

London's Economy Today

Issue 90 | February 2010

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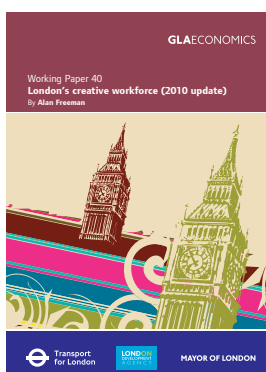
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UK inflation breaches 3 per cent and sovereign debt default risk rises

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

Annual Consumer Price Index (CPI) inflation surged to 3.5 per cent in January 2010, up from 2.9 per cent in December 2009 (see Figure 1). The return of VAT to 17.5 per cent was mainly responsible for this jump although other factors such as higher fuel prices also contributed. Retail Price Index (RPI) inflation also rose in January to 3.7 per cent, up from 2.4 per cent in December 2009. There has been a substantial rise in import costs, which has been driven by the weakness of sterling and this has led to inflationary pressures. If the short-term increase above the Bank of England's target were to create a sustained rise in inflation expectations that would tend to produce a greater risk of higher medium-term inflation. However, that risk is likely to be countered by the weakness of domestic demand and spare capacity in the economy.

Latest news...



● Working Paper 40: London's creative workforce (2010 update)

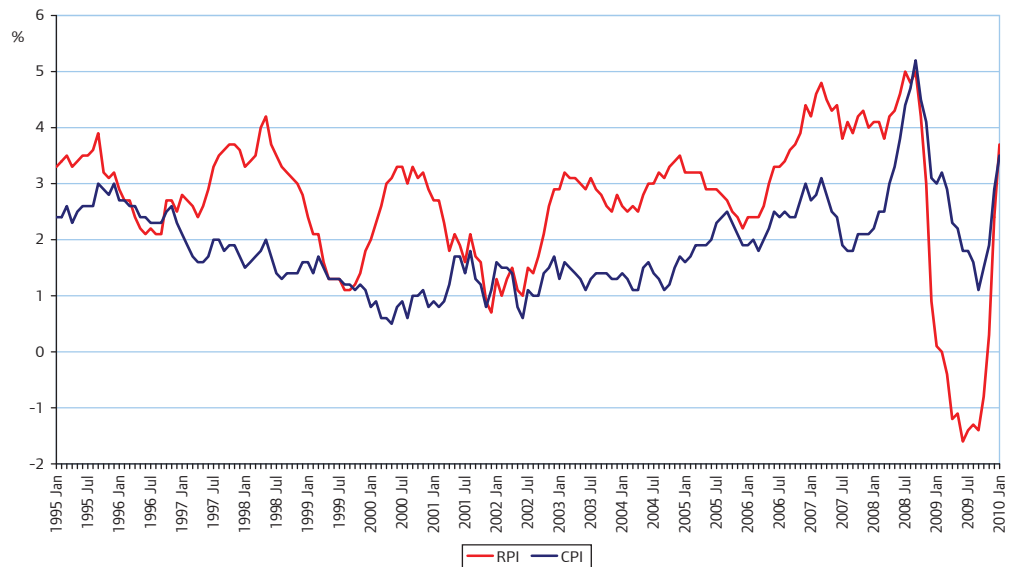
This publication is GLA Economics' third update on London's creative industries, a comprehensive survey of employment and production by London's creative workforce. It confirms that London and its surrounds remain the dominant focus for the UK's creative industries.

Visit <http://www.london.gov.uk/who-runs-london/mayor/publications/business-and-economy/londons-creative-workforce-2010-update> to download this publication.

Figure 1: UK annual inflation rates

Last data point is January 2010

Source: Office for National Statistics



With CPI inflation deviating by more than 1 per cent from the 2 per cent CPI inflation target, the Governor of the Bank of England, Mervyn King, was required to write an explanatory letter to the Chancellor of the Exchequer explaining why inflation had breached 3 per cent. In this letter the Governor noted that the Monetary Policy Committee (MPC) “expects this to be a temporary deviation of inflation from the target”. The MPC believes that “although it is likely to remain high over the next few months, inflation is more likely than not to fall back to the target in the second half of this year, as the short-run factors wane and the influence of spare capacity builds”.

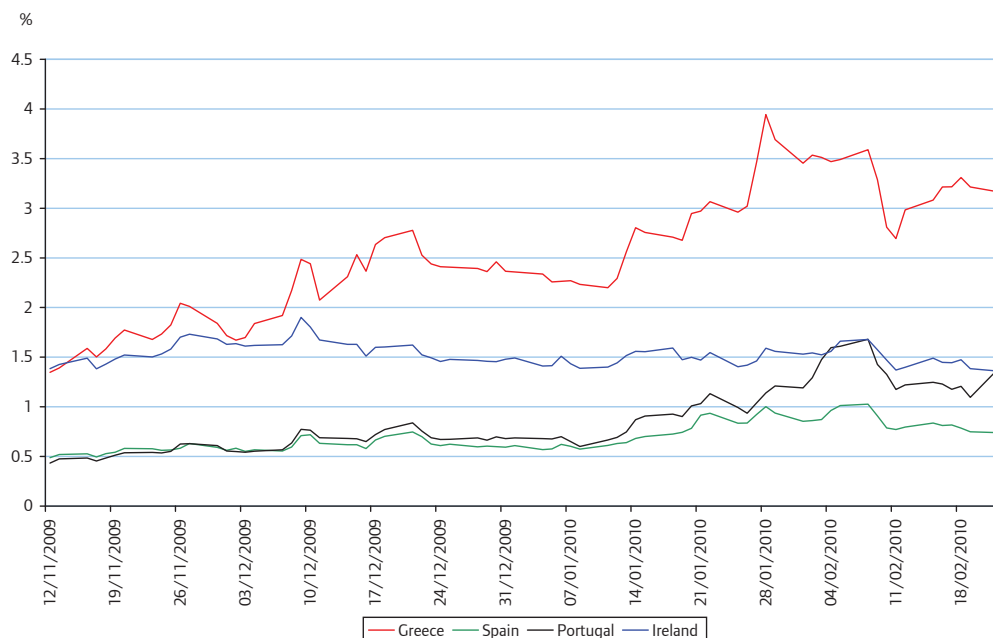
Fears of Greece defaulting on its debt increases interest rates on Government bonds

Concern about the size of Greece’s budget deficit has continued to mount in 2010 with the already elevated spread of its 10-year bonds over German bonds (the difference in interest payments that the Greek government must make on its bonds compared to the interest payments on German bonds) reaching nearly 4 per cent at the end of January (see Figure 2). On 11 February eurozone countries pledged that they were willing to support Greece in response to the pressure this situation has inflicted on the Euro. However, eurozone countries stopped short of providing immediate financial support and want Greece to further sharply consolidate its fiscal position (ie raise taxes and reduce government expenditure) quickly. Without severe and determined action there is a worry that Greece may default on its debt. If Greece were to default on its debt this could have a contagious effect on other countries’ sovereign debt. Severe concern has also therefore been expressed about the fiscal situation in Portugal, Ireland, Italy and Spain.

Figure 2: Ten-year government bond spreads over German bonds, percentage points

Last data point is 22/02/10

Source: Ecwin



Given the huge size of the UK's current budget deficit, fears of contagion spreading to the UK has also risen, especially as the fiscal consolidation plans in the pre-Budget Report were weak and provided insufficient detail. The precarious state of the UK public finances led 20 economists, including Bridget Rosewell, the Chief Economic Advisor to the GLA, to write an open letter to the Sunday Times stating that "it is now clear that the UK economy entered the recession with a large structural budget deficit. As a result the UK's budget deficit is now the largest in our peacetime history and among the largest in the developed world. In these circumstances a credible medium-term fiscal consolidation plan would make a sustainable recovery more likely. In the absence of a credible plan, there is a risk that a loss of confidence in the UK's economic policy framework will contribute to higher long-term interest rates and/or currency instability, which could undermine the recovery. In order to minimise this risk and support a sustainable recovery, the next government should set out a detailed plan to reduce the structural budget deficit more quickly than set out in the 2009 pre-Budget Report".

The risks to the UK economy's fragile recovery from potentially higher long-term interest rates caused by the parlous state of the UK's public finances have increased over the last month. This would crowd-out private sector demand (especially investment), impair the supply-side capacity of the economy and dampen long run growth. The economy is a dynamic organism with innovation and investment being major drivers of growth. Driving up interest rates through too much Government borrowing and taking up available credit will not make this investment possible and will deter innovation. Foreign investors looking at the UK will also see too much unproductive spending and will judge accordingly.

Developed economies face a rocky recovery

Activity has been increasing slowly in the UK's main trading partners with recent positive economic growth in the Eurozone, the US and Japan. However, much of this recorded growth was actually driven simply by an easing in the pace of de-stocking, huge accommodative monetary policies and vast Government fiscal stimuli. The underlying weakness of many economies, such as the UK remains. An overhang of indebtedness (both household and Government) will dampen the recovery in the UK and banks in general need to deleverage their balance sheets further. Lending conditions, despite easing slightly, remain extremely tight. World trade increased in Q3 2009 but remains around 12 per cent below its pre-recession peak.

Meanwhile, emerging market economies such as China and India are growing rapidly. Concerns remain that global imbalances will once again worsen, but hopefully at some point China will revalue the yuan and that domestic Chinese consumption will expand dramatically. So the balance of world economic power is shifting eastwards, however with London being one of the few global cities with a history of openness to trade and innovation this will provide our businesses with a wealth of opportunities.

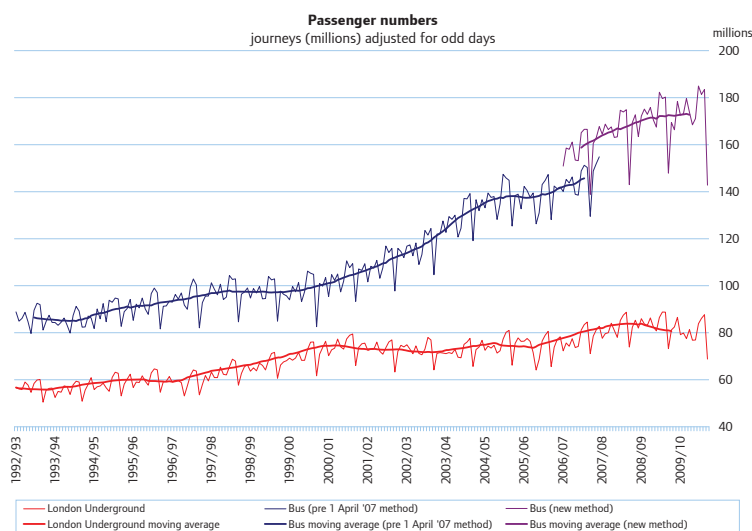
Economic indicators

Decrease in moving average of passenger numbers

- The most recent 28-day period is from 13 December 2009 to 9 January 2010. London's Underground and buses had 211.6 million passenger journeys; 142.8 million by bus and 68.8 million by Underground.
- The moving average of passengers every period decreased to 253.4 million from an upwardly revised 254.1 million in the previous period. The moving average for buses was 172.7 million. The moving average for the Underground was 80.6 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: February 2010

Next release: March 2010



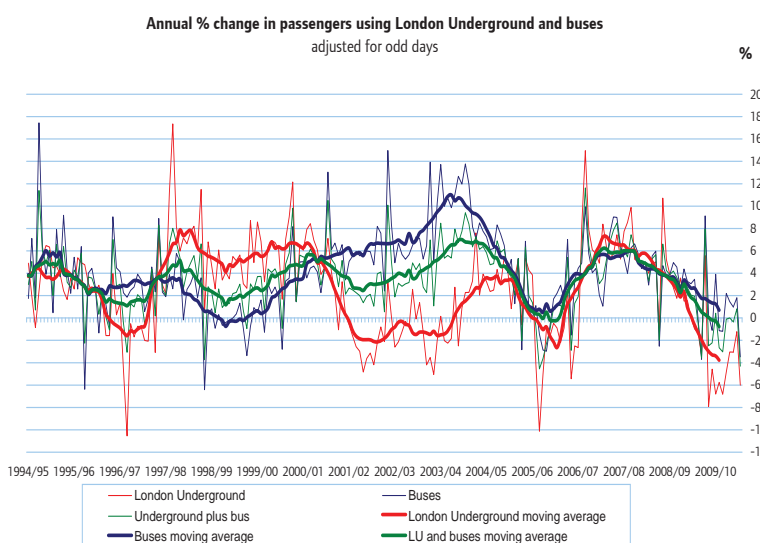
Source: Transport for London

Decrease in average annual growth rate of passengers

- The moving average annual rate of growth in passenger journeys decreased to -0.8% from upwardly revised -0.3% in the previous period.
- The moving average annual rate of growth in bus passenger journey numbers decreased to 0.7% from an upwardly revised 1.2% in the previous period.
- The moving average annual rate of growth in Underground passenger journey numbers decreased to -3.8% from an upwardly revised -3.4% in the previous period.

Latest release: February 2010

Next release: March 2010



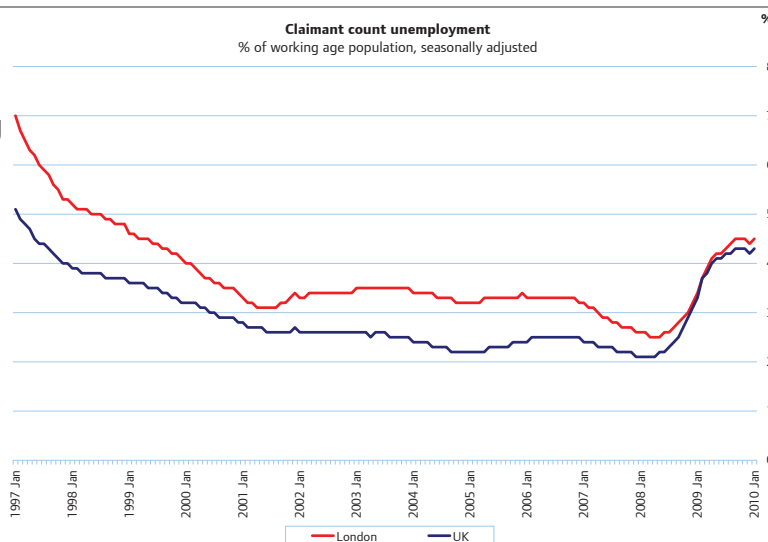
Source: Transport for London

Claimant count unemployment

- The percentage of the resident working age population who are unemployed and claiming Jobseekers' Allowance (seasonally adjusted) in London was 4.5% in January 2010.
- There were 229,600 seasonally adjusted unemployment claimants in London in January compared with an upwardly revised 226,700 in December.
- There were 1,635,600 seasonally adjusted unemployment claimants in the UK in January 2010 compared with an upwardly revised 1,612,100 in December.

Latest release: February 2010

Next release: March 2010



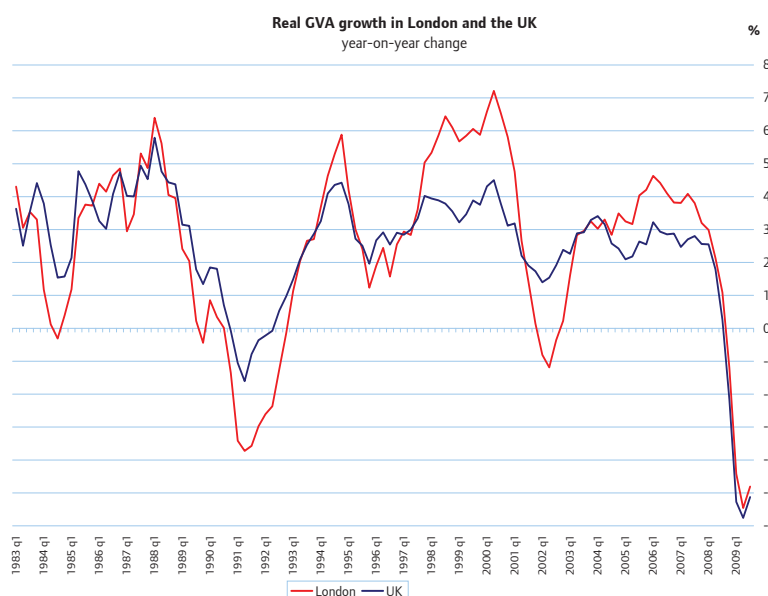
Source: Claimant Count, Nomis

Annual output growth less negative in London than in the UK

- London's annual growth in output increased to -4.8% in Q3 2009 from a downwardly revised -5.5% in Q2 2009.
- Annual output growth in the UK increased to -5.1% in Q3 2009 from -5.8% in Q2 2009.
- There have been revisions to previous growth rates to reflect the availability of new data.

Latest release: February 2010

Next release: May 2010



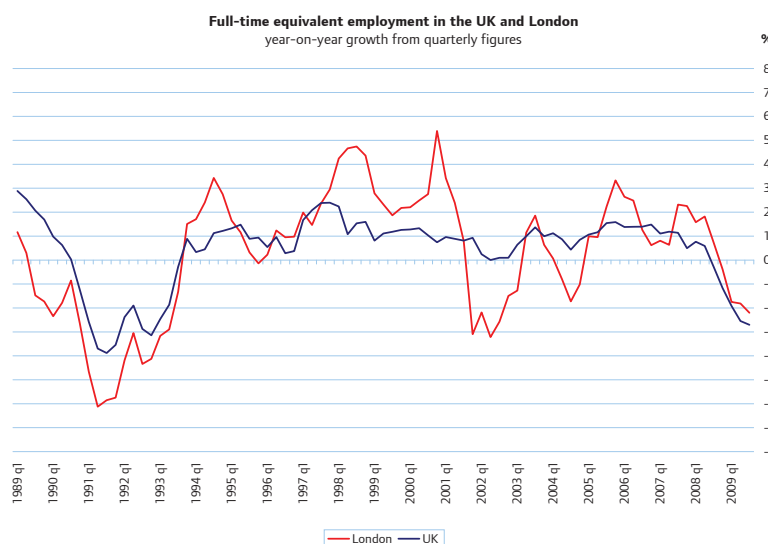
Source: Experian Economics

London's annual employment growth less negative than in the UK

- London's annual employment growth decreased to -2.2% in Q3 2009 from a downwardly revised -1.8% in Q2 2009.
- Annual employment growth in the UK decreased to -2.7% in Q3 2009 from -2.5% in Q2 2009.
- There have been revisions to previous growth rates to reflect the availability of new data.

Latest release: February 2010

Next release: May 2010



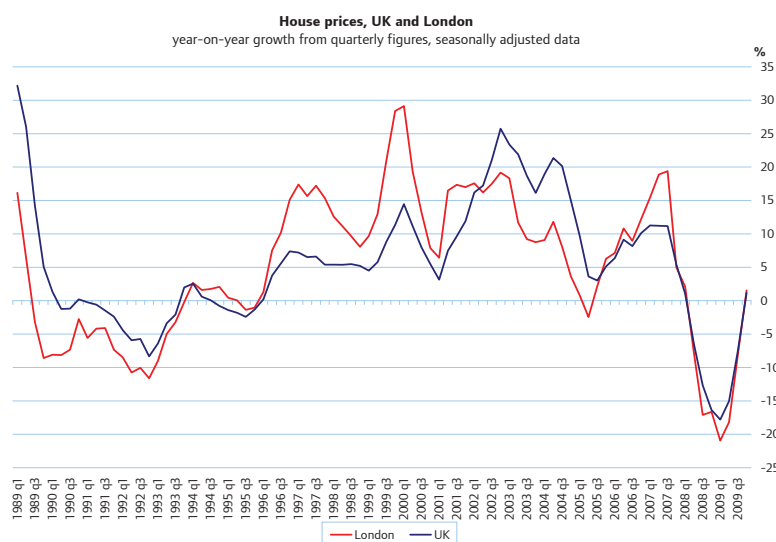
Source: Experian Economics

Annual house price inflation rises

- House prices, as measured by the Halifax house price index, were higher in Q4 2009 than in Q4 2008 in both London and the UK.
- Annual house price inflation in London was 1.5% in Q4 2009, up from -8.1% in Q3 2009.
- Annual house price inflation in the UK was 1.2% in Q4 2009, up from -7.6% in Q3 2009.

Latest release: January 2010

Next release: April 2010



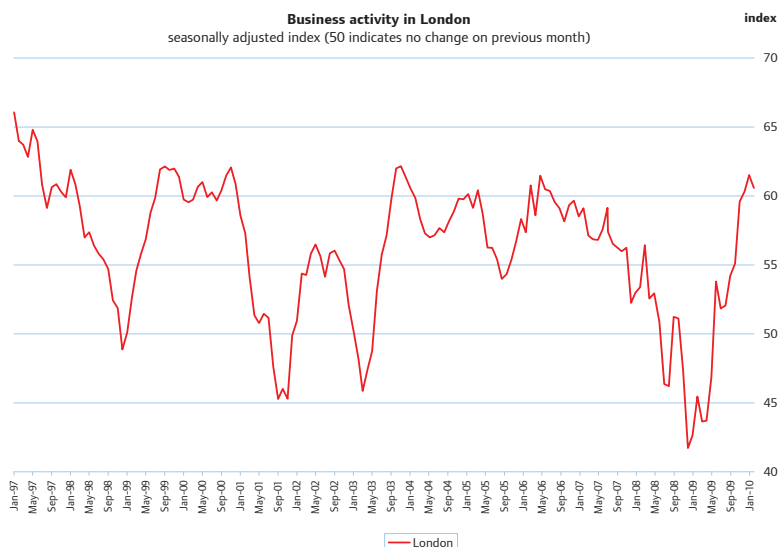
Source: Halifax house price index

London's business activity increasing

- London firms increased their output of goods and services in January 2010.
- The Purchasing Managers' Index (PMI) of business activity recorded 60.6 in January compared to 61.5 in December.
- A rate of above 50 on the index indicates an increase in business activity from the previous month.

Latest release: February 2010

Next release: March 2010

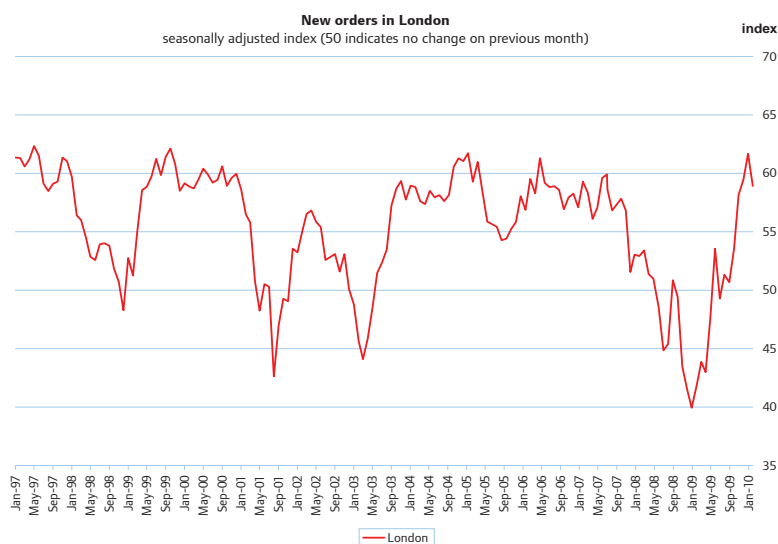


New orders in London rising

- January 2010 saw a rise in new orders for London firms.
- The PMI for new orders recorded 58.9 in January compared to 61.7 in December.
- A rate of above 50 on the index indicates an increase in new orders from the previous month.

Latest release: February 2010

Next release: March 2010

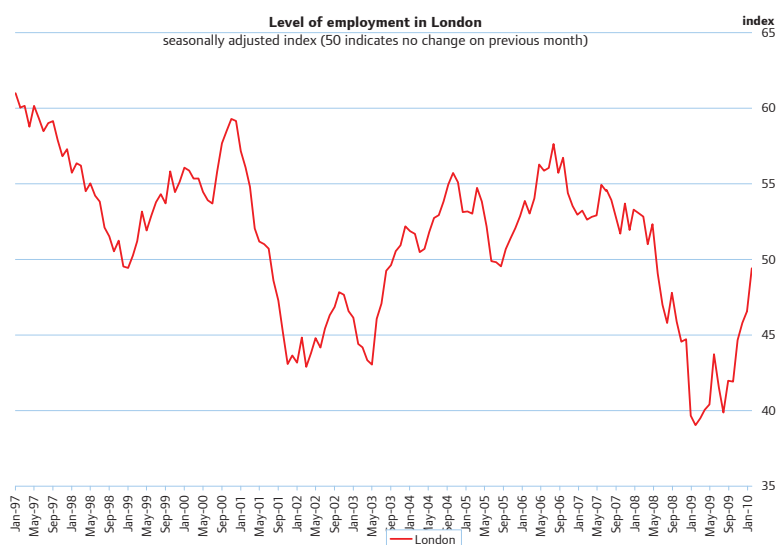


London employment still falling

- The PMI shows that the level of employment in London firms decreased in January 2010.
- The PMI for the level of employment was 49.4 in January compared to 46.6 in December.
- A rate of below 50 on the index indicates a decrease in the level of employment from the previous month.

Latest release: February 2010

Next release: March 2010

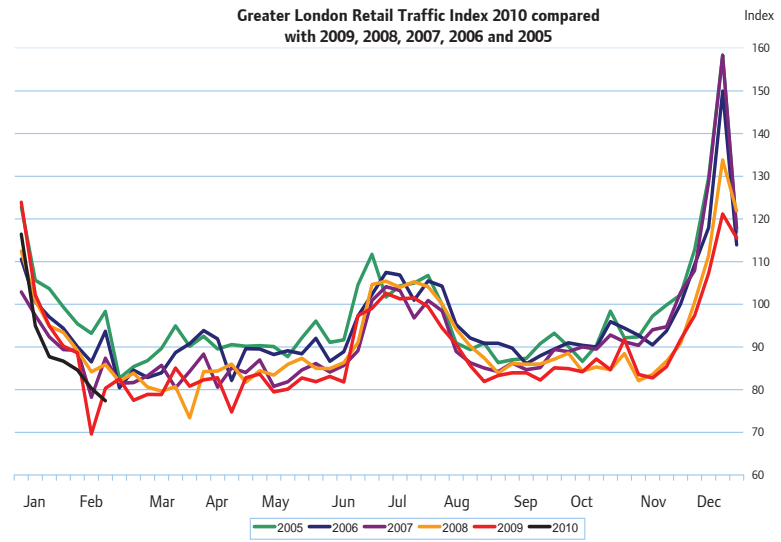


Synovate Retail Traffic Index has weak start to 2010

- The Synovate Retail Traffic Index of shoppers in London was 77.4 in the second week of February compared to 80.3 in the previous week.
- The index so far in 2010 has generally been below 2009 levels.
- Synovate's Retail Traffic Index measures the number of shoppers and does not necessarily reflect the level of spending.

Latest release: Mid-February 2010

Next release: Weekly



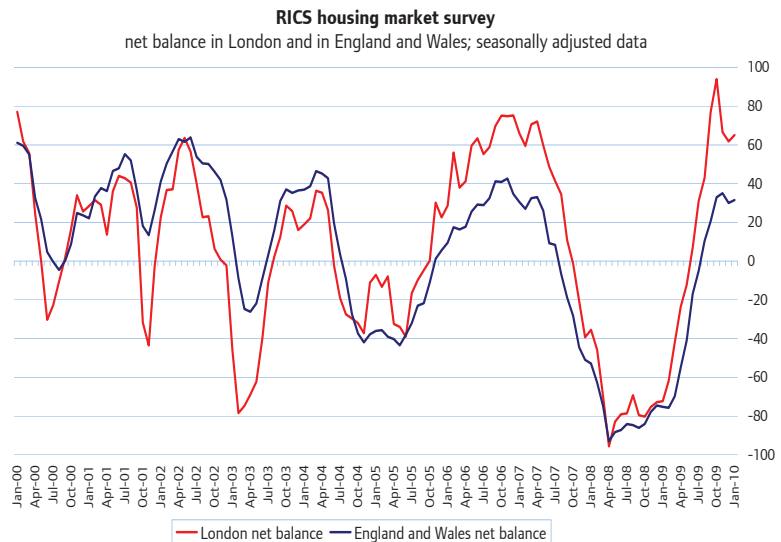
Source: Synovate

Surveyors report that house prices are rising

- The RICS survey shows a positive net balance of 65 for London house prices over the past three months to January 2010. This net balance is up from an upwardly revised 62 in December 2009.
- Surveyors reported a positive net house price balance for England and Wales of 32 in the past three months to January 2010, up from 30 in December 2009.
- London's net house price balance is above that of England and Wales.

Latest release: February 2010

Next release: March 2010



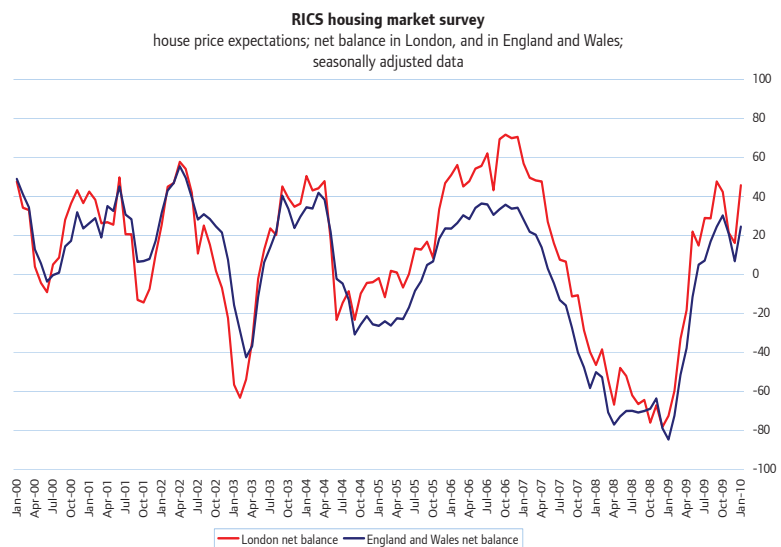
Source: Royal Institution of Chartered Surveyors

Surveyors expect house prices to increase

- The RICS survey shows that surveyors expect house prices to increase over the next three months in London and in England and Wales.
- The net house price expectations balance in London was 46 in January 2010, up from 16 in December 2009.
- For England and Wales, the net house price expectations balance was 24 in January 2010, up from a downwardly revised 7 in December 2009.

Latest release: February 2010

Next release: March 2010



Source: Royal Institution of Chartered Surveyors

Data sources

Tube and bus ridership

Transport for London on 020 7222 5600
or email: enquire@tfl.gov.uk

GDP/GVA growth

Experian Economics on 020 7746 8260

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 unemployment

Unemployment 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.

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 2009/10 there are eleven 28-day periods, one 25-day period and one 32-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 2009/10 there are eleven 28-day periods, one 25-day period and one 32-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
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

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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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