GLAECONOMICS

London's Economy Today

Issue 79 | March 2009

In this issue

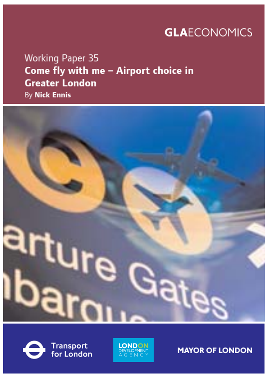
Bank of England begins quantitative easing as the IMF forecasts the first global contraction for 60 years

By **Gordon Douglass**, Economist and **Simon Kyte**, Economist

On 5 March the Bank of England cut interest rates by a further 50 basis points to 0.5 per cent (see Figure 1) - a historic low. Minutes of the Monetary Policy Committee's meeting show that it was united on the cut with the Bank's February Inflation Report projecting a substantial risk of undershooting the 2 per cent inflation target in the next couple of years or so. However, the cut in interest rates has been criticised by some as damaging to savers and others saw it as less significant than the more unconventional policy measures now being considered by the Bank.

With interest rates now close to zero the Bank is left with very little room to cut base rates further. Therefore, much of the policy focus is now shifting to trying to stimulate the economy through various types of 'quantitative easing' – crudely speaking, increasing the money supply. The Bank has created a £75 billion asset purchase package of mainly government gilts, which will be financed by the creation

Latest news...



Coming soon...

- **Working Paper 35: Come fly with me – Airport choice in Greater London**

This publication from GLA Economcs will be available on our website very soon. The research on airport choice in London suggests that:

- Competition for passengers is highest for those originating in Central and Inner London where accessibility to each airport is most similar;
- Each London airport has a distinct passenger catchment area but Inner London is the main source of passengers; and
- Demand for new airport capacity will be correlated with population distribution in the Greater Southeast, with Inner London being a major source of demand.

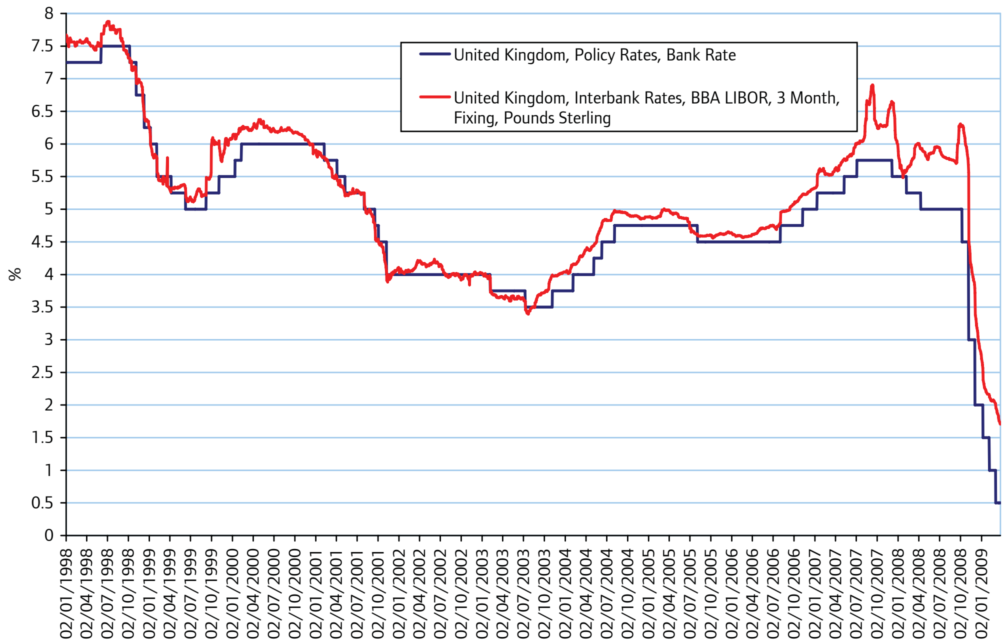
Visit **www.london.gov.uk/mayor/economic_unit** to download this publication in due course.

of central bank reserves. The scheme includes the previously agreed Asset Purchase Facility (APF). However, the Bank announced that "in order to meet the Committee's objective of total purchases of £75 billion, the Bank would also buy medium- and long-maturity conventional gilts in the secondary markets". This is the Bank's first foray into quantitative easing, and it is possible that the final programme may involve a sum as large as £150 billion or more. With the exception of the experience of Japan over the period 2001 to 2006, a policy of quantitative easing is relatively untested. Judging the size of intervention required and the point at which the economy is running sufficiently robustly to begin reducing liquidity - without letting increased liquidity result in high and volatile medium term inflation - will be challenging.

Figure 1: Bank of England's Repo rate and the 3 month London Inter-Bank Offered Rate (LIBOR)

Last data point is 25/03/09

Source: EcoWin

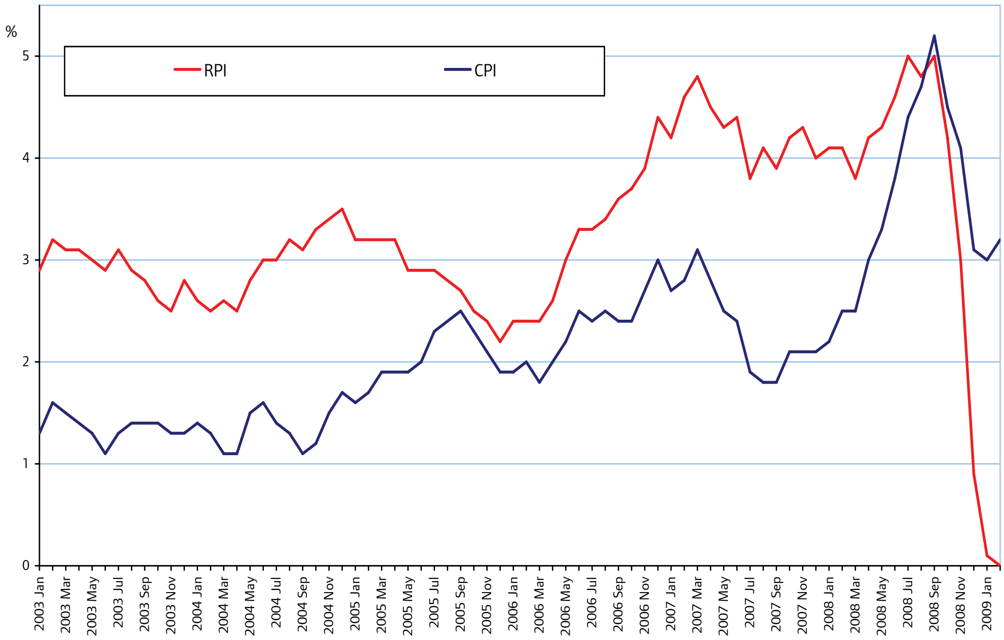


Retail Price Index falls to zero per cent

Many analysts had expected the Retail Price Index (RPI) to fall into deflationary territory when the February data was released. It would have been the first time since March 1960 that RPI inflation had turned negative. Analysts had also expected a further fall in the official target measure, the Consumer Prices Index (CPI). In the event CPI inflation actually rose to 3.2 per cent in February – the first increase for five months – with the largest upward pressures coming from food, beverages and housing costs. RPI inflation – which includes mortgage payments and Council Tax – fell to 0.0 per cent as shown in Figure 2. Petrol prices and the cost of food helped to stop it going negative. As a result of CPI inflation exceeding 3 per cent the Governor of the Bank of England again had to write to the Chancellor explaining that falling prices of international commodities such as oil and food had not passed through fully to retail prices in Britain, primarily on account of sterling's weakness.

Figure 2: Retail Price Index and Consumer Prices Index of inflation, January 2003 to February 2009

Source: ONS Crown Copyright



UK Government introduces toxic loans guarantee scheme

On 7 March the Government announced that it had agreed to insure £260 billion of toxic loans in the Lloyds Banking Group via the Asset Protection Scheme. The Treasury will now take a 65 per cent stake in the Group (with the possibility of this rising to 77 per cent), up from the 43 per cent it already owns, after the Group announced an annual loss of nearly £11 billion. In return, Lloyds has had to commit to extending a total of £14 billion lending to creditworthy borrowers under its existing credit lending criteria. This follows the £325 billion in assets that RBS insured on 26 February in exchange for agreeing to lend up to an additional £25 billion in each of the next two years. HSBC also announced a £12.5 billion rights issue in order to expand its capital base.

In the United States, the Government has increased its stake in Citigroup from 8 per cent to around 35 per cent, converting some of its preferred stock to common shares. A US $9.6 billion goodwill write-down took the bank's net loss for 2008 to US $27.7 billion. Meanwhile, in Iceland, the last major independent Icelandic bank, Straumur Burdaras, has been taken over by the Icelandic Financial Supervisory Authority, which is now in the process of closing it down. The bank had specialised in investment banking services to small and medium-sized business but had expanded its portfolio during 2006 and 2007 into higher risk areas.

In the United States, Treasury Secretary, Tim Geithner, has outlined a plan in which up to US $100 billion in 'Tarp' (Troubled Assets Relief Program) funds will be used as government equity and partnered with private funds to purchase troubled loans or securities. US stocks soared in approval after Geithner detailed his proposals for public-private partnerships on 23 March. Some have broadly welcomed the plan, in part on account of the fact that it ensures that private sector asset managers bid for assets, rather than the Government attempting to guess their correct price. Others are less enthusiastic and see it as very similar to the Paulson Plan from September 2008.

In contrast to the US position, Jean-Claude Trichet, the Chair of the European Central Bank (ECB), has argued that Europe needs no further stimulus but that the ECB could lower its base rate to free up credit. European countries such as France and Germany may oppose any fresh stimulus package at the forthcoming London G20 summit at the beginning of April. The Governor of the Bank of England has also urged the British Government not to unveil any dramatic fiscal stimulus in its Budget statement on 22 April on account of the impact it would have on the UK's deficit.

FSA suggests a new approach to financial regulation

The Financial Services Authority (FSA), in a report released on 18 March, suggests that in future banks will have to hold more capital and liquidity reserves with a strongly countercyclical capital adequacy regime and a minimum gross leverage ratio. It recommends limits on income multiples for mortgages. The report also reverses the FSA's traditional opposition to pan-European legislation and, indeed, argues that other countries should respond to the financial crisis by abandoning the 'light touch' approach. That approach was long seen as giving the UK a competitive edge but has allowed toxic assets to be built up on many financial institutions' balance sheets. The report should help catalyse an international discussion on the issue of the reform of financial services.

UK manufacturing in serious downturn

UK manufacturing has continued to suffer serious declines with the Office for National Statistics releasing data showing that manufacturing output fell by 12.8 per cent in January compared with a year earlier. This was the fastest contraction in manufacturing since January 1981. Car manufacturing has been hit particularly heavily with sales down 22 per cent on the year to February according to the Society of Motor Manufacturers and Traders. Over 300,000 units have been lost from total vehicle output over the last 14 months. On 11 March Toyota announced that it intends to reduce pay and working hours at its UK factories in response to the downturn. Honda is also asking employees to face pay cuts rather than begin a round of compulsory redundancies.

London vital for UK's economic recovery

A YouGovStone survey of 3,000 business leaders in a report from the Communication Group for UK Trade and Investment found that 80 per cent of leaders thought that London was vital for the UK's economic recovery. However, it noted that London should act as a 'global superbrand' in order to fight off smaller rivals and that the capital had failed to highlight its attractiveness to international business and inward investors coherently in the current financial market downturn.

London has retained its lead in the fifth Global Financial Centres Index published by Z/Yen for the City of London in March 2009 with London and New York remaining the 'only truly global financial centres'. Data for the survey, which has been published every six months since March 2007, was collated at the end of December 2008. The report also found that, "London still leads New York in all areas of competitiveness, and in four of the five industry sector sub-indices, although respondents expressed continuing concerns about the likelihood of increased regulatory burden, and a less predictable tax-regime".

UK unemployment exceeds the 2 million level for the first time since 1997

Nationally, unemployment on the International Labour Organisation (ILO) measure rose 165,000 to 2.03 million during the three months to the end of January 2009. The narrower claimant count measure rose 138,400 to 1.39 million in February – the largest single increase since records began in 1971. According to the ONS, private sector employment fell 105,000 to 23.6 million last year, whilst public sector employment rose 30,000 to 5.78 million. Year-on-year private sector earnings fell by 1.1 per cent in January after the fall in bonuses had been taken into account.

However, at present, London's labour market appears to be holding up better than that of the UK as a whole. London's working age employment rate increased to 71.7% (up from 70.7% a year earlier) in the three months to January 2009. That of the UK fell from 74.9 per cent to 74.1 per cent over the same period. The ILO unemployment rate for London stood at 7.5% (up from 6.9% a year earlier) and that for the UK at 6.5% (up from 5.2% a year earlier). ILO unemployment in London actually fell by 1,000 to 307,000 during the three months to the end of January 2009 – but is up on a year earlier. The claimant count measure for London was 3.9 per cent in February 2009 – up from 2.7 per cent in the same month in the previous year. The latest London figure equates to 187,100 claimants on a seasonally adjusted basis[1].

Employment intentions remain low in London

The Labour Market Outlook Survey for the 2008-9 winter quarter was recently published by KPMG and the Chartered Institute of Personnel and Development. Out of those London businesses that responded, positive net recruitment intentions were at 21 per cent - up slightly from 17 in Autumn 2008. However, this was low in comparison to the rest of the UK. Incomes Data Services released data that indicated that about 1 in 10 UK companies was freezing pay for staff in light of the recession. Ken Mulkearn, editor of the report, noted that they were also seeing pay pauses which "means it does not get recorded as a pay freeze even if, in all likelihood that will be the outcome eventually in many cases".

In another sign that, to date, London may be managing to avoid the worst of the recession, the British Retail Consortium/KPMG Retail Sales Monitor suggests that like-for-like retail sales in Central London were up 5.9 per cent on one year earlier. This compares with a 1.8 per cent fall over the same period for the UK as a whole. Helen Dickinson, Head of Retail for KPMG commented that "the results for the month were impacted negatively by the effects of the snowy weather in the first week - but this was more than offset by the ongoing benefits of both the increased level of foreign visitors continuing to take advantage of the favourable exchange rate, and the high levels of discounting and promotions".

The global economic environment continues to deteriorate

The latest IMF forecasts from an analysis conducted for the G20 group of economies, suggest that the global economy as a whole is set to contract for the first time in 60 years. Global activity is now projected to contract between 0.5 and 1.0 per cent in 2009 on an annual average basis. However, the IMF still forecasts modest growth for 2010 which will be conditional upon comprehensive steps being taken to stabilise global financial conditions, a stabilisation of the US housing market and some cushioning effect from lower commodity prices (although crude oil recently surpassed the US $50 mark for the first time since January).

The advanced economies, in particular, are singled out as facing a deep recession with the US being forecast to contract by 2.6 per cent in 2009, the Eurozone by 3.2 per cent and Japan by 5.8 per cent. The IMF pins the poor prospects on a combination of a stalling global economy and the still corrosive financial sector and the feedback loops operating between the two. The emerging and developing economies are expected to face conditions that will limit growth to a weak expansion in 2009.

The report warns that, with credit intermediation impaired, central banks will need to rely increasingly on 'unconventional measures' (such as quantitative easing) in order to stimulate economic activity. It also highlights the deterioration in the UK's public finances. By 2010, it estimates that the UK's deficit relative to the size of the economy will be substantially larger than that of the US and nearly twice the average amongst the G20 group of nations. Therefore the economic environment for both London and the UK is likely to remain very difficult for some time to come.

Footnote

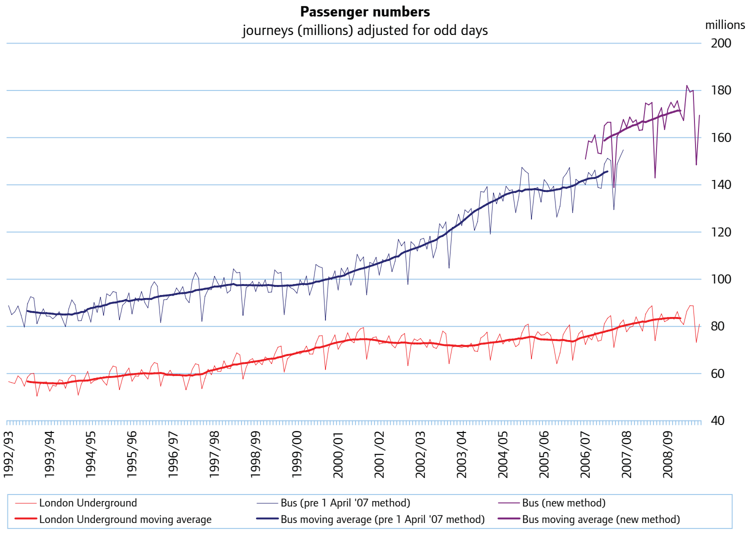
1 The figure in the text is seasonally adjusted and the figure in the Economic Indicators section under 'Claimant Count Unemployment' is not seasonally adjusted. Hence also the small discrepancy in the rates.

Economic indicators

Decrease in moving average of passenger numbers

- The most recent 28-day period is from 4 January 2009 to 31 January 2009. London's Underground and buses had 250.5 million passenger journeys; 169.5 million by bus and 81.0 million by Underground.
- The moving average of passengers every period decreased to 254.8 million from 254.9 million in the previous period. The moving average for buses was 171.4 million. The moving average for the Underground was 83.4 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: March 2009
Next release: April 2009

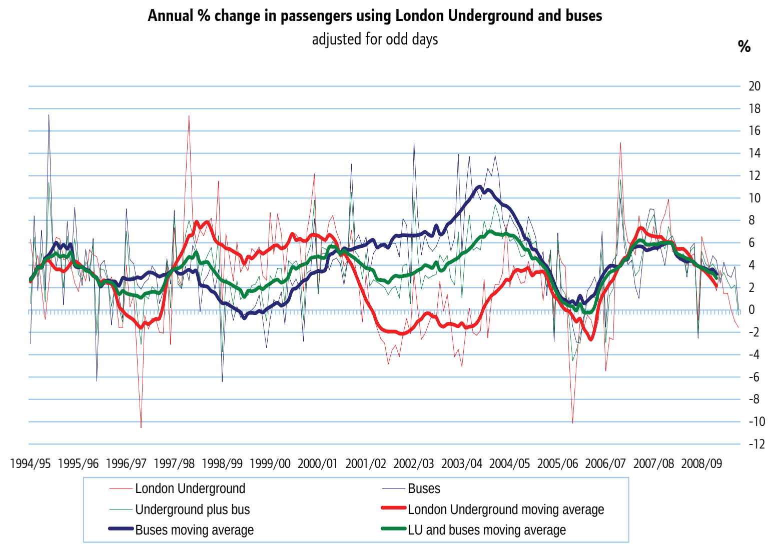


Source: Transport for London

Average annual growth rate of passengers continues to decrease

- The moving average annual rate of growth in passenger journeys decreased to 2.8% from 3.3% in the previous period.
- The moving average annual rate of growth in bus passenger journey numbers decreased to 3.2% from 3.6% in the previous period.
- The moving average annual rate of growth in Underground passenger journey numbers decreased to 2.1% from 2.6% in the previous period.

Latest release: March 2009
Next release: April 2009

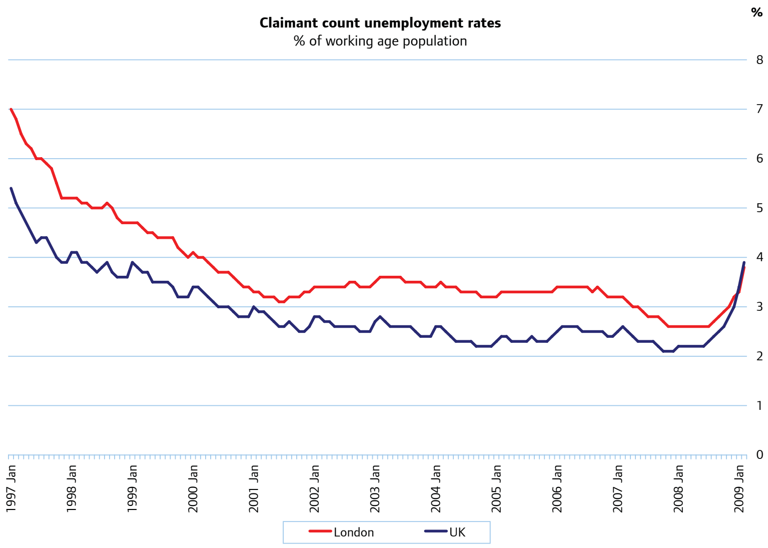


Source: Transport for London

Claimant count unemployment

- The rate of claimant count unemployment (the percentage of resident working age population who are unemployed and claiming Jobseekers' Allowance) in London was 3.8% in February 2009.
- There were 189,900 unemployment claimants in London in February 2009 compared with 132,500 in February 2008.
- The claimant count unemployment rate of London is now slightly below that of the UK.

Latest release: March 2009
Next release: April 2009

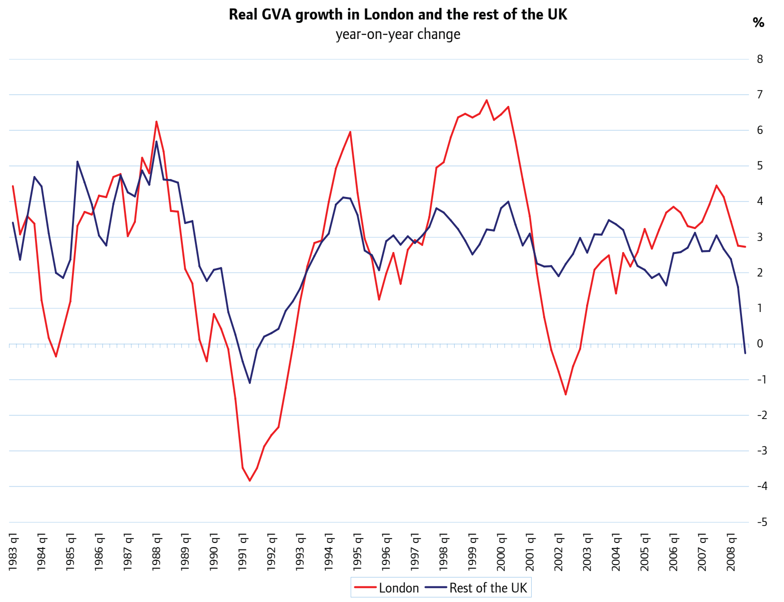


Source: Claimant Count, Nomis

Annual output growth slowing less sharply in London than the rest of the UK

- London's annual growth in output decreased to 2.7% in Q3 2008 from an upwardly revised 2.8% in Q2 2008.
- In the rest of the UK, annual growth in output decreased to -0.3% in Q3 2008 from an upwardly revised 1.6% in Q2 2008.
- There have been revisions to previous growth rates to reflect the availability of new data.

Latest release: February 2009
Next release: May 2009

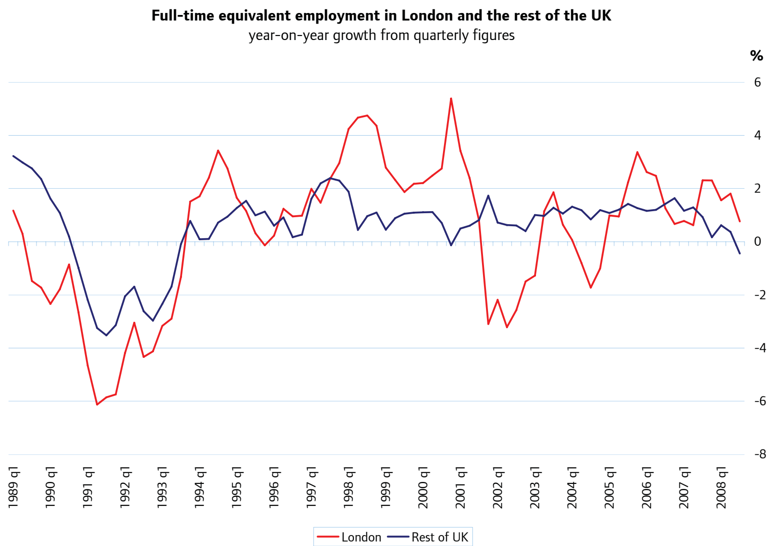


Source: Experian Business Strategies

London's annual employment growth faster than the rest of the UK

- London's annual employment growth decreased to 0.8% in Q3 2008 from an upwardly revised 1.8% in Q2 2008.
- Annual employment growth in the rest of the UK decreased to -0.4% in Q3 2008 from an upwardly revised 0.4% in Q2 2008.
- There have been revisions to previous growth rates to reflect the availability of new data.

Latest release: February 2009
Next release: May 2009

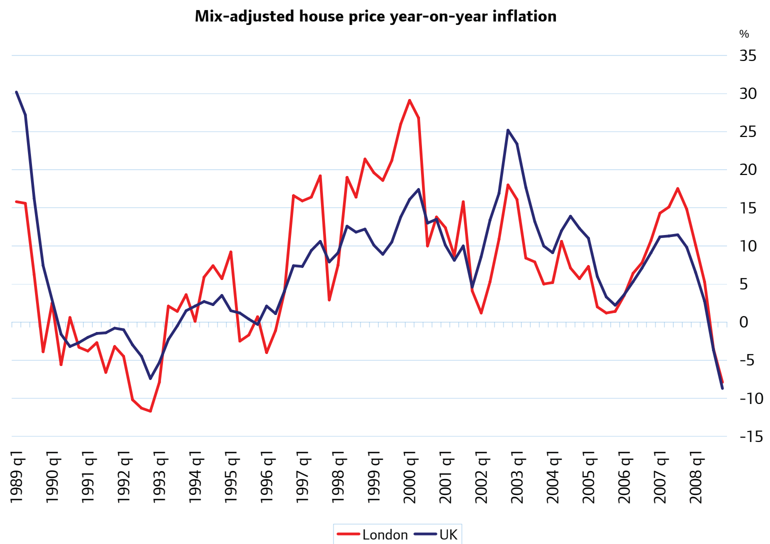


Source: Experian Business Strategies

Falling house prices

- The Department for Communities and Local Government (DCLG) house price index is an official measure of house prices. It is available up to Q4 2008.
- The DCLG reported a fall in annual house prices in both London and the UK in Q4 2008.
- Annual house price inflation in London decreased to -7.9% in Q4 2008 from -3.5% in Q3 2008. Annual house price inflation in the UK decreased to -8.7% in Q4 2008 from -3.7% in Q3 2008.

Latest release: February 2009
Next release: May 2009

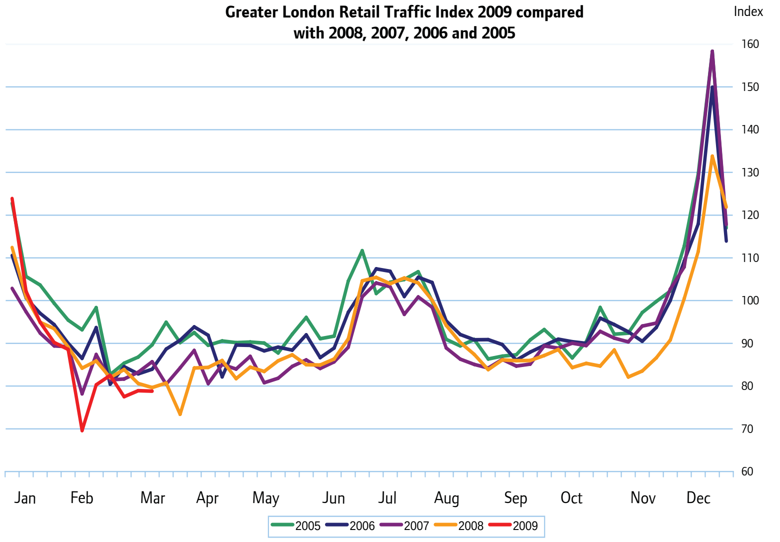


Source: Department for Communities and Local Government

Synovate Retail Traffic Index below 2008 levels

- The Synovate Retail Traffic Index of shoppers in London was 78.8 in the second week of March compared to 78.9 in the previous week.
- The index has been below 2008 levels for the majority of the most recent month.
- Synovate's retail traffic index measures the number of shoppers and does not necessarily reflect the level of spending.

Latest release: Mid-March 2009
Next release: Weekly

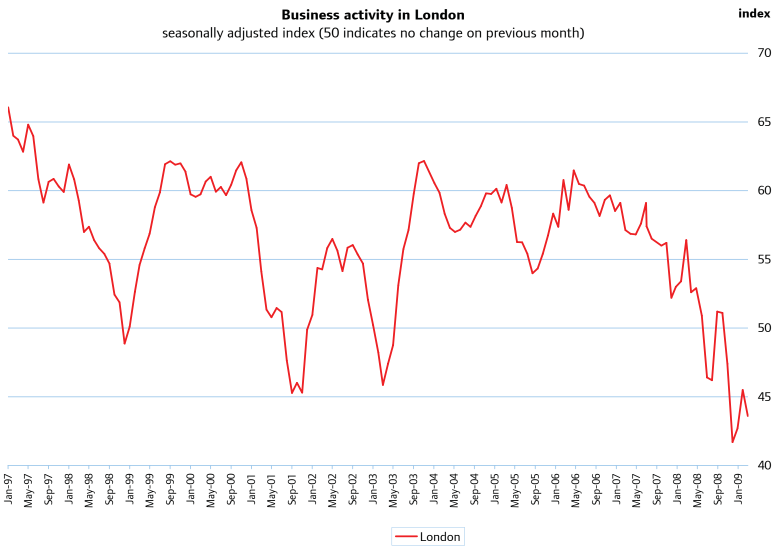


Source: Synovate

London's business activity decreasing

- London firms decreased their output of goods and services in February 2009.
- The Purchasing Managers' Index (PMI) of business activity recorded 43.6 in February compared to 45.5 in January.
- A rate of below 50 on the index indicates a decrease in business activity from the previous month.

Latest release: March 2009
Next release: April 2009



Source: RBS/Markit Economics

London employment remains weak

- The PMI shows that the level of employment in London firms decreased in February 2009.
- The PMI for the level of employment was 39.5 in February compared to 39.0 in January.
- A rate of below 50 on the index indicates a decrease in the level of employment from the previous month.

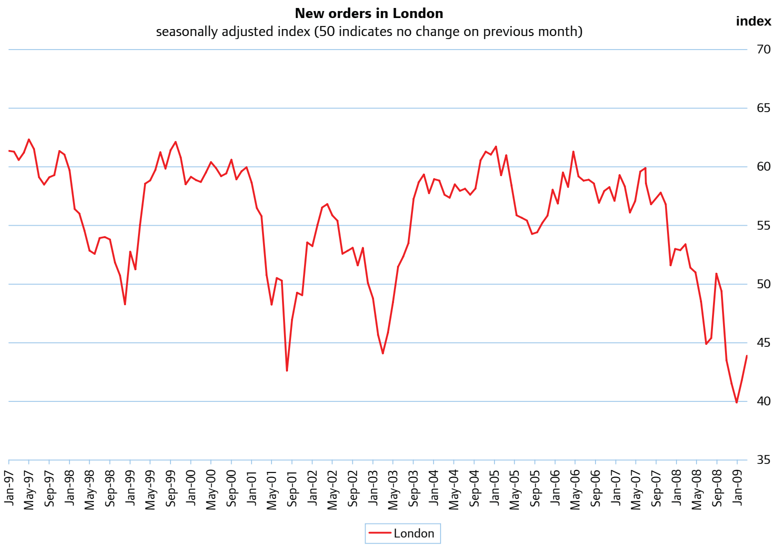
Latest release: March 2009
Next release: April 2009

Source: RBS/Markit Economics

New orders in London remain weak

- February 2009 saw a fall in new orders for London firms.
- The PMI for new orders recorded 43.9 in February compared to 41.8 in January.
- A rate of below 50 on the index indicates a decrease in new orders from the previous month.

Latest release: March 2009
Next release: April 2009

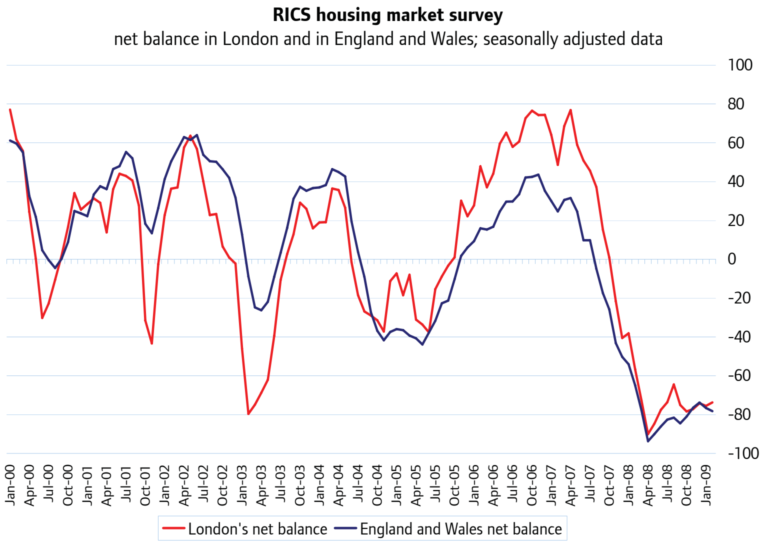


Source: RBS/Markit Economics

Surveyors report that house prices are falling in London and in England and Wales

- The RICS survey shows a negative net balance of -74 for London house prices over the past three months to February 2009. This net balance is up from -76 in January 2009.
- Surveyors reported a negative net house price balance for England and Wales of -78 over the past three months to February 2009, down from -77 in January 2009.
- London's net house price balance is marginally higher than that of England and Wales.

Latest release: March 2009
Next release: April 2009

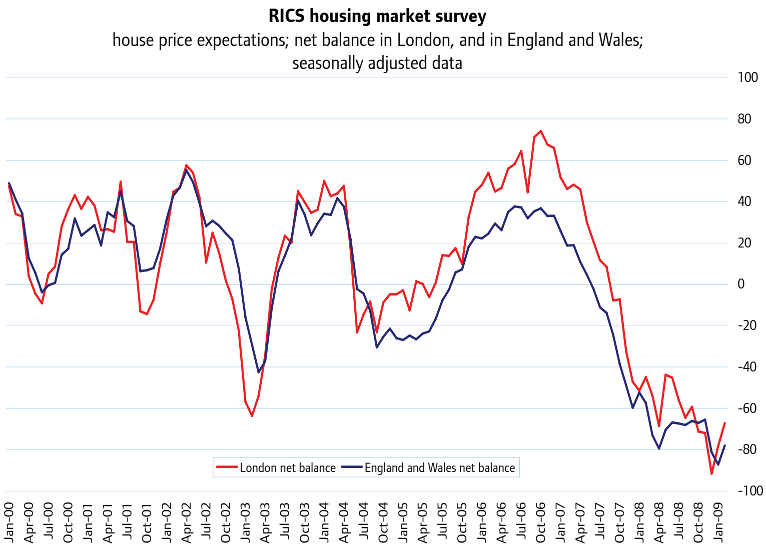


Source: Royal Institution of Chartered Surveyors

Surveyors expect house prices to continue falling

- The RICS survey shows that surveyors expect house prices to continue to decrease over the next three months in London and in England and Wales.
- The net house price expectations balance in London was -67 in February 2009, up from -78 in January.
- For England and Wales, the net house price expectations balance was -78 in February 2009, up from -87 in January.

Latest release: March 2009
Next release: April 2009



Source: Royal Institution of Chartered Surveyors

Additional information

Data sources

Tube and bus ridership	Transport for London on 020 7222 5600 or email: enquire@tfl.gov.uk
GDP/GVA growth	Experian Business Strategies on 020 7630 5959
Tourism – overseas visitors	www.statistics.gov.uk
Tourism – domestic visitors	www.visitlondon.com
London airports	www.caa.co.uk
Business activity	www.rbs.co.uk/pmireports
Unemployment rates	www.statistics.gov.uk

Glossary

Civilian workforce jobs
Measures jobs at the workplace rather than where workers live. This indicator captures total employment in the London economy, including commuters.

Claimant count rate
Unemployment rate based on the number of people claiming unemployment benefits.

Employee jobs
Civilian jobs, including employees paid by employers running a PAYE scheme. Government employees and people on training schemes are included if they have a contract of employment. Armed forces are excluded.

Gross domestic product (GDP)
A measure of the total economic activity in the economy.

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

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

Tube ridership
Transport for London's measure of the number of passengers using London Underground in a given period. There are 13 periods in a year. In 2008/09 there are eleven 28-day periods, one 26-day period and one 31-day period. Period 1 started on 1 April.

Bus ridership
Transport for London's measure of the number of passengers using buses in London in a given period. There are 13 periods in a year. In 2008/09 there are eleven 28-day periods, one 26-day period and one 31-day period. Period 1 started on 1 April.

Acronyms

ABI	Annual Business Inquiry
BAA	British Airports Authority
BCC	British Chamber of Commerce
BITOA	British Incoming Tour Operators Association
CAA	Civil Aviation Authority
CBI	Confederation of British Industry
DCLG	Department for Communities and Local Government
EBS	Experian Business Strategies
GDP	Gross domestic product
GVA	Gross value added
ILO	International Labour Organisation
IMF	International Monetary Fund
LCCI	London Chamber of Commerce and Industry
LET	London's Economy Today
MPC	Monetary Policy Committee
ONS	Office for National Statistics
PMI	Purchasing Managers' Index
PWC	PricewaterhouseCoopers
RICS	Royal Institution of Chartered Surveyors

GLA Economics
City Hall
The Queen's Walk
London SE1 2AA

Tel 020 7983 4922
Fax 020 7983 4137
Email glaeconomics@london.gov.uk
Internet www.london.gov.uk

March 2009

ISSN 1740-9136 (print) ISSN 1740-9195 (online) ISSN 1740-9144 (email)

London's Economy Today is published by email and on www.london.gov.uk towards the end of every month. It provides an overview of the current state of the London economy, and a changing selection of the most up-to-date data available. It tracks cyclical economic conditions to ensure they are not moving outside the parameters of the underlying assumptions of the GLA group and central government.

Subscribe
Subscribe online at http://www.london.gov.uk/mayor/economic_unit

Disclaimer
GLA Economics uses a wide range of information and data sourced from third party suppliers within its analysis and reports. GLA Economics cannot be held responsible for the accuracy or timeliness of this information and data.

GLA Economics, Transport for London, the London Development Agency and the Greater London Authority will not be liable for any losses suffered or liabilities incurred by a party as a result of that party relying in any way on the information contained in this publication.

Other formats
For a summary of this document in your language, or a large print, Braille, disc, sign language video or audio tape version, please contact us at the address below:

Public Liaison Unit
Greater London Authority
City Hall
The Queen's Walk
London SE1 2AA

Tel **020 7983 4100**
Minicom **020 7983 4458**
www.london.gov.uk

Please provide your name, postal address and state the publication and format you require.

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.

GLA Economics is funded by

Transport for London
LONDON DEVELOPMENT AGENCY
MAYOR OF LONDON