London's Economy Today

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GLAECONOMICS

High oil prices moderating growth

by Christopher Lewis
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London's economy is highly productive and benefits the rest of the UK. To keep its position as a world city London requires investment in both social and physical infrastructure, such as in housing and transport. The construction industry, which contributes roughly five per cent of London's annual output, will play an important role in the capital's continued success by building more houses and completing major transport projects, such as the Channel Tunnel Rail Link. The construction of other vital transport infrastructure projects, such as Crossrail and the Thames Gateway Bridge, is also expected over the next ten years. This month's supplement ***Laying Foundations*** **by Damian Walne provides an overview of London's construction industry.**

Overall, London's economy is still performing well. In March, the Purchasing Managers' Index (PMI) measures of seasonally-adjusted business activity and new orders in London both rose to over 60 (this is significantly above 50, which is the level consistent with no change on the previous month). The average annual rate of growth in tube passenger numbers remains positive and is rising slowly while the average annual rate of growth in bus passenger numbers, though declining is still above five per cent. In a recent survey by the Confederation of British Industry (CBI)

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For your copies: www.london.gov.uk/mayor/economic_unit or glaeconomics@london.gov.uk and KPMG, most London businesses believed that the capital was a good or very good place in which to do business. Unsurprisingly businesses also felt that the capital boosts their image and helps networking.

UK cooling as industrial production weakens

Industrial production in the UK fell for the second consecutive month in February and seasonally-adjusted manufacturing output is at its lowest since October. The CBI's latest monthly *Industrial Trends* report also showed total manufacturing orders falling at an even sharper rate in March than in previous months. In addition, the news that MG Rover has gone into administration will put pressure on its suppliers and weaken the sector further. The trend estimate for industrial production is now a negative annual growth rate of one per cent. Despite solid growth in the UK service sector the stagnation of industrial production will dampen the overall performance of the UK economy. Fortunately, for Londoners the capital's economy is more service sector orientated than that for the UK as a whole. UK unemployment remains low, but the latest labour market statistics show International Labour Organisation (ILO) unemployment increasing in the three months to February, and seasonally-adjusted claimant count unemployment rising in both February and March.

Growth in consumer spending continues to ease without collapsing, and confidence in the housing market remains weak. This is unsurprising as interest rate rises over the last 18 months take effect and, according to the Institute of Fiscal Studies, average household incomes actually fell for the first time in a decade between 2003 and 2004. However, there are signs that the housing market may have bottomed. Hometrack have noted that the number of buyers registered on estate agents' books rose by 6.2 per cent in March, only the second rise since May 2004. Mortgage approvals also rose to their highest level for five months in February, but are still over a third down on the equivalent figure last year. Seasonally-adjusted house prices as measured by the Nationwide rose by 0.5 per cent in March but fell by 0.6 per cent on the Halifax measure. At 7.9 per cent and 9.7 per cent respectively the annual house price growth rates of the two measures are now at their lowest since 2001. According to the Halifax, house prices in London rose by 0.1 per cent in the first quarter of 2005 on the back of two small quarterly falls in a row.

Sustained high oil prices

Oil prices rose above $55 per barrel over the last month before falling back slightly (see Figure 1). Oil demand in the US and China continues to increase while oil supplies from Iraq and Nigeria are affected by security and political uncertainties. Oil prices increased on a prediction by Goldman Sachs that they could even exceed $100 per barrel in a 'super-spike'. This seems unlikely, but the International Monetary Fund (IMF) has warned that high oil prices are now likely to be a permanent shock to the world's economy over the next 25 years.

Figure 1: Brent crude oil price ($ per barrel)

Source: FT.com

Higher oil prices and interest rates had a negative impact on US consumer confidence in March. The Federal Reserve has raised US interest rates for the seventh time since June 2004 by a further quarter of a percentage point to 2.75 per cent. Further measured increases in US interest rates are expected throughout this year with the Federal Reserve becoming slightly more concerned about short-term inflationary pressures from rising energy prices.

Japanese and eurozone economies yet to take-off

Japanese business confidence has fallen on concerns about high oil prices and weaker exports. The Japanese economy remains fragile with industrial production and household spending declining and unemployment increasing in February. Annual retail sales are now declining at their fastest rate since November 2003. Germany's high level of unemployment continues to hamper consumer spending and hold back economic growth. The European Central Bank has cut its 2005 growth forecast for the eurozone area to only 1.6 per cent, but despite this it has perversely signalled that its next interest rate move is likely to be upwards. In its latest World Economic Outlook the IMF has argued that world growth in 2005 will be uneven, with China and the USA once again outperforming Japan and Europe.

London performing steadily if unspectacularly

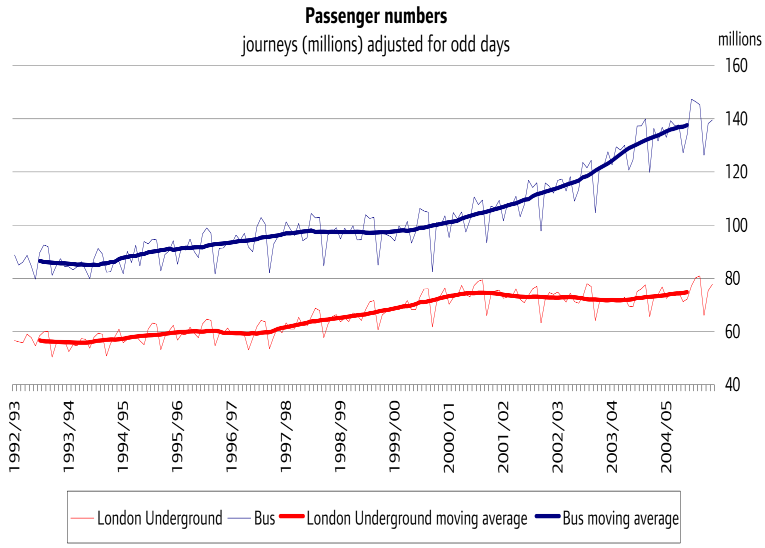
The World Bank has recently warned that global growth momentum has peaked. After rising in 2004 both the World Bank and IMF expect world growth to slow in 2005. Higher oil prices and US interest rates are two important factors contributing to this slowdown. Meanwhile the London economy is growing steadily and the capital's housing market seems to have stabilised. Surveys also suggest that the job market is improving within the City of London's financial services sector and that UK financial services firms intend to employ more workers during spring. Securities traders and fund managers seem especially upbeat about hiring prospects, which is good news for the capital as these firms are concentrated in London. However, there has been some uncertainty in the world's financial markets over the last week. The Dow Jones has fallen to around the 10,000 level and saw its heaviest one-day loss for two years on 15 April. Meanwhile the FTSE 100 has fallen back to around 4,800. Overall, despite higher unemployment in the capital than the rest of the UK a majority of London's businesses disappointingly claim that they are facing skill shortages, which are a significant barrier to their growth.

Economic indicators

Moving average of passenger numbers continue to increase

- In the most recent 28-day period, London's public transport had 217 million passenger journeys; 139.5 million by bus and 78 million by Underground.
- The moving average shows an increase to over 212.4 million passengers every period. The average for buses increased to 137.6 million passenger journeys each period and the average for the Underground was 74.8 million.

Latest release: April 2005
Next release: May 2005



Source: Transport for London

Modest slowdown in passenger journeys' annual growth

- The average annual rate of growth in passenger journeys is 5.2%, slightly below the annual growth in the previous period of 5.3%.
- The average annual rate of growth in bus journey numbers has slowed but remains strong at 6.1%.
- The average annual rate of growth in Underground passenger journey numbers increased to 3.7%.

Latest release: April 2005
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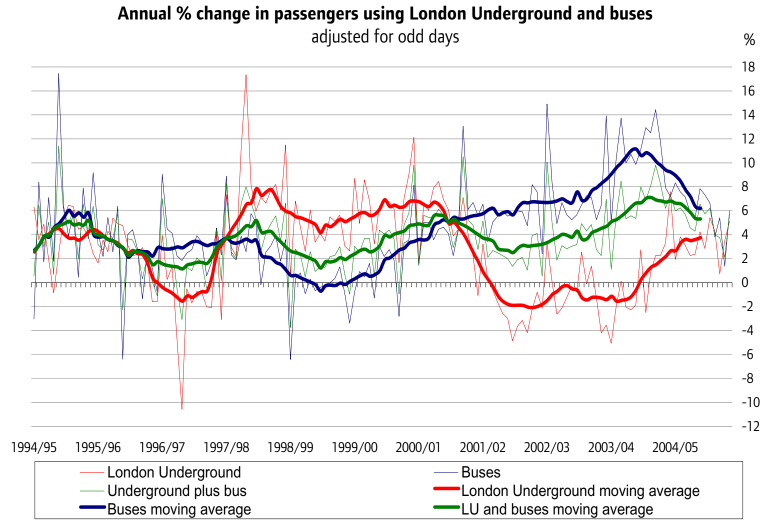
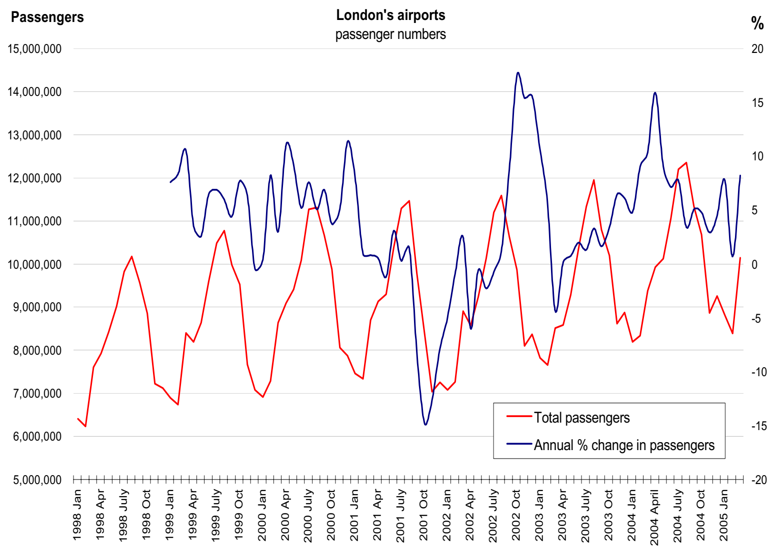


Source: Transport for London

Increase in airport passenger numbers

- 10.1 million passengers travelled through London's airports in March.
- The number of passengers using London's airports increased by 8.1% from March 2004 to March 2005.
- International travel through London's airports continued to grow at the beginning of 2005.

Latest release: April 2005
Next release: May 2005

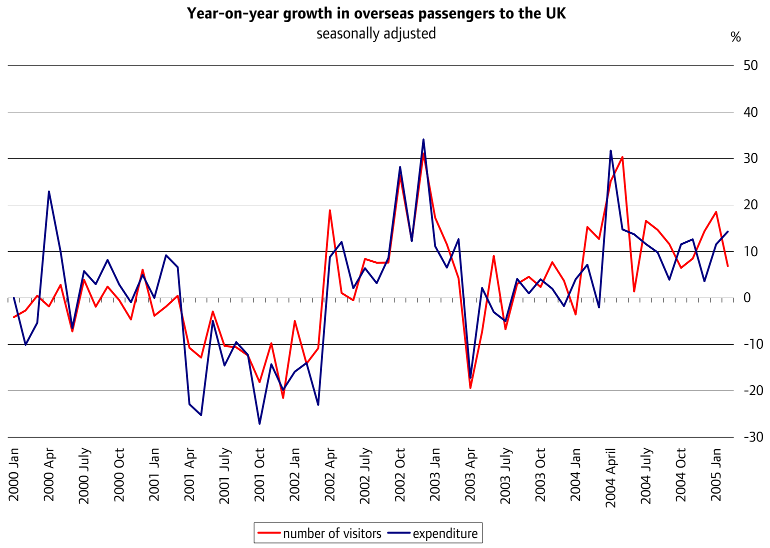


Source: Civil Aviation Authority

Number of overseas visitors to the UK remains high

- The winter months of 2004/05 saw growth in both overseas visitor numbers to the UK and their spending. Up to half of overseas visitors spend time in London.
- The annual growth of overseas visitors to the UK was 6.2% in February 2005.
- The year-on-year growth in expenditure by overseas visitors in the UK was 14.3% in February 2005.

Latest release: April 2005
Next release: May 2005

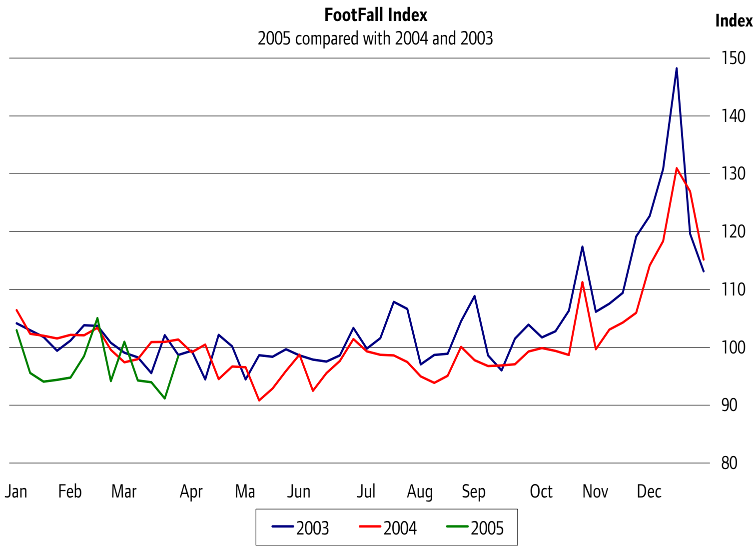


Source: ONS

Shopping numbers recovering

- Generally, the FootFall Index has shown fewer shoppers in London in the early months of 2005 than in the same period in 2004 or 2003.
- The index recovered strongly towards the end of March following the Easter period and is back to similar levels seen in the previous two years.
- The FootFall Index measures the number of shoppers but does not necessarily reflect the level of spending.

Latest release: 28/03/05
Next release: every week

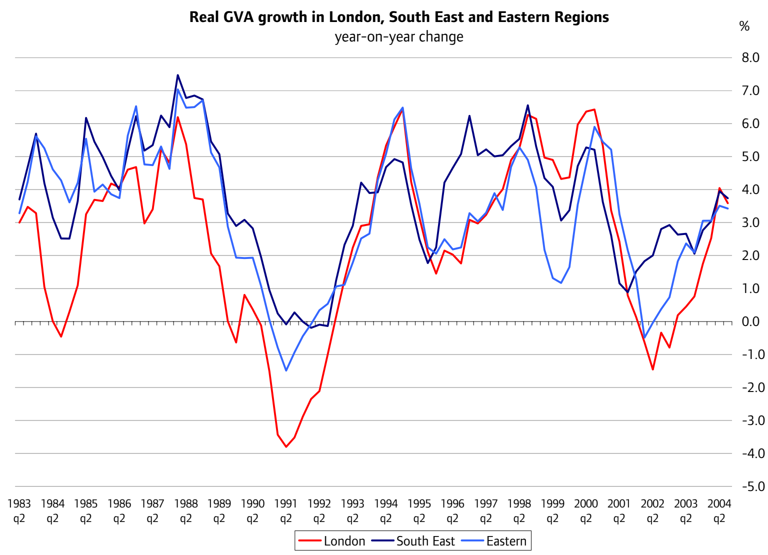


Source: FootFall Limited

Similar growth rates across London and the wider South East

- London's annual growth in output was 3.6% in Q3 2004, down slightly from annual growth of 4% in Q2. However, this continued the robust recovery in 2004.
- The South East region's annual output growth remained strong at 3.7% in Q3 2004 and the Eastern region's output rose by an annual rate of 3.4%.
- London and its two neighbouring regions are currently recording similar rates of growth.

Latest release: February 2005
Next release: May 2005

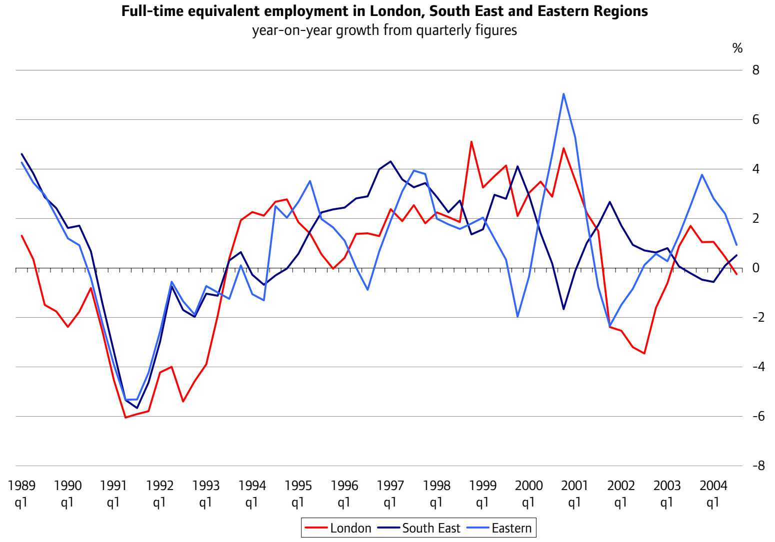


Source: Experian Business Strategies

Employment relatively stable in London and the wider South East

- London's year-on-year employment change was -0.2% in Q3 2004 compared to growth of 0.4% in Q2 2004.
- The South East's year-on year employment growth was 0.5% in Q3 2004, an increase from 0.1% in Q2.
- The Eastern region's year-on-year employment growth was 0.9% in Q3 down from 2.1% in Q2.

Latest release: February 2004
Next release: May 2005

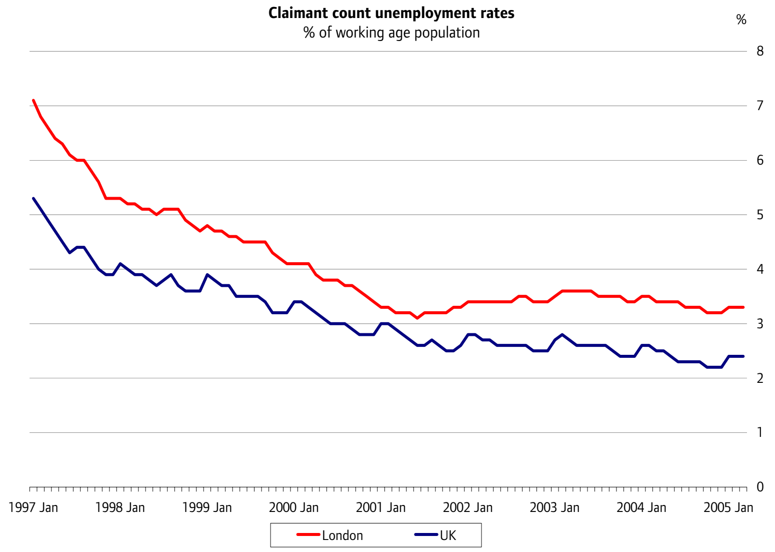


Source: Experian Business Strategies

Claimant count unemployment rate stable

- The rate of claimant count unemployment, people unemployed and claiming Jobseeker's Allowance, in London remained at 3.3% in March 2005.
- There were around 164,000 unemployment claimants in London in March 2005, compared with 168,000 in March 2004.
- The claimant count unemployment rate in the UK remains below that of London.

Latest release: April 2005
Next release: May 2005



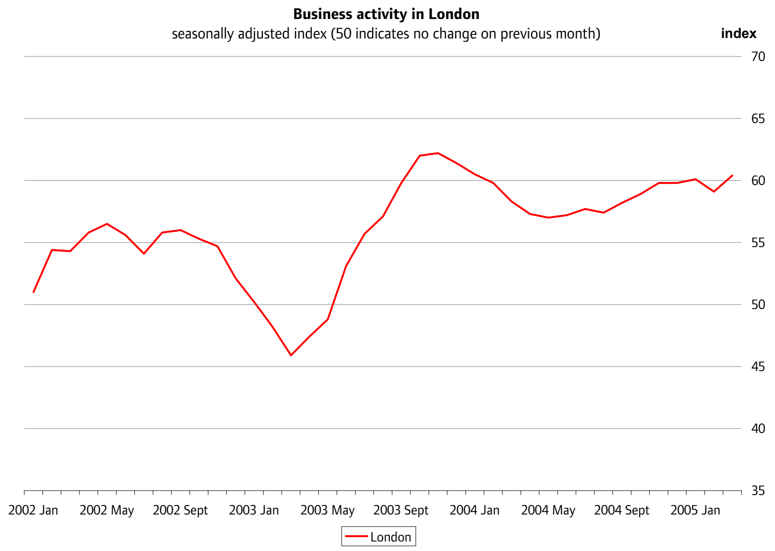
Source: Claimant Count, Nomis

Business activity continues to increase

- London firms continued to expand their output of goods and services in March 2005.
- The Purchasing Managers' Index (PMI) of business activity recorded 60.4 in March compared to 59.1 in February.
- A rate above 50 on the index indicates an increase in business activity from the previous month.

Latest release: April 2005

Next release: May 2005



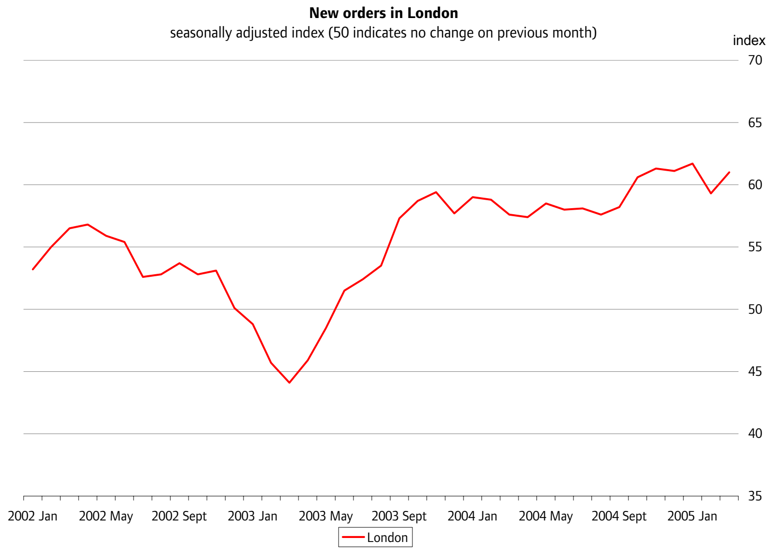
Source: PMI/The Royal Bank of Scotland

Continued growth in new orders

- New orders for London firms continued to rise. The PMI for new orders recorded 61 in March 2005, up from 59.3 in February.
- This compares with 57.6 in March 2004.
- A rate above 50 on the index indicates an increase in new orders from the previous month.

Latest release: April 2005

Next release: May 2005



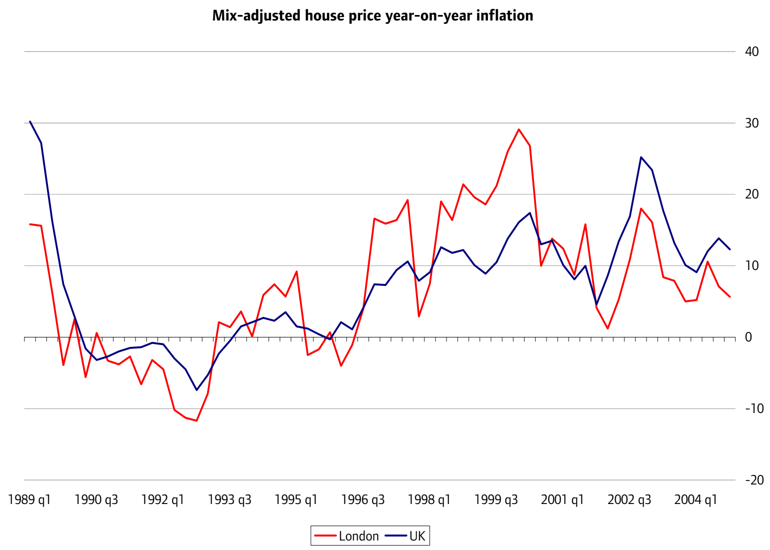
Source: PMI/The Royal Bank of Scotland

Slowdown in the rate of house price growth (1)

- The ODPM house price index is the official measure of change in house prices and is available up to Q4 2004. This shows a slowdown in house price inflation in London and across the UK.
- Annual house price growth in London decreased to 5.6% in Q4 2004 from 7.1% in Q3.
- Annual house price growth for the UK slowed to 12.3% in Q4 2004 from 13.8% in Q3.

Latest release: January 2005

Next release: May 2005



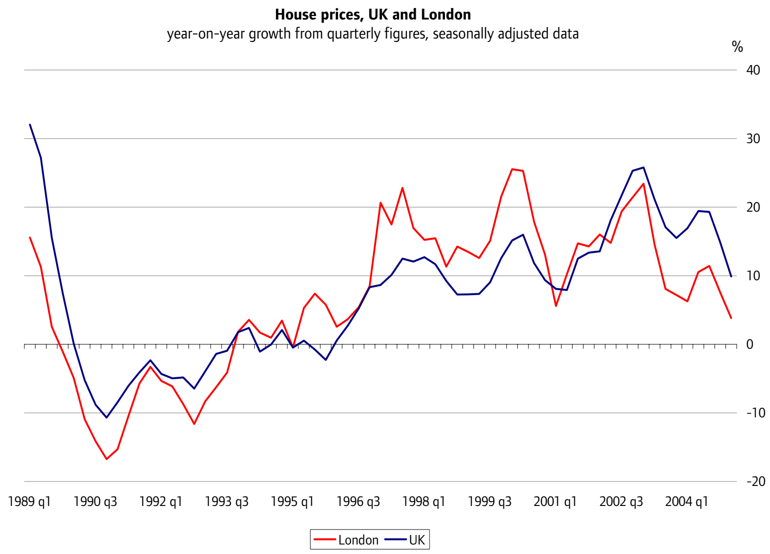
Source: ODPM

Slowdown in the rate of house price growth (2)

- Nationwide provides an index of house prices derived from their lending data. This is available up to Q1 2005 and shows a slowdown in London and across the UK.
- Annual house price growth in London slowed to 3.8% in Q1 2005 from 7.6% in Q4 2004.
- Annual house price growth remained higher for the UK but slowed from 14.8% in Q4 2004 to 9.9% in Q1 2005.

Latest release: April 2005

Next release: July 2005



Source: Nationwide

Laying Foundations

Introducing research into London's construction industry

by Damian Walne
Economist, GLA Economics

London's future prosperity, quality of life and environmental appearance depend on the capital's capacity to construct and maintain its buildings and infrastructure. GLA Economics has an ongoing research programme to identify whether the construction industry can adequately meet the demands of London's expanding economy.

The study's objectives are to:

- Define what is meant by London's construction industry.
- Review London's construction industry's economic performance.
- Consider the volume of construction demand.
- Identify constraints on London's construction industry.
- Assess projections for construction activity in London.

The research begins the process of laying the foundations for understanding the construction industry in London. Here we introduce some of the initial main findings.

Construction at a glance:

- GLA Economics is **researching** the construction industry to see if it can meet the needs of London's expanding economy.
- Construction is a **complex sector** and many statistics need to be interpreted with care.
- London's construction sector has an annual output of **£8 billion** (five per cent of London's economy) and employs **200,000 workers** (4.5 per cent of London's workforce).
- The **recent growth** of London's construction activity has been largely private commercial work. **Future needs** may be determined by demand for housing and transport infrastructure.
- The construction sector faces **constraints**, for example in reaching its potential supply of labour and in developing the skills of workers.

Defining London's construction industry

Defining what is meant by London's construction industry is difficult. The standard industrial classification defines construction as economic activities in site preparation, building of constructions and civil engineering, building installation, building completion, and operation of construction equipment. The definition does not include related activities in architecture, engineering and surveying or related occupations in sectors such as utilities or transport.

Two reasons why construction statistics need to be approached with caution are:

- Output and employment statistics are based on the 'workplace' (i.e. where the business is located). In construction, activity is mobile. The registered workplace is usually an office not located on a construction site.
- With high levels of self-employment and many small firms below the annual turnover threshold for registering for VAT, alongside a structure of contracting and sub-contracting, short-term projects, and cash payments, the construction sector is difficult to measure. Therefore, some construction activity is hidden.

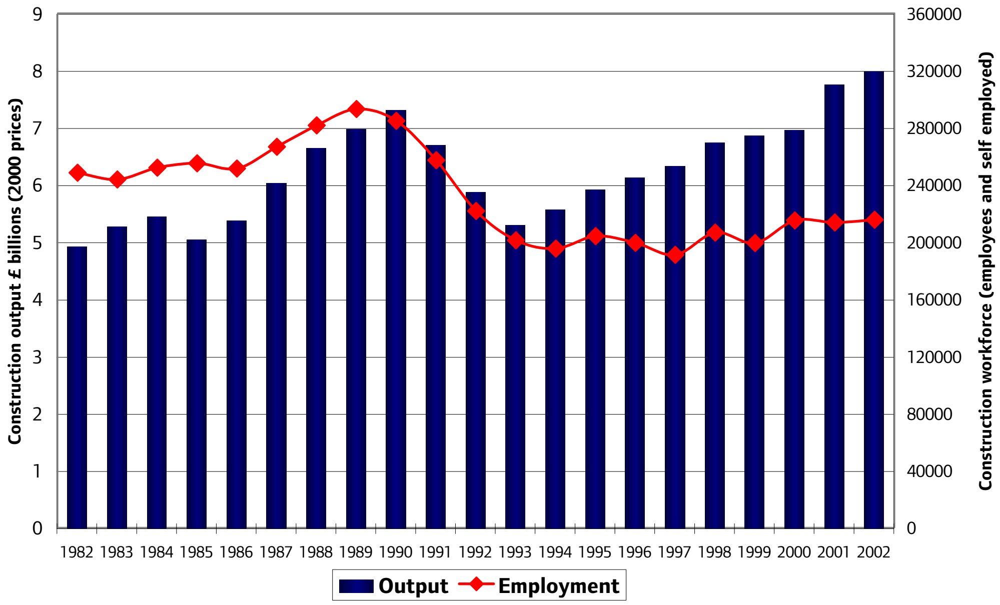
Economists question the data but we must accept the statistics and use a variety of sources to look at London's construction sector.

Assessing construction activity in London

London's construction industry's annual output of £8 billion accounts for almost five per cent of London's total output. The industry employs over 200,000 workers (employees and self-employed), around 4.5 per cent of London's workforce.

Figure 2: History of output and employment in London's construction industry

Source: EBS and ONS



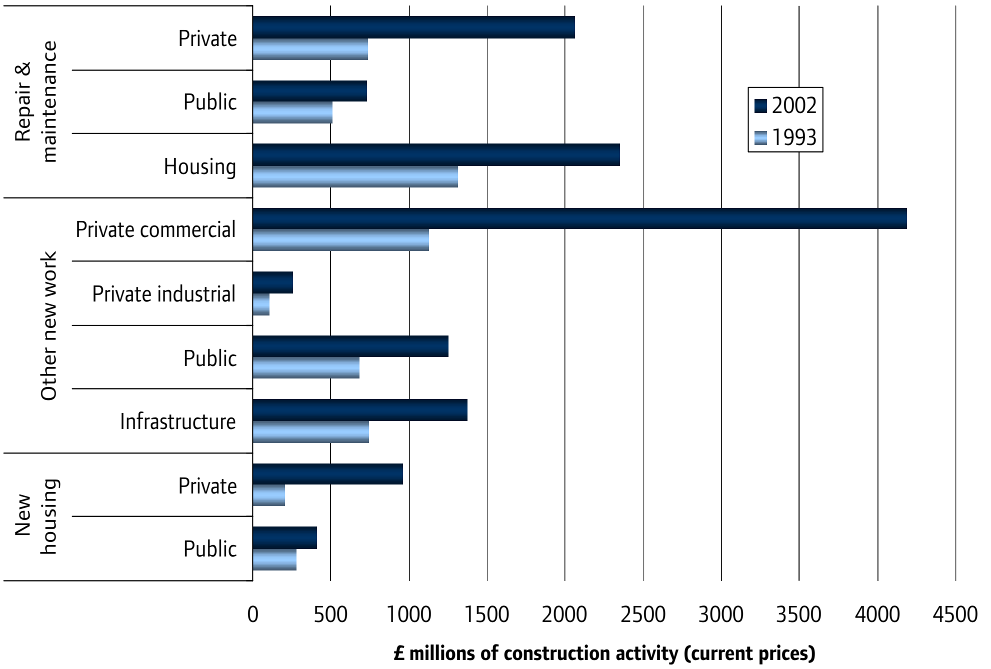
The output of London's construction industry (at constant 2000 prices) grew rapidly in the late 1980s, fell sharply in the early 1990s and since 1993 has risen steadily. Employment in the industry also grew rapidly in the late 1980s and peaked at nearly 300,000 workers in 1989. This fell sharply in the early 1990s to 200,000 workers and has remained around that level despite increasing output. This implies that the output per worker of construction in London has grown dramatically since 1993. These statistics must be interpreted with care. A few major construction projects may distort measures of output.

The Department of Trade and Industry (DTI)'s estimates reveal that 60 per cent of London's construction activity is in new work and 40 per cent is in repairs and maintenance. The composition of activity in London shows:

- Activity in private commercial infrastructure is the largest part of London's construction industry with over 31 per cent of activity.
- New housing is ten per cent of construction activity, mostly from private housing. In contrast, 17 per cent of activity is in repairing and maintaining existing housing.
- Infrastructure accounts for ten per cent of activity.

Figure 3: Estimates of London's construction activity, 2002 and 1993

Source: DTI Construction Statistics Annual



From 1993 to 2002, construction expanded in London largely due to private commercial work. From a relatively low base, London also had high growth in its construction activity in private housing. There were slower rates of growth in new public building and infrastructure.

The demand for construction in London

Demand for construction in London comes from the expanding population, economic growth, investment in London's physical infrastructure, and repairs and maintenance of existing homes and buildings.

- The GLA's London Development Database records significant building developments. From 1993 to 2002, an average of 16,600 new dwellings were completed each year. With the *London Plan* aiming for 30,000 new homes each year, a substantial increase is required.
- Floor-space for non-housing property development increased by 50 per cent from 1993 (one million square metres) to 2001 (1.5 million square metres). Business use accounts for up to half of this total.
- The past decade saw new infrastructure such as the extension to the Jubilee Line, Channel Tunnel Rail Link and Terminal 5 at Heathrow. The Mayor's *Transport Strategy* highlights future investment including extending the East London Line and Docklands Light Railway. There are strong possibilities of a Thames Gateway Bridge and CrossRail.

We cannot project the demand for construction with certainty. The key question is whether construction for commercial use will continue at the high pace it has over the past decade. On the evidence of trends we can speculate that construction will evolve in London with more work in housing and infrastructure but perhaps less expansion in commercial use. This may relieve some capacity on the construction industry.

Constraints on construction in London – considering the workforce

Considering the characteristics of the construction industry's workforce helps anticipate future constraints. The Labour Force Survey shows construction is unique with only ten per cent of construction workers in London being female and only 13 per cent coming from black and minority ethnic groups. This suggests that the industry is restricting its potential supply of labour.

Figure 4: Characteristics of London's construction workforce

Source: Labour Force Survey, 2002

Some commonly held perceptions about London's construction workforce are challenged by the statistics. The construction workforce is relatively old with almost 50 per cent of workers aged over 40 years, but even the London average is 43 per cent. A perception that construction depends on foreign workers is true in that 20 per cent of its London workers are born overseas, but this is less than the London average for all sectors of 27 per cent.

The Labour Force Survey also shows that 50 per cent of construction workers are in skilled trades occupations with only 25 per cent in management, professional and technical occupations. The construction workforce has a small share with higher-level qualifications and a high share with medium-level qualifications or trade apprenticeships. However, almost 30 per cent of construction workers have low or no qualifications, much more than the London average and a potential constraint on the sector's development.

The 2003 National Employer Skills Survey reflects this. Over ten per cent of London's construction employers report unfilled vacancies with half of these as hard to fill. Despite this, the trend in vacancies notified through Jobcentre Plus is declining and vacancies do not appear to be feeding into higher wages. In the New Earnings Survey, the wages in London for occupations in skilled construction trades are around 25 per cent less than the London average and increasing at a much slower rate.

Building on foundations

GLA Economics is producing a report, *Laying the Foundations: London's Construction Economy*, which will develop in more detail the issues illustrated here. We are conscious of the wide interest in the construction industry from academia, public sector and the industry itself.

This research into construction in London will assist in guiding decisions within the GLA family but also aims to contribute to wider discussions on the construction industry with public stakeholders such as the DTI, skills councils and also within the construction industry itself.

For further information:

If you would like to receive a copy of the final report or have any comments, please contact GLA Economics at glaeconomics@london.gov.uk.

Additional information

Data sources

Tube and bus ridership	Transport for London on 020 7941 4500
GDP/GVA growth	Experian Business Strategies on 020 7630 5959
Tourism – overseas visitors	www.statistics.gov.uk
Tourism – domestic visitors	www.visitlondon.com
London airports	www.caa.co.uk
Business activity	www.rbs.co.uk/pmireports
Employment	www.rbs.co.uk/pmireports
London FootFall	www.footfall.com
Office space demand	www.cbhillierparker.com
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.

FootFall Index

Measures the average number of people passing through London shopping centres on a weekly basis. This index is positively correlated with UK retail spending so it can provide an indication of consumer spending in London.

Gross domestic product (GDP)

A measure of the total economic activity in the economy.

Gross value added (GVA)

Used in the estimation of GDP. The link between GVA and GDP is that GVA plus taxes on products minus subsidies on products is equal to GDP.

ILO unemployment rate

The International Labour Organisation's calculation of the number of people out of work.

Tube ridership

Transport for London's measure of the number of passengers using London Underground in a given period. There are 13 periods in a year – twelve 28-day periods and one 29-day period. Period 1 starts at the beginning of the financial year rather than the calendar year.

Acronyms

ABI	Annual Business Inquiry
BAA	British Airports Authority
BCC	British Chamber of Commerce
BITOA	British Incoming Tour Operators Association
CAA	Civil Aviation Authority
CBI	Confederation of British Industry
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
ODPM	Office of the Deputy Prime Minister
ONS	Office for National Statistics
PMI	Purchasing Managers' Index
PWC	PricewaterhouseCoopers
RICS	Royal Institute of Chartered Surveyors

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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.

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