London's Economy Today

Issue 71 | July 2008

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GLAECONOMICS

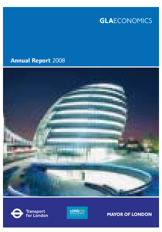
UK stock market enters a bear market as economic gloom mounts

by **Richard Davies**, Economist, **Gordon Douglass**, Economist and **Christopher Lewis**, Senior Economist

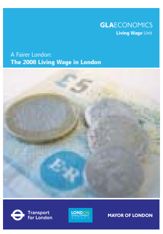
There has been downward pressure on the FTSE 100 over most of the last few months as concerns about the state of the UK economy have increased. On 16 July, the FTSE 100 fell to just above 5150, its lowest point since 2005 (see Figure 1). This meant the FTSE 100 had fallen over 20 per cent below its recent peak (which is the usual definition of a bear market) of just above 6,730 in June 2007.

The slide of the FTSE 100 follows on the heels of continuing bad economic news within the UK. Industrial production declined in May and consumer confidence dropped to –34 as measured by GfK NOP's consumer confidence index, which was only one point above the record low set in March 1990. The latest Quarterly Economic Survey for the British Chamber of Commerce (BCC) also showed a sharp decline in business confidence, increasing pressure on manufacturers to raise prices, and a general deterioration in the UK's prospects. David Kern the BCC's economic advisor said "we are now facing serious risks of recession."

Latest news...



- **GLA Economics' Annual Report 2008** This report covers the work of GLA Economics from April 2007 to March 2008. We have produced analysis on a broad range of issues that have an impact on London including a comprehensive study of adult skills, housing submarkets and Crossrail.



- **A Fairer London: The 2008 Living Wage in London** This fourth annual report from a programme of research by the Living Wage Unit takes a systematic approach to identify what is a living wage in London. The result is a London Living Wage of £7.45 per hour.

Visit **www.london.gov.uk/mayor/economic_unit** to download these publications.

Figure 1: FTSE 100

Source: FT

Inflation on the rise

CPI inflation surged to 3.8 per cent in June making it less likely that the Bank of England will cut interest rates in the near future to support the slowing economy. The next move in interest rates could now even be in an upward direction. Some analysts have suggested that CPI inflation may rise to around 5 per cent later this year particularly if food and oil prices remain high.

RPI inflation, which includes housing costs, rose to 4.8 per cent in June. RPI inflation is often used as a benchmark in many wage negotiations and there is a risk that higher wage claims could cause a wage-price spiral. However, so far annual earnings growth has remained constrained.

Inflation is currently a worldwide phenomenon. In the Eurozone the ECB raised interest rates from 4 to 4.25 per cent on 3 July due to inflation hitting 4 per cent in June. US annual inflation rose to 5 per cent in June, the highest level since 1991. Growing demand for oil, food and other commodities by China and India has put upward pressure on world prices.

Construction industry badly hit as house prices continue to fall

Due to the ongoing credit crunch there is continuing difficulty for people to obtain mortgages. Demand for buying property has therefore fallen causing a drop in house prices. According to HBOS, UK house prices fell by 2 per cent in June alone and it is forecasting that house prices will fall by about 9 per cent this year. Further falls in house prices are expected due to the squeeze in real disposable incomes, the lack of availability of mortgages due to the credit crunch and people holding off making purchases in the belief that house prices will be lower in future.

The commercial property market is also weak. Valuation data from Investment Property Databank showed a 2 per cent fall in commercial property in June. This marks a slide of around 20 per cent since the peak during last year. The downturn in the property market is impacting negatively on employment in the construction sector. Housebuilders Redrow, Bovis Homes, Persimmon, Taylor Wimpey and Barratt Developments have all announced job cuts.

Fannie Mae and Freddie Mac on the brink as IndyMac fails

The US government has announced a number of measures to support Fannie Mae and Freddie Mac after their shares plummeted on Friday 11 July. The companies, which are shareholder owned but mandated by the US Congress to provide funding to the housing market, have been negatively affected by very high mortgage default rates as they guarantee or own around half of the outstanding US mortgage market. They do not lend directly to homebuyers but buy mortgage debt from approved lenders. The Government package asks Congress to increase the companies access to credit and allows the US Treasury to buy shares in them if needed; whilst the Federal Reserve has stated its willingness to lend to the companies if they require extra funds. The intervention occurred because if the companies, which between them guarantee or own $5 trillion worth of mortgages, failed it would lead to dire consequences for the US and world financial system.

Meanwhile financial turmoil in the US continues with the collapse of California based IndyMac Bank due to a liquidity crisis. The Federal Deposit Insurance Corporation took the bank over during the weekend of the 11-13 July. IndyMac Bank is the second largest financial institution to fail in US history. This highlights the continuing problems in the financial services sector, which has been exacerbated by the relentless fall in US house prices.

London economy facing a sharp slowdown

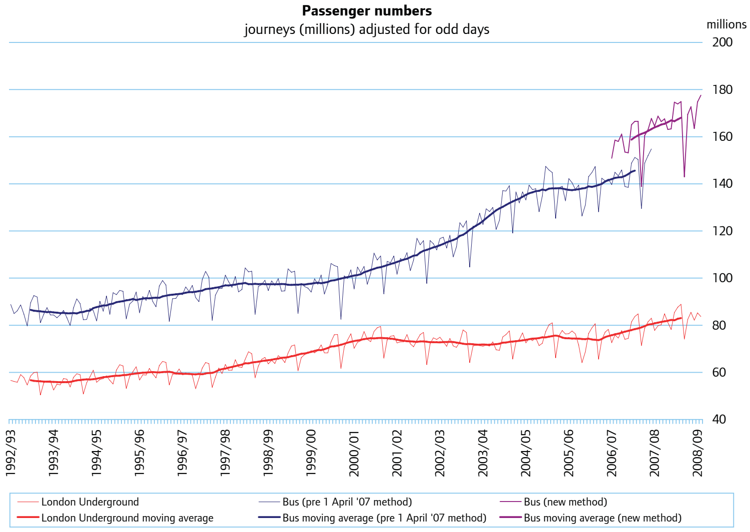
The London economy will face challenging times over the coming year as the financial services sector suffers, the housing market weakens further and higher inflation restricts real disposable incomes. Below trend growth is expected over the next few years and the possibility of a recession should not be ruled out. Business survey evidence for June showed that the London economy weakened dramatically. Claimant count unemployment has started to rise, though from a relatively low level, and employment is expected to fall over the next couple of years. Overall, prospects are at least as tough as in the early part of this decade after the dotcom bust and 9/11. However, with a flexible sterling exchange rate that could depreciate further (supporting net exports and the tourism industry) and strong growth in emerging market economies, conditions still seem slightly more favourable for the London economy than in the early 1990s, but only just.

Economic indicators

Increase in moving average of passenger numbers

- The most recent 28-day period is from 26 April 2008 to 24 May 2008. London's Underground and buses had 261.2 million passenger journeys; 177.6 million by bus and 83.7 million by Underground.
- The moving average of passengers every period increased to 251.1 million from 250.1 million. The moving average for buses was 168.1 million. The moving average for the Underground was 83.0 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: July 2008
Next release: August 2008

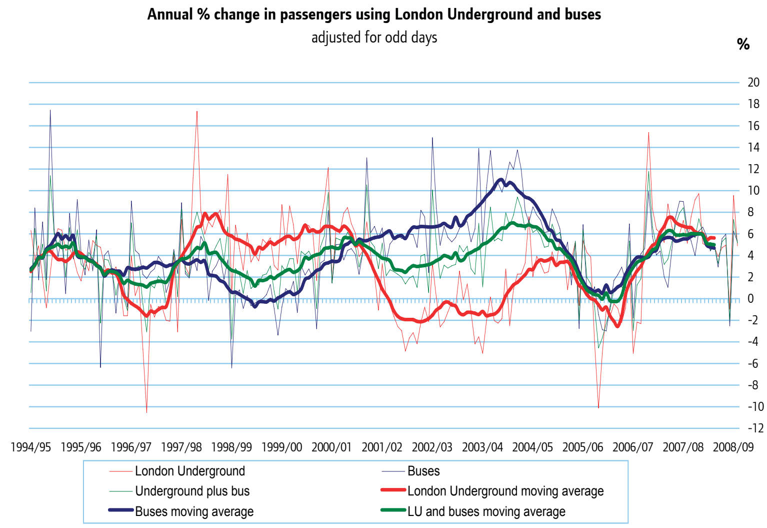


Source: Transport for London

Average annual growth rate of passengers decreases slightly

- The moving average annual rate of growth in passenger journeys decreased to 5.0% from 5.1% in the previous period.
- The moving average annual rate of growth in bus passenger journey numbers decreased to 4.7% from 4.8% in the previous period.
- The moving average annual rate of growth in Underground passenger journey numbers remained at 5.6%.

Latest release: July 2008
Next release: August 2008

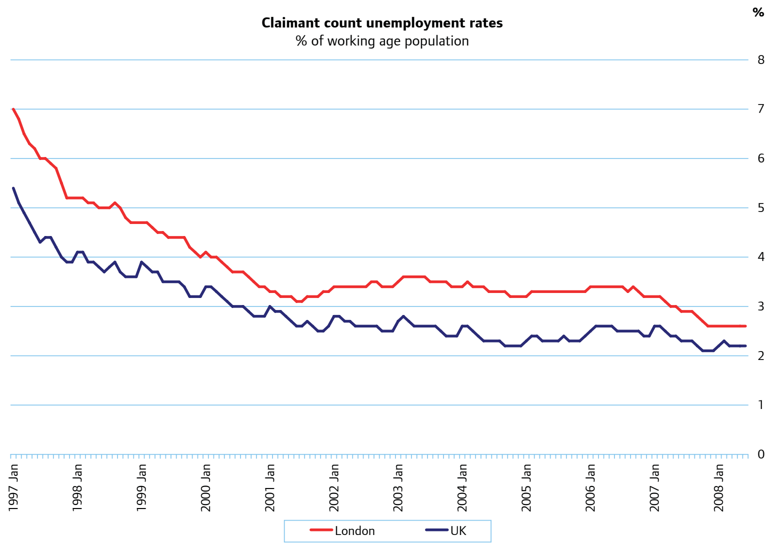


Source: Transport for London

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 June 2008.
- There were 131,000 unemployment claimants in London in June 2008 compared with 145,100 in June 2007.
- The claimant count unemployment rate of the UK remains below that of London.

Latest release: July 2008
Next release: August 2008

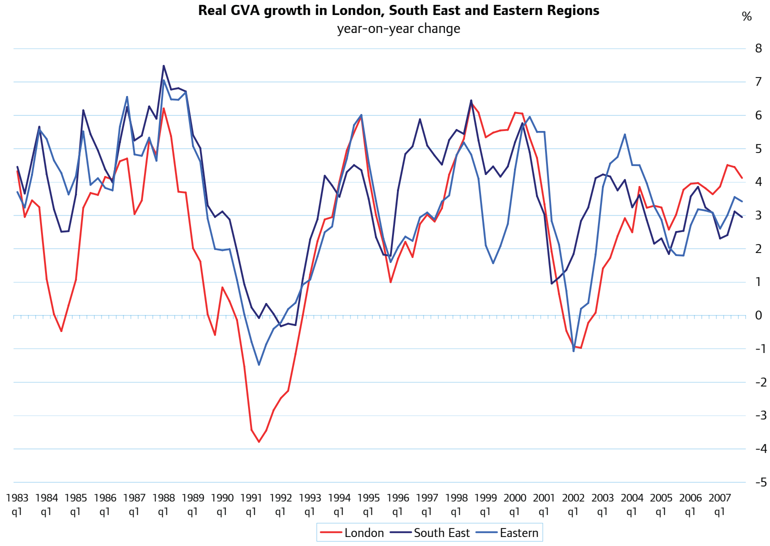


Source: Claimant Count, Nomis

Annual output growth eases in London

- London's annual growth in output decreased to 4.1% in Q4 2007 from a downwardly revised 4.4% in Q3 2007.
- Annual output growth in the South East decreased to 2.9% in Q4 2007 from a downwardly revised 3.1% in the previous quarter.
- Annual output growth in the Eastern region decreased to 3.4% in Q4 2007 from a downwardly revised 3.5% in Q3 2007.

Latest release: May 2008
Next release: August 2008

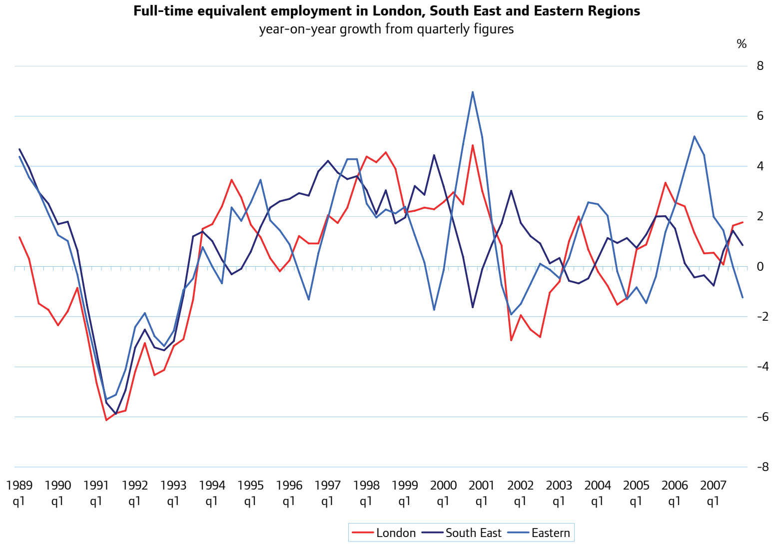


Source: Experian Business Strategies

Annual employment growth in London remained faster than the surrounding regions in Q4 2007

- London's annual employment growth increased to 1.8% in Q4 2007 from 1.6% in Q3 2007.
- Annual employment growth in the South East decreased to 0.9% in Q4 2007 from an upwardly revised 1.4% in Q3 2007.
- Annual employment growth in the Eastern region was –1.2% in Q4 2007, down from an upwardly revised 0.0% in the previous quarter.

Latest release: May 2008
Next release: August 2008

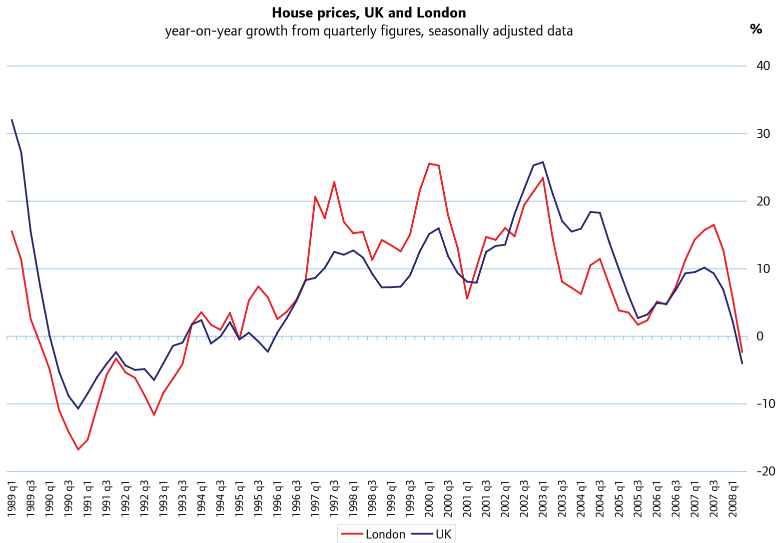


Source: Experian Business Strategies

Falling house prices

- Nationwide reported that annual house prices fell less in London than in the UK in Q2 2008.
- Annual house price inflation in London was –2.3% in Q2 2008, down from 5.6% in Q1 2008.
- Annual house price inflation in the UK was –4.0% in Q2 2008, down from 2.2% in Q1 2008.

Latest release: July 2008
Next release: October 2008

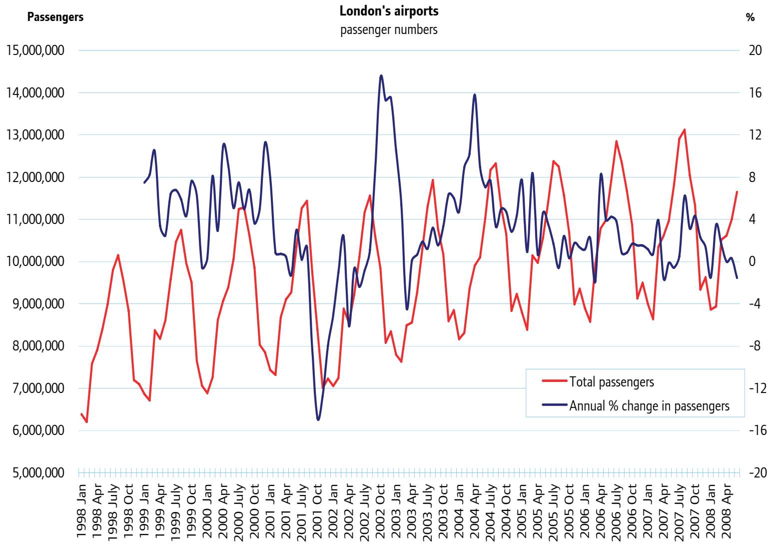


Source: Nationwide

Weak airport passenger numbers

- 11.7 million passengers travelled through London's airports in June 2008.
- The number of passengers using London's airports decreased by 1.5 per cent from June 2007 to June 2008.
- The number of passengers using London's airports has seen no growth over the last few months compared to the same time last year.

Latest release: July 2008
Next release: August 2008

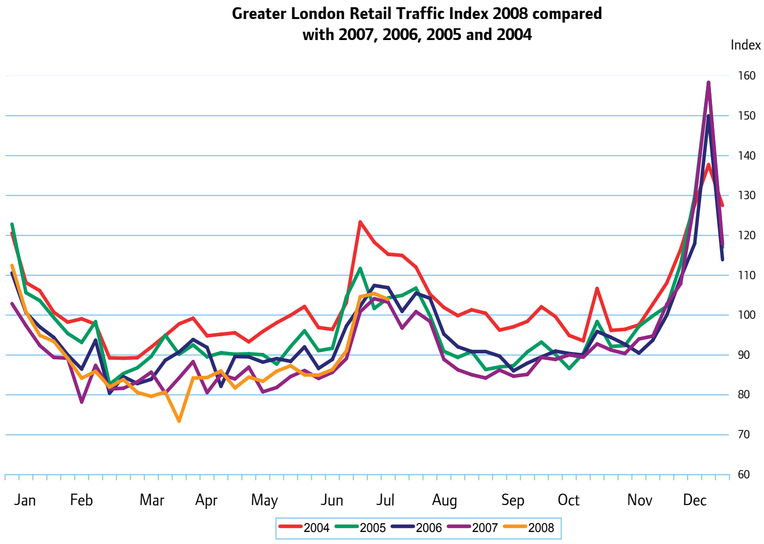


Source: Civil Aviation Authority

SPSL Retail Traffic similar to 2007 levels

- The SPSL Retail Traffic Index of shoppers in London was 104.0 in the first full week of June compared to 105.4 in the previous week.
- The index has been quite similar to 2007 levels this year.
- SPSL's Retail Traffic Index measures the number of shoppers and does not necessarily reflect the level of spending.

Latest release: Mid-July
Next release: Weekly

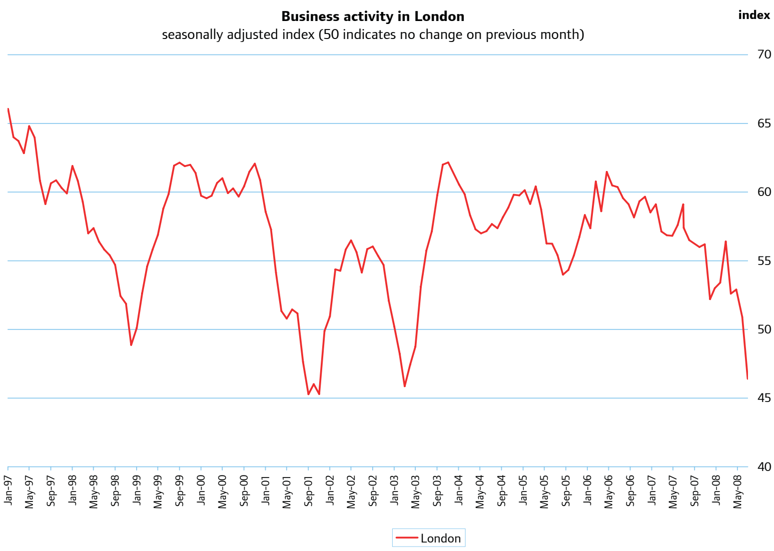


Source: SPSL

London's business activity falls

- London firms decreased their output of goods and services in June 2008.
- The Purchasing Managers' Index (PMI) of business activity recorded 46.4 in June compared to 50.9 in May.
- A rate of below 50 on the index indicates a decrease in business activity from the previous month. The PMI for business activity has fallen below 50 for the first time since May 2003.

Latest release: July 2008
Next release: August 2008

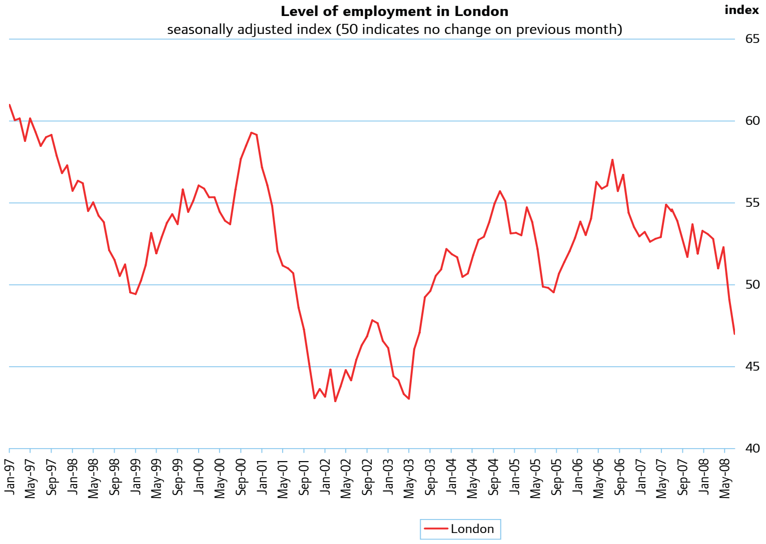


Source: RBS/Markit Economics

London employment weakens sharply

- The PMI shows that the level of employment in London firms remained below the 50 mark in June 2008.
- The PMI for the level of employment was 47.0 in June compared to 49.1 in May.
- A rate of below 50 on the index indicates a decrease in the level of employment from the previous month.

Latest release: July 2008
Next release: August 2008

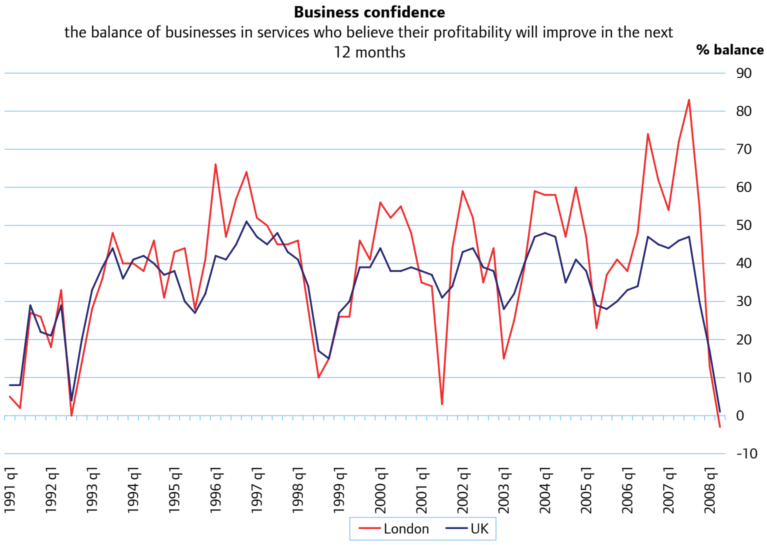


Source: RBS/Markit Economics

Profitability in the service sector expected to stagnate

- The British Chambers of Commerce's July Quarterly Economic Survey (QES) showed that overall London's service sector firms expected their profitability to decrease over the next 12 months.
- The net balance of businesses in services in London expecting to increase their profitability over the next 12 months was -3% in Q2 2008.
- The net balance of UK businesses in services expecting increased profitability over the next 12 months was 1% in Q2 2008.

Latest release: July 2008
Next release: October 2008

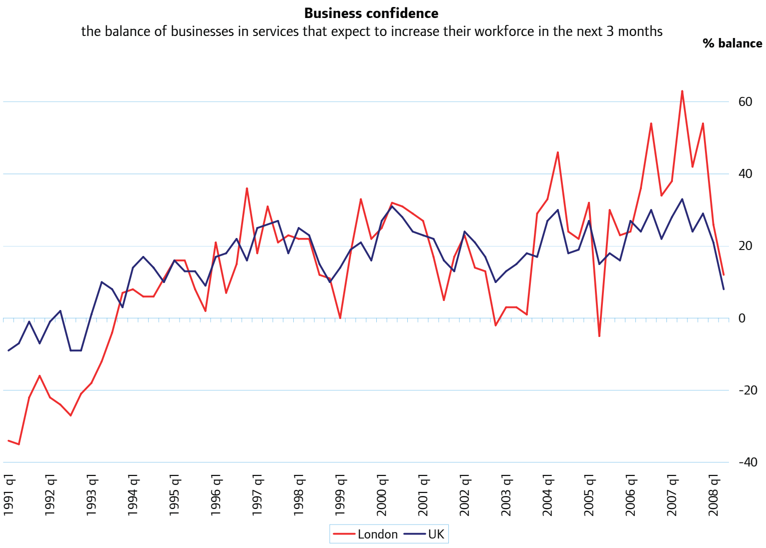


Source: British Chambers of Commerce, Quarterly Economic Survey

Employment expectations in the service sector weakens further

- The British Chambers of Commerce's July Quarterly Economic Survey showed that London's service sector firms still expected to increase their workforce over the next three months.
- For London the net balance expecting to increase their workforce declined to 12% in Q2 2008 from 26% in Q1 2008.
- For the UK the net balance expecting to increase their workforce declined to 8% in Q2 2008 from 21% in Q1 2007.

Latest release: July 2008
Next release: October 2008



Source: British Chambers of Commerce, Quarterly Economic Survey

Self-directed adult social care in London

Matthew Barry,
Economist

In recent years there have been measures to increase the amount of individual involvement in how social care services are delivered, including direct payments and, more recently, individual budgets.

In December 2007, all relevant central government departments, the Local Government Association and a number of other key agencies and associations committed to "Putting People First: A shared vision and commitment to the transformation of adult social care". A key component of this vision is a move to a self-directed adult social care system.

As self-directed social care is fundamental to the goal of helping those with care needs live independently, it directly affects the community care sector – care provided to individuals in their community rather than in care homes.

The Community Care Sector

The general trend from the early 1990s to now has been the growth of independent provision and self-funding, and of home care (care delivered in individuals' own homes) at the expense of residential care. The move to home care has been driven by a combination of factors including: resource constraints; a correction of a traditional bias towards institutional care; central government policy; technological advances; and individuals' preference to stay in their own homes.

Local Authorities still provide about three quarters of formal care funding which amounted to about £2 billion in London in 2005/06. Of this 39.8 per cent (compared to 43.5 per cent in England) was spent on care homes, 42.6 per cent in community care (42.6 per cent in England), while 17.8 per cent was on assessment and care management (13.9 per cent in England). Most of the 42.6 per cent allocated to community care in London was directed towards either home or day care, with only 6 per cent going towards direct payments.

The prevalence of different types of community care varies by the different needs groups. Older people and adults between the ages of 18 and 64 with physical disabilities or sensory impairment are more likely to receive home care than day care (care delivered in day care centres). The reverse is the case for adults between the age of 18 and 64 with mental illness or learning difficulties, with significantly more receiving day care services than home care.

The most recent survey of council-funded home care hours in September 2006 estimated total provision at around 509,000 hours a week in London, provided to around 49,000 households. Of these around 426,000 hours, or 84 per cent, were provided by the private or third sector.

The higher cost of living in London raises the cost of home care, particularly in inner London where the average cost is about 10 per cent above England as a whole. The difference is much higher in day care where land and property costs play a bigger role. Council provided home care in London is roughly twice as costly per hour as home care contracted out.

Privately funded home care by individuals has been steadily increasing in recent years as direct payments have become more prevalent and constraints on public care funding have become more binding. Privately funded home care tends to be provided at a higher intensity, that is, with longer duration of visits, than publicly funded care.

The care workforce is a relatively low paid one with high turnover. In 2006 the average wage in the home care sector in London was estimated to be £6.30 per hour in the independent sector and £7.38 per hour for council staff, both considerably below the London average wage. Home care turnover rates have been estimated at 24.9 per cent per year and vacancy rates at 5.9 per cent. The community care workforce is predominately female, and older on average than the workforce as a whole. London's community care workforce is more ethnically diverse than the broader London population, and significantly more diverse than in England as a whole.

In the 2001 Census 607,000 Londoners stated they provided some amount of informal social care of which 20 per cent provided more than 50 hours of care per week. The cost of replacing all informal care in England with formal care has been estimated recently by Laing and Buisson in their Domiciliary Markets 2007 at £31 billion per year.

The Community Care Market

Demand is determined by the total of public funds directed towards community care and the funds of self-funders. The supply is the total potential provision of care by either Local Authority, private or third sector providers. More broadly, supply of social care includes the informal care provided by family and friends.

The home care market is very fragmented, with a few very large providers and many small ones. There are 584 registered providers in London alone, mostly independent providers who provide around 74 per cent of all home care.

Current contracting arrangements essentially pools together resources to collectively purchase social care, providing local authorities with considerable buying power to keep down costs. Recent trends suggest larger providers are gaining an increasing proportion of local authority contracts while smaller providers have benefited disproportionately from the growth in privately funded home care.

The move to self-directed social care has potentially significant implications for the sector's structure and care outcomes. Traditionally, whether it has been provided by council staff or contracted out, social service departments' decisions on what services to commission essentially established the market. The market for care should become far more fluid with a move to self-directed care.

Policy Instruments of Self-Directed Care

A direct payment is provided as a cash payment, commonly around 90 per cent of the cost of the service that would have otherwise been provided by the local authority.

Take up of direct payments has been slow since they were introduced in 1996. Direct payments are highest among younger adults with physical or sensory disabilities (from whom the push for independent living was generated) and lowest for older people.

A key issue with direct payments is the availability of support to set up and manage a self-directed care plan. A recent survey found about 20 per cent of users had to wait to access direct payment support in England, and implied a gap between support provided and number of recipients.

Individual budgets differ from direct payments in three key ways. Firstly, they aim to coordinate multiple income streams from a number of agencies. Secondly, they allow for these coordinated income streams to be made as a direct payment but do not exclude more limited mechanisms of individual control. Thirdly, their cash value is based on the level of need rather than the cost of alternative council services as is the case with direct payments.

The evaluation of the Individual Budgets Pilot Programme is due to be released in the autumn and a decision as to whether to roll out Individual Budgets across the country will then be taken.

Economic Implications of Self-Directed Care

The transformation to a self-directed adult social care system is likely to have implications for the quality and efficiency of community care. It is still unclear the degree to which users will gain control of the care provision under a transformation to self-directed care, both in the proportion of users that take up a self-directed care mechanism and the degree of restrictions associated with user control in these mechanisms.

Providing the necessary support is there, the impact on the quality of care and how users value it, is likely to be positive with increased user control over their care. Given the information on available providers is good and switching relatively easy, a service user would be able to change providers if they were unhappy with the quality or relevance of that service. Self-directed care could further increase the value of public funded care by allowing users to determine exactly how best to meet their needs given the finance available to them, possibly through a completely different mix of goods and services.

Under current arrangements where the majority of home care is contracted out to the independent sector there is considerable buying power. A shift to a self-directed care system would reduce this buying power as at the very least councils could no longer guarantee clients to contractors.

For existing social services, centralised direction of social care potentially benefits from improved supply information, including better information on cost structures and range of service possibilities. On the other hand, service users have a better understanding of their needs, how they value different service options and how they could best fit in with their lives.

To determine whether public administration costs will be greater or less under a self-directed system depends on whether the costs of supporting and monitoring choice exceed the savings in commissioning and administering care provision. This is ambiguous as it is not yet clear the degree of support brokerage and monitoring that will exist under the new system. Where appropriate support is not provided there is a risk that the administration costs of managing the care provision could shift to those in receipt of direct payments and/or their carers.

Particularly in the provision of day care, a certain minimum of users is required to deliver the service at a justifiable level of cost. If a significant number of users opt out of a particular service, then average costs may rise to a level that makes the service unviable to those remaining. As such, those in need could feasibly be adversely affected despite not having opted for an individual budget or a direct payment.

The transformation to a self-directed care sector will have significant impact on employment in the sector. The profile of the workforce, from the direct providers of care to those administering and facilitating it, will be required to change considerably in a successful transformation to self-directed care. Emerging roles such as support brokers and personal assistants will become significant components of the social care workforce.

Currently, all home care providers are required to register with the Commission for Social Care Inspection and are subjected to periodic inspection and evaluation. Self-directed care poses a considerable regulatory challenge. As empowerment is a product of choice and risk, it is necessary that some risk be born by users.

Policy Issues of Self-Directed Care

A successful move to a self-directed adult social care sector is likely to result in a system that better meets the needs of service users. Like any institutional transformation however, there are a number of important implications and risks that need to be thought through in planning the transition.

Fundamental change will be required in the function of council social service departments where they move from a role of "gatekeepers" of care access and provision to market-enablers and supporters of user controlled care. Likewise, there are a number of broader issues in relation to market management and policy friction that require consideration.

There are a number of income streams and support options currently available to carers and people with care needs, provided by a number of agencies. In addition to Local Authorities, these include Independent Living Funds, Primary Care Trusts and social security benefits such as Disability Living Allowance and Attendance Allowance. If carried out properly, independent budgets provide the opportunity to significantly reduce the overlap in assessment processes and case management.

A bank of experience and knowledge in individuals and organisations that are trusted by users is vital to the effectiveness of a self-directed social care system. The absence of this is likely to: increase the possibility of individuals purchasing care at a higher price than they would otherwise have; purchasing care packages that fail to meet their needs; or simply opting for the status quo. A strong support network that is well funded and enabled could provide a mechanism to overcome many of the potential negatives of a self-directed system in relation to information, transaction costs, risk, and buying power.

A key policy problem with decentralising decision making is the loss of scale economies associated with collecting information on cost, quality and availability of services. Support organisations and networks that collectively collect and pool information along with councils, regulators and other agencies, will likely mitigate much of this potential loss. In a recent survey of direct payments, London boroughs were most likely to cite a lack of available support service as a critical hindrance to the expansion of direct payments.

A move to self-directed social care is likely to have fundamental implications to the profile of the adult social care sector and its workforce. This will create significant challenges of adaptation for social service departments, central policy makers as well as independent providers. Common commitment and collaboration in addressing these challenges, both nationally and locally, is vital to the success of this transformation.

Additional information

Data sources

Tube and bus ridership	Transport for London on 020 7222 5600 or email: enquire@tfl.gov.uk
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. In 2008/09 there are eleven 28-day periods, one 26-day period and one 31-day period. Period 1 started on 1 April.

Bus ridership

Transport for London's measure of the number of passengers using buses in London in a given period. There are 13 periods in a year. In 2008/09 there are eleven 28-day periods, one 26-day period and one 31-day period. Period 1 started on 1 April.

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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ISSN 1740-9136 (print) ISSN 1740-9195 (online) ISSN 1740-9144 (email)

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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.

GLA Economics is funded by

Transport for London

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