London's Economy Today

Issue 64 | December 2007

In this issue

GLAECONOMICS

UK base rate cut to 5.5 per cent

by Richard Davies, Economist

The Bank of England cut the base rate for the first time in over two years when it met on 6 December, reducing the rate by 25 basis points to 5.5 per cent (see Figure 1). The Bank had already indicated in its November Inflation Report that it was more concerned about the expected slow down in growth in the economy in 2008 than a small upside risk to inflation. Therefore, a cut in interest rates was on the cards, however until only a few days earlier the Bank had been expected to wait.

The credit crunch continues

The on-going credit crunch in financial markets since the Summer has led to an increase in borrowing costs for both businesses and consumers. Banks have become more reluctant to lend money to each other because of an increased perceived risk that banks will default on these loans. This increased risk has been priced into interbank lending rates. The LIBOR 3 month inter-bank lending rate has been a lot higher than the base rate for several months, peaking at nearly 6.9 per cent in September. Despite the cut in the base rate on 6 December, the 3 month LIBOR is still stubbornly high at around 6.5 per cent. This will adversely impact on the ability of firms and consumers to borrow in order to invest or spend. On the other hand,

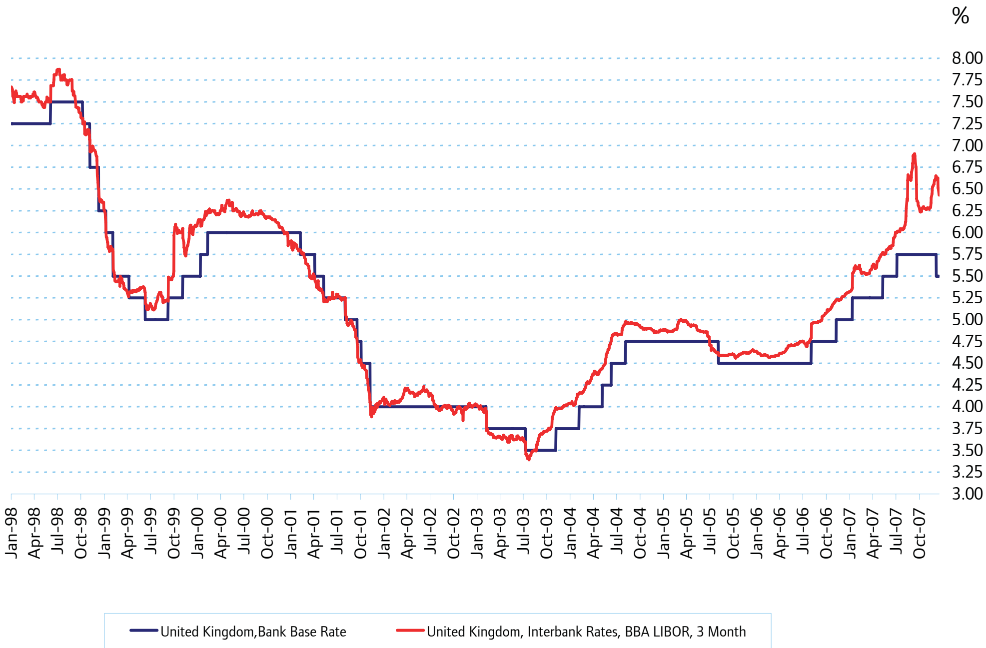
Latest news...

- **'London's Central Business District: Its global importance' seminar**
GLA Economics will be hosting a seminar on the morning of Wednesday 23 January on the subject of London's CBD. Bridget Rosewell (GLA Economics), Tony Travers (LSE), Rory Joyce (Drivers Jonas), and John Ross (GLA) will be exploring the unique characteristics of the CBD, its key economic drivers and the critical factors for continuing its success. If you would like further information about this event please email glaeconomics@london.gov.uk or telephone 020 7983 4922.

those relying on savings for income have benefited from higher rates on savings accounts, with some banks offering around 6.5 per cent per annum. Banks have offered favourable savings rates in order to attract more cash deposits to help raise funds.

Figure 1: Bank of England's repo rate and the LIBOR 3 month inter-bank rate

Source: Ecowin



In order to ease the credit crunch situation and lower inter-bank rates, the US Federal Reserve, European Central Bank, Bank of England, the Swiss National Bank and Bank of Canada announced on 12 December that they would make available $110 billion to world money markets. This move, co-ordinated by the US Federal Reserve, means that central banks will help each other out in providing substantial liquidity in an attempt to revive the inter-bank market. This illustrates how serious the issue of illiquidity in money markets has become. A Bank of England spokesman said that, "this co-ordinated set of actions is a response to pressures in inter-bank markets, which have increased in recent weeks, reflecting sentiment about the global financial sector." Commercial banks will still have to provide collateral and meet certain conditions in order to get help from the central banks, but a far wider range of collateral will be accepted.

UK housing market slowing down

The prospect of future further interest rate cuts may help to stabilise a slowing housing market. Some areas of the UK have experienced modest house price falls in recent months and transaction levels are well down. However, this has been after a sustained period of strong growth in house prices over the past ten years. The London housing market is currently still performing a great deal stronger than the rest of the UK. The FT House Price Index reported that London house price inflation for October was over 17 per cent year on year. This is nearly twice as much as the next highest region in the UK. However, most analysts are expecting London house price growth to be flat during 2008 because of the expected slow down in the economy. Any job losses in the City and reductions in City bonuses are likely to lead to less activity in the London housing market.

Business and consumer confidence expected to weaken

Overall, the turmoil in financial markets and the slow down in the property market have contributed to a decrease in both business and consumer confidence in recent months. The Institute of Chartered Accountants UK Business Confidence Monitor for Q4 fell for a second consecutive quarter to a two-year low. However, business confidence in London actually rose marginally in Q4. This was particularly due to IT and business services. Consumers, particularly in London, are so far showing few signs of reducing their spending. Central London retail sales have been stronger than other parts of the UK. Many retailers remain cautious about future prospects and it will be important to see how sales go over the festive period.

Inflationary pressures are still a concern

The Bank of England is still mindful about the inflationary pressures that exist in the economy. High oil, fuel and food prices were responsible for annual CPI inflation rising from 1.8 per cent to 2.1 per cent in October. CPI inflation remained unchanged in November but RPI inflation rose from 4.2 per cent to 4.3 per cent. Oil prices have receded back slightly from just below the $100 dollar threshold in recent weeks, but Brent crude is still around $90 per barrel. ONS data for November shows that output price annual inflation for all manufactured products rose to 4.5 per cent. This is the highest rate of annual increase since August 1991. At the same time, input price annual inflation has risen to 10.3 per cent in November from 8.5 per cent. Inflation hit 3.1 per cent in the Eurozone in November, the highest rate for more than six years, which will make it difficult for the European Central Bank to reduce its base rate in the short term.

London's economy to slow in 2008

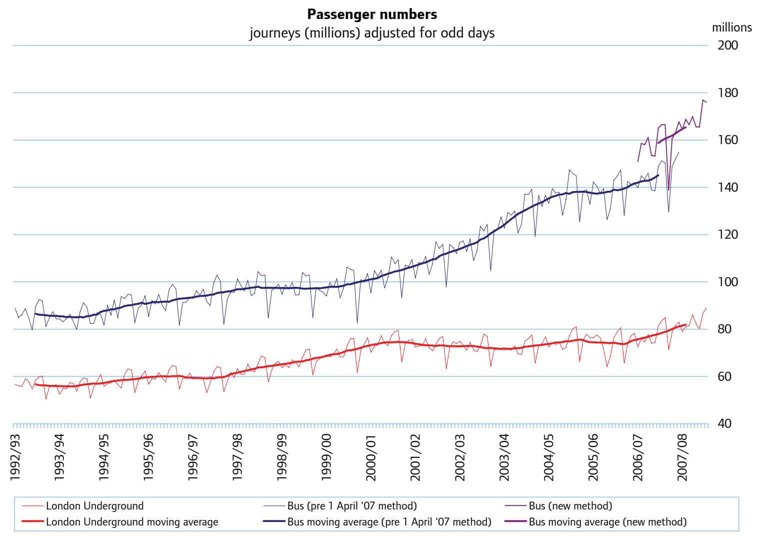
With US and UK growth due to slow down in 2008 the London economy faces a trickier period than the buoyant conditions seen over the last couple of years. The Capital's economy will be impacted by the continuing credit crunch and its adverse effect on the financial services sector. The weak US dollar is also likely to impact negatively on US tourist visitors to London and their spending. Commercial property markets are also showing steep falls in capital values. However, emerging market economies, such as China and India, and their financial markets still show considerable strength, which should help to support overall world growth. We remain concerned that these countries too will be affected by slowing in their export markets and there must be a risk that worse things are to come.

Economic indicators

Increase in moving average of passenger numbers

- The most recent 28-day period is from 14 October to 10 November 2007. London's Underground and buses had 265.0 million passenger journeys; 176.0 million by bus and 89.0 million by Underground.
- The moving average increased to 247.3 million from 246.2 million passengers every period. The moving average for buses was 165.4 million. The moving average for the Underground was 81.9 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: December 2007
Next release: January 2008

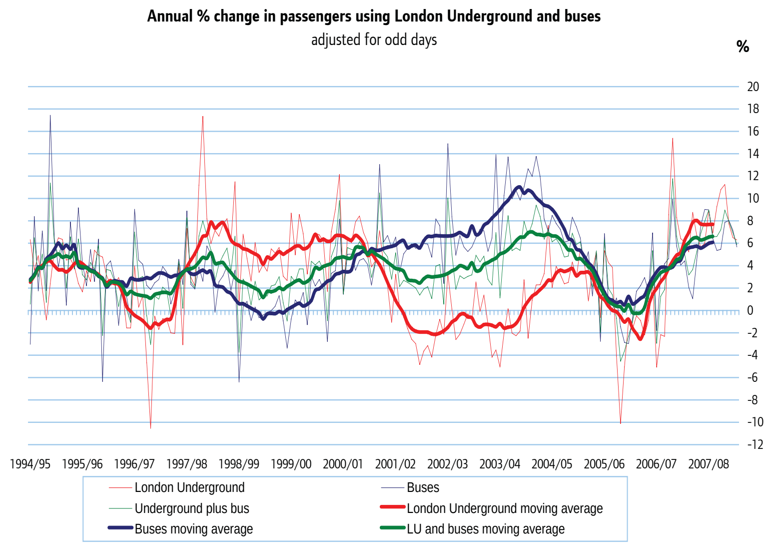


Source: Transport for London

Annual growth rate of passengers increases

- The moving average annual rate of growth in passenger journeys increased to 6.6% from 6.5% in the previous period.
- The moving average annual rate of growth in bus passenger journey numbers increased to 6.1% from 6.0% in the previous period.
- The moving average annual rate of growth in Underground passenger journey numbers remained at 7.7%, the same as in the previous period.

Latest release: December 2007
Next release: January 2008

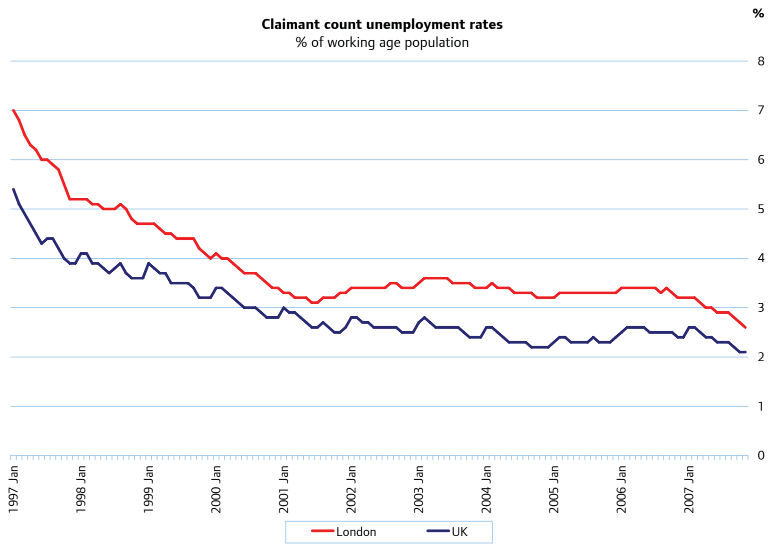


Source: Transport for London

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 2.6% in November 2007.
- There were 132,700 unemployment claimants in London in November 2007 compared with 163,500 in November 2006.
- The claimant count unemployment rate of the UK remains below that of London.

Latest release: December 2007
Next release: January 2008

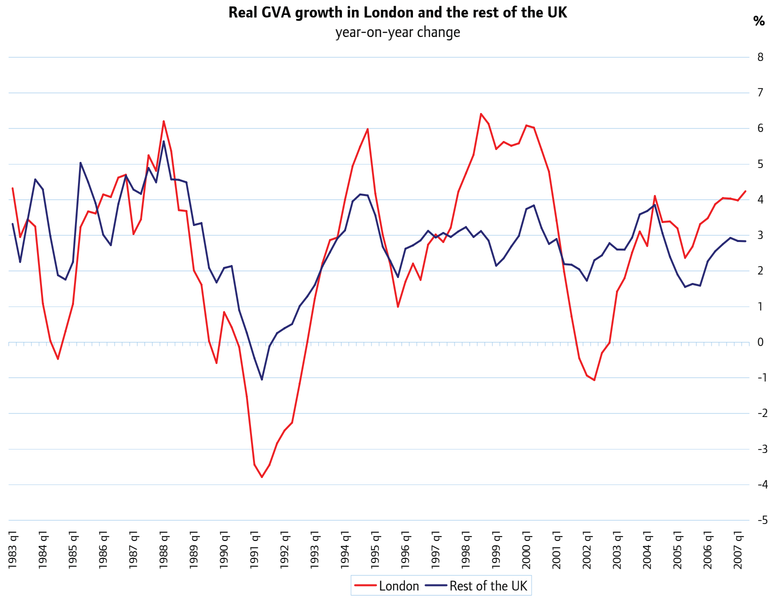


Source: Claimant Count, NOMIS

Annual growth in London quicker than the rest of the UK

- London's annual growth in output increased to 4.2% in Q2 2007 from 4.0% in Q1 2007.
- The rest of the UK's annual growth in output was 2.8% in Q2 2007, the same as the upwardly revised Q1 2007 growth rate. London has been growing at a faster annual rate than the rest of 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

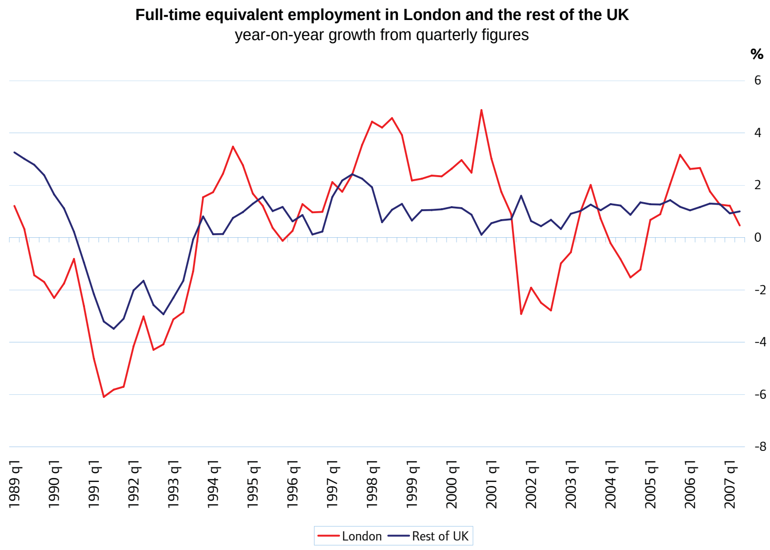


Source: Experian Business Strategies

Lower annual employment growth in London than the rest of the UK

- 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 rest of the UK increased to 1.0% in Q2 2007 from 0.9% 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

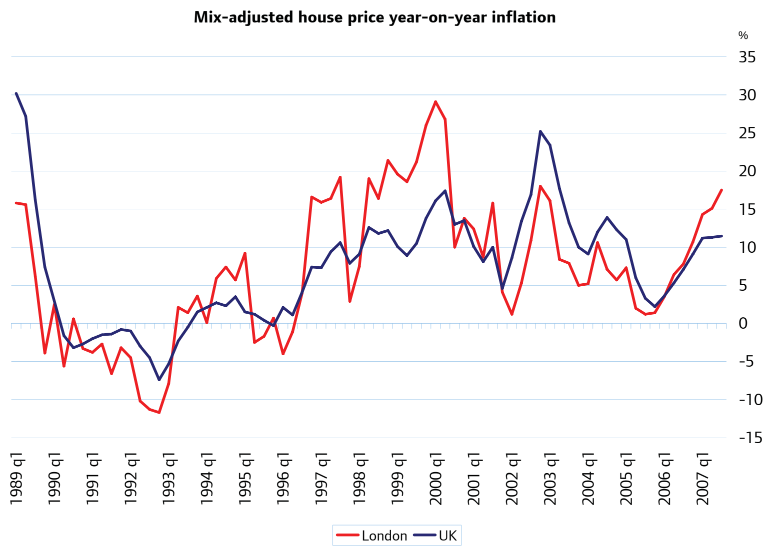


Source: Experian Business Strategies

Annual house price inflation higher in London than the UK

- The Department for Communities and Local Government (DCLG) house price index is an official measure of house prices. It is available up to Q3 2007.
- The DCLG reported an increase in annual house price inflation in London and the UK in Q3 2007.
- Annual house price inflation in London increased to 17.5% in Q3 2007 from 15.1% in Q2. Annual house price inflation in the UK increased slightly to 11.5% in Q3 from 11.3% in Q2.

Latest release: November 2007
Next release: February 2008

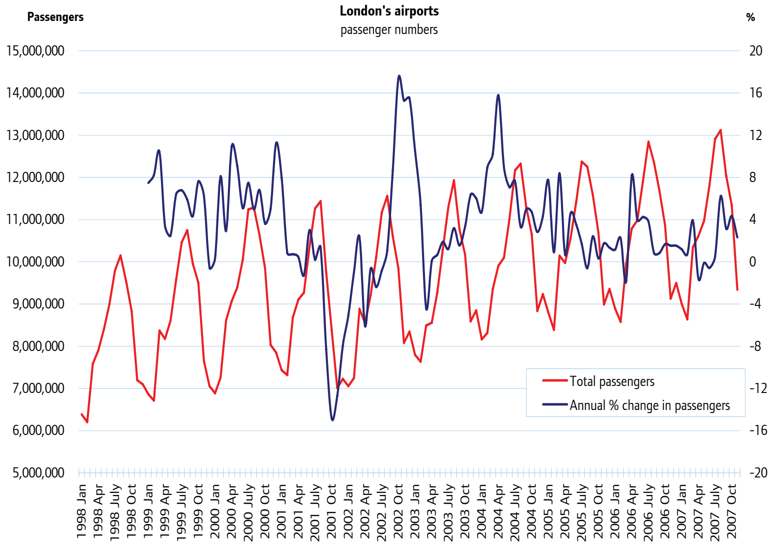


Source: Department for Communities and Local Government

Small increase in year-on-year airport passenger numbers

- 9.3 million passengers travelled through London's airports in November 2007.
- The number of passengers using London's airports increased by 2.3 per cent from November 2006 to November 2007.
- The number of passengers using London's airports has risen year-on-year for the past five months.

Latest release: December 2007
Next release: January 2008

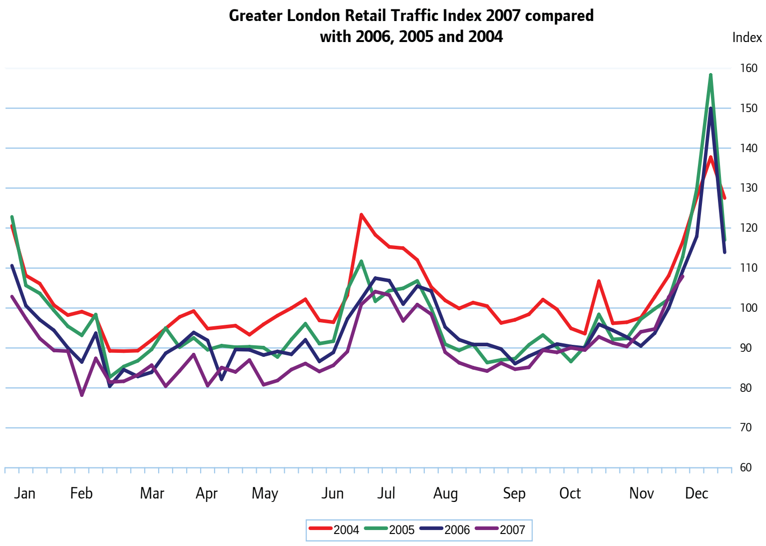


Source: Civil Aviation Authority

SPSL Retail Traffic now similar to 2006 levels

- The SPSL Retail Traffic Index of shoppers in London was 107.9 in the first week of December compared to 102.7 in the previous week.
- The index in 2007 has generally been lower than 2006 levels but this was not the case for most of November.
- 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: weekly

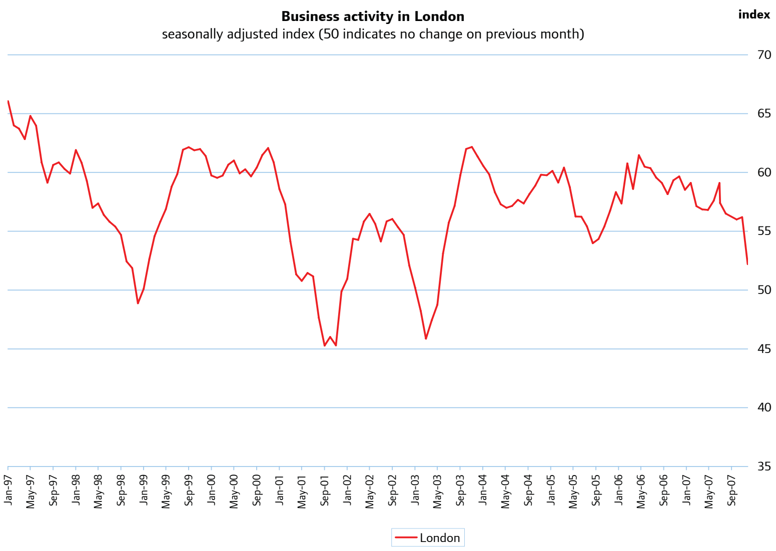


Source: SPSL

London's business activity expands at a slower pace

- London firms continued to expand their output of goods and services in November 2007 but at a slower pace compared to previous months.
- The Purchasing Managers' Index (PMI) of business activity recorded 52.2 in November 2007 compared to 56.2 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 2007
Next release: January 2008

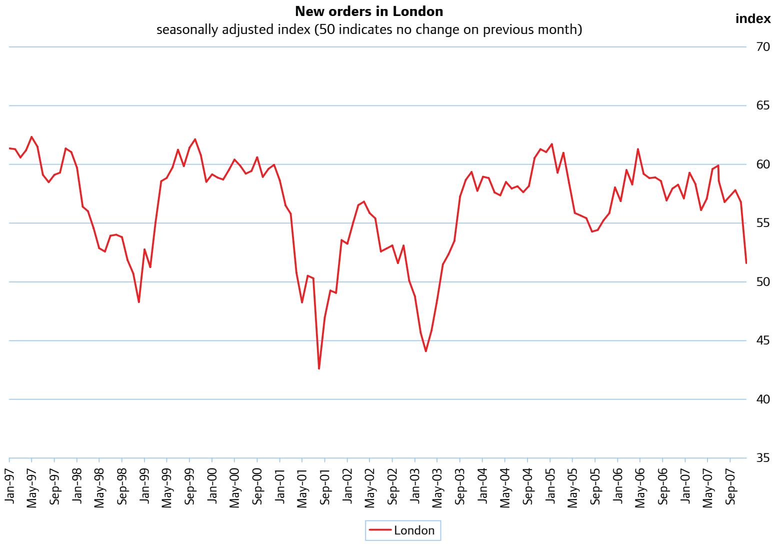


Source: The Royal Bank of Scotland /NTC Economics

New orders for London increasing at a substantially slower pace

- November 2007 saw substantially slower growth in new orders for London firms.
- The PMI for new orders recorded 51.6 in November compared to 56.8 in October.
- A rate of above 50 on the index indicates an increase in new orders from the previous month.

Latest release: December 2007
Next release: January 2008

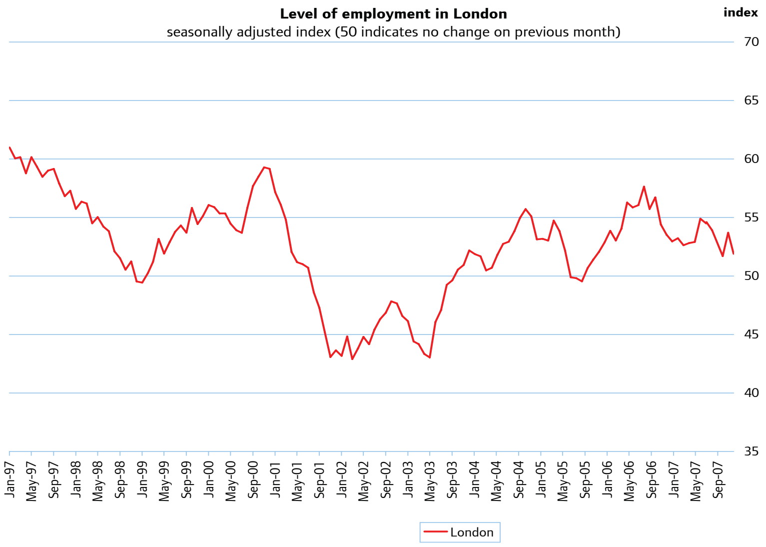


Source: The Royal Bank of Scotland /NTC Economics

Slowing employment growth in London

- London firms continued to increase their level of employment in November 2007 but at a slower rate than in October.
- The PMI for the level of employment was 51.9 in November compared to 53.7 in October.
- A rate of above 50 on the index indicates an increase in the level of employment from the previous month.

Latest release: December 2007
Next release: January 2008

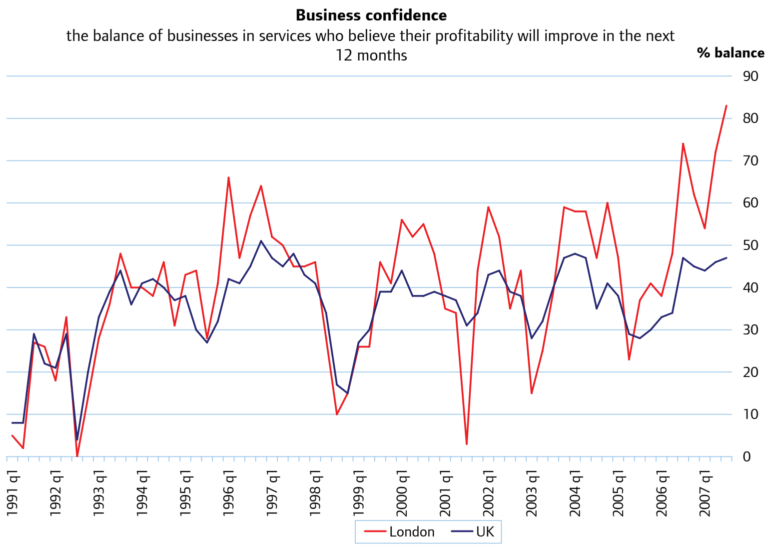


Source: The Royal Bank of Scotland /NTC Economics

Expectations of profitability remain higher in London than for the UK

- The British Chamber of Commerce's October Quarterly Economic Survey (QES) shows that London's service sector expects its profitability to improve.
- The net balance of businesses in services in London expecting to increase their profitability over the next 12 months was 83% in Q3 2007.
- The net balance of UK businesses in services expecting increased profitability over the next 12 months was 47% in Q3 2007.

Latest release: October 2007
Next release: January 2008



Source: British Chamber of Commerce, Quarterly Economic Survey

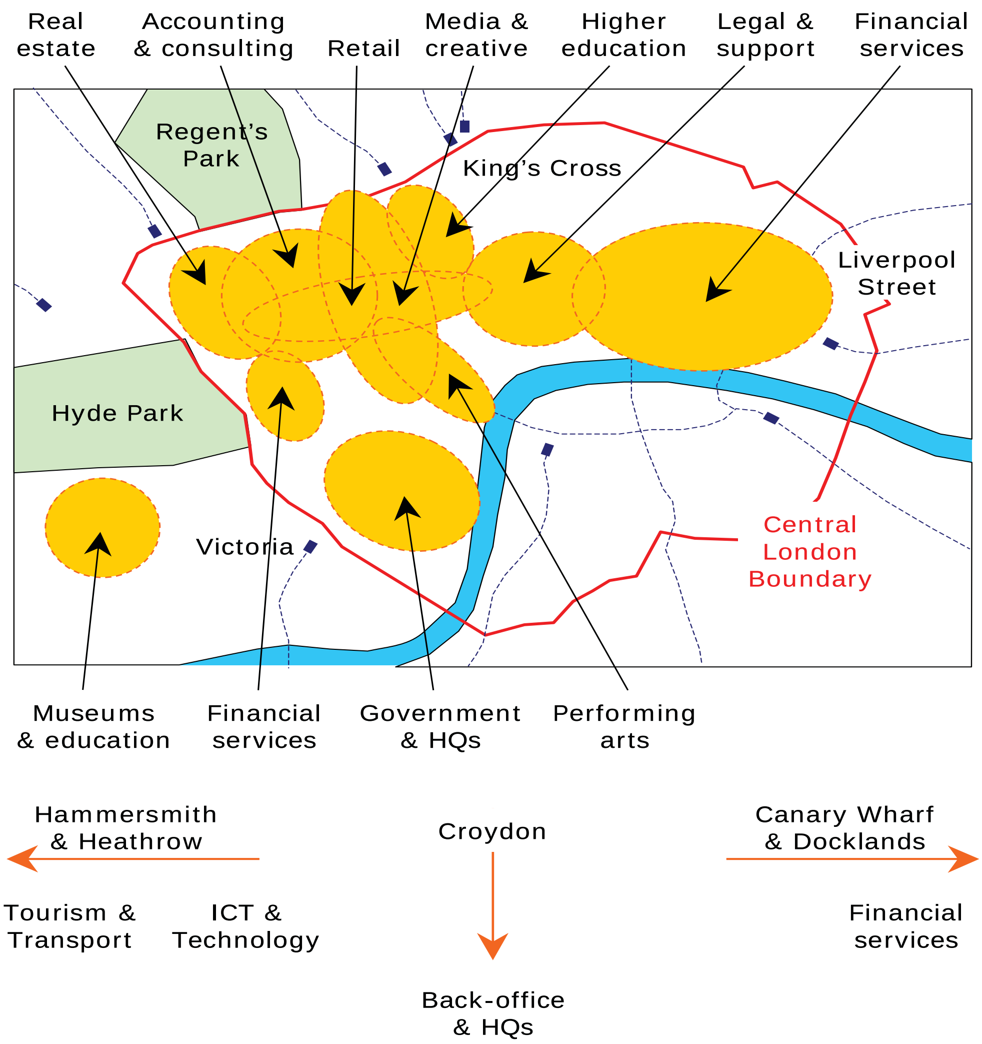
Duncan Melville,
Deputy Chief Economist
Ryan Emmett,
Economist

The Central Business District (CBD) including Canary Wharf is home to many of the capital's core activities and businesses, including not just international finance and business, but also world-renowned retail and leisure functions. It is a business district of global standing employing one and a half million people and is also home to around 300,000 residents and a celebrated centre for culture, including theatres, museums and cinemas. By focusing on how the various functions of the central area interact we can hopefully understand better what underpins the uniqueness and dynamism of London's economy.

Central London has a distinct economic geography containing a range of distinct concentrations and quarters as highlighted in Figure 2. Notable examples are the financial district in the City of London, legal firms and functions around Holborn, retail and creative industries in the West End and higher educational institutions south of Euston. This supplement summarises

Figure 2: Identifying the CBD's Key Industry Clusters

Source: Cabinet Office, Prime Minister's Strategy Unit, London Project Report (July 2004)



the contents of an upcoming GLA Economics report on the CBD (designed to support the development of various policy strands on Central London and is aimed at filling a gap in existing analysis) focusing on the characteristics and economic importance of these individual functions. The City of London is core to London's global city role, but also crucial are the range of professional and supporting business services that have national and international linkages in their own right.

The City of London holds a significant market share in most of the key internationally-traded financial services and is home to the world's international bond market and the London Market for international insurance. Over the last decade it has strengthened its position relative to other financial centres, increasing its share of cross-border bank lending and foreign exchange turnover, while gaining an overwhelming share of the rapidly developing hedge fund market.

The economic importance of London's CBD is emphasised by the sheer density of economic activity it captures, and not just in financial services. We outline some key economic facts relating to the Central Business District:

- The CBD including Canary Wharf is home to around 1.5m jobs – one third of London's employment in just 2 per cent of London's land space.
- Activities such as fund management, banking, insurance, and other finance (located mostly in the CBD) total over £7.8 billion of exports per annum.
- Business services including consulting, legal, advertising, computing, architecture, engineering and media (again, mostly located in the CBD) and a range of other business services total over £7.7 billion of exports per annum.
- The CBD including Canary Wharf employs approximately 750,000 people in finance and business services.
- The area is a leading centre for foreign banks and is the number one location for international finance in general. In 2007, 245 foreign banks were present in London compared to 210 in New York, and 67 in Tokyo.
- The CBD is home to three out of the top four leading law firms in the world and over 200 foreign law firms.
- Total CBD employment is equivalent to the whole of Greater Manchester and well in excess of any North American CBD with the exception of New York.
- The West End, including Covent Garden accounted for over £5.3 billion of comparison retail spending and 6.6 million square feet of comparison retail floorspace in 2006.

Alongside the finance sector are world-class business services including legal firms, accounting and consultancy with their own distinct concentrations in and around the City of London and West End. For example, accounting services are clustered in the West End, close to corporate and high-value private clients but within easy reach of financial institutions in the City of London.

London is also a major centre for the provision of legal services, and particularly international services which have grown rapidly on the back of globalisation and the opening up of the EU market. Legal firms in London are clustered between the City of London and West End close to the Royal Courts of Justice and Inns of Court with smaller concentrations within the Square Mile. In addition the consultancy sector employs roughly 28,000 workers (around 10 per cent of the UK total) involved in areas such as outsourcing and IT. Management consultants naturally prefer a central city location where they maintain regular contact with clients and promote close working relationships. They are predominantly clustered around the West End and the City fringe, but are also present within the Square Mile and Canary Wharf.

However, the competitive strength of the CBD economy applies to other activities beyond finance and business services. The West End's retail offer is unmatched anywhere in the UK, and a major attraction to shoppers from not just the UK but all over the world. Shopping in Central London is often combined with other leisure activities. The concentration and variety of theatres, museums, galleries and prestigious venues makes London a world cultural and leisure capital which is complemented by a myriad of restaurants, pubs and bars. The constituent elements present a formidable tourist offer and significant generator of export income for the UK economy.

How these various functions – from finance and business services to retail and cultural institutions – work in a cohesive manner is critical to understanding the unique nature of the CBD economy. At the core of this argument is the economics of agglomeration. Firms tend to locate close to their clients but also other businesses as this enables them to take advantage of shared inputs such as specialised labour and suppliers. This in turn attracts more workers and firms, increases competition and further reduces the cost of doing business. We can identify principally three forms of agglomeration:

1. Specialized input suppliers - a large cluster of businesses can provide the necessary market to support a diverse and competitively priced range of input suppliers. This is seen in the way in which London's corporate legal services support the financial services industry.

2. Labour market pooling - provides an efficient matching of vacancies and workers as well as greater access to specialised workers – especially important for businesses operating in uncertain market conditions.

3. Knowledge spillovers - access to increasingly specialised knowledge is fundamental to innovation and growth. CBDs operate as a dense network where ideas and information can diffuse easily across a range of channels both formal eg, conferences and seminars as well as informal, eg, restaurants and bars.

The critical mass (or agglomeration) of specialised skills, knowledge, inputs and markets in the central area encourages competition and innovation. Hence locating within the CBD is often a competitive necessity for a business. A 'cross pollination' of ideas occurs between different but interrelated business activities which enables further diversification and strengthening of the economic base. This has been demonstrated recently in the rapid growth of London's creative industries sector, and in the development of new financial products such as derivatives.

This process of agglomeration has in some cases led to Central London activities developing on the fringes of these areas, resulting in the geographic extent of London's CBD changing over time. The development of Canary Wharf is clearly visible from all over London, but change is also occurring in locations such as Paddington, riverside Southwark and Camden. These areas are becoming more 'CBD like' in the nature of the activities located there.

The opening up of international markets with globalisation has enabled London to develop its 'global city' role. London's linkages with other cities and financial centres extends far beyond the UK. This role is set to grow with the continued economic development of emerging economies, with India and China the most notable examples, and present potential opportunities for London's CBD. For example, the need to address the weakness of the Chinese financial system suggests opportunities for law firms and economic consultants to offer advice on regulatory reform and system architecture. In India the need for greater investment offers opportunities for London's financial sector. London is well placed to take advantage of opportunities such as these given its concentration of world class performing corporate financial and business services.

As one of the world's top business centres alongside New York, London is able to attract highly skilled and talented individuals from across the globe which means that the diversity and quality of its workforce is at least on a par with New York and unrivalled elsewhere. Openness to foreign operators, and the regulatory and legal environments are also key factors contributing to London's economic success.

However, while progress is being made, improving the public transport network remains an ongoing challenge for all of London and particularly for the centre. A key argument that helped to secure the recent announcement of a funding package for Crossrail was how transport promotes agglomeration and productivity and this similarly applies to the Underground upgrade and Thameslink schemes. The economic primacy of the CBD means its linkages spread well beyond Greater London. Hence increasing transport capacity and reliability are key to strengthening these linkages if the central area is to fully realise its future job growth potential.

Ensuring that the CBD serves all of London goes beyond addressing transport concerns. The concentration of employment at all levels in the centre is a potential opportunity to match workless individuals with jobs. This requires overcoming the barriers that prevent workers from entering employment and offering employers the skills and attributes they need. Another concern is that Central London is a potential high profile target for terrorists, as the events of July 2005 demonstrated. The Metropolitan Police continue to work with the Security Service and with Londoners themselves to combat this threat.

London's CBD is economically vibrant and successful but its position as a global centre is not self-contained. The continuation of success depends on retaining its strengths, such as its highly skilled and talented workforce, whilst tackling those areas which could hold back its potential, such as the need for ongoing transport and other infrastructure improvements to match its growing population and employment levels.

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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GLA Economics
City Hall
The Queen's Walk
London SE1 2AA

Tel 020 7983 4922
Fax 020 7983 4137
Email glaeconomics@london.gov.uk
Internet www.london.gov.uk

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Public Liaison Unit
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The Queen's Walk
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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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