GLAECONOMICS

London's Economy Today

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Transport for London

MAYOR OF LONDON

LONDON DEVELOPMENT AGENCY

London's Economy Today: Edition 2

GLA Economics Staff

- London's economic performance has turned below that of the rest of the UK, though there is no evidence yet of a recession developing.
- The growth of London's economy – like the rest of the UK – has been sustained for the last three years by consumer spending.
- Low interest rates and rising house prices have encouraged the use of borrowing to finance consumption which will be hard to maintain if house price growth weakens and income growth flattens further.

London's economy weaker than the UK

Recent estimates from Experian Business Strategies suggest that London under-performed against the UK in the second quarter. This may well persist into the third. The reasons are not hard to find - London's heavy dependence on the increasingly troubled Financial Services sector and the fact that high-spending tourists have continued to stay away.

The consensus view is that growth both in London and in the UK as a whole, though disappointing, is relatively stable, suggesting that the economy will continue to edge forward with little chance of a major break-out in either direction. It is certainly difficult to spot the engines of near-term growth. A turnaround in the depressed investment cycle can be ruled out for the foreseeable future and may only happen once delayed investment in new IT systems can be postponed no longer. This could possibly be well into 2003.

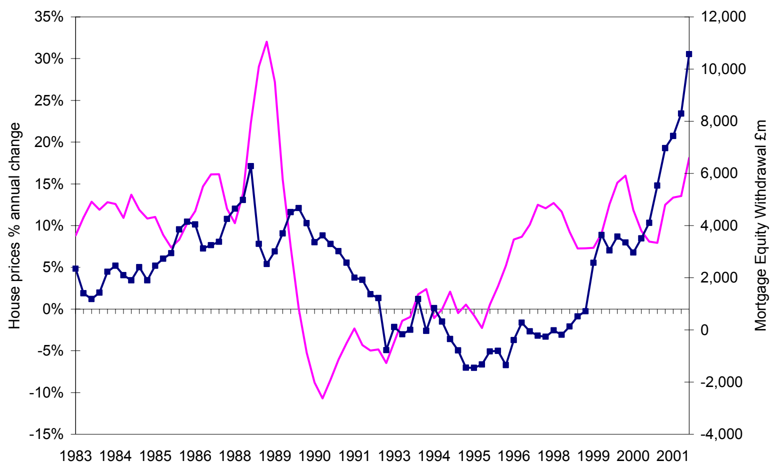
International trade, the difference between exports and imports of goods and services, is unlikely to provide much impetus. This sector has exerted a consistently negative impact on domestic demand throughout the UK (almost certainly including London too), over the whole of the current economic cycle. With the global economy still in the doldrums and sterling over-valued we can confidently rule this out as the catalyst for growth in the short run. Government expenditure, on the other hand, is beginning to pick up, as the spending plans announced in the Chancellor's last Budget Statement are translated into action. But this alone will not be enough to make the difference.

This leaves consumer spending, which for the last three years has been the only major component of demand, contributing materially to the growth of UK GDP. With earnings growth slowing down and personal savings at historically low levels, we have expected for some time that consumer spending growth will slow down.

The housing market is the key

The housing market and, in particular, the level of mortgage equity withdrawal (MEW) – have been supporting continued growth. The Bank of England defines mortgage equity withdrawal[1] as borrowing that is secured on the housing stock but not invested in it. In other words, homeowners see that they can borrow cheaply against the security of their property and therefore do so. The funds released in this way are available to finance consumption, for re-investment or for paying off more expensive forms of debt. According to

Mortgage Equity Withdrawals & House Prices - UK



Source: Nationwide & Bank of England

[1] Mortgage equity withdrawal and consumption, Bank of England Quarterly Bulletin

MORI only 9 per cent of those withdrawing equity saved the money for any length of time. The most popular targets for increased spending are household furniture and furnishings, cars and holidays.

Although MEW in money terms is now almost double the level of the peak reached in early 1989, it is still below the proportion of net income at that time (See page 4). Survey evidence suggests that around one third of MEW is either invested in other financial assets or is used to pay off existing debt. If this were the case, around 3 per cent of GDP would be affected if mortgage equity withdrawal were to stop.

This would be sufficient to produce a recession if taken straight through into reductions of spending. As the chart on page 1 shows, equity withdrawal closely tracks changes in house prices.

The impact on London

These effects are at least as important for the London economy as elsewhere in the UK and could be far higher. The average price of houses in London is almost double the national average – and higher in relation to average income. Equity withdrawal could well have contributed considerably more to sustaining activity in London than elsewhere. The corollary is that the risks to the London economy are rather larger than elsewhere.

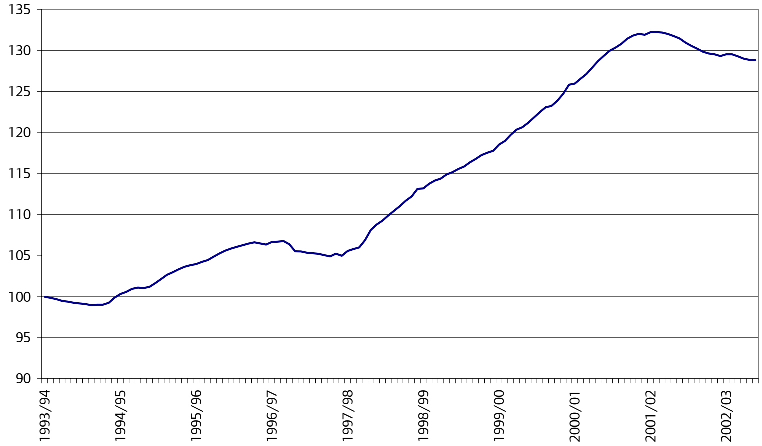
Tube Usage

Source: Transport for London
Latest Release: Tue 15 Oct 2002
Next Release: Tue 19 Nov 2002

- The latest tube usage figures reflect the current uncertainty about which way the London economy is going - for the second four-week period in succession the trend in tube usage has been flat.
- In the four weeks to 14 September 2002, passenger journeys fell slightly, but roughly in line with the normal seasonal trend.
- Tube usage has been broadly in decline since April 2001.

London Underground Passenger Journeys

Moving Average Index (Period 1 1993/94 = 100)*



Source: Transport for London * The year is subdivided into 13 periods - period 1 commences around the beginning of April

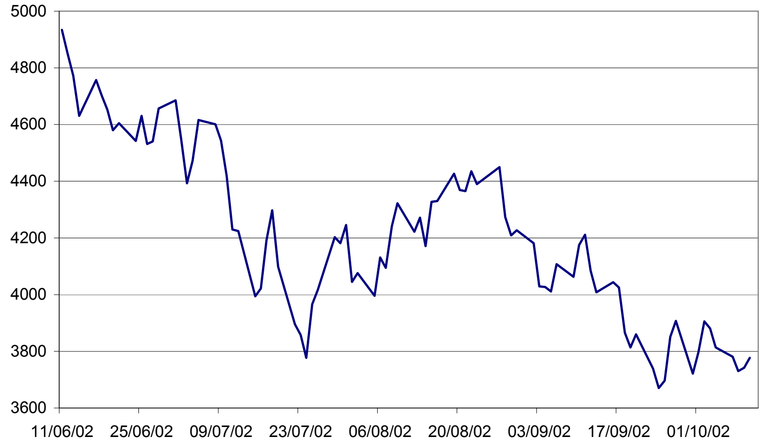
Financial Markets

Source: Financial Times
Latest Release: Tue 11 Oct 2002
Next Release: Daily

- The FTSE 100 Index reached a low this month dipping below 3700, with no signs as yet of recovery.
- Over the past four months the Index has fallen by over ten per cent.
- The Index has fallen by as much as 47 per cent from the all time high at the end of 1999 to this month's low.

FTSE 100 Index

Past 4 months: 11 June to 11 October 2002



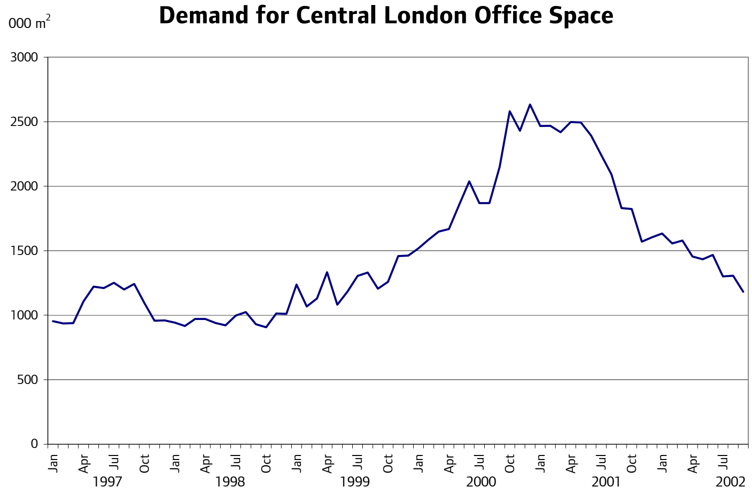
Source: Financial Times

Office Space Demand

Source: CB Hillier Parker
Latest Release: Tue 1 Oct 2002
Next Release: Fri 1 Nov 2002

- Demand for central London office space continues to decline – demand has now more than halved since December 2000.
- August saw a very slight revival in demand, an increase of 0.5 per cent, but was followed by a significant fall of 9.5 per cent in September.
- The current level of demand for central London office space has not been seen since June 1999.

Demand for Central London Office Space

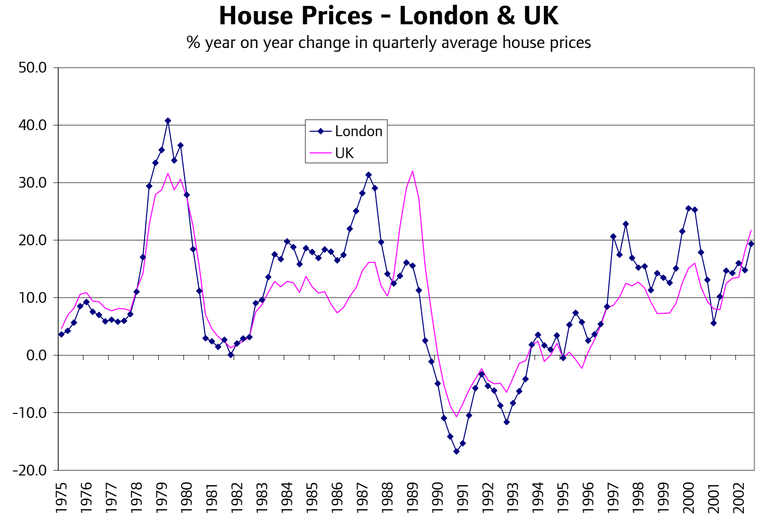


Source: CB Hilier Parker

House Prices

Source: Nationwide
Latest Release: October 2002
Next Release: January 2003

- London house prices increased rapidly during the third quarter of 2002 with still little evidence of the slowdown that has been predicted by commentators consistently over the past year.
- Nationwide puts the average London house at £197,500, whilst the Halifax now puts the figure at £206,400.
- London year-on-year house price growth lagged behind the UK in Q3 for the second quarter in succession.

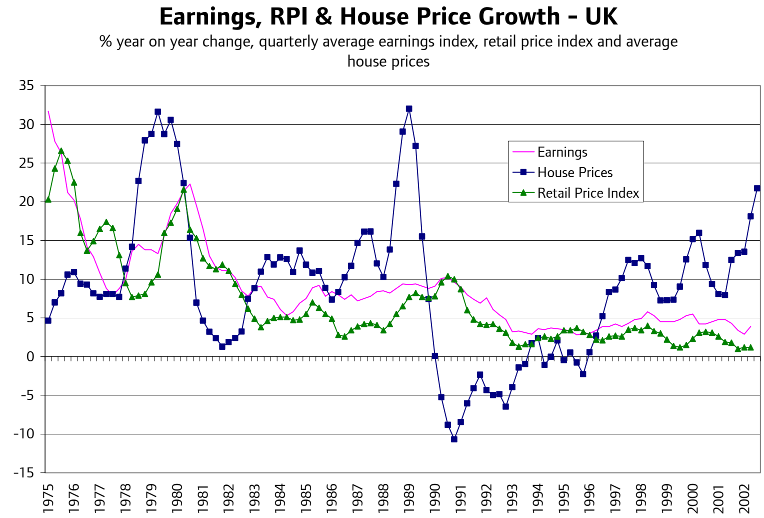


Source: Nationwide

Earnings, Inflation and House Prices

Source: ONS & Nationwide
Release dates: Various

- UK house price increases have exceeded average earnings growth and inflation since 1996.
- Earnings and inflation growth have been relatively stable since 1993, whilst house prices have moved from decline to rapid expansion.
- In Q2 2002 the year-on-year change in house prices was 18.1 per cent, compared to average earnings growth of 3.9 per cent and RPI growth of 1.2 per cent.

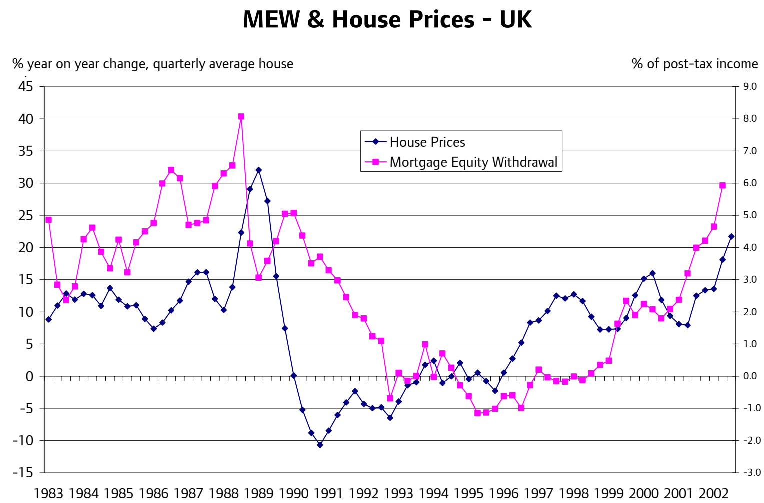


Source: ONS & Nationwide

Mortgage Equity Withdrawals and House Prices

Source: Bank of England & Nationwide
Release dates: Various

- Mortgage equity withdrawal rose from less than 5 per cent of net income in Q2 to 6 per cent in Q3.
- The total amount of equity withdrawn in Q3 is almost twice as high as the previous peak in 1989.
- Equity withdrawal is continuing to finance a significant proportion of consumer spending both in London and elsewhere in the UK.

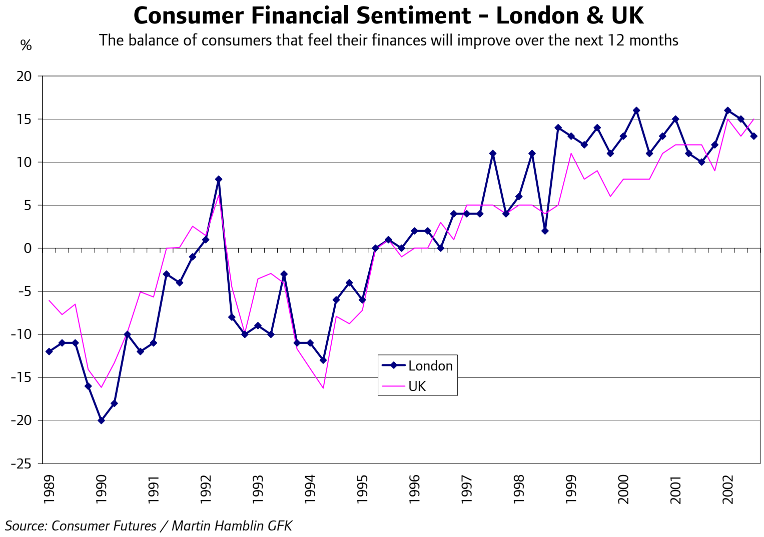


Source: Nationwide & Bank of England

Consumer Confidence

Source: Consumer Futures/ Martin Hamblin GfK Survey
Latest Release: Fri 27 Sep 2002
Next Release: Dec 2002

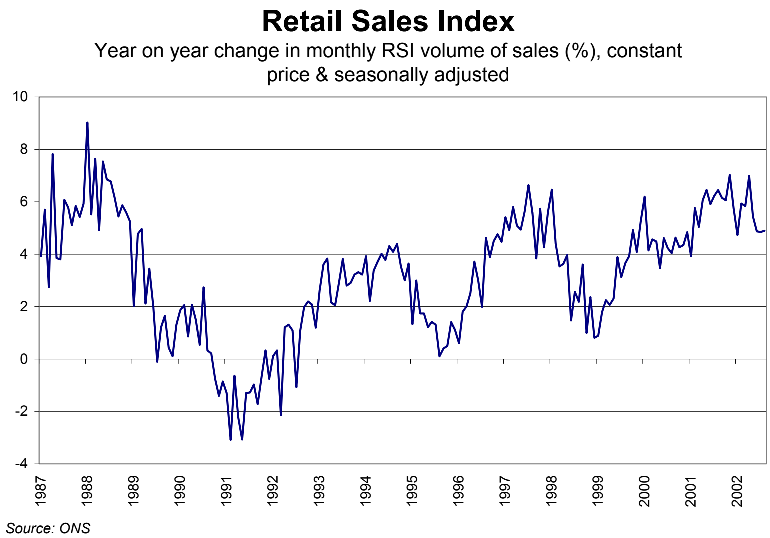
- Consumer confidence in London about future finances has fallen for the second quarter in succession, though UK consumers overall are feeling more confident about their future finances than ever before.
- A balance of 13 per cent of London consumers surveyed were confident their finances would improve over the coming 12 months, only marginally below the 15 per cent for the UK.



Retail Sales

Source: ONS
Latest Release: Thu 19 Sep 2002
Next Release: Thu 24 Oct 2002

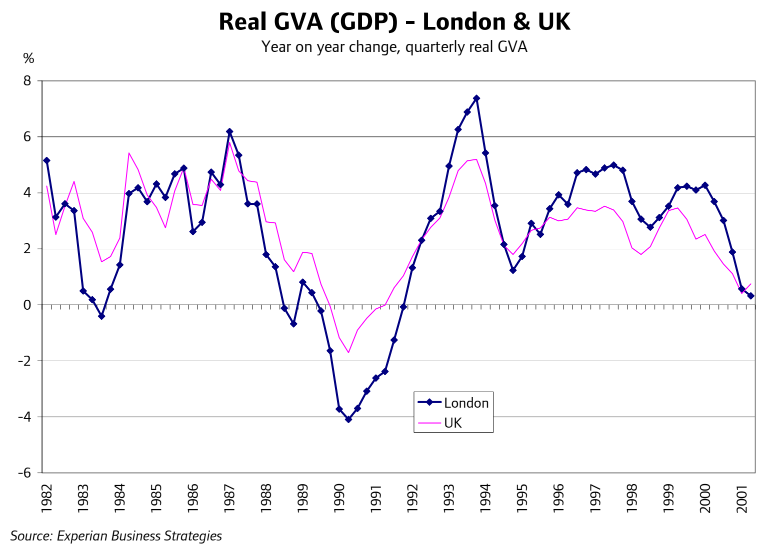
- Retail sales figures for August did not reveal the significant slowdown anticipated by some commentators.
- The seasonally adjusted estimate of retail sales volume for August was 135.1, 0.6 per cent higher than in July and 5.0 per cent above the August 2001 level.
- The latest CBI Distributive Trades Survey suggests that September saw a slight pick up in sales growth, but underlying growth is still weaker than earlier in the year.



GDP/GVA Growth

Source: Experian Business Strategies
Latest Release: Tue 15 Oct 2002
Next Release: Nov 2002

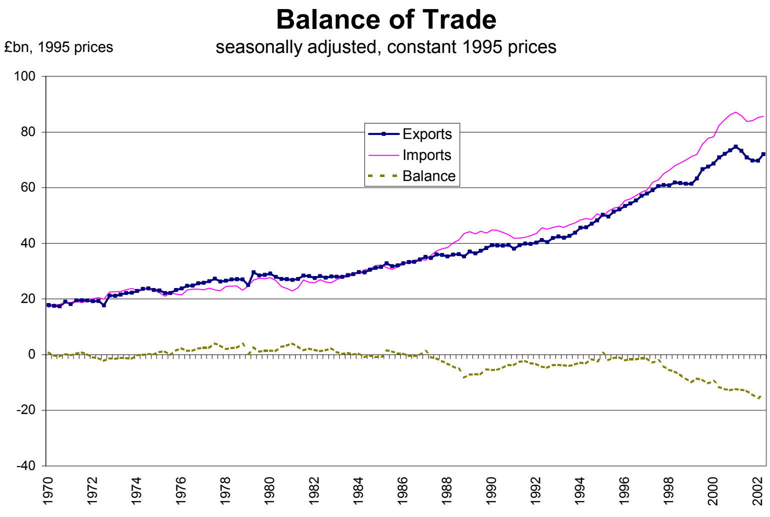
- Experian Business Strategies have revised down their estimates of real GVA growth for London and the UK for the first and second quarters of 2002.
- The UK saw a modest revival in output growth in Q2 2002, up 0.7 per cent on Q2 2001 (0.3 per cent for London).
- GVA for London is now believed to have contracted in Q1 2002 compared to the previous quarter, though quarterly growth recovered in Q2 to 0.3 per cent.



Balance of Trade

Source: ONS
Latest Release: Wed 9 Oct 2002
Next Release: Fri 8 Nov 2002

- The UK balance of trade has widened significantly over the past five years.
- However, the balance narrowed marginally in the second quarter of 2002, only the third time this has occurred since 1997.
- Having contracted in real terms for four consecutive quarters, exports are on the increase again.

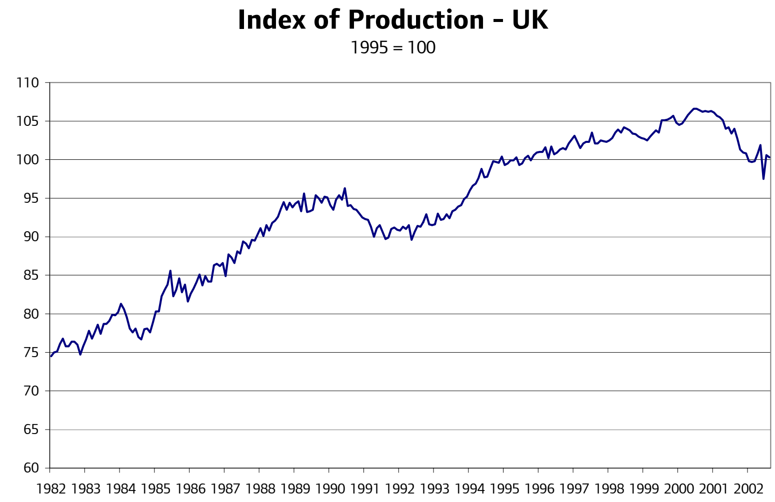


Source: Office of National Statistics

Index of Production

Source: ONS
Latest Release: Mon 7 Oct 2002
Next Release: Mon 5 Nov 2002

- UK manufacturing output remained flat between July and August following an erratic few months.
- This was the result of a large rise in motor vehicles output (17.8 per cent), combined with falls in ten out of the thirteen sub-sectors.
- In August, the seasonally adjusted index for the output of the production industries fell marginally to 100.3 (1995 prices).

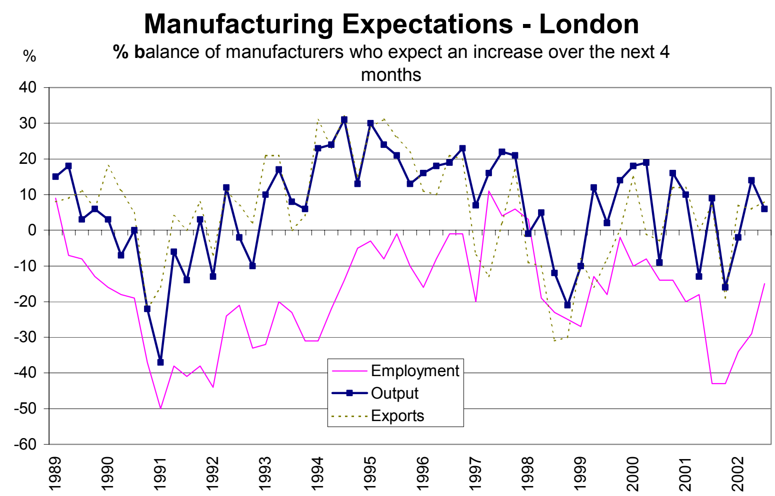


Source: Office of National Statistics

Manufacturing Expectations

Source: CBI Regional Trends Survey
Latest Release: Tue 6 Aug 2002
Next Release: Tue 12 Nov 2002

- London manufacturers have been getting consistently less pessimistic about employment prospects since Q4 2001.
- In addition export expectations are the highest they have been since Q1 2001.
- Expectations of output growth are positive at the moment, though less positive than they were the second quarter of 2002.

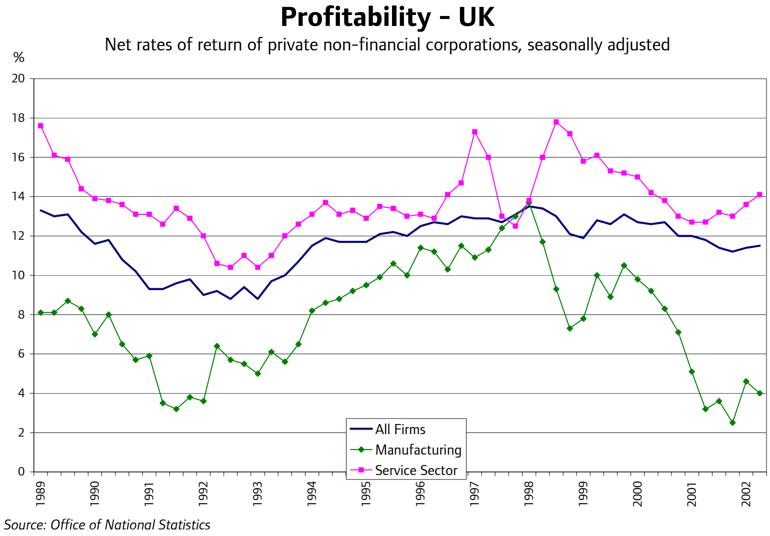


Source: CBI Regional Trends Survey

Profitability

Source: ONS
Latest Release: Thu 3 Oct 2002
Next Release: Tue 7 Jan 2003

- UK private non-financial corporations were slightly more profitable for the second quarter in succession.
- The net rate of return by private non-financial corporations in the second quarter of 2002 was 11.5 per cent, compared with 11.2 per cent in the final quarter of 2001.
- Manufacturing profitability fell marginally but this was more than compensated for by the increase in service sector profitability.

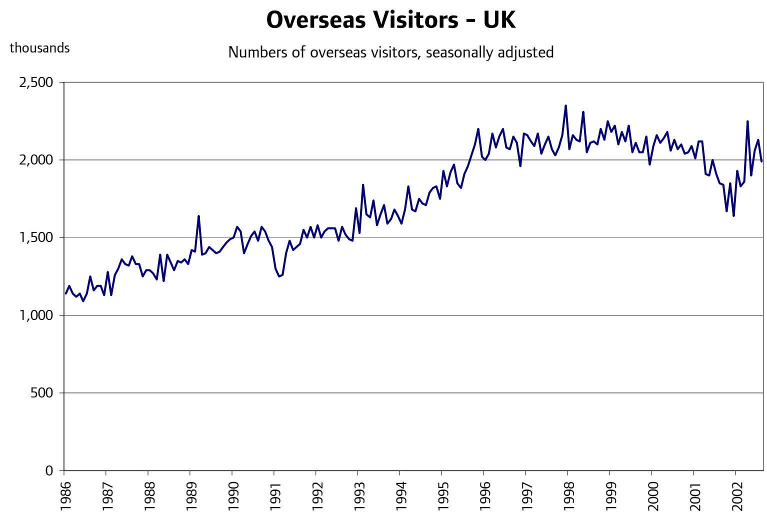


Source: Office of National Statistics

Tourism – Overseas Visitors

Source: International Passenger Survey
Latest Release: Wed 9 Oct 2002
Next Release: Wed 6 Nov 2002

- August saw a slight decline in the seasonally adjusted number of overseas visitors to the UK, although the overall trend continues to be upward.
- Visitor numbers were estimated at 1.99 million compared to 2.13 million in July, and produced earnings of an estimated £930 million in August.



Source: ONS, International Passenger Survey

London Airports

Source: Civil Aviation Authority
Latest Release: Mon 16 Sep 2002
Next Release: Mon 14 Oct 2002

- The number of people using London's airports has almost recovered again to the levels reached before 11 September 2001.
- In July 11.2 million passengers used London's airports compared to 11.3 million in July 2001.

Source: Civil Aviation Authority

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
Office Space Demand	Further information see www.cbhillierparker.com
House Prices	Nationwide house price data available from www.nationwide.co.uk/hpi/
Average Earnings & RPI	Data available from www.statistics.gov.uk
MEW	Data available from www.bankofengland.co.uk/mew.htm
Consumer Confidence	Further information see www.martinhamblin.co.uk
Retail Sales	Data available from www.statistics.gov.uk/rsi
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
Profitability	Data available from www.statistics.gov.uk
Tourism - Overseas Visitors	Data available from www.statistics.gov.uk
London Airports	Data available from www.caa.co.uk

Abbreviations

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
MEW	Mortgage Equity Withdrawals
ONS	Office of National Statistics
RPI	Retail Price Index

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.

If you have any comments or require any further information regarding this publication please contact:

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Front-page photo: Adam Hinton

London's Economy Today: Supplement

Forecasts for the London Economy: A comparison of independent forecasts and a GLA Economics view

Introduction

This is a review of forecasts prepared for London by the main forecasting organisations, which looks at the main indicators of economic activity and then takes an independent view. We propose to move towards a regular publication of these comparisons and to extend the coverage. The purpose of this review is to provide a basis for a short-term consensus forecast, and to understand the alternative views of the forecasting bodies.

Short-term forecasts are notoriously difficult to provide. In general, the errors on a forecast suggest that it is impossible even to be sure whether the positive or negative sign of a forecasts change is reliable.

For this reason, and because of uncertainty about model design, errors in estimation, exogenous shocks and inherent complexity, bodies such as the Bank of England prepare ranges of possible outcomes. These have probabilities attached. The range depends on assumptions made, model simulations and indeed the models used.

This review lets us identify a range of most likely outcomes prepared by different bodies. Except where there are good reasons and/or specialised or additional information, we propose to use the average of these forecasts as a baseline forecast and as a guideline for drawing up and evaluating short-term policy proposals. This does not apply to long-term forecasting.

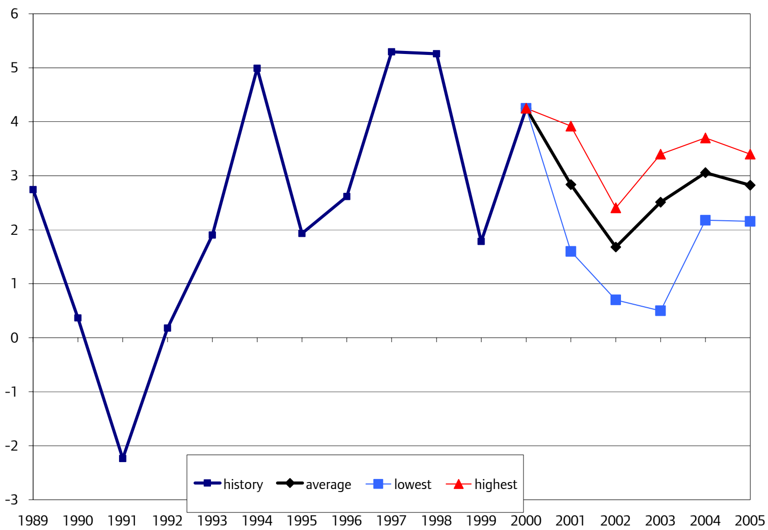
We report the average, worst-case and best-case short-term (five-year) forecasts for employment, GDP and consumer spending in London. Again unless there are specific reasons not to, we propose to use the worst-case forecasts to provide an indicator of the central risk on the downside and the best-case forecasts as an indicator of the central risk on the upside.

The forecasts

Forecasts are supplied for the main macroeconomic aggregates on the basis of forecasts from Cambridge Econometrics (CE), the Centre for Economic and Business Research (CEBR) Experian Business Strategies (EBS), the London Economy Research Project (LERP) and from Oxford Economic Forecasting (OEF).

The following graphs and tables report employment growth, output growth and growth in consumer expenditure. For employment and output, actual history over the previous business cycle is also reported.

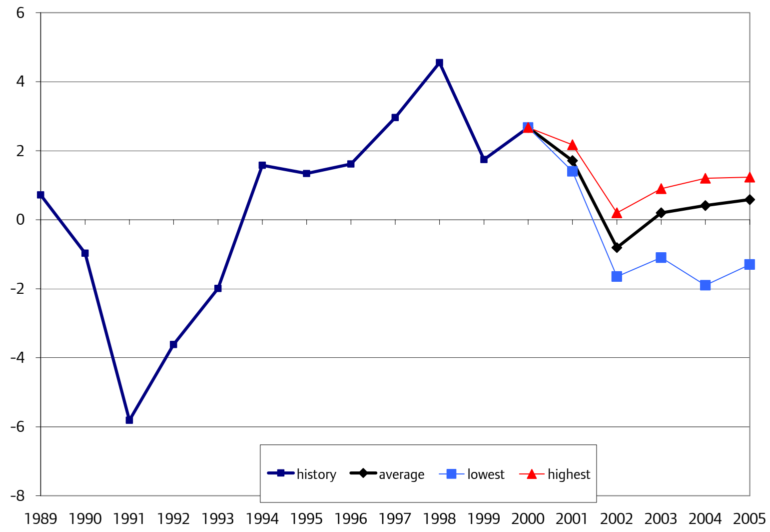
Chart 1: Annual growth in London's GDP (GVA at 1995 prices)



There is general agreement that output growth will remain positive – in contrast with the last cycle – and will bottom out early in 2003 at which point annual growth is expected to fall to 1.7 per cent, slightly below the previous low of the cycle, which was 1.8 per cent in 1999.

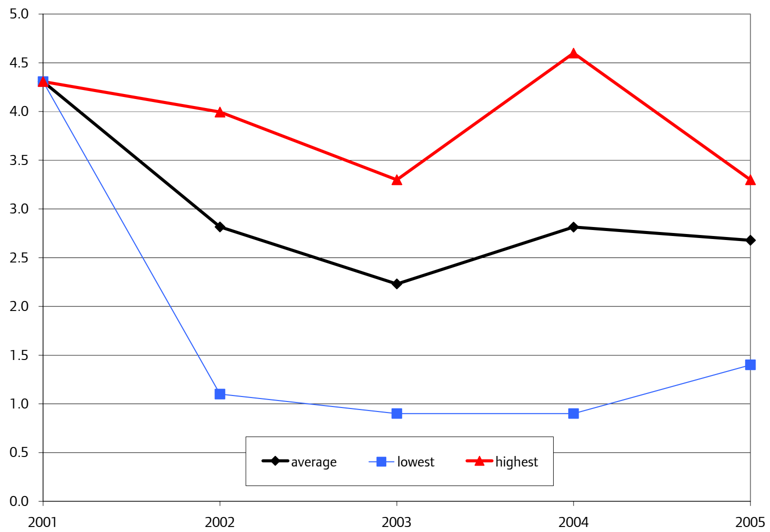
The central risk low forecast diverges most sharply from this baseline in 2002 (low forecast: 0.7 per cent growth) and 2003 (low forecast: 0.5). By 2005, at 2.2 per cent, it is within 25 per cent of the central baseline. The central risk high forecast diverges less sharply (greatest divergence 2002, at 2.4 per cent compared with the baseline 1.7 per cent)

Chart 2: Annual growth in London's employment



The employment growth baseline dips below zero in 2002 and then recovers slowly to reach 0.6 per cent by 2005, considerably below its level between 1994 and 2000, during which time it never fell below 1.3 per cent.

Chart 3: London consumer expenditure (2000=100)



For the baseline (average) forecast, the growth rate of consumer spending dips to a low of 2.2 per cent in 2003 and then rises slightly but does not regain its 2001 high of 4.3 per cent. Central risk forecasts, as with output and employment, diverge from the average initially (lowest: 0.9 per cent in 2003 and 2004, highest: 4.6 per cent in 2004).

Chart 4: Annual productivity growth; baseline forecast compared with history

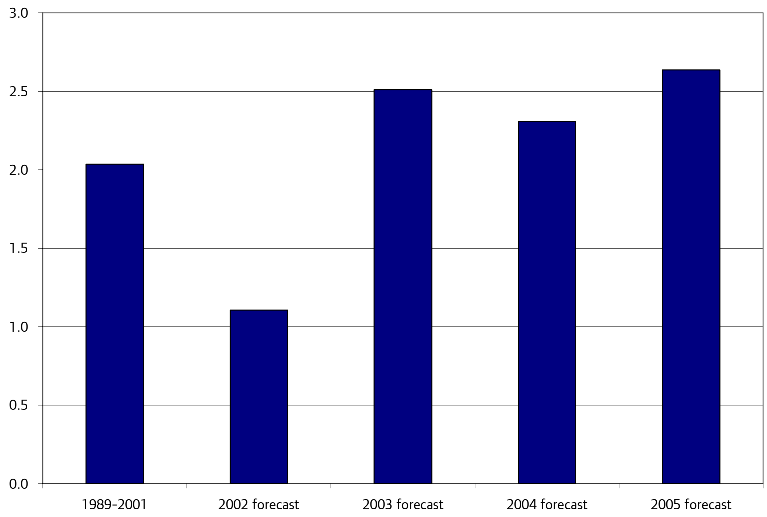


Chart 4 records the rates of change in productivity implicit in the baseline forecasts for output and for employment. After a low of 1.1 per cent, these are consistently between 2.3 and 2.6 per cent, close to the average for the last business cycle of 2.0 per cent and the average over the forecast is in line with current trends.

Tables: Growth rates

Total GDP/GVA	history	average	lowest	highest
1989	2.74			
1990	0.37			
1991	- 2.23			
1992	0.18			
1993	1.90			
1994	4.99			
1995	1.93			
1996	2.62			
1997	5.30			
1998	5.26			
1999	1.78			
2000	4.25	4.25	4.25	4.25
2001		2.84	1.60	3.92
2002		1.68	0.70	2.41
2003		2.51	0.50	3.40
2004		3.06	2.18	3.70
2005		2.82	2.16	3.40

Total Employment	history	average	lowest	highest
1989	0.72			
1990	- 0.97			
1991	- 5.81			
1992	- 3.62			
1993	- 1.99			
1994	1.57			
1995	1.34			
1996	1.62			
1997	2.96			
1998	4.55			
1999	1.75			
2000	2.67	2.67	2.67	2.67
2001		1.71	1.40	2.17
2002		- 0.81	- 1.65	0.20
2003		0.20	- 1.10	0.90
2004		0.41	- 1.90	1.20
2005		0.58	- 1.30	1.23

Consumer spending	average	lowest	highest
2001	4.31	4.31	4.31
2002	2.82	1.10	3.99
2003	2.23	0.90	3.30
2004	2.81	0.90	4.60
2005	2.68	1.40	3.30

Creativity: London's Core Business

A GLA Economics Publication

The creative industries may be London's 'next big thing' says a new report by GLA Economics, launched by the Mayor on 1 October 2002. London's creative industries – from architecture and advertising to the performing arts and publishing, are creating more new output than any other sector.

London's Creative Industries:

- Add £21 billion annually to London's output – more than all the production industries combined and second only to business services at £32 billion.
- Employ 525,000 people (either directly or in creative occupations in other industries) – making them London's third largest employment sector.
- Are London's second biggest source of job growth – contributing roughly one in every five new jobs.

This is a decisive for the sustainability of London's growth. London's expansion has been driven in the past by business service industries – accountants, lawyers and consultants. Now creativity is taking over - the creative industries make London an engine of growth for the UK, contributing a substantial and growing export surplus and leading a growth in almost all regions.

As the population gains more leisure time, its requirements diversify and its tastes become more discerning. It demands customised goods and services delivered with high quality to exacting deadlines. London offers a unique combination of the supply conditions needed to achieve this. Its diverse, multi-lingual and highly skilled population offers the creative and intellectual input required. Its hi-tech infrastructure, and the huge variety of business services it offers, makes it an ideal location to make and sell creative products efficiently to a mass, expanding domestic and global market.

The report signals the importance of continued attention and continued research for this vital area. The decisive condition for maintaining London's lead is the supply conditions that allowed the creative industries to thrive. The difficulties encountered by some sectors amidst this general pattern of growth show that all these supply conditions must be present or leaders may move elsewhere.

London's unique strengths are its social capital – the talents and diversity of its workforce; its range of services; its hi-tech infrastructure, and its electronic connectivity and lead in communications. That is what has turned it into the UK's Creative Factory.

If you would like a copy/copies of the Creativity: London's Core Business, please complete the details below and return them to Nina Sarney, GLA Economics, 7th floor, City Hall, The Queen's Walk, London SE1 2AA or e-mail this page to nina.sarney@london.gov.uk.

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