GLAECONOMICS

London's Economy Today

Issue 77 | January 2009

In this issue

UK economy in recession and interest rates cut to their lowest ever

by **Gordon Douglass**, Economist, **Simon Kyte**, Economist and **Christopher Lewis**, Senior Economist

The UK economy contracted by 1.5 per cent in the fourth quarter of 2008 (see Figure 1), the fastest pace of quarterly decline since the second quarter of 1980. With the economy having already contracted by 0.6 per cent in the third quarter, the UK economy is now in an official recession for the first time since the early 1990s.

In 2008 the annual rate of economic growth was 0.7 per cent, the weakest growth since 1992. Output declined in virtually every sector of the economy in the fourth quarter, with an extremely steep fall in manufacturing, which declined by 4.6 per cent. Business services and finance was actually one of the better performing sectors with a decline of 0.5 per cent in the fourth quarter. Business surveys are currently very weak so despite the depreciation of sterling, there would appear to be few signs of good cheer on the horizon for the UK economy.

Latest news...

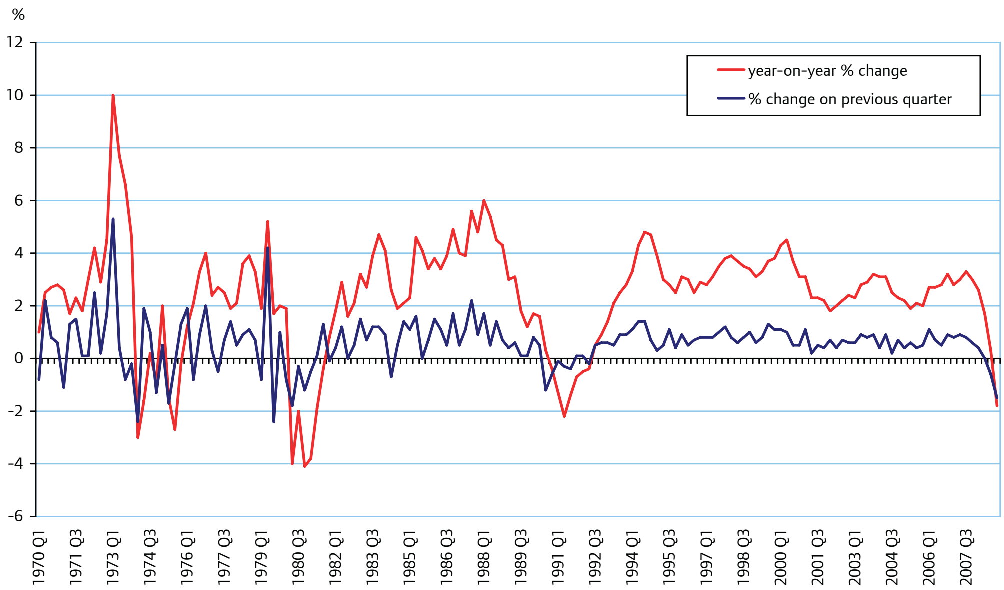
- **London Economic Development Snapshot**

This periodic report prepared by GLA Economics in conjunction with the LDA shows the progress made in delivering the objectives set out in the Economic Development Strategy for London. Amongst other things, the report highlights that after two and a half years in which there has been a significant narrowing of the gap with London as a whole, the combined employment rate for the seven most disadvantaged boroughs in London has shown signs of deterioration over the past nine months.

Visit **www.london.gov.uk/mayor/economic_unit** to download this publication.

Figure 1: UK GDP Growth

Source: Office for National Statistics



The High Street faces tough times

The economic downturn has hit the High Street with a number of prominent chains entering into administration or closing. The Christmas and New Year period saw the high profile closing of Woolworths. Other firms such as MFI, Adams, Waterford Wedgwood, Zavvi and Whittards also entered administration or closed over the holiday period. Office for National Statistics (ONS) data showed a 1.6 per cent increase in the volume of retail sales in December compared with the same period in 2007, while the value of retail sales actually declined by 0.8 per cent due to heavy discounting. The British Retail Consortium has released figures compiled by KPMG that showed a 3.3 per cent decline in like-for-like sales in the UK during December compared with a year earlier (for central London the decline was only 0.7 per cent). The retail trading situation for at least the first half of 2009 is likely to be harsh as rising unemployment dampens household consumption.

Interest rates cut to a historic low

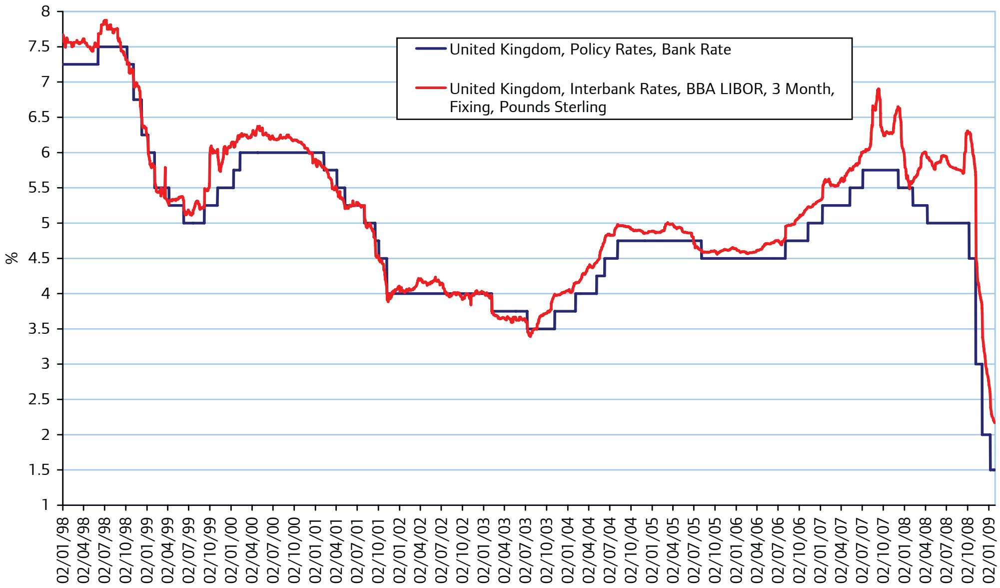
On 8 January the Bank of England cut interest rates by 50 basis points to 1.5 per cent (see Figure 2) the lowest rate it has ever set since its founding in 1694. This was the fourth cut in interest rates in as many months, which has seen rates fall by 350 basis points since the beginning of October. With the UK economy in recession and the world economy faltering, further cuts are likely in the coming months. Inflationary concerns are rapidly diminishing as shown by the fall in CPI inflation to 3.1 per cent in December 2008 from 4.1 per cent in November. RPI inflation is expected to turn negative very shortly.

The credit crunch still reverberating

The Bank of England's 2008 Q4 Credit Conditions Survey showed that the effects of the credit crunch are still being felt. Further reductions in credit availability are expected in the first quarter of 2009, whilst default rates have already risen. Meanwhile a CBI/PricewaterhouseCoopers survey showed that the volume of business conducted by the financial services sector with industrial and commercial companies fell in the final quarter of 2008. A majority of financial services firms thought that the volume of business would fall again in the first quarter of 2009.

Figure 2: Bank of England's Repo rate and the 3 month London Inter-Bank Offered Rate (LIBOR)
Last data point is 28/01/09

Source: EcoWin



UK banks in trouble as the Government makes a raft of new announcements

The Royal Bank of Scotland (RBS) announced on 19 January that it expected to have suffered more than £20 billion, and perhaps as much as £28 billion, in losses in 2008, which would make it the largest British corporate loss in history. UK banking shares fell dramatically with this news and concerns over the creeping nationalisation of the UK banking sector by the Government. They have recovered slightly since the publication of a letter by the chairman and chief executive of Barclays on 26 January saying Barclays was well funded and profitable. The UK car industry is also in trouble so on 27 January Lord Mandelson outlined a package of government support for the UK car industry potentially worth up to £2.3 billion. This package includes guarantees to unlock loans of up to £1.3 billion from the European Investment Bank and another £1 billion in loans to fund investment in green-friendly vehicles.

On 19 January the UK Government announced a further package of measures to encourage increased lending by banks. Existing support to banks is to be increased and the Government stake held in RBS is to rise to around 70 per cent. In return, RBS has promised to increase its lending in 2009 by £6 billion. However, the key part of the Government package is an asset protection scheme that will allow banks to buy government insurance against additional losses for assets denominated in any currency on their books in return for a fee. The scheme is expected to last for at least five years. In exchange, banks taking part in the scheme (which is voluntary) will have to sign legally binding agreements to increase lending. Northern Rock, which was nationalised last year, will also face a complete policy reversal. Now instead of having to wind down its mortgage book it will have to offer new loans in an attempt to increase capacity in the mortgage market. The Treasury has also authorised the Bank of England to buy 'high quality' corporate assets, initially worth up to £50 billion from 2 February. It is hoped that this will improve financial stability and reduce the financial constraints on large companies. The government has also announced that the credit guarantee scheme that had been due to expire in April, will now be extended to the end of the year.

In response to the ongoing difficulties faced by businesses attempting to get access to credit, the UK Government has unveiled a 3-point plan. Under one scheme, the Government will underwrite half of up to £20 billion of short-term credit providing working capital for companies with a turnover of up to £500 million. The Government also plans to guarantee up to 75 per cent of loans for businesses with a turnover of up to £25 million. However, this part of the scheme will only be targeted at particular sectors of the economy. Finally, the £50 million fund announced as part of last November's Pre-Budget Report focused on over-indebted small businesses with high growth potential is to be expanded with £25 million of fresh funding from banks. These schemes along with recent bank nationalisations, weakening tax revenues and increases in expenditure on benefits such as Job Seekers Allowance will worsen the Government's already deteriorating public finances.

Banking problems are also continuing in the rest of the world. Commerzbank, Germany's second largest bank, announced on 8 January that the German government would inject €10 billion, taking a 25 per cent stake plus 1 share in the bank, whilst the Irish government said on 15 January that it would nationalise the Anglo Irish Bank. It was announced on 16 January that the Bank of America would receive a further $20 billion of new US government aid along with $118 billion worth of guarantees against bad assets. The US Senate has also released the remaining $350 billion of the first US financial bailout package.

Rapid slowdown at the end of 2008 expected to continue

Stock markets suffered during 2008 with the FTSE 100 ending the year over 30 per cent down, its worst annual decline since the index was created in 1985. Meanwhile sterling fell by around 25 per cent against a trade-weighted basket of currencies during 2008. With the beginning of 2009 seeing major concerns about the UK banking sector and the Government's finances sterling continued to fall hitting a 24-year low against the dollar. At least this will help to support the UK's net exports. Unemployment has risen in the UK with ILO unemployment increasing to 7.4 per cent in the three months to November 2008. Morgan McKinley, the financial recruitment specialist has reported a 34 per cent drop in job vacancies in the City of London in December compared with the same period a year ago. Meanwhile the British Chambers of Commerce's Economic Survey for Q4 2008 found that "all the critical national balances have worsened, for both manufacturing and services, and all are in negative territory", whilst the results "highlight a frightening deterioration in the UK economic situation".

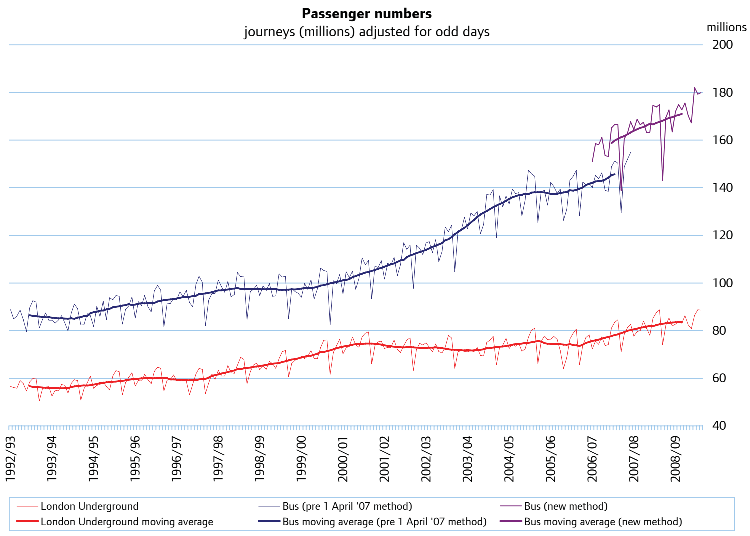
In the Eurozone economic confidence has fallen to levels not seen since the 'Economic Sentiment Index' was first introduced in January 1985. Spain, Portugal and Greece all fell victim to Standard and Poor's downgrades. German manufacturing has been hit particularly hard by reduced global demand, with exports slumping by 10.6 per cent in November. Responding to the downturn and rapidly falling inflation the European Central Bank cut interest rates by 50 basis points in January to 2 per cent – the lowest they have been since the end of 2005. Elsewhere, US unemployment hit 7.2 per cent after rising by 524,000 in December. The downturn in global demand is also having an impact on China, which experienced an annualised growth rate of just 6.8 per cent in the final quarter of 2008. With the global downturn picking up speed and Mervyn King, the Governor of the Bank of England, warning that "the contraction of lending to ordinary viable businesses… is threatening to drive the economy further into recession" it is likely that the UK and London economies will experience an extremely tough 2009.

Economic indicators

Increase in moving average of passenger numbers

- The most recent 28-day period is from 9 November 2008 to 6 December 2008. London's Underground and buses had 268.5 million passenger journeys; 179.9 million by bus and 88.6 million by Underground.
- The moving average of passengers every period increased to 254.5 million from a downwardly revised 254.2 million. The moving average for buses was 171.0 million. The moving average for the Underground was 83.6 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 issue 58 (June 2007).

Latest release: January 2009
Next release: February 2009

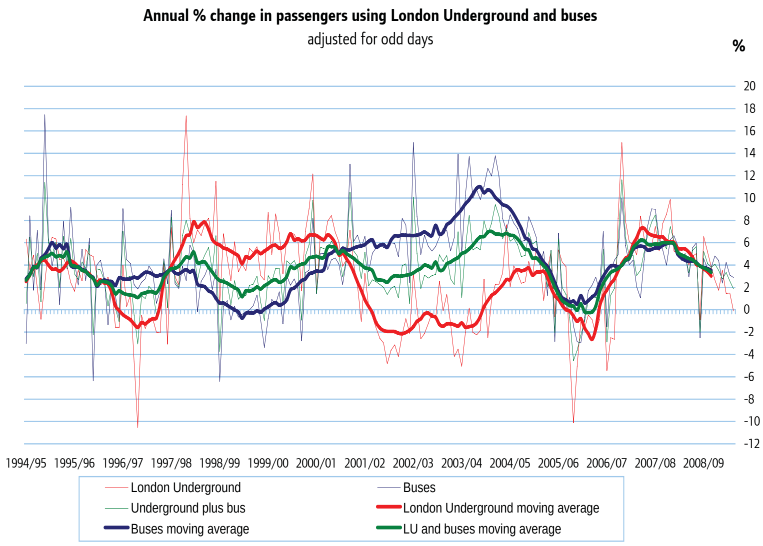


Source: Transport for London

Average annual growth rate of passengers continues to decrease

- The moving average annual rate of growth in passenger journeys decreased to 3.3% from a downwardly revised 3.6% in the previous period.
- The moving average annual rate of growth in bus passenger journey numbers decreased to 3.5% from a downwardly revised 3.7% in the previous period.
- The moving average annual rate of growth in Underground passenger journey numbers decreased to 3.0% from 3.4% in the previous period.

Latest release: January 2009
Next release: February 2009

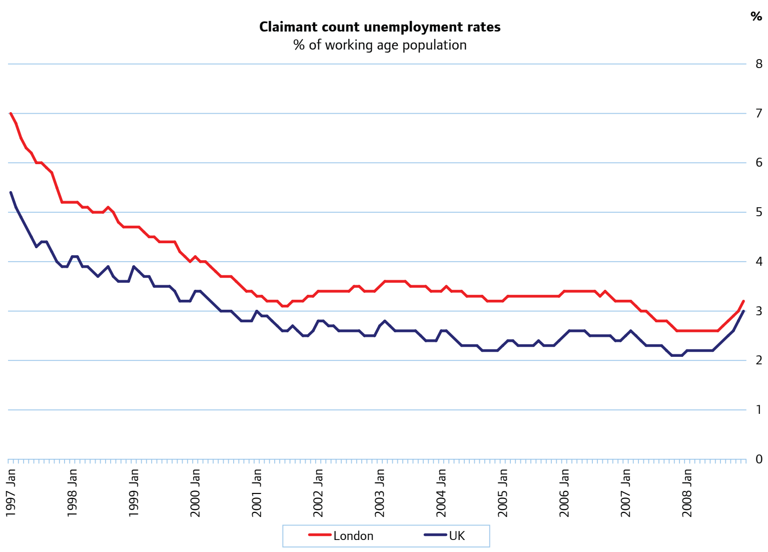


Source: Transport for London

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 3.2% in December 2008.
- There were 160,000 unemployment claimants in London in December 2008 compared with 131,100 in December 2007.
- The claimant count unemployment rate of London remains above that of the UK.

Latest release: January 2009
Next release: February 2009

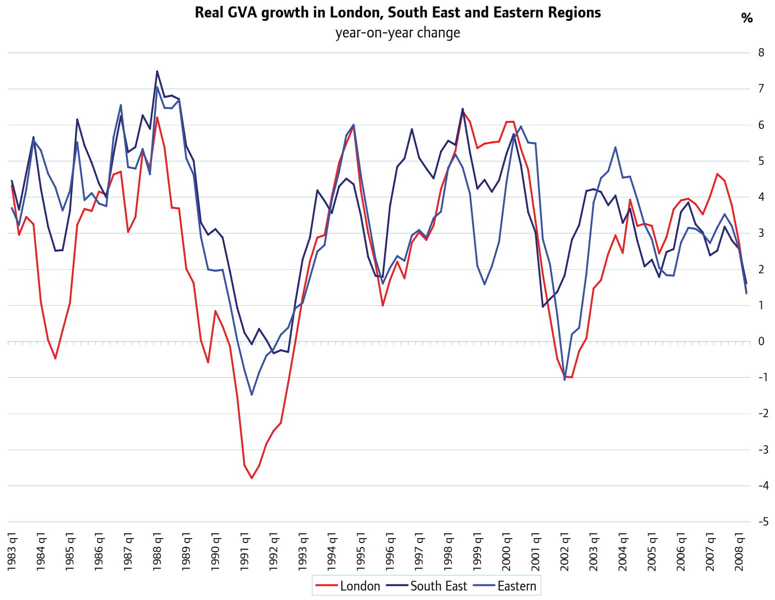


Source: Claimant Count, Nomis

Annual output growth eases in London

- London's annual growth in output decreased to 1.3% in Q2 2008 from a downwardly revised 2.7% in Q1 2008.
- Annual output growth in the South East decreased to 1.6% in Q2 2008 from a downwardly revised 2.6% in Q1 2008.
- Annual output growth in the Eastern region decreased to 1.4% in Q2 2008 from a downwardly revised 2.5% in Q1 2008.

Latest release: November 2008
Next release: February 2009

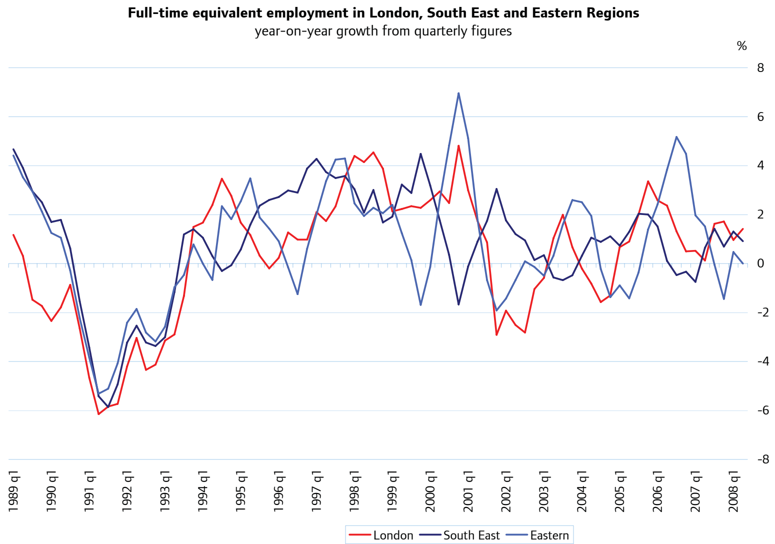


Source: Experian Business Strategies

Annual employment growth in London faster than in surrounding regions

- London's annual employment growth increased to 1.4% in Q2 2008 from an upwardly revised 1.0% in Q1 2008.
- Annual employment growth in the South East decreased to 0.9% in Q2 2008 from a downwardly revised 1.3% in Q1 2008.
- Annual employment growth in the Eastern region decreased to 0% in Q2 2008 from a downwardly revised 0.5% in Q1 2008.

Latest release: November 2008
Next release: February 2009

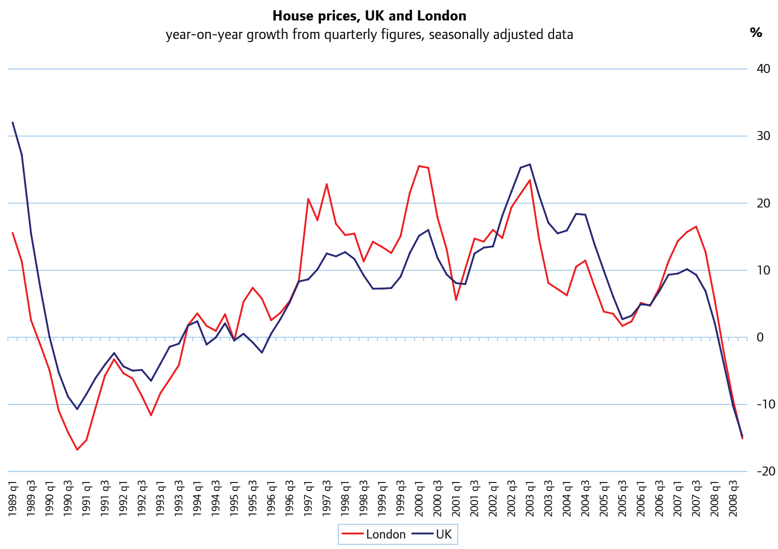


Source: Experian Business Strategies

Falling house prices

- Nationwide reported that house prices in London fell at their fastest year-on-year rate since Q1 1991 in Q4 2008.
- Annual house price inflation in London was –15.1% in Q4 2008, down from –9.4% in Q3 2008.
- Annual house price inflation in the UK was –14.7% in Q4 2008, down from -10.3% in Q3 2008.

Latest release: January 2009
Next release: April 2009

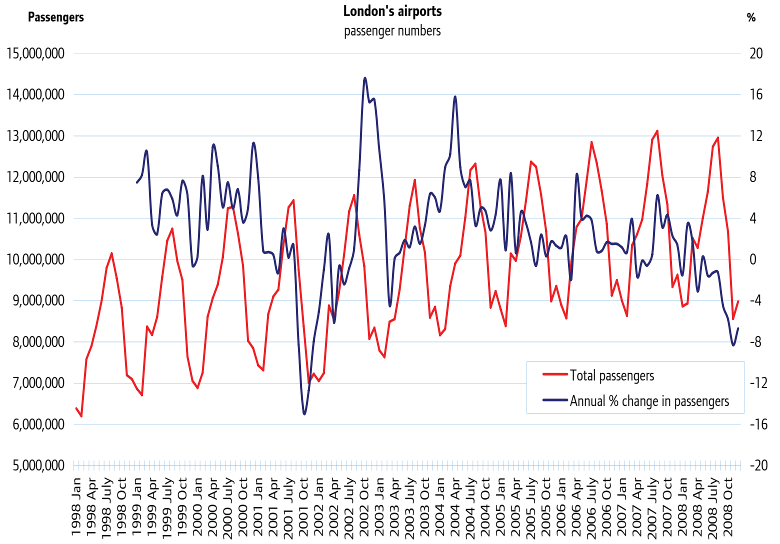


Source: Nationwide

Weak airport passenger numbers

- 9.0 million passengers travelled through London's airports in December 2008.
- The number of passengers using London's airports decreased by 6.7 per cent from December 2007 to December 2008.
- The year-on-year percentage change in passenger numbers using London's airports was negative for most of 2008.

Latest release: January 2009
Next release: February 2009

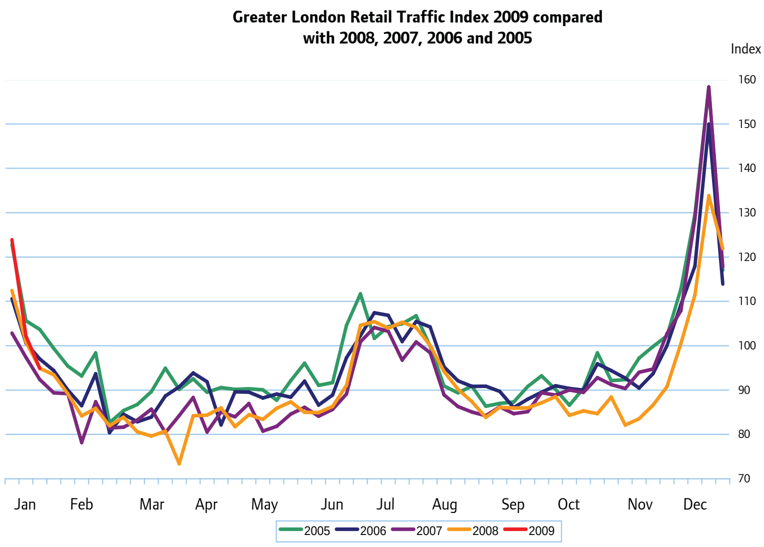


Source: Civil Aviation Authority

Synovate Retail Traffic was extremely weak for much of 2008

- The Synovate Retail Traffic Index of shoppers in London was 94.9 in the second week of January compared to 102.2 in the previous week.
- Compared to previous years the index was extremely weak between mid-September and the third week of December 2008. However, since then the index has been above or similar to previous years.
- Synovate's Retail Traffic Index measures the number of shoppers and does not necessarily reflect the level of spending.

Latest release: Mid-January 2009
Next release: Weekly

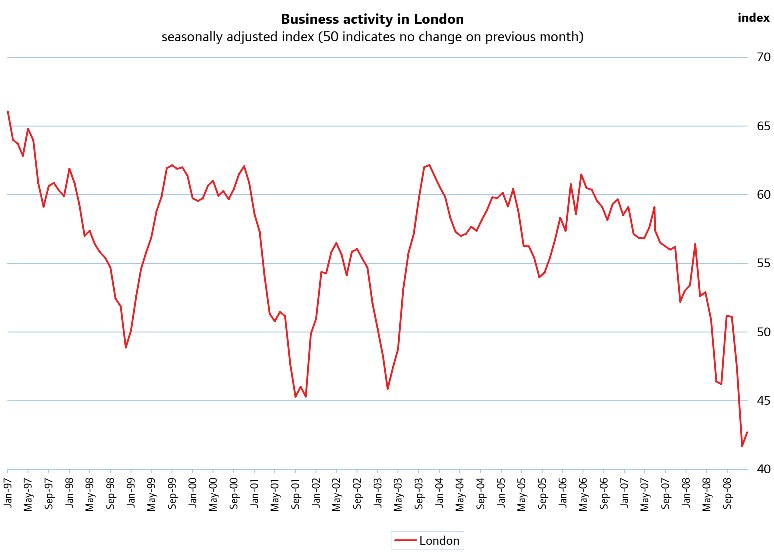


Source: Synovate

London's business activity decreasing

- London firms decreased their output of goods and services in December 2008.
- The Purchasing Managers' Index (PMI) of business activity recorded 42.7 in December compared to 41.7 in November.
- A rate of below 50 on the index indicates a decrease in business activity from the previous month.

Latest release: January 2009
Next release: February 2009

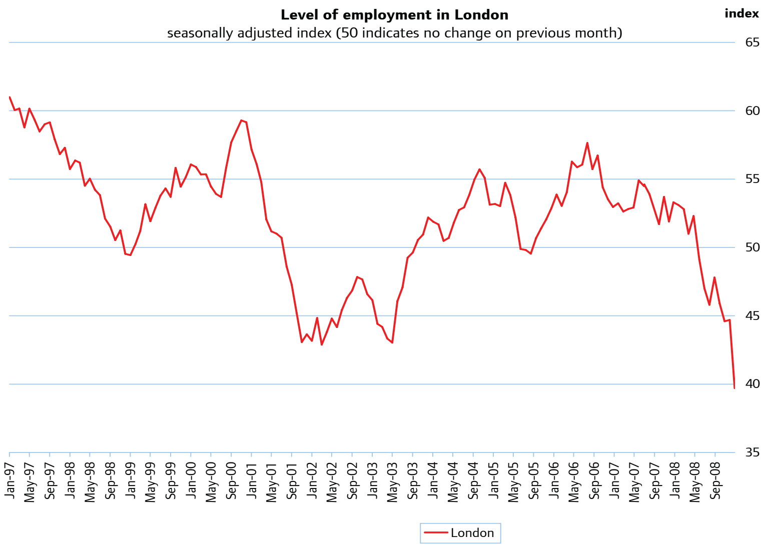


Source: RBS/Markit Economics

London's employment has poor December

- The PMI shows that the level of employment in London firms decreased in December 2008.
- The PMI for the level of employment was 39.7 in December compared to 44.7 in November.
- A rate of below 50 on the index indicates a decrease in the level of employment from the previous month.

Latest release: January 2009
Next release: February 2009

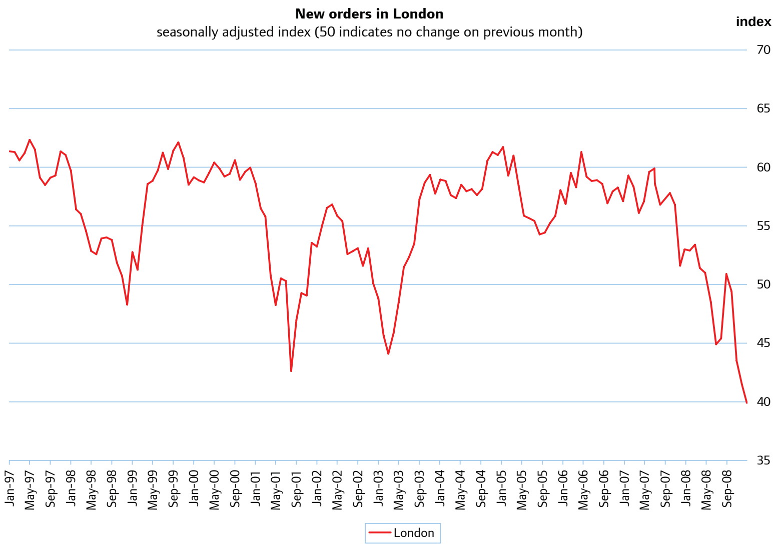


Source: RBS/Markit Economics

New orders in London drop

- December 2008 saw a fall in new orders for London firms.
- The PMI for new orders recorded 39.9 in December compared to 41.5 in November.
- A rate of below 50 on the index indicates a decrease in new orders from the previous month.

Latest release: January 2009
Next release: February 2009

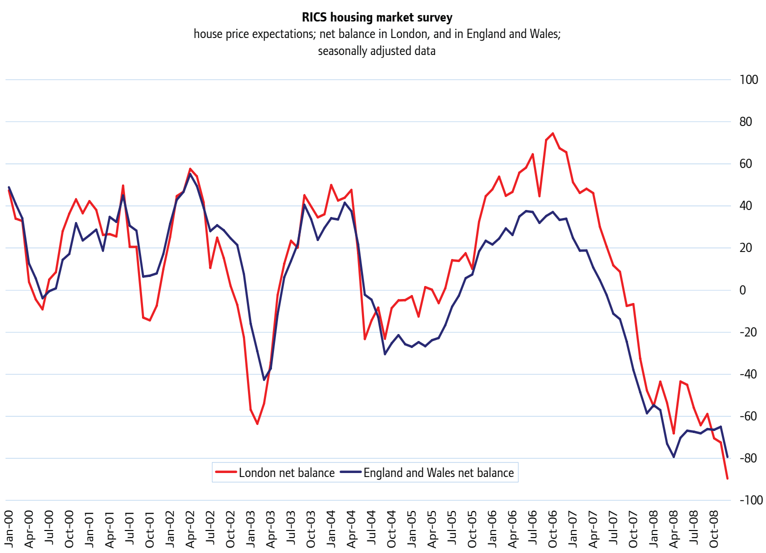


Source: RBS/Markit Economics

Surveyors expect house prices to continue falling

- The RICS survey shows that surveyors expect house prices to continue to decrease over the next three months in London and in England and Wales.
- The net house price expectations balance in London was -90 in December 2008, down from -72 in November.
- For England and Wales, the net house price expectations balance was –79 in December 2008, down from –65 in November.

Latest release: January 2009
Next release: February 2009



Source: Royal Institution of Chartered Surveyors

Business births and closures

By **Matthew Waite**,
Senior Economist

In November 2008 the Office for National Statistics (ONS) produced new statistics on business births and deaths. These new statistics replace the existing BERR statistics published in "Business start ups and closures: VAT registrations and deregistrations in the UK", for which 2008 will be the last publication date. The new statistics are produced under the guidance and methodology of Eurostat and aim to ensure comparability of business demography statistics across Europe. This supplement presents the latest data for both the ONS and BERR statistics, summarises the main differences between the two and sets out the impact of the change for London.

The main difference between the ONS and BERR statistics concerns coverage. Whilst the BERR statistics include only those businesses that are above the threshold for VAT payments, the ONS statistics also include PAYE registered businesses. This means that for the first time, businesses that do not pay VAT are included in the measures for business demography.

Figure 3 shows the number of business births and deaths for the UK, using both BERR and ONS data. The inclusion of PAYE-registered businesses ensures a more comprehensive approach to business demography. As a result, births and deaths as measured by the ONS are consistently higher than the corresponding BERR statistics.

Figure 3: Numbers of business births and deaths for the UK (2000-2007)

Source: ONS

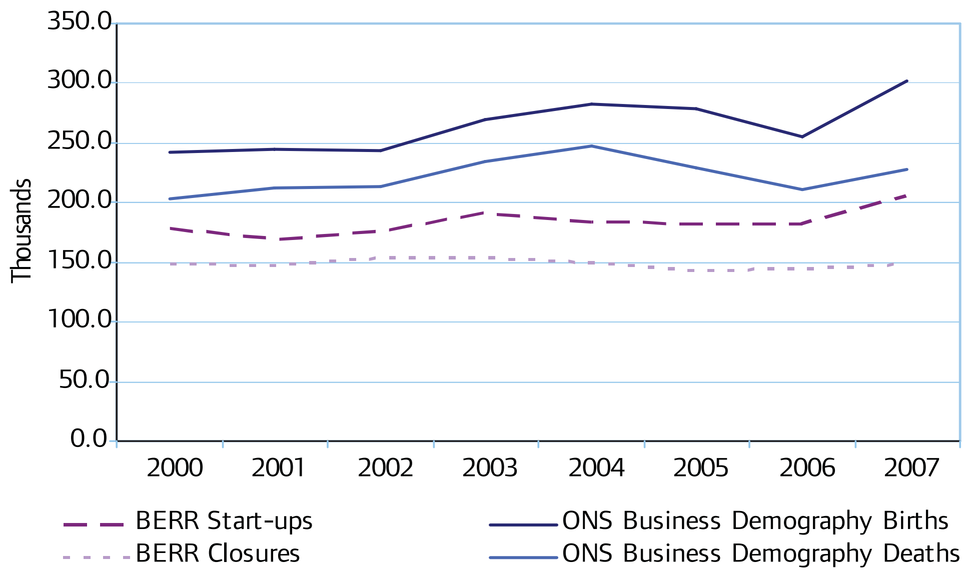


Figure 4: Business birth and death rates for the UK (2000-2007)

Source: ONS

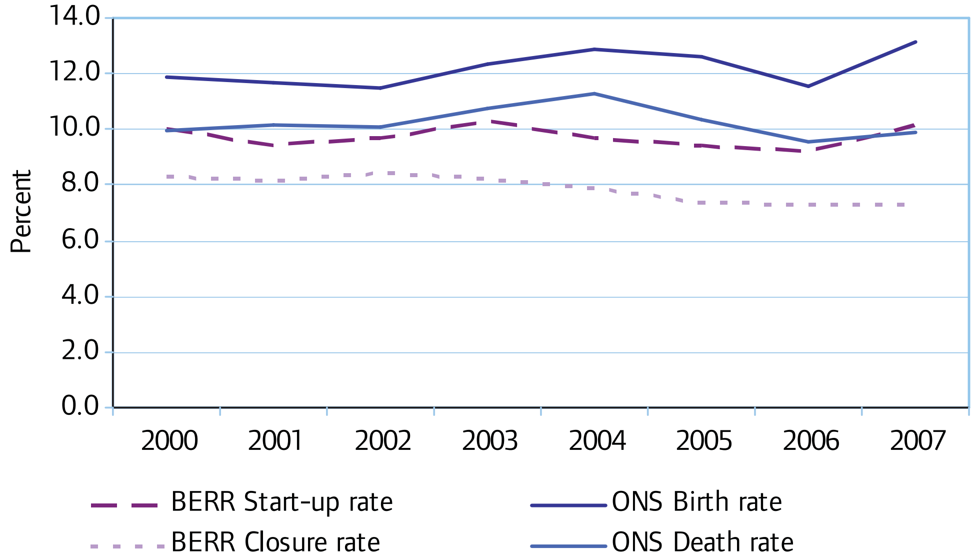


Figure 4 shows the business birth and death rates using both BERR and ONS data for the UK as a whole. The chart shows that over time birth and death rates are higher when using the ONS methodology as compared to the BERR methodology. This gap between the two is due primarily to the inclusion of PAYE registered businesses but may also be due, in part, to changes in the measurement of the stock of businesses.

In order to measure the stock of businesses, the BERR statistics look at a snapshot of the business stock at a specific point in time. The new ONS series additionally accounts for any business activity taking place at any point in time within a year. Other differences between the two series relate to the legal status of businesses included, the industries included, as well as on adjustments and revisions. More detail on the specific differences can be found at: http://stats.berr.gov.uk/ed/vat/ED_AU_Article_for_Economic_and_Labour_Market_Review_Final_Version.pdf

Regional data from the new ONS statistics are available for 2007 only. These data show that, of all UK regions, London benefits the most from the change in the methodology of estimating business demography. Data for 2007 show that the ONS methodology captures around 67,000 additional businesses for London as compared to the BERR approach and, as a result, London accounts for a 1 percentage point higher share of all UK businesses when compared to the BERR statistics. For 2007, the ONS estimates the business birth rate for London at 16.5 per cent and the business death rate at 11.8 per cent. For the same year BERR estimates the business start up rate for London at 12.8 per cent and the business closure rate at 8.6 per cent.

For more information on the new series see the ONS website: http://stats.berr.gov.uk/UKSA/ed/sa20081128.htm

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
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 Institution of Chartered Surveyors

Past features

Issue	
53	London Economic Development Snapshot London's employee jobs - the latest trends
54	Crossrail: Where is it going?
55	How large is wage inequality in London? Budget 2007: The implications for London
56	The McKinsey Report and its relevance to London's financial services sector
57	Focus on key London employment sectors
58	Increasing London's housing supply
59	London Economic Development Snapshot
60	Creative London - London's Creative Sector: 2007 Update
61	The value of London's key exports
62	Globalisation, skills and employment: The London story
63	Working hard or hardly working? How cities could work better. GLA Economics' international conference reviewed
64	London's Central Business District: Its global importance
65	London Economic Development Snapshot
66	Women, employment and the gender pay gap
67	Budget 2008: A summary
68	Employment in London by firm size
69	Credit crunch and the property market
70	The evolution of UK and London employment rates
71	Self-directed adult social care in London
72	Snapshot mid-year update
73	Filling the coffers: London's tax export
74	The LDA's London Annual Business Survey (LABS)
75	Pre-Budget report 2008
76	Capacity takes centre stage in Transport for London's latest business plan

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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