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The London Economy

by Damian Walne

Uncertain times

- These are uncertain times. Headlines on war and terrorism are adding to the anxiety.
- The situation is most clearly reflected in the stock market with falling share prices illustrating faltering confidence in the economy.
- The Bank of England cut interest rates and reduced its growth forecasts – but remains positive that a recession is unlikely.
- Amidst the uneasiness, analysis shows that business investment is showing signs of recovery, pointing to more encouraging prospects for the economy.

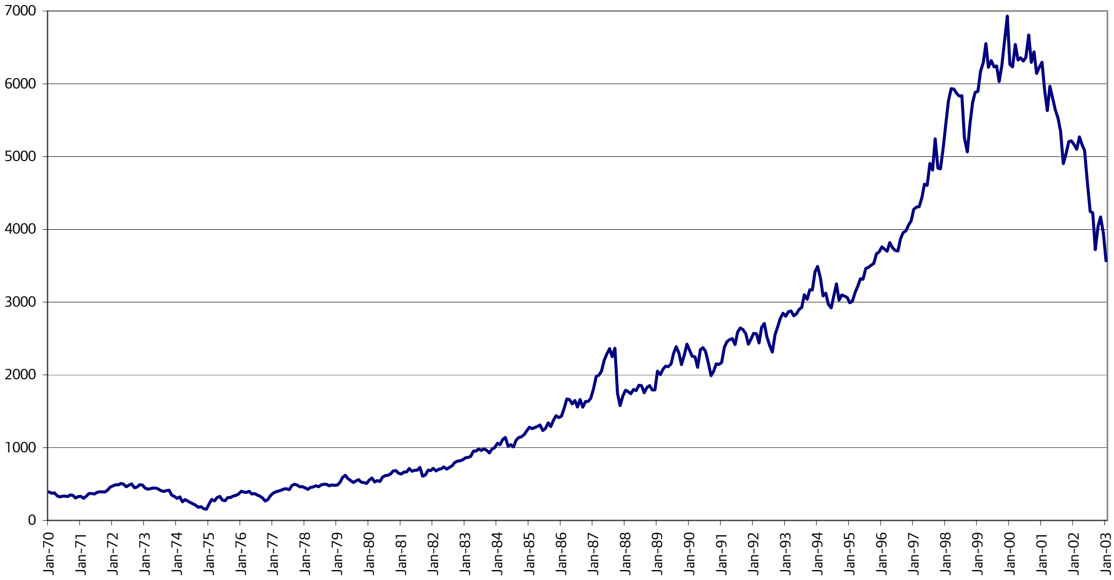
The news headlines over recent weeks have been dominated by prospects of a war with Iraq, accompanied by possible threats of terrorism and a state of high security at UK airports. This has been set against a background of uncertain times which risks undermining confidence in the strength of UK economy.

This is clearly reflected in the stock-markets across the world. In January, the FTSE 100 Index of shares fell for 10 consecutive days, reaching its lowest level since 1995. In January 2003, the value of the FTSE was down 30 per cent on January 2002. This is the largest annual fall since the 1970s.

The value of the FTSE now is almost half what it was in the bullish years over 1998 to 2000. The resulting loss of confidence and increased nervousness in the City clearly affects the economy of London as a whole, where so many jobs are in the City and Financial services.

The decision by the Bank of England to reduce interest rates by a quarter per cent to 3.75 per cent after fourteen months on hold, also took many commentators by surprise. It was viewed as a signal that the Bank expects also tougher times ahead, and the Bank subsequently revised downwards the forecasts for economic growth.

FTSE 100 Index
January 1970 to January 2003



Source: Financial Times

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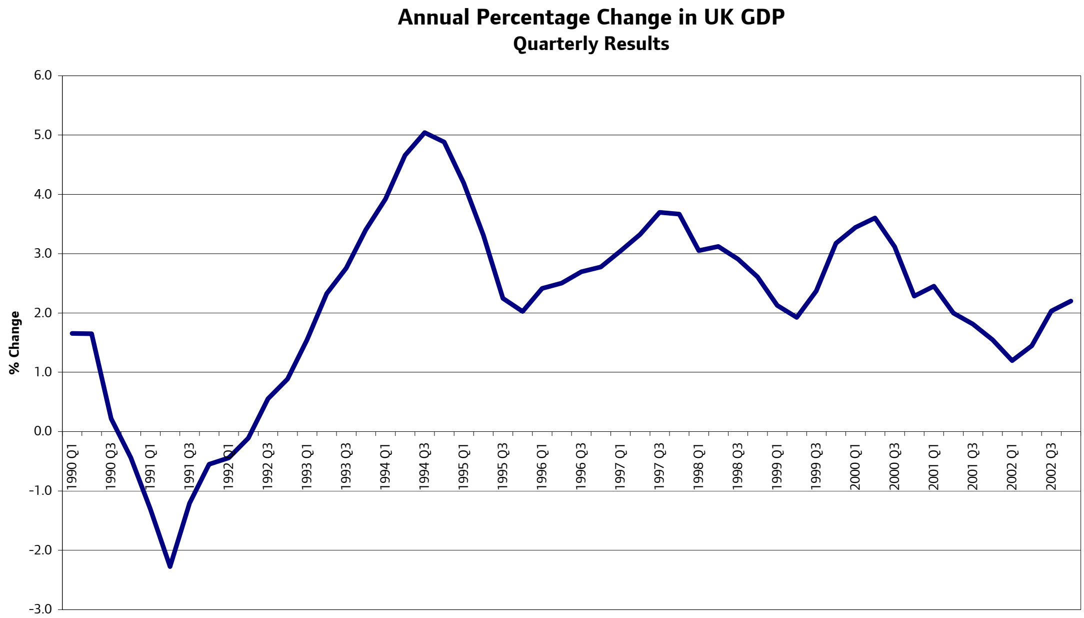


Source: Office of National Statistics

The Bank's new growth forecast is of 2.5 per cent for this year and 2 per cent for next. Therefore, growth remains much slower than that experienced a few years ago. However, it remains close to the UK's trend rate of growth.

If growth is sustained at this level, then a contraction in the economy such as that in the recession of the early 1990s will be avoided. The low interest rates and continuing low inflation of today are in stark contrast to the situation faced by the UK economy a decade ago.

Similarly, the latest employment estimates show that the number of people in work nationally has reached an all time high, and the levels of unemployment have continued to fall. Retail sales growth has remained strong illustrating continued confidence among consumers.

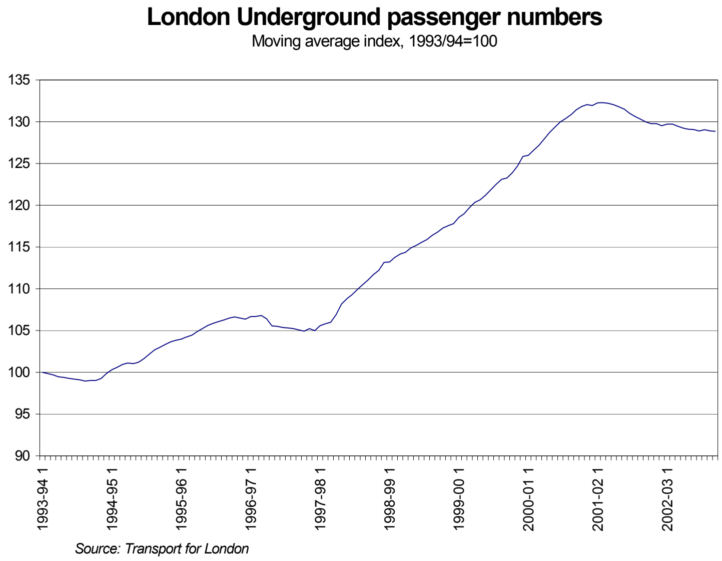
The economic picture is therefore highly mixed. The nervousness in the financial markets and anxiousness over the possibility of a war is occurring alongside more encouraging signals in employment and continuing economic growth.

Our supplement this month looks at business investment in the UK and London, using the most recent survey data. This shows that business investment is actually recovering after experiencing a slowdown since 2001. London, in particular is showing a strong recovery in investment. Amidst the clouds of pessimism, this highlights a more positive outlook for sustained growth.

The current uncertainty could risk undermining confidence and the prospects for business investment. Developments over the next month should at least provide some clarity as to what lies ahead.

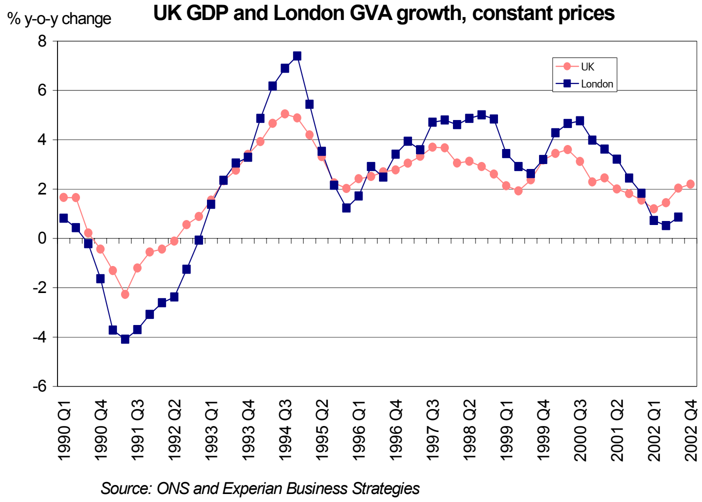
Source: TfL
Latest release: 04/02/03
Next release: 04/03/03

- Latest London Underground passenger numbers remained broadly stable in early January from last month.
- The moving average index was unchanged at 128.9 (until 4 January 2003) from the previous period.
- It is comforting that this index, which has been a reliable indictor of London's performance, is stabilising. This suggests that the downturn in London's economy since the second quarter of 2001 has not worsened further in the past months.



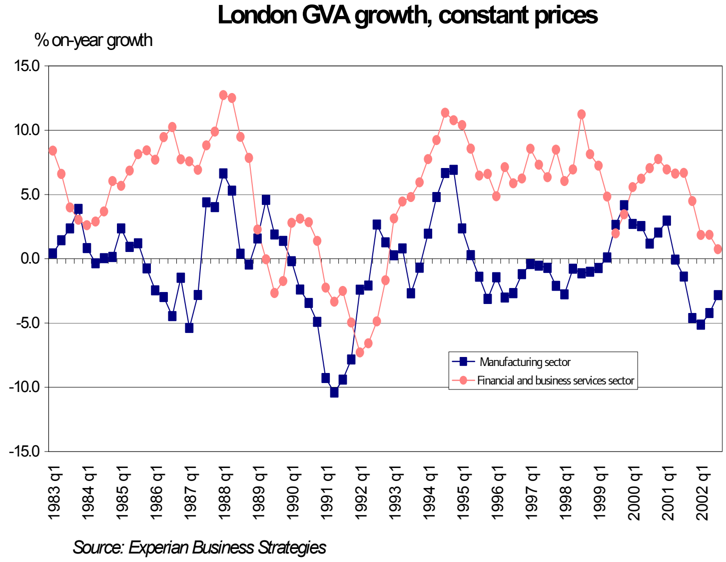
Source: ONS and EBS
Latest release: 5/12/02
Next release: Spring 2003

- Provisional figures by the ONS on GDP in Q4 increased only by 0.3 per cent compared to 0.9 per cent in the previous quarter. However, annual growth in the UK was 2.2 per cent in 2002 Q4. This is a relatively strong growth above the average growth in 2002 of 1.7 per cent.
- London's GVA estimates will be published in early spring. In Q3 London's GVA growth rose by 0.9 per cent from the previous quarter. This represents a recovery from the slowdown in the second half of 2000.



Source: Experian Business Strategies
Latest release: 5/12/02
Next release: Spring 2003

- Since mid-1995 the financial and business sector has grown much faster than the manufacturing sector.
- The slowdown experienced in London's economy in the second quarter of 2001 has been felt in these two sectors. But at least the financial and business services sector continues to record a positive growth.
- In contrast, the manufacturing sector has remained very depressed in the past year, with negative growth, but with an upward trend from 2002 Q2.



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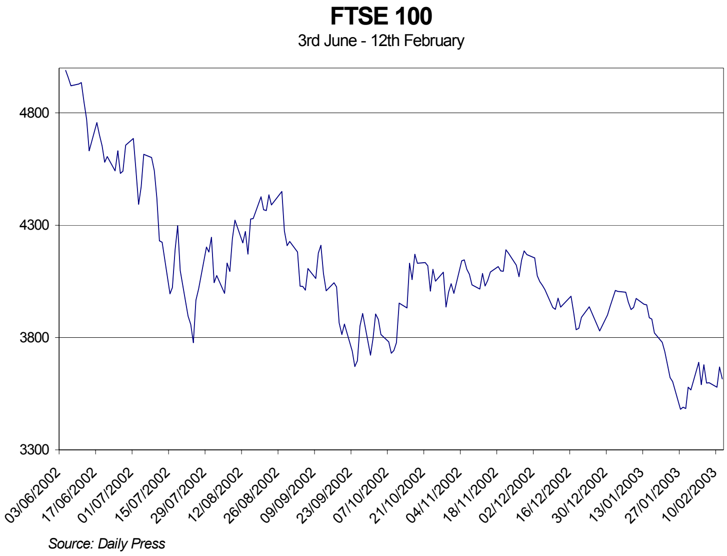
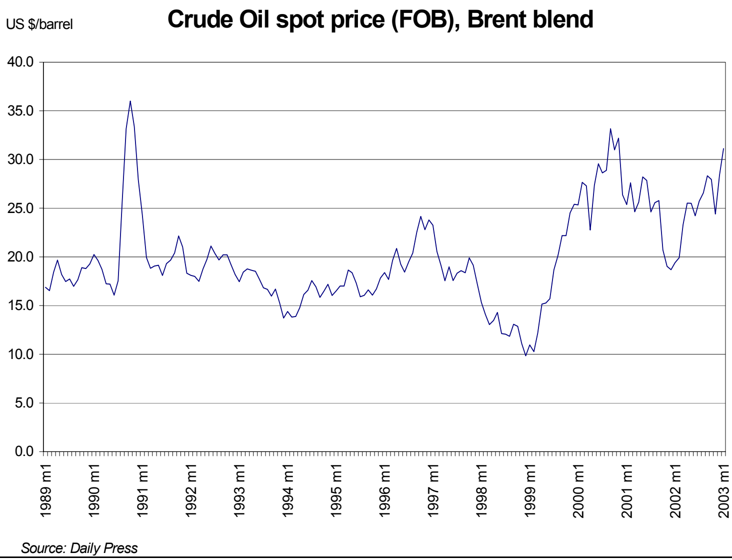
Source: Financial Times
Released daily

- In the past weeks jitters about a looming war in Iraq have caused steep falls in UK equity prices. Since our last report the FTSE 100 index has fallen by 5 per cent.
- In-mid January, the FTSE 100 index declined for 10 consecutive days, reaching the 3480 level. This indicates rising tensions between Iraq and US that can exacerbate the effects of already weak domestic and world demand.
- Despite the Bank of England's interest rate cut of 0.25 per cent in early February, equity prices have not yet risen.



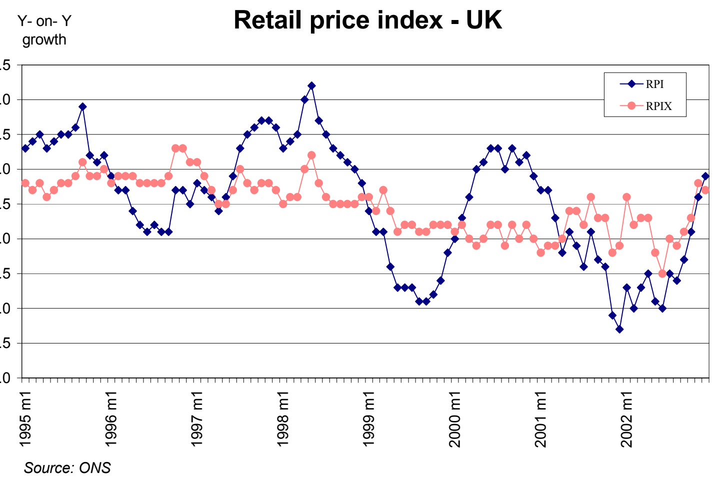
Source: Daily Press
Released daily

- Brent crude oil price continued its upward trend, around $US 31 in January, way above the OPEC target price of $22-28 per barrel.
- Fears of a US attack on Iraq have increased in early January and the general oil strike in Venezuela persists. Together these factors and uncertainty in the global economy recovery have increased oil prices further since December.
- However, oil prices are still below those levels seen of $US 36 during the Iraqi invasion in Kuwait in the early 1990s.



Source: ONS
Latest release: 18/02/03
Next release: 18/03/03

- Since 1999 the UK inflation rate has been low and below its target of 2.5 per cent, with the exception of 2000 and the first two months of 2001.
- However, in the past months the annual rate in the Retail Price Index (RPI) edged up little above its target level, recording 2.9 per cent. This increase has been due to higher petrol prices and housing costs.
- The Bank of England believes this is to be temporary and reduced its repo rate by 0.25 per cent on 6 February in the interests of longer term inflation.



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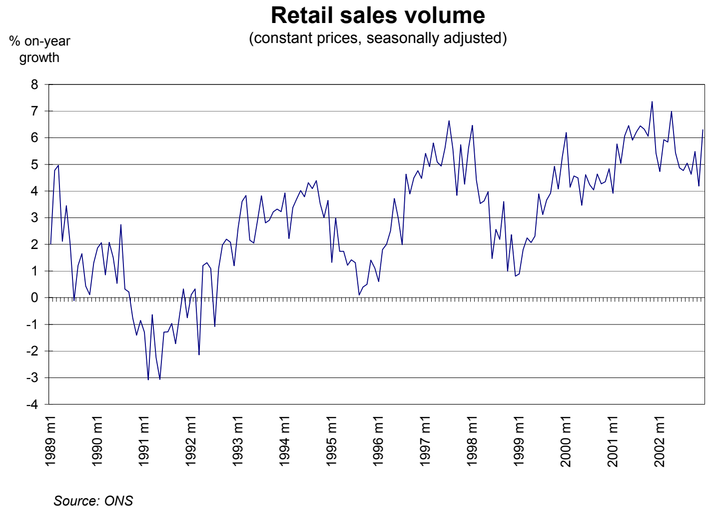
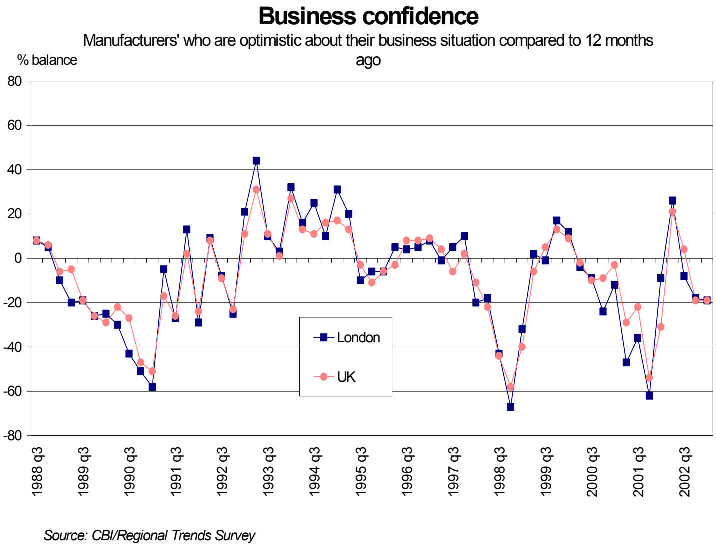
Source: ONS
Latest release: 20/02/03
Next release: 20/03/03

- UK retail sales growth bounced back in December, increasing 1.1 per cent from the previous month.
- Annual growth was 6.4 per cent in December, suggesting that consumer confidence (with regard to their financial situation) remains stable despite increasing fears about a war in Iraq.
- Consumers have not lost their appetite for spending in December, though recent increases in retail sales were underpinned by further build up in credit cards debts.



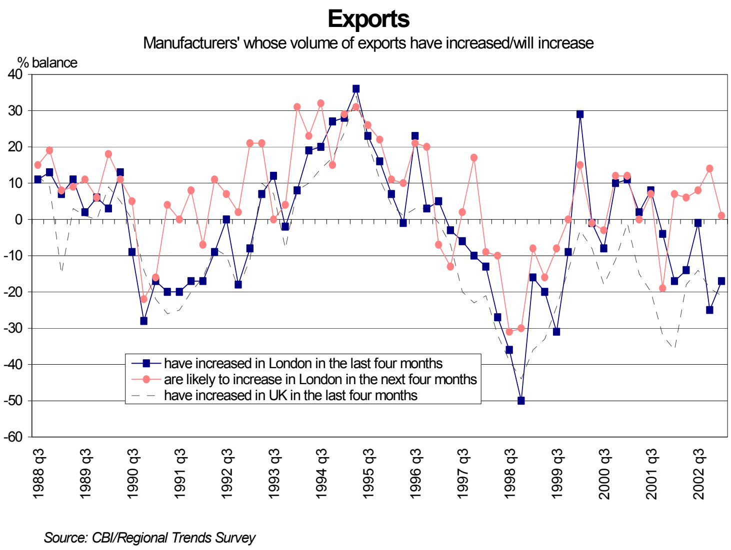
Source: CBI/Regional Trends Survey
Latest release: 01/02/03
Next release: Late May

- Business confidence in the UK in January remains stable from the last three months. But manufacturers in London are marginally more pessimistic than the UK.
- CBI data in January shows a continued negative balance of manufacturers in UK reporting that they are optimistic about their business situation. However, this balance has not deteriorated further from December.
- In London, the balance recorded –19 per cent in January compared to –18 per cent in the last three months.



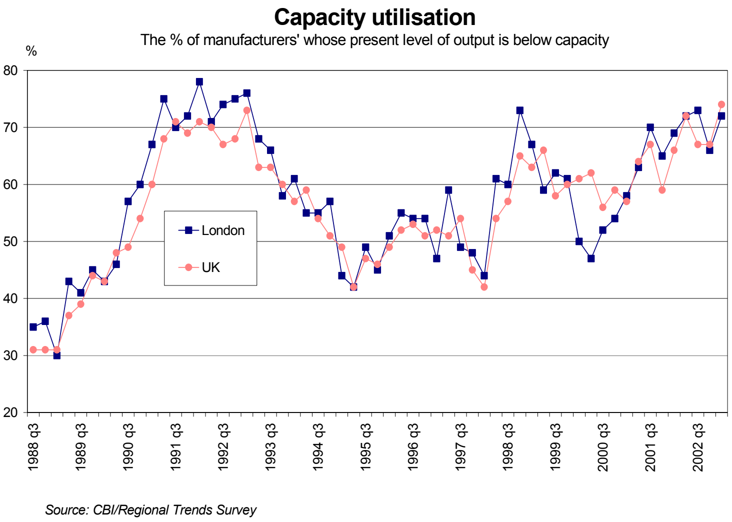
Source: CBI/Regional Trends Survey
Latest release: 01/02/03
Next release: Late May

- Manufacturers in the UK appear to be facing difficulties in export markets, with falls in export optimism in most regions of the country.
- In London, exporters are little more positive about their outlook compared to the UK.
- The balance of London's manufacturers reporting increases in volume of exports remains negative in 2002 Q4 at –17 per cent, but it has picked up slightly from the previous quarter.



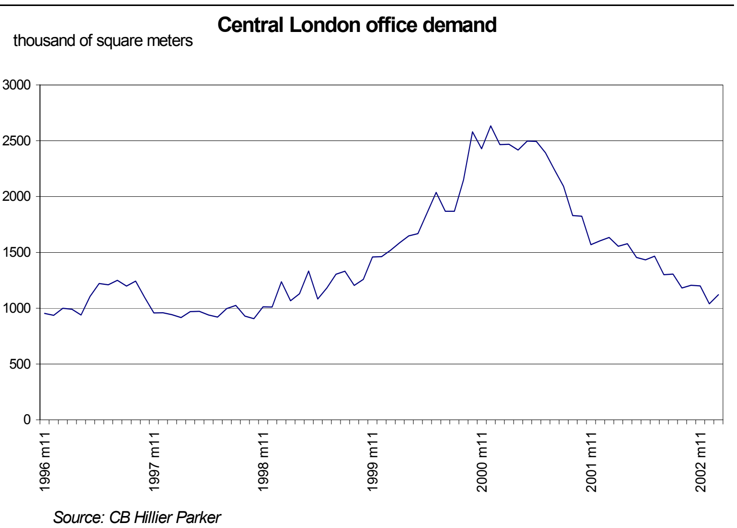
Source: CBI/Regional Trends Survey
Latest release: 01/02/03
Next release: Late May

- Latest CBI data indicate that a higher percentage of manufacturers are operating their present output level below full capacity in the last quarter of 2002 compared to the previous quarter.
- That is, about 74 per cent of firms in the UK and 72 per cent in London out of total respondents of the survey reported being in this pessimism.
- Currently, manufacturers in UK and London are feeling more pessimistic than during the slowdown in the UK economy in 2001 Q2.



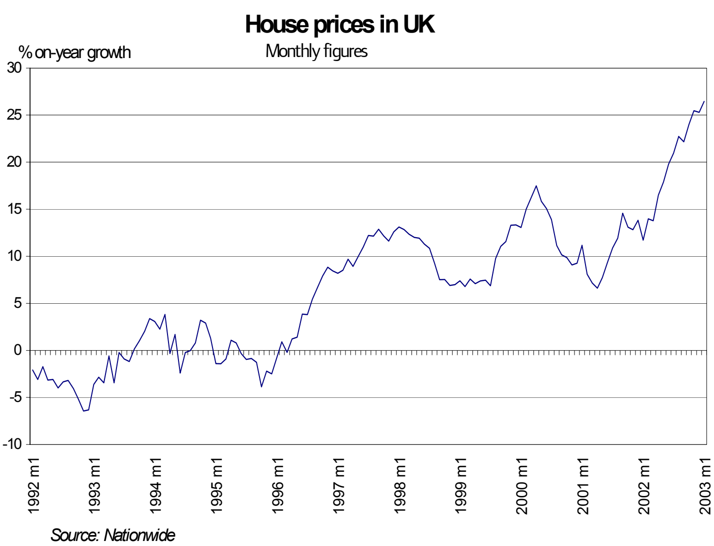
Source: CB Hillier-Parker
Latest release: 12/02/03
Next release: not known

- Demand for office space in London has continued to decline from its peak in 2000, but rose slightly in January.
- As more companies in the financial services sector in London are affected by weak global demand and uncertainty in equity markets their demand for office space has deteriorated in the past months.



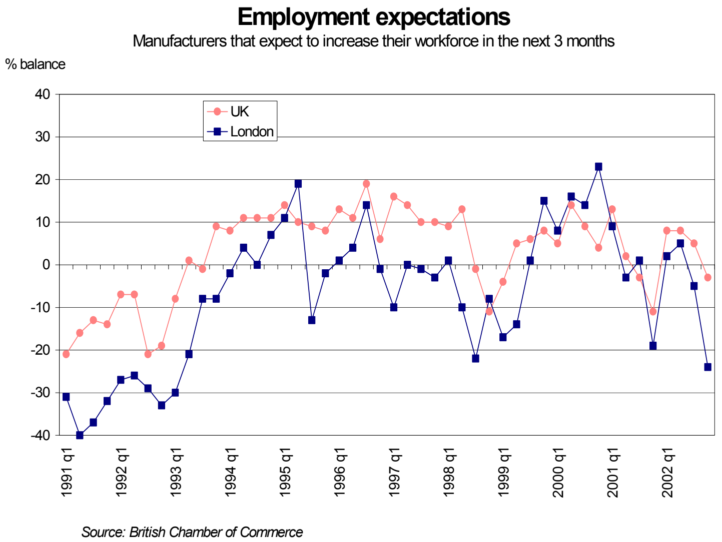
Source: Nationwide
Latest release: 03/02/03
Next release: 03/03/03

- Latest figures from Nationwide shows a steady growth in UK house prices in January. The annual growth was 26.5 per cent compared to 25.3 per cent in December.
- Nationwide's press release indicates that London house prices have a different fortune from the UK as a whole, since house price growth in London continued to slow down.
- The Land Registry reported that the slowest growth in house prices was in Greater London at 19 per cent.



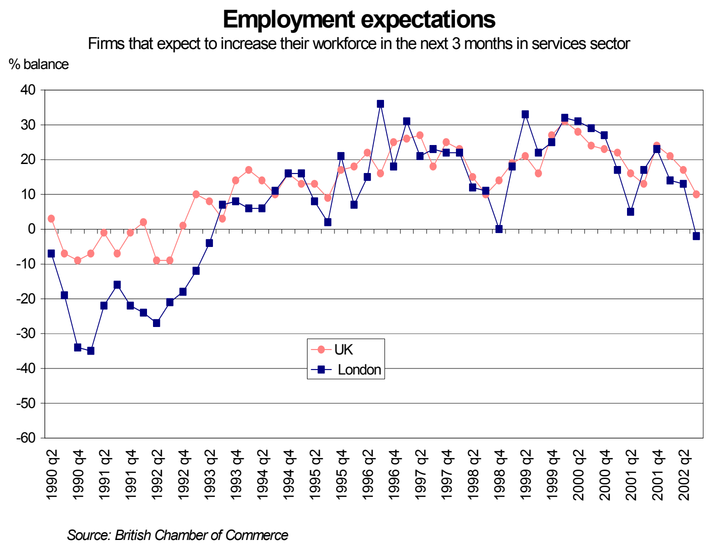
Source: BCC
Latest release: 23/01/03
Next release: end April

- Latest BCC data shows more markedly pessimistic employment expectations in the UK and London in 2002 Q4 compared to the previous quarter.
- Firms in the manufacturing sector in London are gloomier with regard to increasing their workforce than those in the UK.
- Manufacturers in London are particularly feeling the pressure of a weak global demand. The balance of firms expecting to increase their workforce in the next three months has declined for the third consecutive quarter.



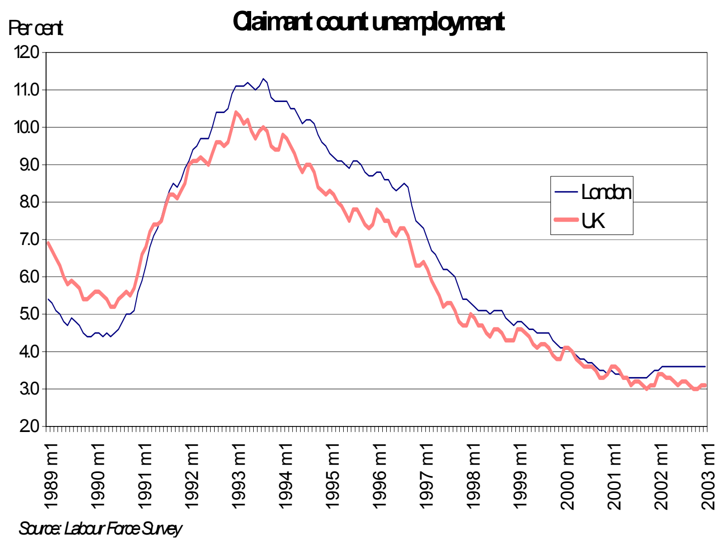
Source: BCC
Latest release: 23/01/03
Next release: end April

- Companies in the services sector in London are not feeling confident about increasing their workforce in the next three months.
- Companies in this sector appear to be more pessimistic about creating jobs in the near future in comparison to the UK.



Source: Labour Force Survey
Latest release: 12/02/03
Next release: 19/03/03

- The labour market remained broadly stable in both the UK as a whole and in London for January. Both claimant unemployment rates in the UK and London are unchanged since our last report.
- The claimant unemployment rate recorded 3.1 per cent in January. This rate is low and it is below the rate recorded at the beginning of 2002.
- In London the claimant unemployment rate continued at 3.6 per cent from the past month.



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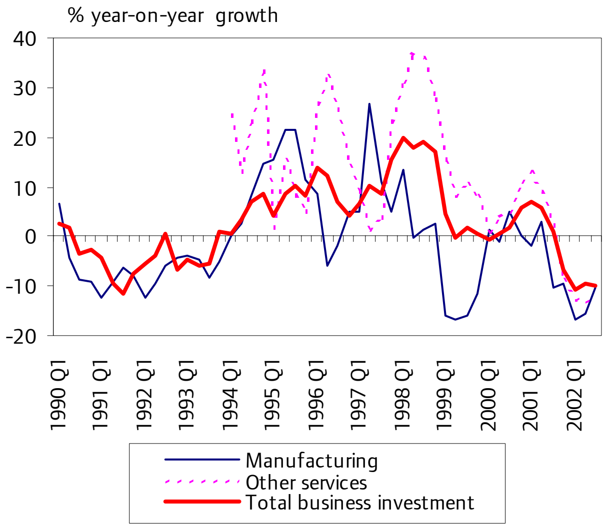
Recent developments in UK and London's business investment
by Leticia Verueta-McKay

- UK business investment growth has been weakening since the second half of 2001, but the fall stabilised with no downturn in the second half of 2002. The northern regions in the country have recorded negative investment growth in 2002 Q4 from the previous quarter but this is not the case for London or the south east.
- Business investment growth in London within the services sector has fared better than within the manufacturing sector in the past two quarters.
- Main factors that explain investment growth in London in the manufacturing sector are profitability expectations, volume of domestic sales and past year expenditure in plant and machinery. For the services sector, investment growth is driven by similar factors as in the manufacturing sector, except that profitability expectations does not appear to affect investment.
- As long as confidence about profitability and domestic sales demand remain firm, we expect investment growth in London to continue recovering. But heightened uncertainty about the recovery in domestic and global economy and increasing fears of US attack on Iraq can make this recovery in business investment more muted.

National perspective

In the past two years consumer spending has been the engine of economic growth in the UK. In contrast, business investment has been contributing less to output growth.

Chart 1. Private business investment, manufacturing and services investment, constant prices



Source: ONS

Annual investment growth has fallen sharply since 2001 Q2, remaining negative even in Q4. Manufacturing investment growth also has deteriorated since the slowdown in the UK economy in 2001 Q2, but has edged up recently. Investment growth in other services has been negative, but less pronounced decline than in the manufacturing sector.

Are other regions within the country or even London experiencing a similar deterioration in their investment plans? Have manufacturing and services sectors been affected in a similar way? Dissagregated data can help to answer these questions.

Unfortunately, there are no regular official figures recorded for business investment by sector and across regions.

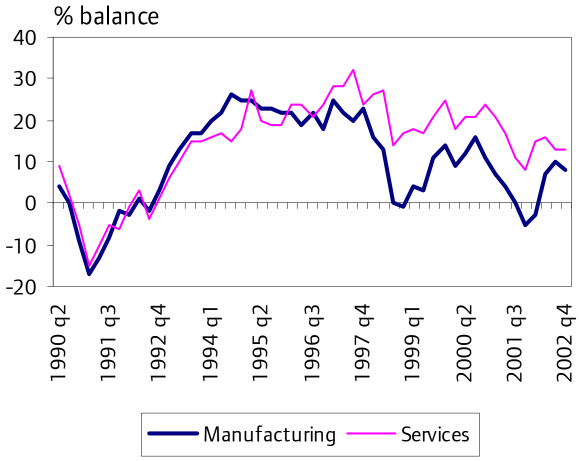
However, data on investment for 2002 is available from estimates or economic surveys on a quarterly basis. In late January 2003, the British Chamber of Commerce (BCC) produced their quarterly economic survey results and in early February 2003 the Confederation of British Industry (CBI) and Regional Trends released new results.

Our analysis concentrates on the BCC survey since it covers a much larger sample size than the CBI survey. The former considers 6,364 firms while the latter interviews only 904 companies. Furthermore, almost 60 per cent of respondents in the BCC survey are firms from the services sector the other 40 per cent are manufacturers. The CBI/Regional Trends Survey only includes firms from the manufacturing sector.

Another main difference is that CBI survey considers a different question about investment intentions. Firms report on their investment plans for the next 12 months. In the BCC survey, companies respond to whether investment intentions increase/decrease over the past three months. So these surveys might show contrasting results at times.

Chart 2 presents the percentage balance of investment plans in plant and machinery for the manufacturing and services sectors. The percentage balance is determined by subtracting the percentage of firms reporting decreases in investment plans from the percentage of firms reporting increases.

Chart 2. UK percentage balance in investment plans in plant and machinery: breakdown by sectors



Source: BCC

At a national level investment growth in the manufacturing and services sectors was relative stable in the last quarter of 2002 compared with the previous quarter. Since the second half of 2002, the balance of investment plans has become positive in the manufacturing sector, indicating signs of recovery in investment since the sharp decline in 2001 and also first half of 2002. The balance in service investment has remained positive. UK investment plans in plant and machinery in the services sector fared better in the past quarter of 2002.

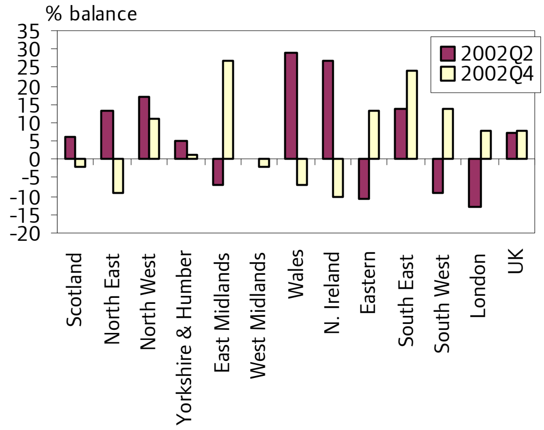
Regional perspective

A sectoral breakdown across regions shows that investment growth by firms has been uneven.

Manufacturing

Northern regions have significantly restricted investment towards manufacturing plant and machinery in 2002 Q4 compared to the second quarter of 2002, unlike the southern regions.

Chart 3. Percentage balance in manufacturing investment by region

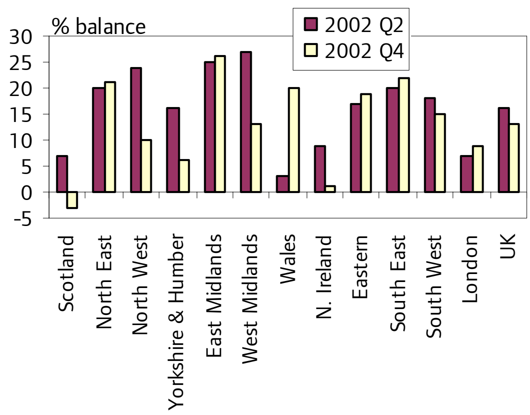


Source: BCC

Services

Firms in the services sector are more optimistic about investment plans across the country than companies in the manufacturing sector. Scotland is the only region to record a negative percentage balance in investment intentions. Although a very low growth in investment was also registered in Northern Ireland in Q4.

Chart 4. Percentage balance in services investment by regions



Source: BCC and LCC

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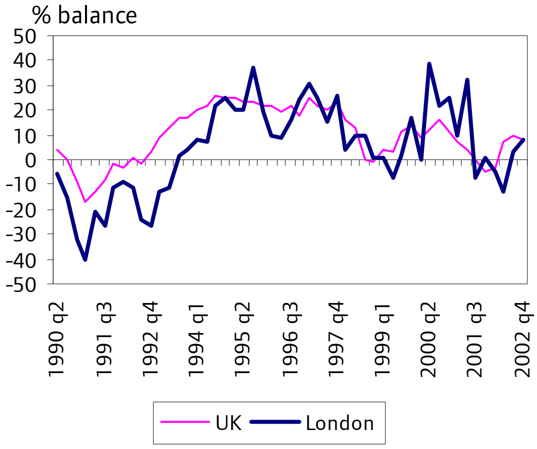
London and the UK as a whole

Manufacturing investment growth in London has generally been more volatile than in the UK, with more pronounced upswings and investment falling more sharply in London during the last recession.

Since the slowdown in the London's economy in 2001 Q2, manufacturers in London have been more cautious about investing in plant and machinery compared to the rest of the UK. However, investment growth in London has been recovering since the second half of 2002. Currently, manufacturers in London and UK have similar plans for investment growth.

Chart 5. Percentage balance in investment plans in London and the UK, manufacturing sector

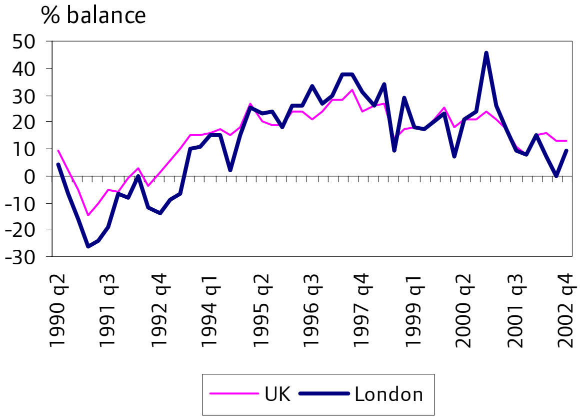


Source: BCC and LCC

Similarly, investment growth in the services sector in London appears to fluctuate more than the UK as a whole. Investment growth in the services sector has deteriorated since the second half of 2001, but it has bottomed out and reversed its downward trend since Q3 of last year.

The downturn in London's economy affected more significantly investment plans of manufacturers than firms in the services sector. It is important noting that business services now contribute three times as much to London's output as manufacturing. The role of the services sector as driver of economic growth in London has increased even further since 1996, see London's Economy Today, issue 4. The rapid growth experienced by firms in the services sector has translated into more investment plans than it has in the manufacturing sector.

Chart 6. Percentage balance in investment plans in London and the UK, services sector

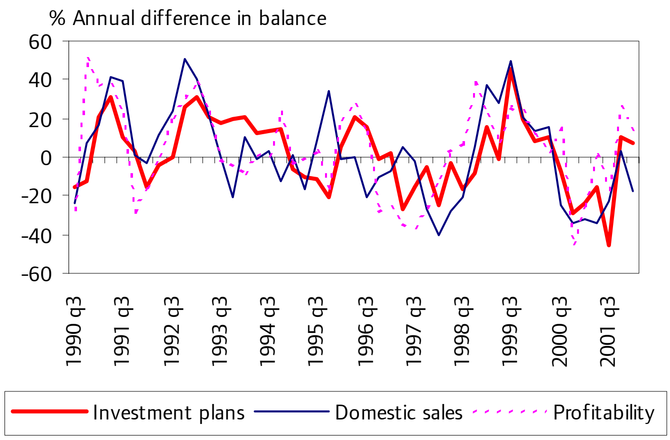


Source: BCC and LCC

Recently, commentators are suggesting that the UK manufacturing sector has been hit hard by the weak global demand that in turn has reduced their volume of export sales. Additionally, it is argued that more and more manufacturers are operating their output level below full capacity and their profits have been squeezed, so manufacturing investment has weakened.

We explore the main factors driving changes in investment growth in London for the period 1991 Q2-2002 Q4 in the manufacturing and services sectors.

Chart 7. Manufacturing investment in London

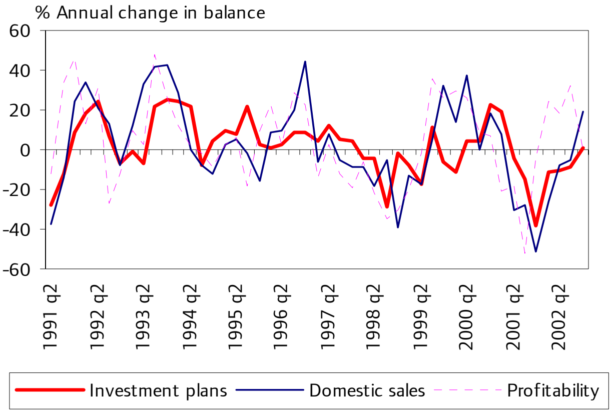


Source: BCC and LCC

The annual absolute change in the percentage balance of manufacturers in London on their investment plans in plant and machinery is depicted in chart 7. Also the graph shows the annual differences in the balance of profitability and domestic sales.

Same variables are displayed in the chart below for the services sector.

Chart 8. Service investment in London



Source: BCC and LCC

In order to determine the impact that these variables have on investment growth, GLA Economics conducted a statistical analysis. Detail of this analysis can be found in Current Issues, Note Number 1 GLA Economics.

Results indicate that changes in investment growth in London in the manufacturing sector are mainly attributed to changes in profitability expectations, changes in volume of domestic sales and changes in investment plans in the previous year.

Fifty-two per cent of the variation in investment growth in plant and machinery are explained by these factors. Future profits prospects have the highest impact for manufacturers on investment plans. Moreover, when manufacturers increase their expenditure in plant and machinery this has a positive effect on future investment plans, with investment sustained in the subsequent year.

Surprisingly, the volume of export sales and the capacity of utilisation do not appear to explain movements in investment.

For the services sector, around forty three per cent of movements in investment growth are explained by changes in volume of domestic sales and changes in previous year investment. Other factors such as profitability expectations and volume of export sales appeared not to have any effect in investment plans.

As long as confidence about profitability and domestic sales demand remain firm, we expect investment growth in London to continue recovering. But heightened uncertainty about the recovery of the domestic and global economy and increasing fears of war with Iraq can make more gradual the recovery in business investment.

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Data Sources

Tube Usage	Further information contact Transport for London on 020 7941 4500
FTSE 100 Index	Further information see www.ft.com or the daily Financial Times
Brent Crude oil	Further information see www.ft.com or the daily Financial Times
Office Space Demand	Further information see www.cbhillierparker.com
House Prices	Nationwide house price data from www.nationwide.co.uk/hpi/
	Land Registry data from http://www.landreg.gov.uk
Consumer Confidence	Further information see www.martinhamblin.co.uk
Average earnings	Data available from www.statistics.gov.uk
Retail Price Index	Data available from www.statistics.gov.uk
MEW	Data available from www.bankofengland.co.uk
Retail Sales	Data available from www.statistics.gov.uk/rsi
Unemployment rates	Data available from www.statistics.gov.uk
GDP/GVA Growth	Data available from Experian Business Strategies on 020 7630 5959
Balance of Trade	Data available from www.statistics.gov.uk
Index of Production	Data available from www.statistics.gov.uk
Manufacturing Expectations	Further information see www.cbi.org.uk
Services Sector	Data available from www.cips.org
Profitability	Data available from www.statistics.gov.uk
Tourism - Overseas Visitors	Data available from www.statistics.gov.uk
Tourism - Domestic Visitors	Data available from www.londontouristboard.com
London Airports	Data available from www.caa.co.uk

Abbreviations

BCC	British Chamber of Commerce
CBI	Confederation of British Industry
FTSE 100	Financial Times Stock Exchange 100 index of stocks traded on the London Stock Exchange
GDP	Gross Domestic Product
GVA	Gross Value Added
ILO	International Labour Organisation
LCC	London Chamber of Commerce
MEW	Mortgage Equity Withdrawal
ONS	Office of National Statistics
RPI	Retail Price Index
CIPS	The Chartered Institute of Purchasing and Supply

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Email: GLAEconomics@london.gov.uk
Tel: 020 7983 4100

GLA Economics

This publication is produced by GLA Economics, which was established in May 2002 by the Mayor of London to provide a firm statistical, factual and forecasting basis for policy decision-making by the GLA and its functional bodies.

London's Economy Today is published on the GLA website on the third Tuesday in every month. It seeks to provide an overview of the current state of the London economy, publishing a changing selection of the most relevant and up-to-date data available. It will track cyclical economic conditions to ensure that they are not moving outside the parameters of the underlying assumptions of the GLA and central government.

Greater London Authority
City Hall
The Queen's Walk
London SE1 2AA
www.london.gov.uk
Enquiries **020 7983 4100**
Minicom **020 7983 4458**

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