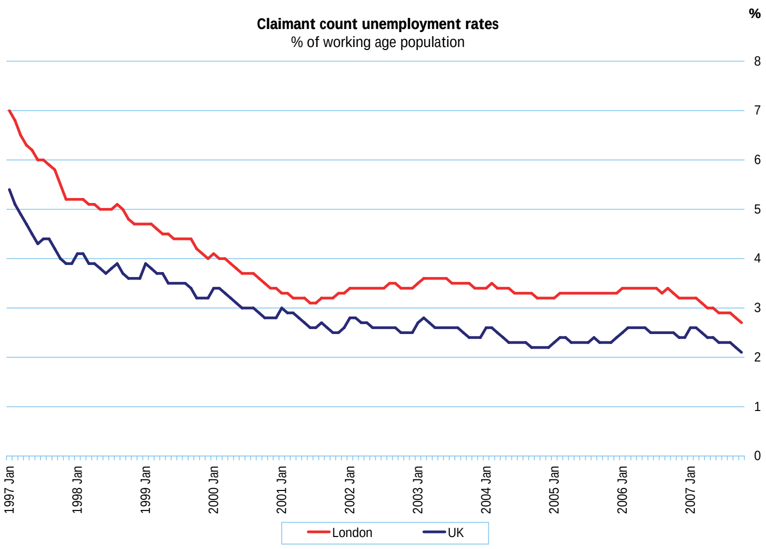


Source: Transport for London

Claimant count unemployment

- The rate of claimant count unemployment (the percentage of resident working age population who are unemployed and claiming Jobseekers' Allowance) in London was 2.7% in October 2007.
- There were 136,600 unemployment claimants in London in October 2007 compared with 166,600 in October 2006.
- The claimant count unemployment rate of the UK remains below that of London's.

Latest release: November 2007
Next release: December 2007

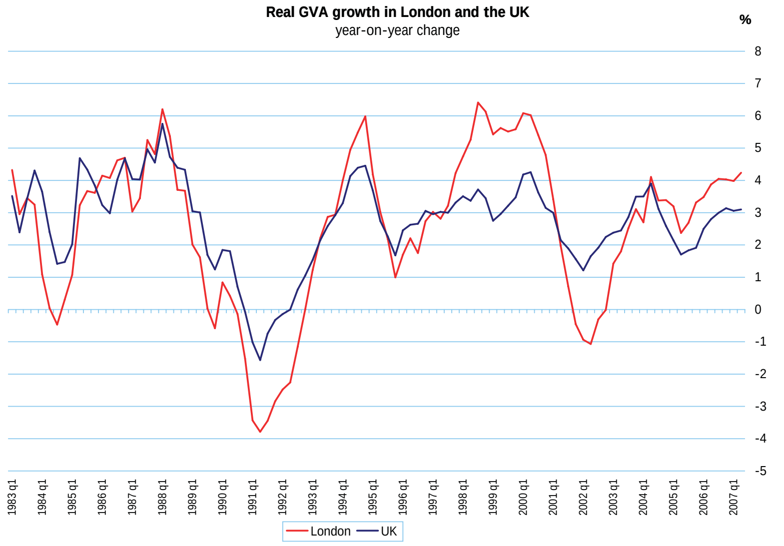


Source: Claimant Count, NOMIS

Annual output growth in London still faster than the UK's

- London's annual growth in output increased to 4.2% in Q2 2007 from 4.0% in Q1 2007.
- The UK's annual growth in output was 3.1% in Q2 2007, the same as the upwardly revised Q1 2007 growth rate. London has been growing at a faster annual rate than the UK since Q2 2004.
- There have been revisions to previous growth rates to reflect the availability of new data.

Latest release: November 2007
Next release: February 2008

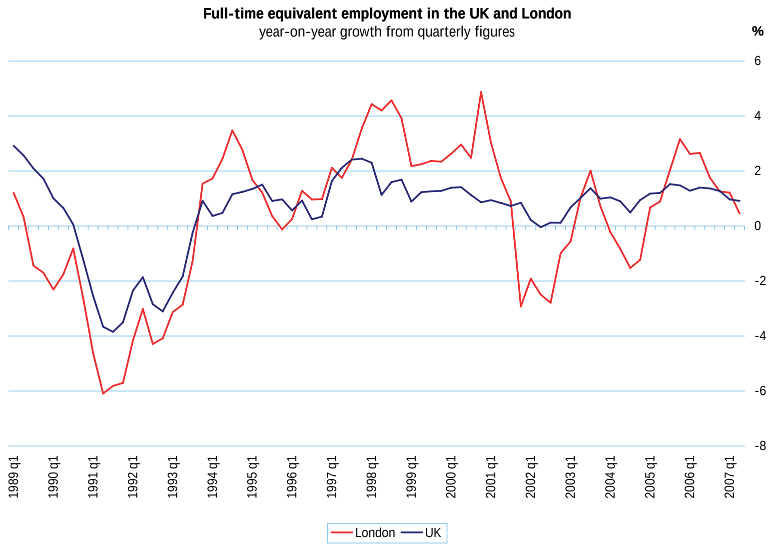


Source: Experian Business Strategies

Annual employment growth slowing

- London's annual employment growth decreased to 0.5% in Q2 2007 from an upwardly revised 1.2% in Q1 2007.
- Annual employment growth in the UK decreased to 0.9% in Q2 2007 from an upwardly revised 1.0% in Q1 2007.
- There have been revisions to previous growth rates to reflect the availability of new data.

Latest release: November 2007
Next release: February 2008

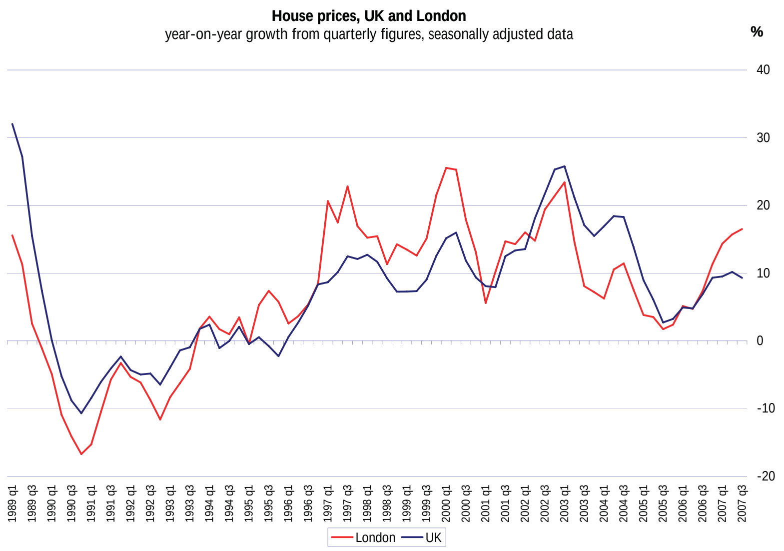


Source: Experian Business Strategies

Annual house price inflation higher in London than the UK

- Nationwide reported stronger annual house price inflation for London than the UK in Q3 2007.
- Annual house price inflation in London was 16.5% in Q3 2007, up from 15.7% in Q2 2007.
- Annual house price inflation in the UK was 9.3% in Q3 2007, down from 10.2% in the previous quarter.

Latest release: October 2007
Next release: January 2008

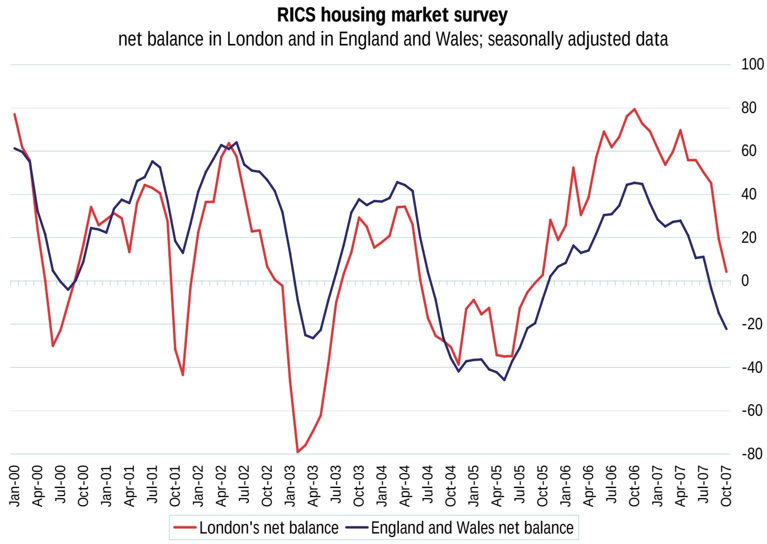


Source: Nationwide

Surveyors report that house prices are increasing in London but falling in England and Wales

- The RICS survey shows a positive net balance of 4 for London house prices over the past three months up to October 2007. This net balance is down from 19 in September.
- Surveyors reported a negative house price net balance for England and Wales of -22 in October, down from -15 in September.
- London's net balance remains above that of England and Wales.

Latest release: November 2007
Next release: December 2007

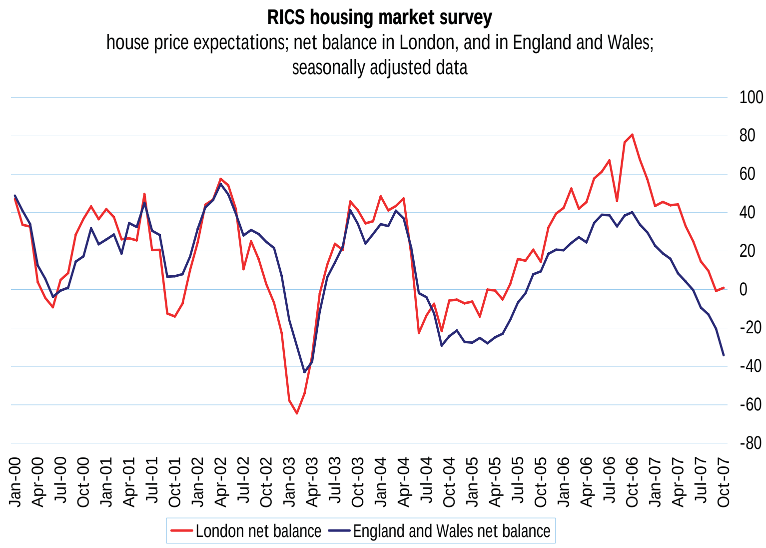


Source: Royal Institute of Chartered Surveyors

Surveyors expect London house prices to increase but to fall in England and Wales

- The RICS survey shows that surveyors expect house prices to increase over the next three months in London but to decrease in England and Wales.
- The net house price expectations balance in London was 1 in October, up from -1 in September.
- For England and Wales, the net house price expectations balance was –34 in October, down from –20 in September.

Latest release: November 2007
Next release: December 2007

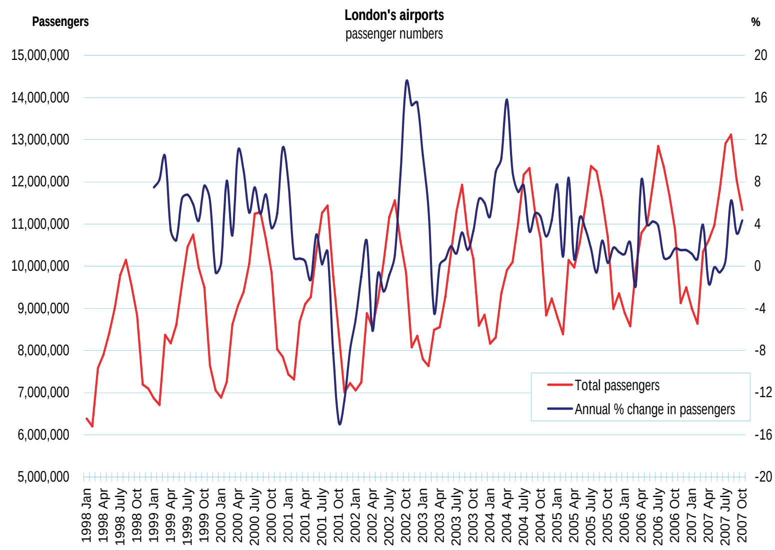


Source: Royal Institute of Chartered Surveyors

Increase in year-on-year airport passenger numbers

- 11.3 million passengers travelled through London's airports in October 2007.
- The number of passengers using London's airports increased by 4.3 per cent from October 2006 to October 2007.
- The number of passengers using London's airports has risen year-on-year for the past four months.

Latest release: November 2007
Next release: December 2007

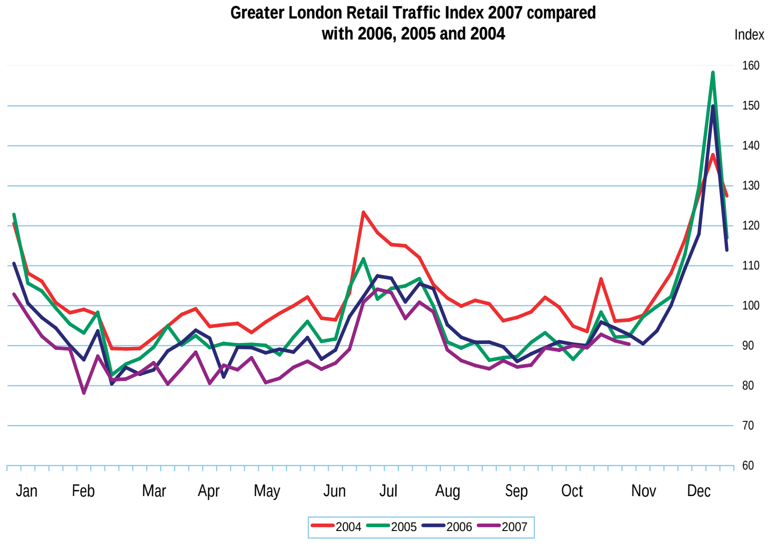


Source: Civil Aviation Authority

SPSL Retail Traffic still below 2006 levels

- The SPSL Retail Traffic Index of shoppers in London was 90.4 in the first week of November compared to 91.2 in the previous week.
- The index has generally been lower than 2006 levels throughout 2007 so far.
- SPSL's Retail Traffic Index measures the number of shoppers and does not necessarily reflect the level of spending.

Latest release: Mid-November
Next release: Weekly

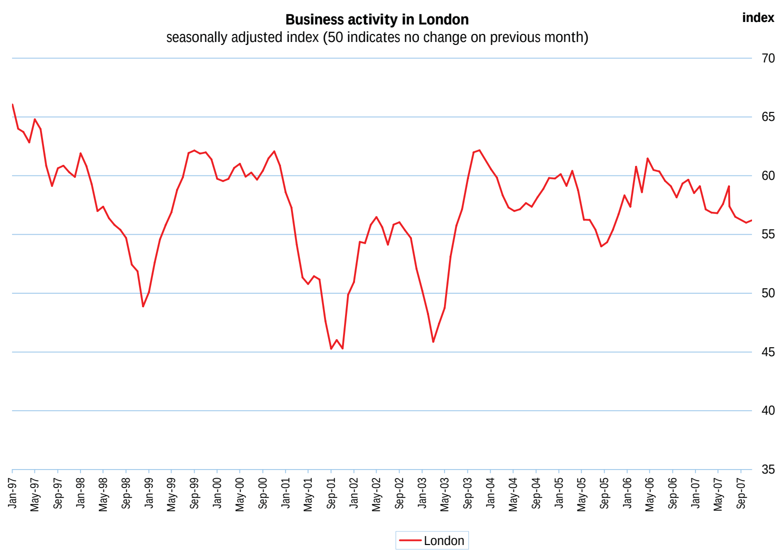


Source: SPSL

London's business activity still expanding

- London firms continued to expand their output of goods and services in October 2007.
- The Purchasing Managers' Index (PMI) of business activity recorded 56.2 in October 2007 compared to 56.0 in September.
- 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: November 2007
Next release: December 2007

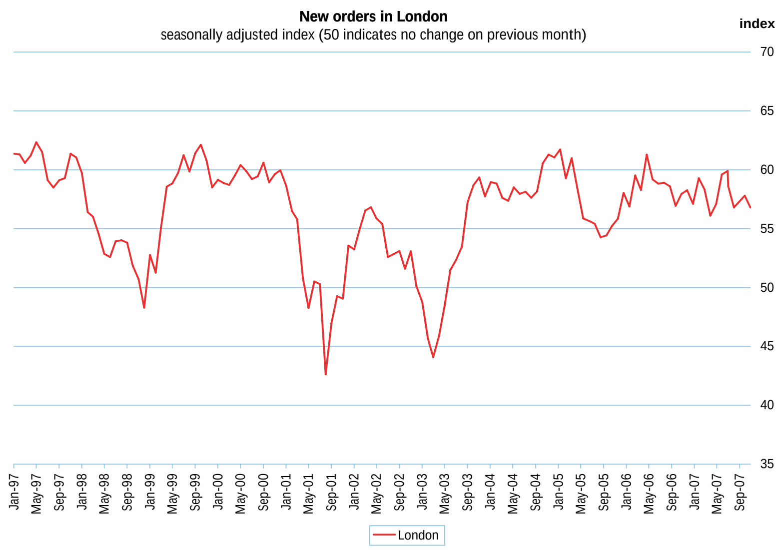


Source: The Royal Bank of Scotland/NTC Economics

New orders in London increasing at a slightly slower pace

- October 2007 saw continued growth in new orders for London firms.
- The PMI for new orders recorded 56.8 in October compared to 57.8 in September.
- A rate of above 50 on the index indicates an increase in new orders from the previous month.

Latest release: November 2007
Next release: December 2007



Source: The Royal Bank of Scotland/NTC Economics

Working hard or hardly working? How cities could work better. GLA Economics' international conference reviewed

by David Chappell,
Marketing Consultant,
GLA Economics

GLA Economics' third international conference, *Working Hard or Hardly Working? – How cities could work better*, took place on Thursday 22 November and saw experts from Europe gather to debate issues as diverse as optimum city size, the role of agglomeration, and challenges such as transport and housing supply that currently face cities like London.

More than 150 delegates from local and central government, the private sector and academia heard from four keynote speakers in the morning before continuing the debate in the afternoon in six different workshops – inequality, accessibility and transport, environment, skills, openness and housing. The conference concluded with a presentation from the London Development Agency's Chief Executive, Manny Lewis.

Baroness Jo Valentine, Chief Executive, London First, chaired the conference and opened by warning against a rise of global protectionism and anti-capitalism. Jo stressed that regulation should be proportionate and taxes in London should be competitive, especially with Europe. Developing London's skill base and infrastructure were mentioned and Jo noted that while the mobility of talent has helped London attract highly skilled workers, these workers could equally decide to leave again.

Following Jo, Tony Venables, the Department for International Development's Chief Economist, spoke about cities in the developing world, noting that 2007 is the first year in which more than half of the word's population will live in cities. More wealth and higher incomes were two of the benefits of cities with poverty rates in developing countries lower in urban than rural areas. Tony agreed that cities can be both productive and parasitic but the evidence increasingly suggests they are chiefly productive.

Picture 1: Tony Venables

Source: GLA Economics

Tony said that doubling the size of a city raises productivity by three to eight per cent but sometimes cities can become 'too big' and setting up new centres of urbanisation can be difficult. Tony stressed the importance of early investment in infrastructure, good governance and noted urban areas were hard to define which made comparisons difficult.

Paul Cheshire from the London School of Economics spoke about *European cities – The bigger and brighter the better*. Paul stated that cities were fundamental to civilisation and intrinsic to economic and cultural development. He said that Europe as a whole was less urbanised than countries such as Australia, Argentina or even the US. In an analysis of the costs and benefits of living and working in cities, he noted that while cities impose costs (eg pollution, congestion) they also produce benefits (eg welfare benefits, higher wages). Paul argued that there was no such thing as an optimal city size and that if anything, London was too small and should be bigger to take into account the functional urban region.

The morning's final keynote speaker was GLA Economics' Consultant Chief Economist, Bridget Rosewell, who spoke about *What drives cities – density, agglomeration and innovation*. Bridget noted that cities exist because they add value. The reason they add value is because of agglomeration – the benefits that firms and people obtain when locating near each other. Investment in London's infrastructure is vital for maximising the benefits of agglomeration. A better understanding of the linkages that create agglomeration is also needed.

Bridget also noted that one reason for London's success has been its ability to innovate (eg the decline of manufacturing was counter balanced by the increase in other sectors such as financial services). As it's not known when the next shock will occur in financial services, London's resilience depends on its ability to innovate. Bridget explored the differences between dense, shocked, and sparse networks.

Picture 2: (l-r) Paul Cheshire, Bridget Rosewell and Jo Valentine

Source: GLA Economics

Following the keynote speakers, delegates attended a selection of six workshops.

Inequality

Chair: Matthew Toombs, HM Treasury
Presenter: Duncan Melville, GLA Economics

There has been a substantial increase in income inequality in the UK since the mid 1970s. Moving into work significantly increases households' chances of escaping poverty, although significant in-work poverty exists amongst couples where only one works and amongst single adult households which only work part-time. Poverty rates are particularly high for people of Pakistani/Bangladeshi ethnic origins. London has both higher poverty rates and larger degrees of wage inequality than the rest of the UK. More positively, the gap between low paid workers and those in the middle of the wage distribution in London has declined slightly in recent years.

Accessibility and transport

Chair: Paul Buchanan, Colin Buchanan and Partners (CBP)
Presenter: Ryan Emmett, CBP consultant working for GLA Economics

The link between accessibility and employment and population density was explored. Ryan pointed out how improving accessibility aids higher employment densities and agglomeration. Also highlighted was the general increase in the amount of traveling as people commute further to work and take more leisure trips. Compared to other world cities, London has a relatively low population density but public transport was at capacity. A debate about whether flexible working could reduce congestion followed.

Environment

Chair: Gerry Acher, London Climate Change Partnership
Presenter: Simon Kyte, GLA Economics

London's desire for more stringent targets and its unique position as a leader in reducing carbon emissions were both discussed. The need for realistic carbon output estimates and for developed countries to 'lead the way' were noted. The issue of data comparisons was discussed with consensus being that better data was needed in order to compare 'like with like'. Gerry said that the business community was aware of the challenges from climate change and would welcome further research and evidence to underpin their action for risk mitigation.

Skills

Chair: Mario Arbela, London Skills and Employment Board
Presenter: Richard Prothero, GLA Economics

London's success at attracting a highly-skilled workforce was noted, but so to was London's continued high levels of worklessness. The importance of young Londoners attaining good qualifications was discussed in light of the rising demand for high-skilled employees by London employers. Mario spoke about the recently launched Mayor's skills strategy and the five key challenges identified in the report. Audience debate centred on whether attention should focus on people with no qualifications or whether other objectives were just as important.

Housing

Chair: Tim Craine, London Development Research
Presenter: Sandeep Sankoli, GLA Economics
Panel members: Steve Hilditch and Richard Donnell

Housing remains one of the most important challenges in London with the house price to earnings ratio recently reaching an all-time high. There was debate over whether the focus should be on increasing new supply or improving existing stock with both options being linked back to environmental arguments or concerns. Richard stressed that managing land values was key to assisting London's housing problems.

Openness

Chair: Ian Gordon, London School of Economics
Presenter: Stephen King, GLA Economics

London's openness to capital, labour, trade and tourism were seen as key reasons for its success. London is the most globalised city in the world in terms of its population mix and extent of international linkages, and this provides a benefit for the rest of the UK. Ian Gordon noted that recent migrants to London tended to be young and well educated.

Manny Lewis

The conference concluded with a presentation from the London Development Agency's Chief Executive, Manny Lewis. Manny stressed that transport and housing were two of the key issues facing London with the environment increasing in significance. With an extra one million jobs predicted in the capital by 2026, East London was seen as the place where population would grow the quickest. The 2012 Olympics were seen as a catalyst for change in East London.

GLA Economics wishes to thank all speakers, chairs and delegates who helped make the conference such a success.

To view the conference's material, please visit:
http://www.london.gov.uk/mayor/economic_unit

If you attended the conference and have any feedback, please email
glaeconomics@london.gov.uk

Picture 3: Bridget Rosewell and Manny Lewis

Source: GLA Economics

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
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
BAA	British Airports Authority
BCC	British Chamber of Commerce
BITOA	British Incoming Tour Operators Association
CAA	Civil Aviation Authority
CBI	Confederation of British Industry
DCLG	Department for Communities and Local Government
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
ONS	Office for National Statistics
PMI	Purchasing Managers' Index
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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LONDON DEVELOPMENT AGENCY

MAYOR OF LONDON