

London's Economy Today



Issue 26 | October 2004

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Growth in London's economy but oil prices rise above \$50

by Christopher Lewis
Senior Economist, GLA Economics

London's economy continues to expand and currently seems to be outpacing the UK economy as a whole. The Purchasing Managers Index (PMI) measure of business activity in London rose to 58.2 in September (from 57.4 in August).

In comparison the index level for the nation as a whole was 54.3. The PMI measure of new orders for London firms remains robust and also rose to 58.2 in September (this is significantly above 50, which is the level consistent with no change on the previous month). The positive average annual rate of growth in tube passenger numbers has been sustained and the average rate of growth in bus passenger numbers though still declining, remains strong.

London's commercial property market seems to have strengthened over the summer. Investment in buying London offices has increased in recent months despite yields remaining low. Office lettings in central London have risen to their highest level for two years and vacancy rates are set to fall further according to research from property consultants. The revival of demand from low levels has been driven by creative companies and financial and professional services firms. The recovery has been most significant in the West End market. However, not all economic news for London has

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Latest news...

- **Get the insight:** Next week GLA Economics will publish one of their most sought after publications, **London's Economic Outlook**. The outlook is published once every six months and provides medium-term planning projections for London's economy. For your copy, email glaeconomics@london.gov.uk.
- **New blood:** GLA Economics welcomes Sandeep Sankoli, Dahyana Zapata and Justin Ram to its team. Sandeep and Dahyana have accepted 12-month contracts while Justin is replacing Adarsh Varma who is taking a four month sabbatical.

been good. A recent Confederation of British Industry survey suggests that the UK financial sector – a very important sector for the London economy – is now showing some signs of weakness. Confidence fell across the sector and business volumes were poor except for banks. London's unemployment rate trend also appears to be broadly flat and the rate is still significantly above the UK's.

UK unemployment still falling but the end may be in sight

All measures of UK unemployment continue to fall. Using the International Labour Organisation measure the unemployment level and rate in the three months to August 2004 were the lowest since comparable records began in 1984. The claimant count measure of unemployment fell for the sixteenth consecutive month in September to its lowest since July 1975. However, the fall was only by 200 to 834,000. Unemployment figures for autumn are eagerly anticipated with Mervyn King, Governor of the Bank of England, saying in October that 'the combination of low and stable inflation and continuously falling unemployment must come to an end at some point, and may already have done so.'

There are a few signs that the UK economy is now going through a softer patch after strong growth in the first half of 2004. Consumer spending and house price growth finally seem to be slowing and companies' cost pressures are growing mainly due to the rise in oil prices. Consumer confidence as measured by GFK Hamblin also registered an 18-month low in September and industrial production fell in August for the third consecutive month. This combined cooling of the economy has led the National Institute of Economic and Social Research to trim its forecast of third quarter growth to 0.4 per cent, which would be below trend. However, there are some reasons to be optimistic about the UK economy with corporate profitability, business investment and labour productivity all improving.

US economic recovery continues to outpace that of the eurozone

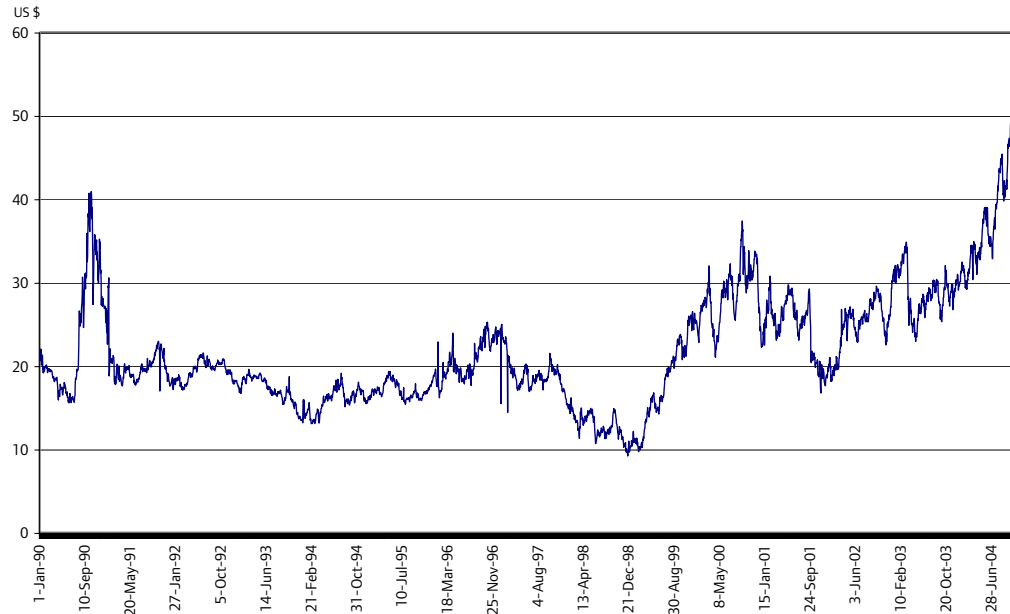
The final reading for the US's Q2 Gross Domestic Product (GDP) growth has been revised upwards and the US economy is expected to grow strongly during the rest of 2004. Current US consumer confidence remains consistent with moderate spending growth. In September, US retail sales rose (they are 7.7 per cent higher than a year earlier) and jobs growth continued, but the increase of around 100,000 jobs represented a slowdown from August. The greatest risk to the US economy remains the possibility that the rest of the world stops funding its current account deficit leading to a rapidly depreciating dollar.

The economic recovery in the eurozone remains tentative with the European Commission reporting that 'higher oil prices and lacklustre employment growth will continue to hamper consumption growth in the months to come.' The eurozone purchasing managers' indices for both the services and manufacturing sectors have weakened in the last month and unemployment in Germany continues to rise. Germany's institutional investor sentiment in mid-October was at its weakest since June 2003. French industrial output also recorded a sharp drop of 1.9 per cent in August compared with July.

Oil prices rose above \$50 during the last month. The price rises were caused by production glitches in the Gulf of Mexico after Hurricane Ivan and continued fears of disruption to supplies in Nigeria and the Middle East. The damage from Hurricane Ivan drove US crude oil output in September to its lowest since 1950. Offshore production in the Gulf of Mexico is not expected to fully recover until next year and the US Energy Department has already taken the step of lending a small proportion of its national stockpile of crude oil to domestic refineries.

Chart 1. Brent crude oil prices (\$ per barrel)

Source: FT.com



Oil prices expected to dampen growth in 2005

The International Monetary Fund predicts that the world's economy in 2004 should grow at its fastest rate since 1973, but will then slow down more than previously expected in 2005 with the balance of risks on the downside. Oil prices are a particular concern with the US budget and trade deficit and low European growth also problems. The President of the European Central Bank has said that the eurozone recovery is ongoing but the outlook is 'surrounded by a good deal of uncertainty, which at present is particularly related to oil prices.' The most obvious policy solution to help solve the problem of eurosclerosis¹ would be for eurozone countries, especially Germany, to quicken the pace of their proposed labour market reforms to ease their longer term structural rigidities. A failure to do this will put at risk longer term performance as well as slowing shorter term recovery.

In the UK, oil prices have been the main reason for annual input price growth for manufacturing (at 7.3 per cent) reaching its highest level since winter 2000 and for annual manufacturing output price growth (at 3.1 per cent) reaching its highest level since spring 1996. If the Bank of England responds to this data by continuing its gentle tightening of monetary policy in November, the expected slowdown in 2005 of the UK and London's growth is even more likely to occur. However, current consumer inflation is not a concern in the UK with annual inflation, as measured by the Consumer Price Index, falling from 1.3 per cent to 1.1 per cent in September, which is well below the Bank of England's target of two per cent.

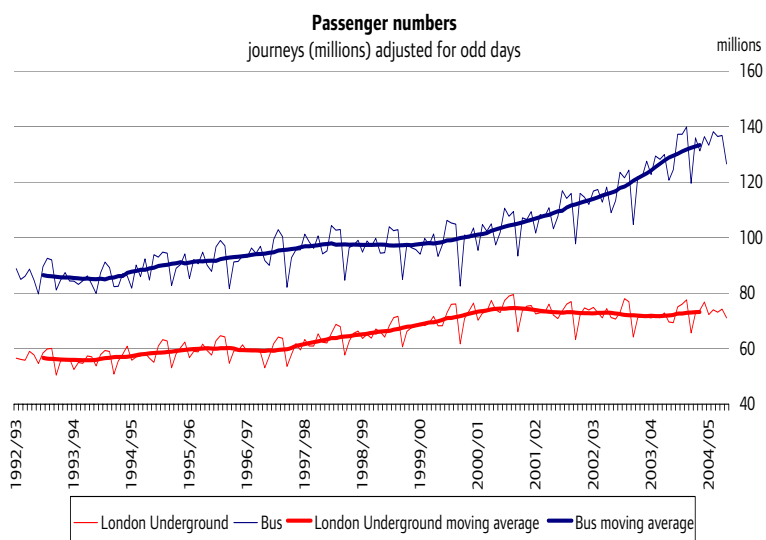
(Footnotes)

¹ eurosclerosis is the term used for the rigid, inflexible markets, especially labour markets, in parts of continental Europe.

Moving average passenger numbers continue to rise

- In the most recent 28-day period, London's public transport had 198 million passenger journeys; 127 million by bus and 71 million by Underground.
- The moving average showed an increase to just under 207 million passengers every period. The average for buses remained around 133 million passenger journeys each period and the average for the Underground remained around 73 million.

Latest Release: September 2004
Next Release: October 2004

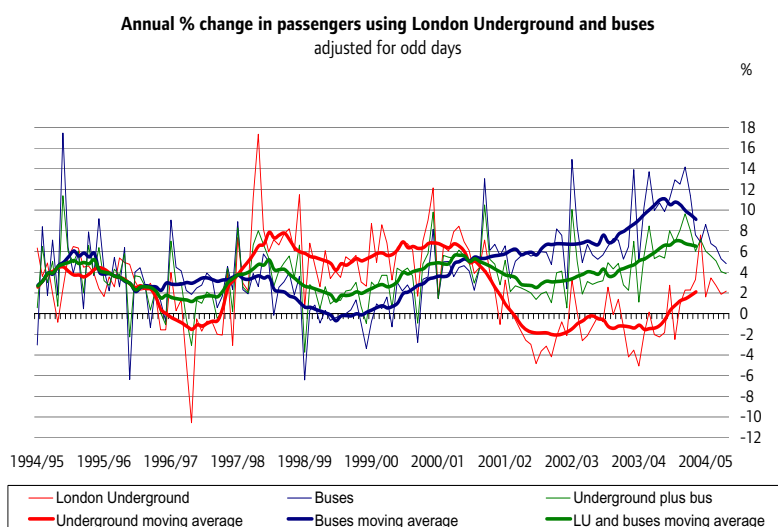


Source: Transport for London

Sustained growth on buses and the Tube

- The average annual rate of growth in passenger journeys is 6.4%.
- The average annual rate of growth in the number of bus journeys at 9% is slightly below last period's figures.
- The recovery in Underground passenger numbers has been sustained. The average annual rate of growth is 2%, its sixth period of positive growth.

Latest Release: September 2004
Next Release: October 2004

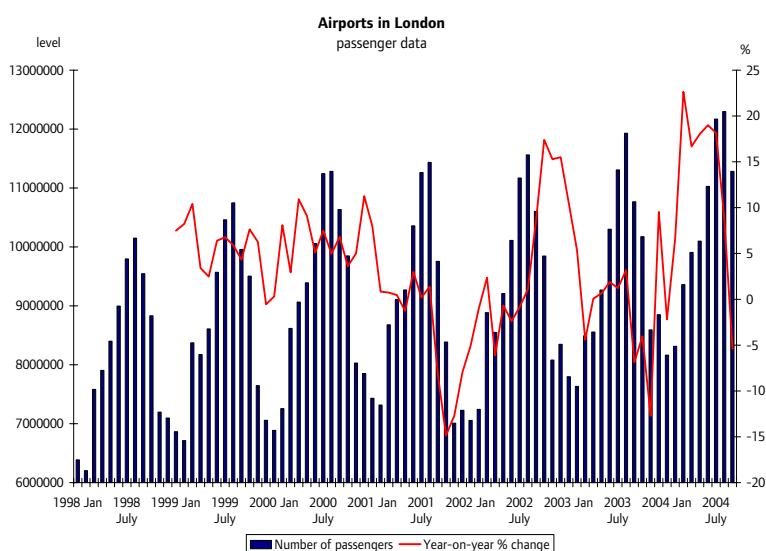


Source: Transport for London

Passengers using London airports falls

- The number of passengers using London's airports decreased by 5.4% in Sept 2004 compared to Sept 2003.
- This is the largest year-on-year decrease in passenger numbers since January 2004, after a summer of high growth in passenger numbers from March 2004 to August 2004.

Latest Release: October 2004
Next Release: November 2004



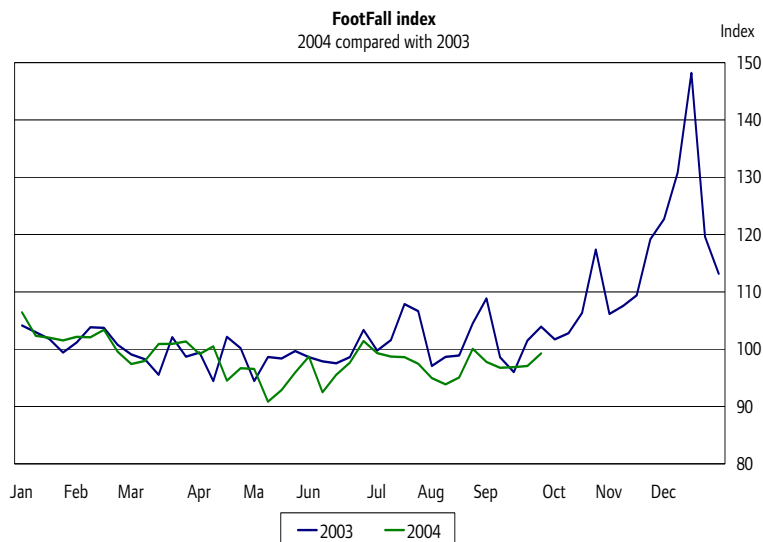
Civil Aviation Authority

Recovery in the number of shoppers

- The FootFall index is starting to rise again.
- However, the current level of the index is below the level of the same time last year, suggesting fewer numbers of shoppers this autumn.
- The FootFall index measures the number of shoppers but does not necessarily reflect the level of spending.

Latest Release: 04/10/04

Next Release: Every week



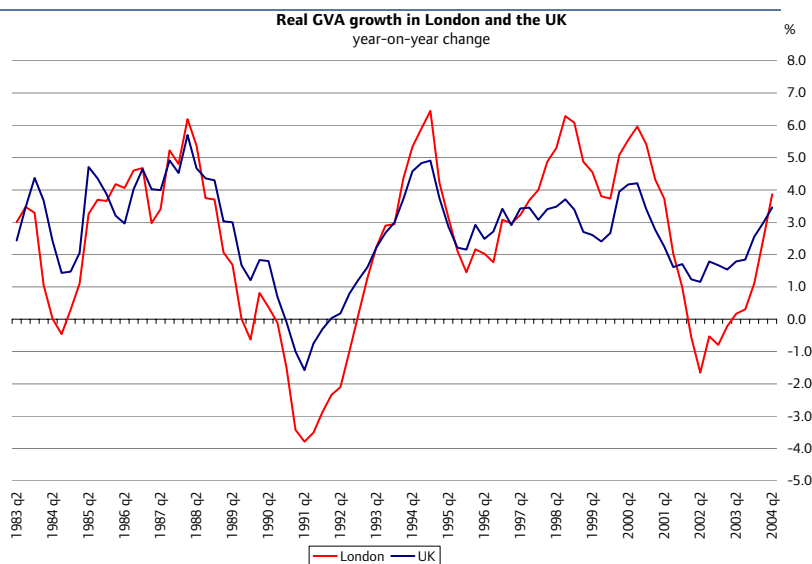
Source: FootFall Limited

Strong recovery in economic growth

- London's annual growth in output grew strongly by 3.9% in Q2 of 2004, up from annual growth of 2.5% in Q1.
- This represents a strong recovery in 2004 from the poorer growth rates over 2001 to 2003.
- London's GVA growth is now faster than that for the UK as a whole.
- EBS revised the estimates of recent output and these revisions are explained in this month's supplement.

Latest Release: September 2004

Next Release: January 2005



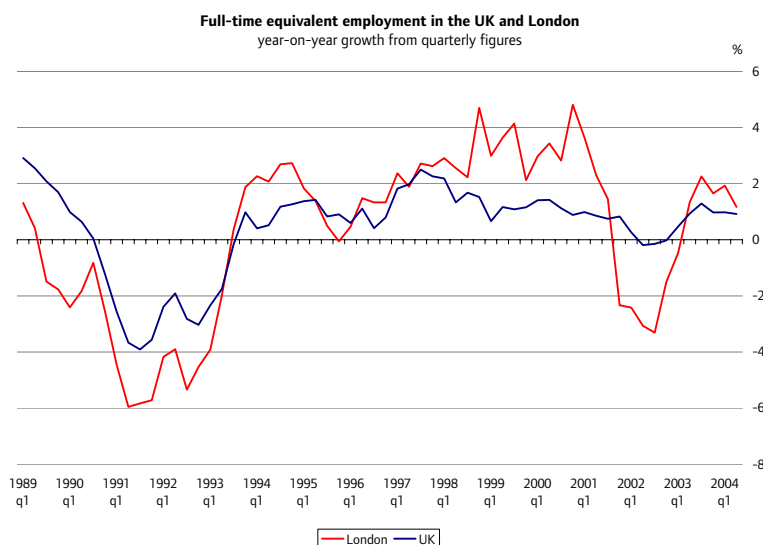
Source: Experian Business Strategies

Sustained employment growth

- London's year-on-year employment growth was 1.7% in 2004 Q1 and reduced slightly to 1.2% in 2004 Q2.
- London's employment growth for 2004 so far is faster than in the UK as a whole, which grew at annual rates of 1% in Q1 and 0.9% in Q2.
- EBS revised the estimates of recent employment and these revisions are explained in this month's supplement.

Latest Release: September 2004

Next Release: January 2005



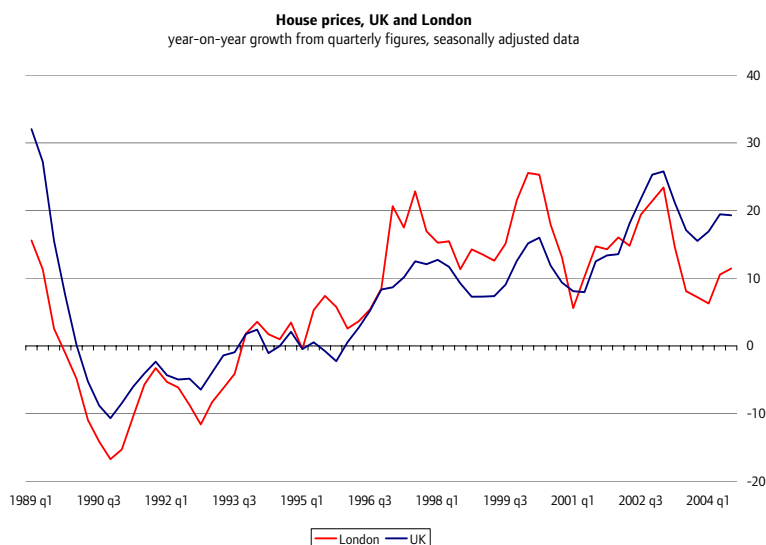
Source: Experian Business Strategies

London's housing market weaker than the UK's (1)

- House prices, as calculated by Nationwide showed steady growth in Q3 2004 in London and across the UK.
- Annual house price growth in London increased slightly to 11.4% in Q3 2004 from 10.5% in Q2, which was higher than the rate of 6.3% in Q1.
- Annual house price growth remained higher for the UK but did fall from 19.4% in Q2 2004 to 19.3% in Q3 2004.

Latest Release: October 2004

Next Release: January 2005



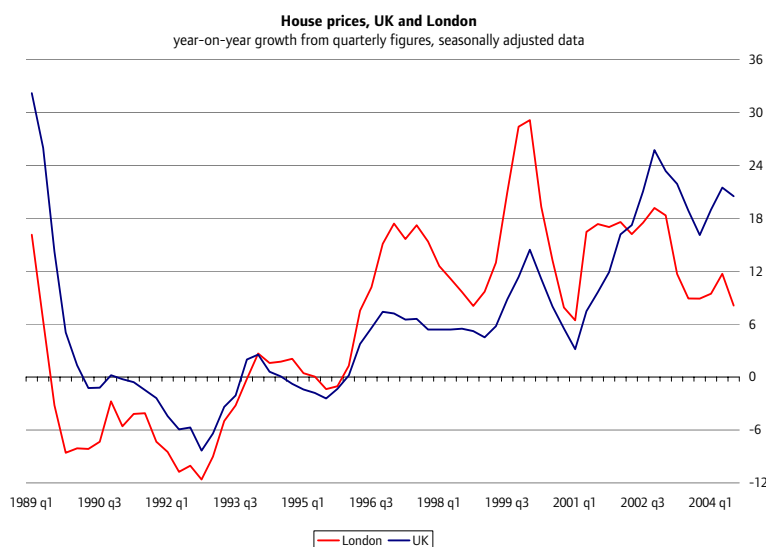
Source: Nationwide Housing

London's housing market weaker than the UK's (2)

- House prices, as measured by HBoS showed a slowdown in the rate of growth in Q3 2004 in London and the UK.
- Annual house price growth in London slowed to 8.1% in Q3 2004 from 11.7% in Q2 and is at its slowest since 2001 as calculated by HBoS.
- Annual house price growth is much higher for the UK slowing marginally to 20.5% in Q3 2004.

Latest Release: October 2004

Next Release: January 2005



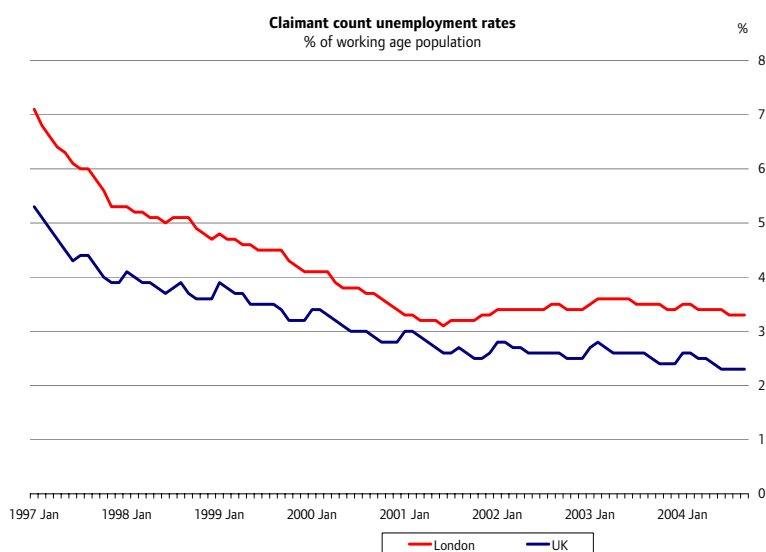
Source: HBoS Housing

Claimant count unemployment rate remains low

- The rate of claimant count unemployment, people unemployed and claiming Job-seekers Allowance, remained stable in London at 3.3% in September.
- There were 162,300 unemployment claimants in London in September 2004, compared with 172,500 in September 2003.
- Claimant count unemployment rate in the UK remains below that of London.

Latest Release: October 2004

Next Release: November 2004



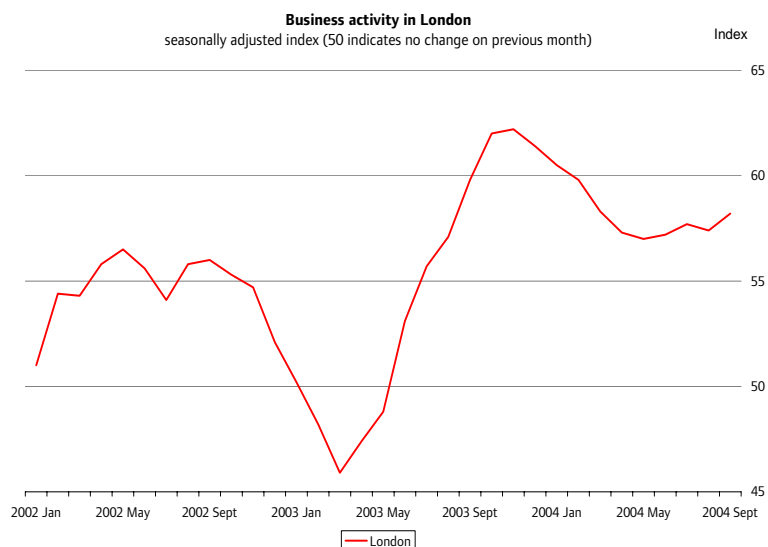
Source: Claimant Count, Nomis

Business activity in London expands

- London firms continued to expand their output of goods and services in September with the rate of growth increasing slightly.
- The Purchasing Managers' Index (PMI) of business activity recorded 58.2 in September 2004, up from 57.4 in August 2004.
- A rate above 50 on the index indicates an increase in business activity from the previous month.

Latest Release: October 2004

Next Release: November 2004



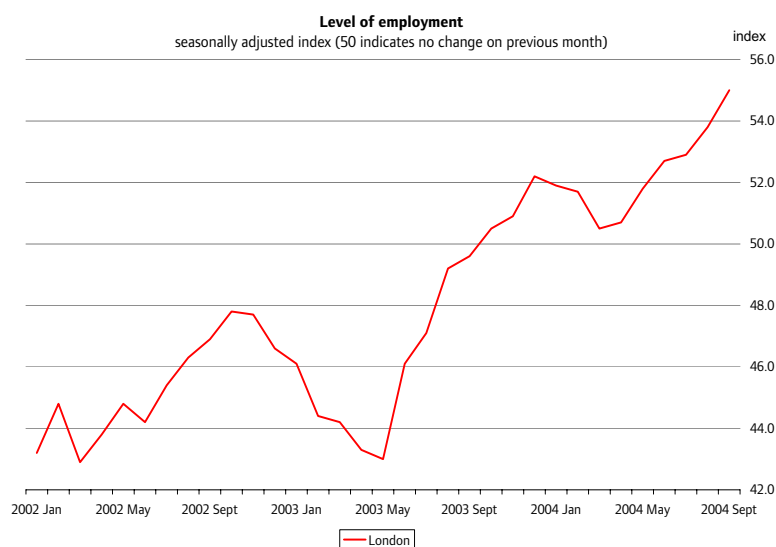
Source: PMI/The Royal Bank of Scotland

Strong employment growth in London

- London firms increased their level of employment in September. The PMI for the level of employment recorded 55.0 in September 2004, which compares with 49.6 in September 2003.
- This is the highest level for PMI's employment index in recent times.
- A rate above 50 on the index indicates an increase in the level of employment from the previous month.

Latest Release: October 2004

Next Release: November 2004



Source: PMI/The Royal Bank of Scotland

New orders in London remain robust

- New orders for London firms continued to expand in September. The PMI for new orders was 58.2 in September 2004, which compares with 57.3 in September 2003.
- A rate above 50 on the index indicates an increase in new orders from the previous month.

Latest Release: October 2004

Next Release: November 2004



Source: PMI/The Royal Bank of Scotland

Atoms and DNA: Revising London's Economy

Changes to estimated GVA and employment growth in London

by Damian Walne,
GLA Economics

with thanks to Dr Neil Blake,
Experian Business Strategies

The discovery of atoms changed our view of physics. The discovery of DNA changed our view of biology. Like physics and biology, economics is not immune to change. New data for output and employment has resulted in revisions to GLA Economics' data series. While revising data series can be a frustrating experience for economists, it is essential. Three of the key outcomes of the data revisions are:

- There have been revisions to the output and employment series used in *London's Economy Today* reflecting new data from the Office for National Statistics (ONS).
- These revisions show that economic growth rates in London over 2002 and 2003 were lower than previously thought.
- Despite the lower rates, the overall story of London's economy remains that it performed stronger in the recent downturn than the downturn of the early 1990s.

Economic Indicators

In the Economic Indicators section of *London's Economy Today*, GLA Economics presents two data series provided by Experian Business Strategies:

- 1. Real Gross Value Added (GVA)** as a measure of the total economic output of London, other UK regions and the UK as a whole. This series is provided in constant prices on a quarterly basis. The year-on-year percentage change for each quarter is presented as the most recent indicator of overall economic performance.
- 2. Full-time equivalent employment** as a measure of jobs in London, other UK regions and the UK as a whole. This measure uses information on full-time, part-time and self-employment and adjusts these to reflect differing average hours worked by these groups. This data is available on a quarterly basis. The year-on-year percentage change is presented as the most timely indicator of employment change.

Experian Business Strategies recently revised the data series for GVA and employment to reflect the availability of new data. This in turn alters the year-on-year percentage change charts that GLA Economics presents. This supplement is an opportunity to transparently present the differences between the old and new charts and briefly explain why these changes occurred.

Something old and something new

The old chart and the new revised chart for GVA change in London and the UK are shown as Charts 2 and 3. The main points to note are:

- The revisions make little, if any, difference to the year-on-year percentage

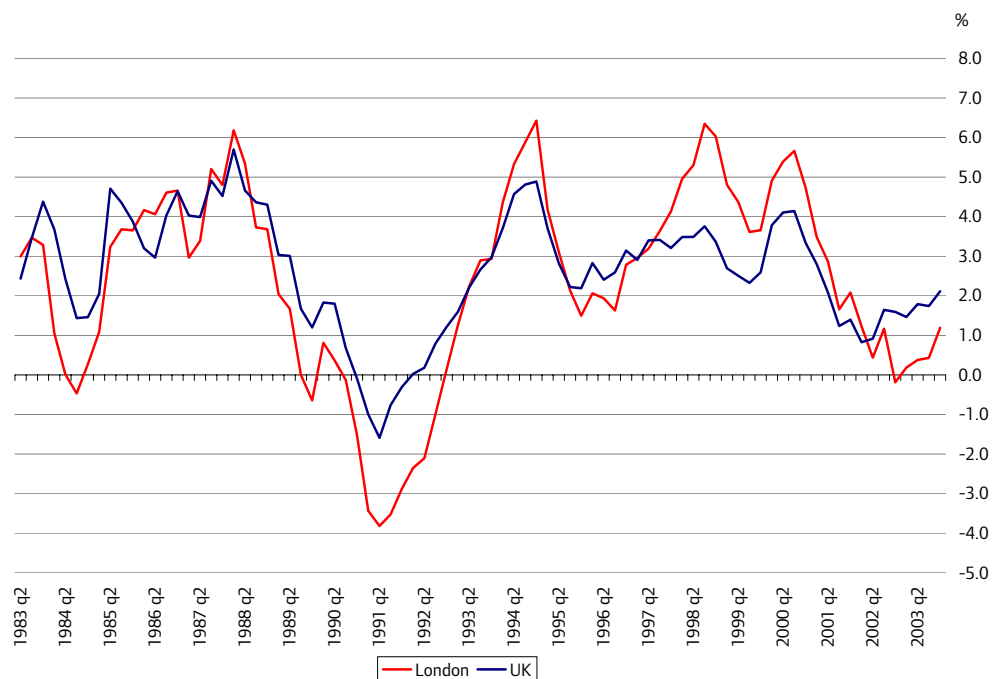
change in GVA growth up until the late 1990s when there are some small, mostly upward revisions in the London and UK growth rates.

- From 2000 quarter three (Q3) to 2001 Q3 there are more significant upward revisions in London's growth rate. Much of 2001 had GVA growth of up to a percentage point more than previously thought.
- From 2001 Q4 to 2003 Q1, there are significant downward revisions for the growth rate in London with some small upward revisions for the UK. London's year-on-year growth rates at the end of 2002 and in the first half of 2003 were up to two percentage points lower than previously recorded.
- The effect of these revisions is that London had five quarters of negative annual growth rates from 2002 Q1 to 2003 Q1. This contrasts with the pre-revision scenario when there was only one quarter with negative annual growth.
- More positively, the new estimates for 2004 for which there was previously no data, point to a strong acceleration in London's rate of growth.

**Chart 2. Old data series:
Real GVA growth in
London and the UK**

year-on-year change

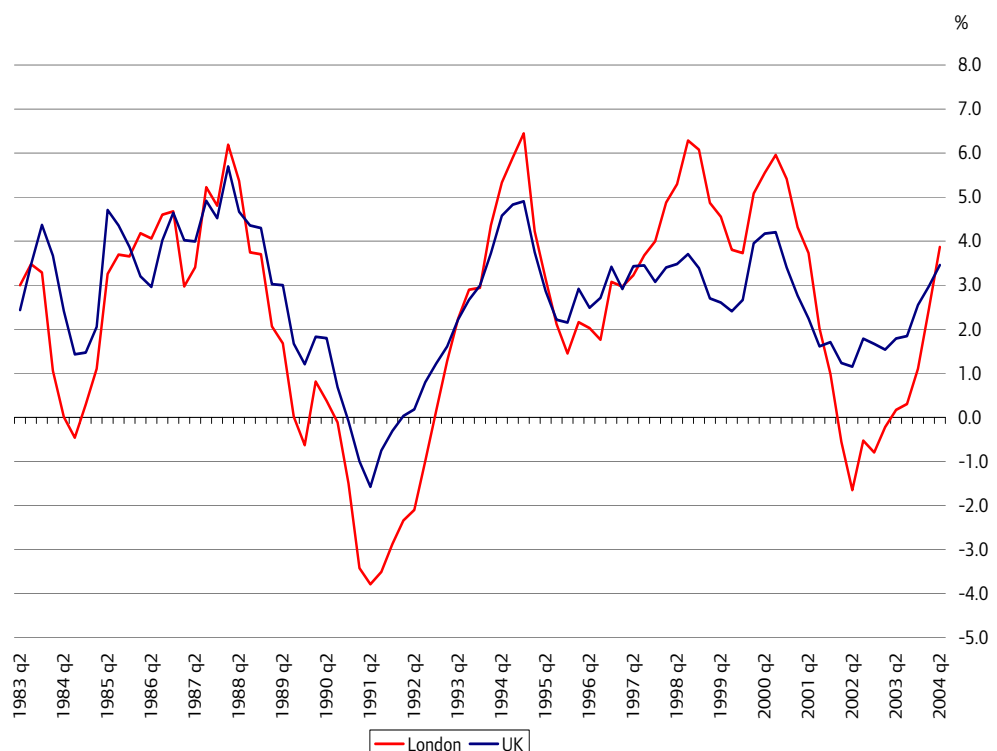
Source: Experian Business
Strategies



**Chart 3. New data series:
Real GVA growth in
London and the UK**

year-on-year change

Source: Experian Business
Strategies



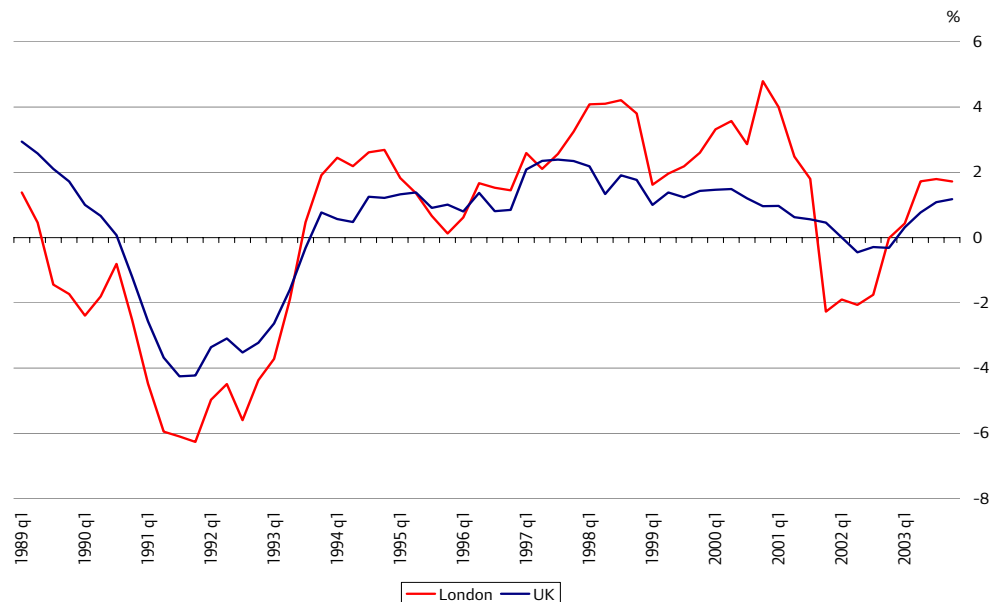
The old chart and the new revised chart for full-time equivalent employment change in London and the UK are shown as Charts 4 and 5. The main points to note are:

- The revisions make some small historical differences to year-on-year employment change. There are upward revisions in both London and the UK for the early 1990s, slight downward revisions in the mid 1990s followed by some upward revisions in the late 1990s.
- More recently, the downturn in employment in London 2001 Q4 to 2003 Q1 is sharper than was previously recorded. For example, in 2002 Q3, year-on-year employment fell by over three per cent in the revised data compared to less than two per cent previously.
- Revisions to the UK data are much less significant but with slightly higher employment growth in recent years.
- Overall, the story of London's recent employment growth has changed little other than that the magnitude of the recent downturn was sharper than previously thought and the recovery seems stronger.
- The new estimates for 2004 for which there was previously no data, point to a continuing recovery in London's jobs growth rate.

**Chart 4. Old data series:
Full-time equivalent
employment in London
and the UK**

year-on-year growth from
quarterly figures

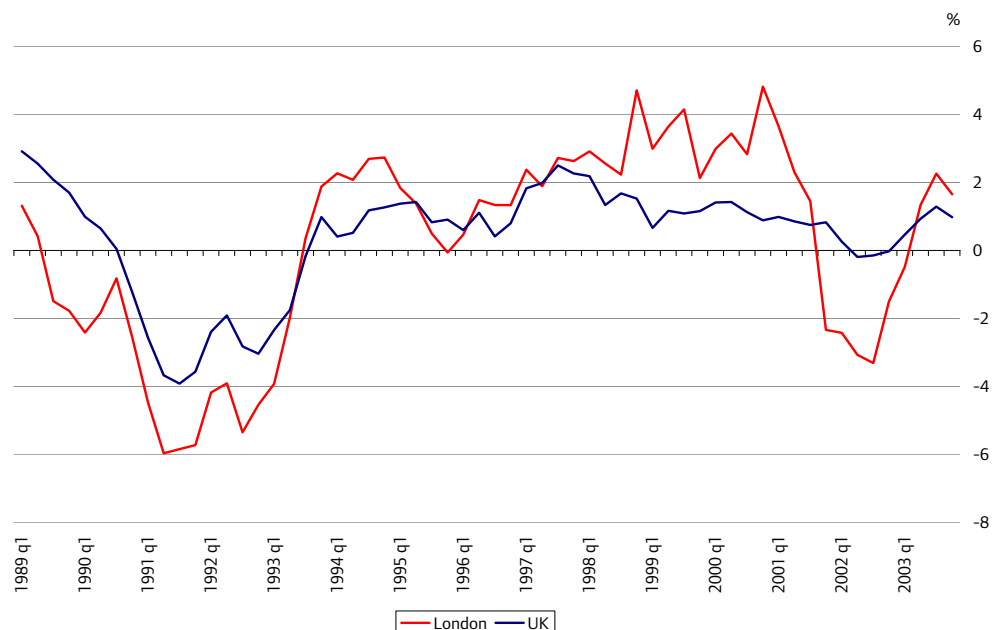
Source: Experian Business
Strategies



**Chart 5. New data series:
Full-time equivalent
employment in London
and the UK**

year-on-year growth from
quarterly figures

Source: Experian Business
Strategies



Understanding the method

The GVA and employment series draw largely from data produced by the ONS. This includes sources of employment, business and output data from the *Annual Business Inquiry*, *Labour Force Survey* and *New Earnings Survey*. The real GVA data is built on ONS Regional Accounts data and has to be adjusted to measure output by workplace (where people work) rather than by residence (where people live). Further information is obtained from other sources such as surveys of employment and output from the British Chamber of Commerce and the Confederation of British Industry, and estimates from the Department of Trade and Industry. This is particularly important in interpolating quarterly results from annual data.

Much of the ONS data, for example the ONS Regional Accounts, are often around two to three years out of date, often even more so for breakdowns at industrial levels. It is because of this lack of recent official data that economists have to 'forecast' the recent past. This means extrapolating the most recent official ONS Regional Accounts data and using more recent data on employment, earnings and surveys.

The quarterly employment estimates also relate closely to the results for GVA. There is a plausible assumption that employment change follows GVA change. An increase in employment is indicative of a more rapid increase in GVA and similarly a fall in employment is indicative of slower growth in GVA.

What the revisions mean for London

There have been some long-term revisions, affecting data back to the 1980s, which are due to changes in National Accounts, Regional Accounts and historical employment data. Overall, these changes are relatively minor and there is no reason to question the existing understanding of London's economy over the 1980s and 1990s. The discussion below focuses on clarifying the data revisions for the last few years as this affects the interpretation of the London economy since 2000. These revisions affect London, other regions and the UK.

The recent revisions are:

- Revisions to 2001. That is namely new ONS data for regional GVA by industry.
- Revisions to 2002. There are new ONS estimates for regional GVA but without an industrial breakdown.

The revised estimates for 2001 result in a slightly higher London GVA increase. The ONS's London GVA by industry in particular pointed to a much higher increase of output in transport and communication than was previously estimated. This reflects erratic movements of earnings data in the industry. The revised employment estimates for 2001 point to slightly slower employment growth largely in financial and business services and in distribution and catering.

The revisions for 2002 are more significant than those for 2001. The previous estimates were provisional and based solely on employment estimates and earnings data. The new estimates draw on the new 2002 regional accounts. The GVA result for London in 2002 is much lower than was previously estimated, falling from positive annual growth of 0.7 per cent to a negative rate of 0.9 per cent. Similarly, the fall in total employment was greater than estimated, from a fall of 1.8 per cent to a fall of 3.2 per cent. The revisions can be explored by considering employment data for 2002 to identify change by industry. This identifies that the downward revisions with the largest impact are in distribution and catering, transport and communications and also in other services (e.g. recreation and entertainment).

Conclusions

The data revisions affect our understanding of London's recent economic performance but this needs to be put into context. For example, the revisions mean that at the end of 2003 London had 3.94 million full-time equivalent jobs rather than 3.98 million. Moreover, the recent period of negative annual GVA growth for London, five quarters with a low of minus 1.7 per cent remains moderate compared with the previous downturn of nine quarters and a low of minus 3.8 per cent in the early 1990s. Similarly, the recent downturn led to 44,000 fewer full-time equivalent jobs in London, which contrasts with the severer losses of over 400,000 in the previous downturn.

The ONS made substantial revisions to employment and regional accounts data for 2002 and this in turn impacts on the estimates for 2002 to 2004 produced by independent forecasters. Above all, this highlights the difficulties and headaches involved in using regional level economic statistics and the need to understand how such statistics are collected and interpreted.

The Allsop Review¹, the Review of Statistics for Economic Policy Making (March 2004) commissioned by HM Treasury, emphasised the need for good quality statistics at a regional level. The review's recommendation of developing regional accounts to provide better quality and more timely annual baseline statistics is one welcomed by both GLA Economics and Experian Business Strategies.

(Endnotes)

¹ http://www.hm-treasury.gov.uk/consultations_and_legislation/allsop_review/consult_allsopp_index.cfm

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	IMF	International Monetary Fund
BAA	British Airports Authority	LCCI	London Chamber of Commerce and Industry
BCC	British Chamber of Commerce	LET	London's Economy Today
BITOA	British Incoming Tour Operators Association	MPC	Monetary Policy Committee
CAA	Civil Aviation Authority	ODPM	Office of the Deputy Prime Minister
CBI	Confederation of British Industry	ONS	Office of National Statistics
EBS	Experian Business Strategies	PMI	Purchasing Managers' Index
GDP	Gross domestic product	PWC	PricewaterhouseCoopers
GVA	Gross value added	RICS	Royal Institute of Chartered Surveyors
ILO	International Labour Organisation		

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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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