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In this issue

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Speculation of interest rate rises on the tenth anniversary of the financial crisis

By **Gordon Douglass**, Supervisory Economist, and **Mark Wingham**, Economist

September marks ten years since what many see as the beginning of the financial crisis in the UK. It started with the problems at Northern Rock, though its origins lay in the credit crunch in the US which happened earlier. Over this ten-year period, the Bank of England has not raised interest rates once. Instead, there were sharp reductions in interest rates between 2007 and 2009, followed by an almost decade-long period of flat rates, though there was a further cut last year (see Figure 1).

However, recently there has been some talk about the possibility of tightening monetary policy. This is mainly being driven by higher rates of inflation, which have continued to remain above the Bank of England's central symmetrical target of 2 per cent. For example, the latest estimate puts consumer price index (CPI) inflation rising from 2.6 per cent in July to 2.9 per cent in August. In examining the latest rise in inflation, the Office for National Statistics (ONS) observed that "rising prices for clothing and motor fuels were the main contributors to the increase".

Latest news...

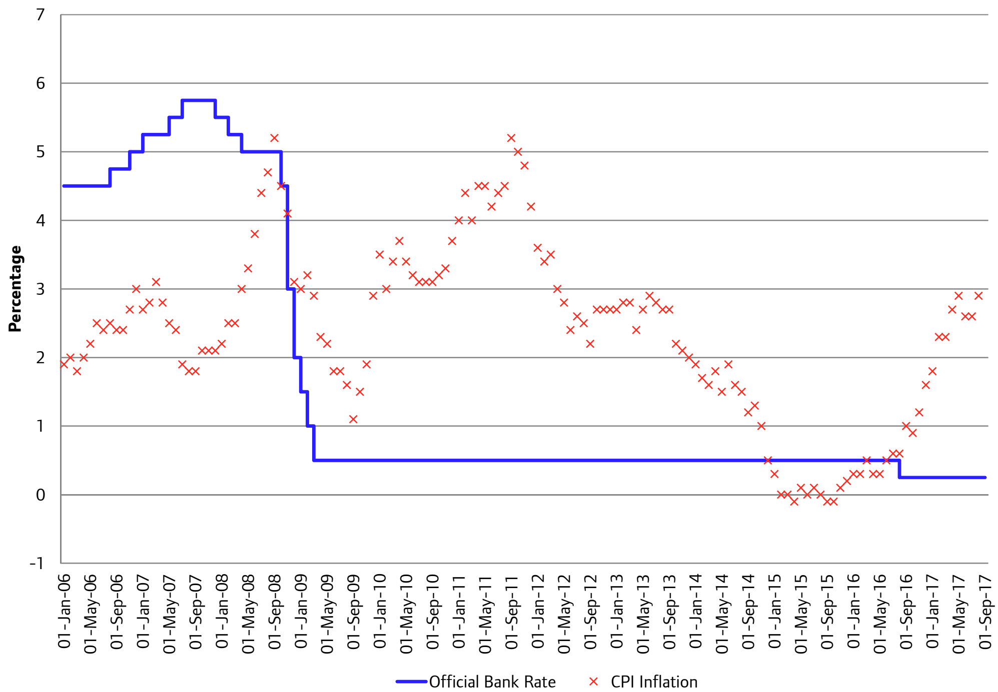
London labour market projections 2017

The central projection estimates that jobs in London will grow from 2016 at an annual average rate of 0.78 per cent a year, equivalent to 49,000 jobs, to reach 6.907 million in 2041.

Download the full publication.

Figure 1: Bank of England base rate and CPI inflation

Source: ONS & Bank of England

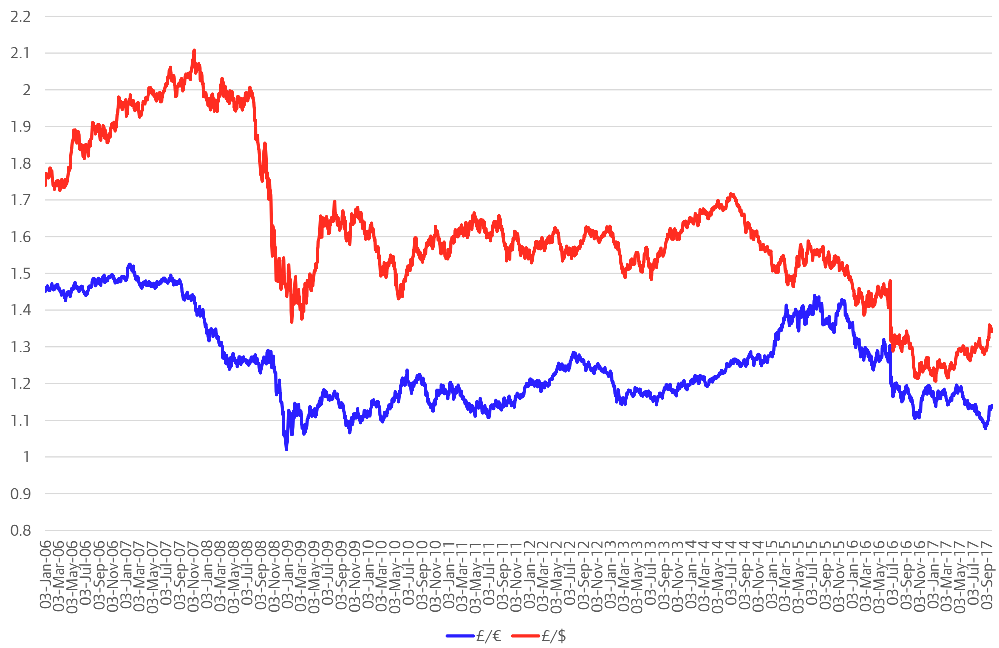


Given this, the Governor of the Bank of England, Mark Carney, has indicated that higher inflation and any pickup in growth could see a rate rise in the coming months. He observed that while there is a balance between controlling inflation and supporting growth, the majority of members of the Monetary Policy Committee see that this "balancing act is beginning to shift, and that in order to... return inflation to that 2% target in a sustainable manner, there may need to be some adjustment of interest rates in the coming months". The Governor also added that this decision will be based on the data, but the possibility of a rate rise has "definitely increased". The currency markets responded strongly to the possibility of a looming rate rise with sterling appreciating to its highest level against the dollar since the referendum vote, although against the euro the pound remains weaker (see Figure 2). Nevertheless, it should be noted that over the preceding ten years there has been considerable speculation of a rate rise with none occurring as of yet.

Figure 2: The sterling exchange rate against the US dollar and euro

Last data point: 26/9/17

Source: Bank of England



Several indicators show growth in the UK economy, but economic forecasts remain subdued

If interest rates were to rise this is likely to be on the back of continued economic growth as most economic indicators, while not all rosy, continue to move in the right direction. For example, the ONS reported that the UK's employment rate in the three months to July 2017 was 75.3 per cent – the highest since comparable records began in 1971. Likewise, the UK's unemployment rate was 4.3 per cent in the same period, down from 4.9 per cent a year earlier and the lowest since 1975.

Similarly, ONS data showed quite strong retail sales growth with the quantity bought (volume) in the retail sales industry in August increasing by 1 per cent on the previous month and 2.4 per cent on August 2016. Commenting on the retail figures, Kate Davies, ONS Senior Statistician said "within this month's retail sales we are seeing strong price increases across all store types compared with a year ago, reflecting wider inflationary pressures. However, we are still seeing underlying growth in sales volumes, and with strong growth in non-essential purchases as consumers continued to buy more from non-food stores". However, in less positive news, the Society of Motor Manufacturers and Traders observed a fifth consecutive month of falls in new car sales in the UK in August.

Despite these positive indicators, economic forecasts remained subdued as shown by the latest forecast from the British Chambers of Commerce (BCC) published in September. Although the forecasts were not significantly revised, the BCC still expect relatively subdued growth with the economy forecast to expand by 1.6 per cent this year (compared to a previous forecast of 1.5 per cent growth). For 2018, it forecasts growth of 1.2 per cent (compared to 1.3 per cent previously); and for 2019, 1.4 per cent (compared to 1.5 per cent previously forecast).

This relatively downbeat tone was similarly repeated by the ratings agency Moody's. They downgraded the UK's credit rating from Aa1 to Aa2 in September citing concerns around the public finances and also the challenges of Brexit. However, the Treasury discounted Moody's assessment arguing that it was based on outdated information. Nonetheless, the UK's credit rating is now two levels below the coveted AAA rating that the UK previously held for 35 years up until 2013.

ECB forecasts faster Eurozone growth this year

Internationally, the picture for growth seems a touch stronger with the European Central Bank (ECB) forecasting growth of 2.2 per cent for the Eurozone for 2017 in their latest forecast. This would be the fastest rate of growth for the Eurozone in ten years. Looking forward, the ECB observes that annual real GDP growth may average around 1.8 per cent in both 2018 and 2019. While Eurozone inflation also rose slightly to 1.5 per cent (from 1.3 per cent), it remains below the ECB's target of inflation being close to, but below 2 per cent.

Further afield, the US economy continues to add jobs. However, the addition of 156,000 jobs in August was lower than in July and below forecasts. This led to the unemployment rate ticking up to 4.4 per cent, from 4.3 per cent in July. Still, most observers remain confident on the state of the US economy. This is indicated by the Federal Reserve's (Fed) continued normalising of monetary policy, which has already seen it raise interest rates a few times from their historic lows seen in the aftermath of the financial crisis. The Fed took another step in this process of normalisation on 20 September when it announced it would start to roll back its Quantitative Easing programme. From October, it will reduce its $4.2 trillion portfolio of US Treasury bonds and mortgage-backed securities by up to $10 billion a month.

Elsewhere, data published at the end of August showed that the Indian economy grew at an annualised rate of 5.7 per cent in the three months to June, down from 6.1 per cent in the previous quarter. This was its slowest rate of growth in three years.

Overall, views on the international economy remain generally positive with the OECD in their Interim Economic Outlook published in September forecasting economic growth in the US of 2.1 per cent in 2017 and 2.4 per cent in 2018. Similarly, the OECD forecasts growth of 1.8 per cent in both years for the Eurozone. However, its forecast for UK economic growth was a bit weaker; the OECD forecasts growth of 1.6 per cent in 2017 and 1 per cent in 2018 for the UK.

London's economic indicators show growth, but some business surveys show concerns

In London, several economic indicators support the view of continued growth in the capital. For instance, data from the ONS published this month showed that the number of jobs located in London (whether or not they are taken by residents of London) reached 5.8 million in Q2 2017, which was a record high. In addition, London's employment rate (the proportion of London's residents aged 16-64 population in employment) increased to 74.9 per cent in the three months to July 2017. That is the highest employment rate since the ONS data series began in 1992, and an increase of 1.5 percentage points on the year.

However, some business surveys showed businesses are concerned about the future. For example, the London Small Business Index from the Federation of Small Businesses (FSB) fell from +25 in Q2 2017 to -16 in Q3 2017. The FSB noted that "confidence has decreased sharply since a year ago and is in negative territory for the third time over the past 18 months. Small businesses in London are the most pessimistic about future prospects". The FSB also observed that Brexit and the impact of business rates revaluations may be driving some of this fall in sentiment.

Similarly, the CBI/CBRE London Business Survey published in September found that "following a turbulent first half of 2017, business optimism declined with only 10% of firms feeling more optimistic about the economy over the next six months, compared with six months ago, where 19% of firms felt more optimistic". The survey also noted that "Brexit is having a significant impact on the capital's companies. Just under three-quarters of firms (73%) view uncertainty over the UK's role in Europe as their top concern, whilst a similar number (69%) have developed, or are developing, a contingency plan for when the UK leaves the EU. Indeed, over a quarter of respondents (27%) indicated they are planning to move part of their operations overseas. Close to two-thirds (62%) have, or are developing, a strategy to address skill shortages that could be incurred if restrictions are placed on EU nationals working in the UK".

Still, other surveys have been a cause of more optimism for London. For instance, the latest Global Financial Centres Index from Z/Yen showed that London is still ranked as the leading financial centre ahead of New York and Hong Kong which were in second and third place respectively. Meanwhile, the latest Times Higher Education World University Rankings, which was published in September, showed four London universities in the top 50 in the world. These were Imperial College London (8th), University College London (16th), the LSE (25th) and King's College London (36th).

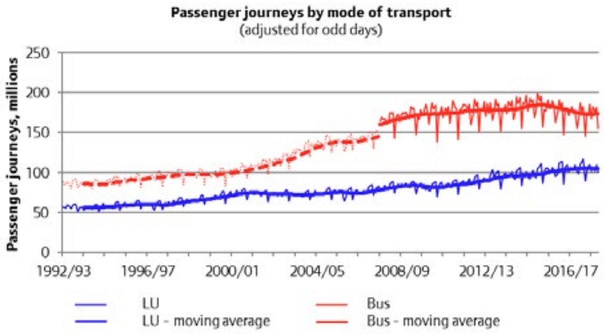
Consequently, overall, although concerns remain about the economic environment in the coming years, the strengths of the capital both at the moment and going forward also remain clear.

Economic indicators

Broadly stagnant trends in number of passenger journeys

- Between 23 July and 19 August and accounting for odd days, there was a total of 255.9 million passenger journeys. This consisted of 101 million tube journeys and 154.8 million bus journeys.
- The moving average number of Underground and bus passenger journeys were largely unchanged from the previous period at 105.1 million and 173.2 million respectively.
- The methodology used to calculate the number of bus passenger journeys was changed by TfL on 1 April 2007. For a detailed explanation, please see LET issue 58 (June 2007).

Latest release: September 2017
Next release: October 2017

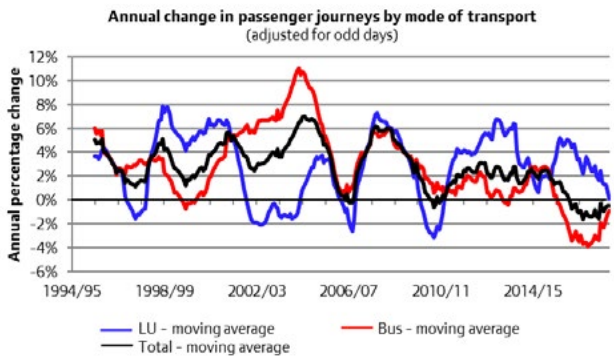


Source: Transport for London

Underlying trend in total passenger journeys remains negative

- The number of Underground passenger journeys was unchanged from a year earlier (0.0 per cent). The underlying trend was one of slight growth (0.1 per cent).
- The moving average annual rate of change in bus passengers remained negative (-0.9 per cent), though the pace of decline was the weakest (i.e. least negative) for over two years.
- Overall, the moving average annual rate of change in total passenger journeys remained unchanged at -0.5 per cent.

Latest release: September 2017
Next release: October 2017



Source: Transport for London

London's unemployment rate reaches a new record low

- The number of London residents aged 16 years and over who were unemployed stood at 253,900 in the three months to July 2017.
- London's unemployment rate fell 0.8 percentage points since the three months to April to 5.2 per cent – a new record low.
- The UK's unemployment rate was 4.3 per cent, which was the lowest since mid-1975.

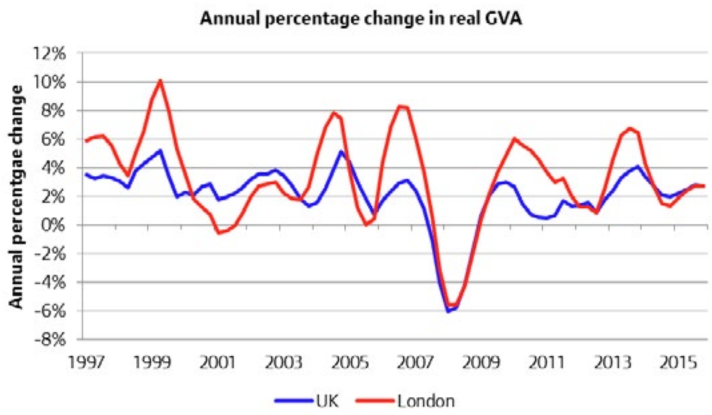
Latest release: September 2017
Next release: October 2017

Source: ONS Labour Force Survey

Annual output growth in London higher than the UK as a whole

- London's annual growth in output slowed marginally to 2.5 per cent in Q1 2017, from 2.6 per cent in Q4 2016.
- Annual output growth in the UK decreased to 2.3 per cent in Q1 2017, from 2.7 per cent in Q4 2016, meaning that London's output is now higher than the UK for the first time since Q1 2015.
- From LET Issue 165 (May 2016), GLA Economics now reports our own GVA estimates for London and ONS data for the UK.

Latest release: July 2017
Next release: October 2017

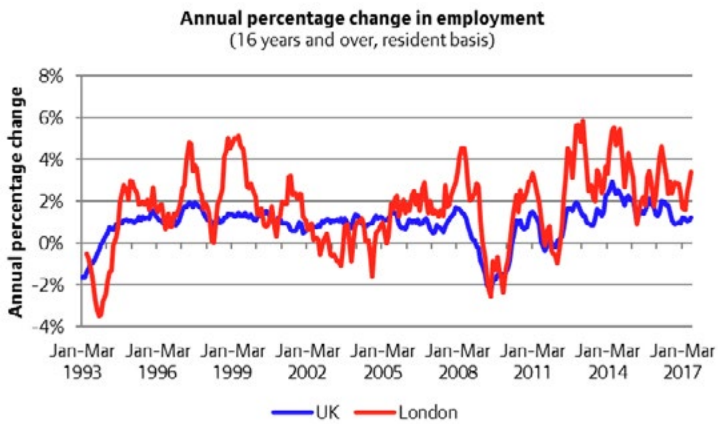


Source: GLA Economics and ONS

Employment growth in London strengthens

- There were 4.67 million London residents aged 16 years and over in work during the three months to July 2017.
- The rate of annual employment growth in London was 3.4 per cent, which was the fastest pace for over a year.
- London saw a faster rate of employment growth than the UK average which was 1.2 per cent.

Latest release: September 2017
Next release: October 2017

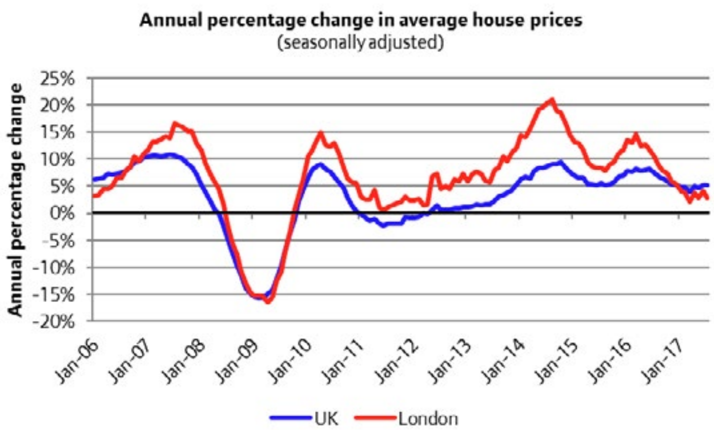


Source: ONS Labour Force Survey

House prices in London increase at one of the slowest rates since 2012

- The average house price in London was £481,500 in July 2017.
- The annual rate of house price inflation was 2.8 per cent in London. That was slower than the pace recorded in June (4.1 per cent) and was one of the weakest since 2012.
- The UK saw house prices rise 5.1 per cent year-on-year in July.

Latest release: September 2017
Next release: October 2017

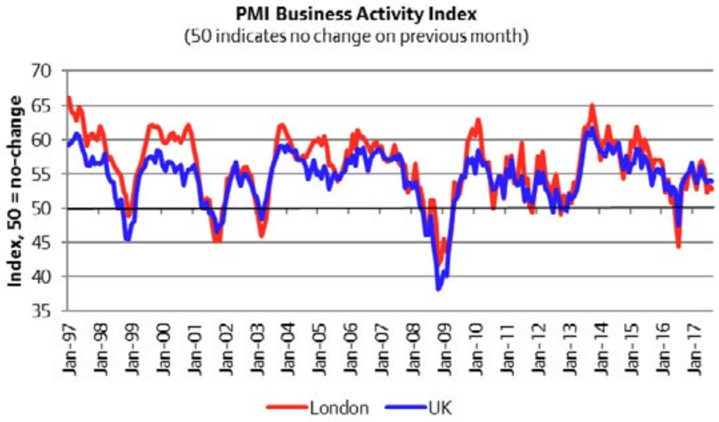


Source: Land Registry and ONS

PMI signals a modest rise in business activity

- The Purchasing Managers' Index (PMI) survey shows the monthly business trends at private sector firms. Index readings above 50.0 suggest a month-on-month increase in that variable, while readings below indicate a decrease.
- London firms reported a further increase in output during August (52.8). The rate of growth was modest, though slower than those seen at the start of 2017.
- Businesses across the UK also reported an increase in activity (54.0).

Latest release: September 2017
Next release: October 2017

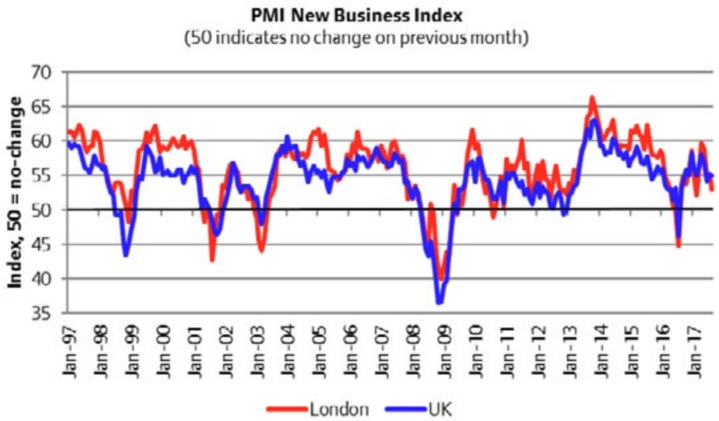


Source: IHS Markit

Modest rise in new business, but rate of growth at a six-month low

- The PMI New Business Index was at 53.0 in August and signalled a modest rise in new work. However, the rate of growth was the slowest since February.
- New business also increased across the UK as a whole (55.0).
- An index reading above 50.0 indicates an increase in new orders from the previous month.

Latest release: September 2017
Next release: October 2017

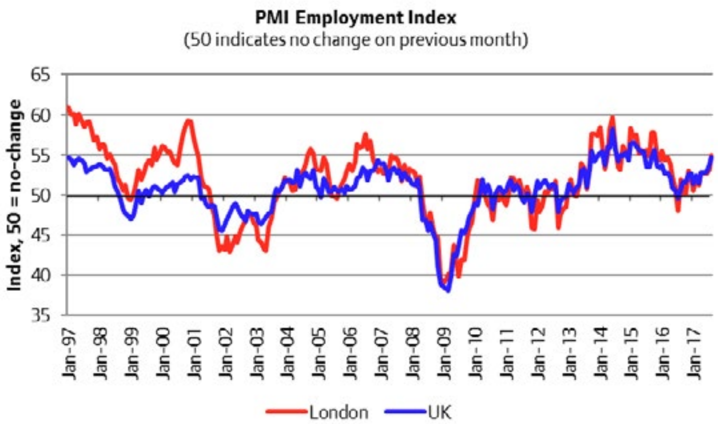


Source: IHS Markit

PMI Employment Index reaches a 19-month high

- The PMI Employment Index shows the monthly change in employment at private sector firms. Readings above 50.0 suggests an increase, whereas a reading below indicates a decrease in employment from the previous month.
- At 55.0 in August, the PMI Employment Index for London signalled the fastest rate of job creation since January 2016.
- The rate of employment growth also quickened across the UK as a whole, with the index rising to 54.6 – it's highest since October 2015.

Latest release: September 2017
Next release: October 2017

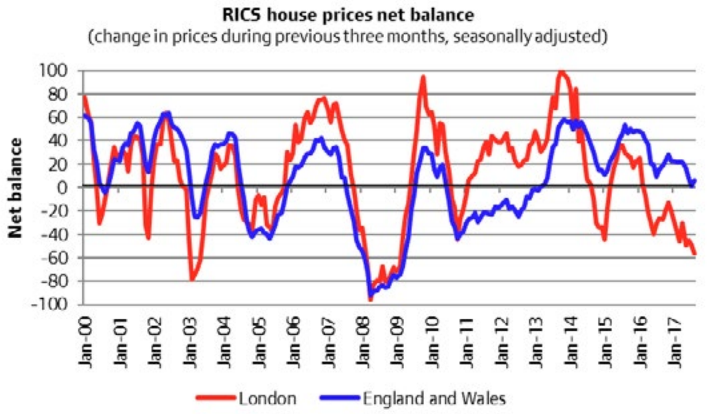


Source: IHS Markit

House prices continue to fall in London

- A majority of property surveyors reported a fall in London's house prices during the three months to August 2017.
- The net balance was at -56, which was the lowest since February 2009.
- In contrast, the net balance was positive for England and Wales as a whole. However, at +6, it was one of the lowest since early 2013.

Latest release: September 2017
Next release: October 2017

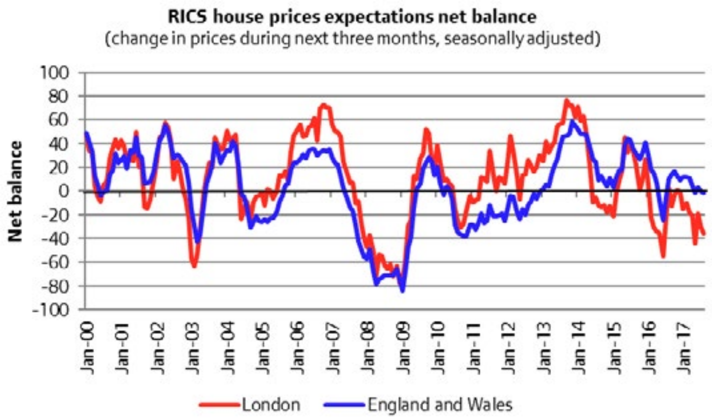


Source: Royal Institution of Chartered Surveyors

House price expectations remain on balance negative

- Property surveyors have on balance a negative sentiment towards London's house prices over the next three months. The net balance was -35 in August, down from -30 in July.
- There was a broadly equal split between surveyors expecting an increase or decrease in house prices across the UK with the net balance close to zero (-2).
- House price expectations were also negative in the South East, the South West and the North.

Latest release: September 2017
Next release: October 2017

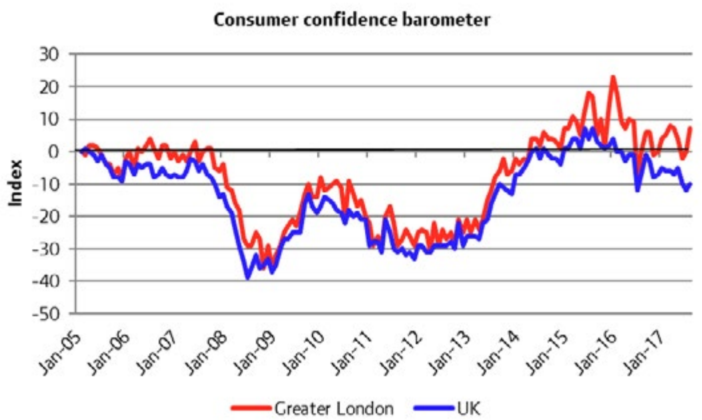


Source: Royal Institution of Chartered Surveyors

London consumers are confident about the future

- The GfK index of consumer confidence reflects people's views on their financial position and the general economy over the past year and in the next 12 months. A score above zero suggests positive opinions; a score below zero indicates negative sentiment.
- The index returned to signalling positive sentiment in London (+7) for the first time in three months in August.
- Consumer confidence across the UK remained negative in August (-10), but was slightly less negative than July's one-year low (-12).

Latest release: September 2017
Next release: October 2017



Source: GfK NOP on behalf of the European Commission

Transport expenditure in London

By **Mark Wingham,**
Economist

A good transport system that is efficient and reliable is essential for supporting economic growth, argues our recent research paper looking at transport expenditure in London.

Some of the benefits of a good transport network include:

- Faster, more efficient journeys which can lead to time and cost savings.
- Providing access to new markets enabling firms to sell their products to a larger audience.
- Allowing people to access more jobs across a larger area.
- Stimulating private sector investment.
- Agglomeration benefits, where positive externalities (such as productivity gains) arise from specialised economic activity taking place in a spatial concentration.

However, despite these arguments, congestion and overcrowding can potentially dampen these benefits and raise questions as to whether the transport infrastructure can support economic growth in the future. This is particularly true for London where, as illustrated by Chapter 6 of the Economic Evidence Base for London[1], the capital faces acute capacity issues with its transport network. For example, there were around 31.5 million daily journey starts in London during 2015 – almost a quarter more than in 2000 – and means that overcrowding on trains and the number of hours idling in traffic in the capital is worse than other UK cities.

At the same time, the media often reports that London receives a lot more in transport spending than any other region. Indeed, the public sector spent approximately £8.5 billion on transport in London during 2015-16, which was more than a quarter of the UK total. This is true even after accounting for population differences. However, these simple regional comparisons are flawed.

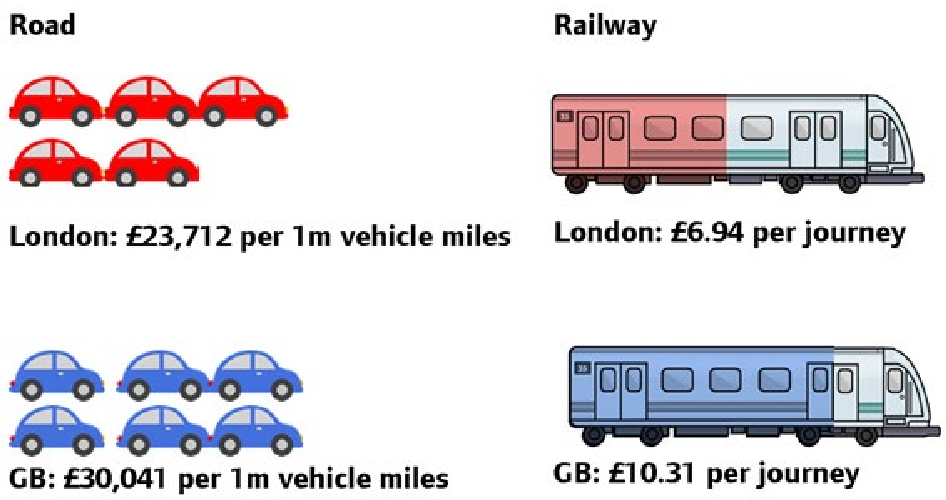
Comparisons with London and other UK regions are not necessarily on a like-for-like basis. Transport is likely to represent a larger proportion of spending in an urban rather than rural area. Given that London is entirely urban, whereas other regions are a mix of urban and rural areas, the capital is likely to be at a disadvantage. Instead, it may be more appropriate to make comparisons with the Greater South East (GSE) – London, South East and East of England – which is more balanced in terms of land use. London also has a large number of commuters who use the capital's transport system giving further argument for using the GSE in comparisons. For example, London accounted for over 40 per cent of an area's total employment in some parts of the GSE[2].

It also does not consider the demand or need for transport in a region. Instead of a per head measure, looking at the actual number of transport users gives a much more accurate representation of demand for transport. On this basis, the amount spent on railways per rail passenger journey and the amount spent on roads per 1 million vehicle miles in London was one of the lowest in Great Britain (Figure A1).

1 GLA Economics (2016). Economic evidence base for London 2016.
2 Ibid.

Figure A1: Road and railway public sector expenditure per user for London and Great Britain in 2015-16

Source: HM Treasury Public Sector Expenditure Analysis, Department for Transport Road Traffic Statistics, Office for Rail and Road Regional Statistics, GLA Economics calculations



It is also not necessarily appropriate comparing investment in terms of the total amount spent. That is because it does not consider the benefits of the investment or the size of the economy it supports. Instead, looking at transport in terms of the size of the economy it supports is more 'rational' and brings it in line with how other economic indicators, such as national debt[3] and R&D investment[4], are compared. On this basis, transport spending as a share of economic output (measured using gross value added) in London was largely on par with Wales and Scotland; while for the GSE more generally, it was in line with the UK average. This means that transport expenditure in London and the surrounding area was proportionate to the size of its economy.

It is also worth considering public sector expenditure in terms of the amount of tax a region generates. On this basis, London raised more in tax than it received in total public sector spending.

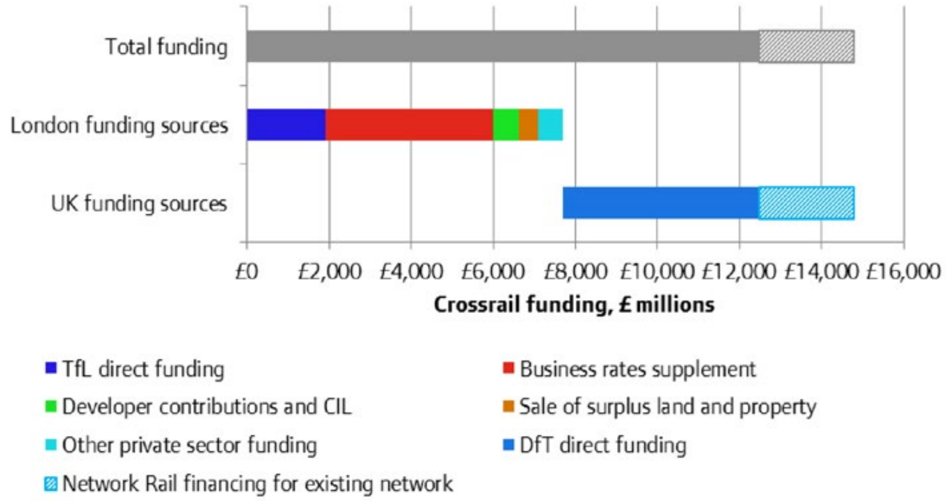
It should also be noted that London is increasingly paying directly for its own transport investment. For example, more than half of the cost of Crossrail 1 is funded directly by London businesses and Londoners (Figure A2). This includes the Crossrail business rate supplement which is an additional tax on London businesses only and, being a new tax, does not 'subtract' funds from other transport projects. However, the fact that London is directly contributing to the cost of its transport projects is not shown in the public sector expenditure data used above – it simply just looks at the cost of projects. Consequently, again, the above comparisons may give a misleading view of transport spending.

3 Keep, M. (2017), 'Government borrowing and debt: international comparisons', House of Commons Library Briefing Paper 06054.

4 Office for National Statistics (2017), 'UK gross domestic expenditure on research and development', statistical bulletin.

Figure A2: Funding sources of Crossrail 1, £ millions

Source: National Audit Office (2014), Crossrail, HC 965.



Investing in London's transport network should also not be seen as being at the expense of other parts of the UK. On the contrary, the Growing Together II[5] report by GLA Economics suggests that London's growth is beneficial to the rest of the UK. This can be in the form of investment creating demand for goods and services along the supply chain; to ensuring London remains internationally competitive which otherwise means business would go to other global cities rather than other parts of the UK.

So, overall, while initially London receives more than a quarter of the UK's expenditure on transport, it is reflective of the demand and need for transport in the capital. That is, London has one of the lowest amounts of railway expenditure and road spending per 'user' in Great Britain; total spending is in proportion to the size of the economy; and London receives less in public expenditure as a whole than what it contributes in tax. London is also directly contributing to the cost of its transport projections, something not captured in the statistics. And investing in London's transport system should not be seen as a 'zero-sum game' as essentially when London grows, the rest of the UK grows too.

More information about London's transport expenditure can be found in GLA Economics Current Issues Note 54 which, along with our other research, is available to download from the GLA Economics publications webpage.

5 GLA Economics (2014), 'Growing Together II: London and the UK economy'.

Additional information

Data sources

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

ILO unemployment
The International Labour Organization (ILO) measure of unemployment assesses the number of jobless people who want to work, are available to work and are actively seeking employment.

Residence-based employment
Employment measures the number of people in work rather than the total number of jobs (as people may have more than one job). It consists of employees, self-employed as well as unpaid family workers and those on government supported training and employment programmes. The measure included here is residence-based.

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 2017/18 there are twelve 28-day periods and one 29-day period. Period 1 started on 1 April 2017.

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 2017/18 there are twelve 28-day periods, and one 29-day period. Period 1 started on 1 April 2017.

Acronyms

BCC	British Chamber of Commerce
BRES	Business Register and Employment Survey
CAA	Civil Aviation Authority
CBI	Confederation of British Industry
CLG	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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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 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.

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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.

MAYOR OF LONDON